Docket #0134 Date Filed: 11/1/2013

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.	
UMB BANK, N.A., IN ITS CAPACITY AS INDENTURE TRUSTEE FOR THE 9.625% JUNIOR SECURED GUARANTEED NOTES, et al.,	Adv. Case No. 13-01343 (MG)
Defendants.	
OFFICIAL COMMITTEE OF UNSECURED CREDITORS, on behalf of the estate of the Debtors,	
Plaintiffs,	
v.	Adv. Case No. 13-01277 (MG)
UMB BANK, N.A., AS SUCCESSOR INDENTURE TRUSTEE UNDER THAT CERTAIN INDENTURE, dated as of June 6, 2008, et al.,	
Defendants.	

PLAINTIFFS' PHASE I POST-TRIAL BRIEF

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GLOSSARY OF DEFINED TERMS

All capitalized terms used herein shall be defined in accordance with these definitions.

Term	Definition
Ad Hoc Group	The Ad Hoc Group of holders of the Notes that, through counsel, has appeared in the Chapter 11 Cases
Additional AFI Grantors	Any person that became a grantor under the Revolver Security Agreement other than the First Priority Collateral Agent, Revolver Lender, the borrowers under the Revolver, the guarantors of the Revolver, Hidden Springs, DOA Holdings, GMAC Model Home Finance I, LLC, Equity Investment IV, LLC, RFC Construction Funding, LLC, the AFI Equity Pledgors, the AFI FABS Grantors or the AFI Additional Account Parties
Additional Notes Grantors	Any person that became a grantor under the Revolver Security Agreement other than ResCap, RFC, GMACM, GMAC-RFC, GMAC-RHC, Homecomings, the Notes FABS Grantors, the Notes Equity Pledgors, or the Notes Additional Account Parties
Adjusted Preference Assets	All assets listed on Schedule 6 to the Complaint in the Committee Action, admitted as PX-127, that do not meet the definition of Non-Preference Assets
AFI	Ally Financial, Inc. (f/k/a GMAC, LLC)
AFI Additional Account Parties	Signatories to the Revolver Security Agreement other than the First Priority Collateral Agent, Revolver Lender, the borrowers under the Revolver, the guarantors under the revolver, Hidden Springs, DOA Holdings, GMAC Model Home Finance I, LLC, Equity Investment IV, LLC, RFC Construction Funding, LLC, the AFI Equity Pledgors, and the AFI FABS Grantors
AFI APA	The Asset Purchase Agreement between AFI and ResCap, dated May 13, 2012
AFI Borrowers	RFC and GMACM, in their capacity as borrowers under the Revolver Loan Agreement
AFI Contribution	The sum of $2.1 billion in cash AFI agreed to contribute to the Debtors' estates pursuant to the terms of the Global Settlement and the Chapter 11 plan
AFI DIP Order	The Final Order Under Sections 105, 361, 362, 363, and 364 of the Bankruptcy Code and Bankruptcy Rules 2002, 4001, 6004, and 9014 (I) Authorizing the Debtors to Obtain Postpetition Financing on a Secured, Superpriority Basis, (II) Authorizing the Use of Cash Collateral, and (III) Granting Adequate Protection to Adequate Protection

Term	**Definition**
	Parties [Case No. 12-12020, Dkt. No. 491], which was admitted as PX-76
AFI Equity Pledgors	RAHI and PATI, in their role as equity pledgors under the Revolver Security Agreement
AFI FABS Grantors	RAHI and PATI, in their role as grantors of certain financial asset backed securities under the Revolver Security Agreement
AFI Guarantors	ResCap, Homecomings, GMAC-RHC, and GMAC-RFC, in their capacity as guarantors under the Revolver Loan Agreement
Ally Accounts	Deposit Account Nos. xxxx3803 and xxxx6323 maintained at Ally Bank
Ally Bank	AFI's indirect banking subsidiary (f/k/a GMAC Bank), a commercial state charted bank regulated by the FDIC and the State of Utah.
APAs	Collectively, the AFI APA and the Nationstar APA
August 13 Opinion	The Memorandum Opinion dated August 13, 2013 in which the Court granted in part and denied in part the Note Trustee's motion to dismiss [Adv. Case No. 13-01277, Dkt. No. 21]
Avoidable Deposit Accounts	The Deposit Accounts excluding the Controlled Accounts, the WF Accounts and the Proceeds Account
Bar Date Order	The *Order Establishing Deadline for Filing Proofs of Claim and Approving the Form and Manner of notice Thereof,* entered by the Bankruptcy Court on August 29, 2012 [Dkt. No. 1309], as amended, supplemented, and modified by *Order Extending Deadline for Filing Proofs of Claim*, entered by the Court on November 7, 2012 [Dkt. No. 2093]
Barclays	Barclays Bank PLC
Barclays DIP	The post-petition financing facility the Debtors obtained from Barclays
Base Collateral	The value of the JSNs' collateral as of the Effective Date ($1.888 billion)
Berkshire APA	The Amended and Restated Asset Purchase Agreement, dated as of November 2, 2012, among Berkshire Hathaway, ResCap, and certain other Debtor signatories that was admitted as PX-31
Berkshire Hathaway	Berkshire Hathaway, Inc.

Term	**Definition**
Bilateral Facilities	The financing arrangements to which certain Debtors or their affiliates were parties to as of June 6, 2008, which were listed on Schedule 7.01(t) to the Original AFI Loan Agreement
Blanket Lien Collateral	ResCap's assets other than Primary Collateral that (i) were pledged under the Revolver and the Notes; and (ii) do not fall within the definition of "Excluded Assets" under the terms of the Revolver Security Agreement or the Notes Security Agreement
Blanket Loan Release	The Partial Release of Collateral dated May 14, 2010 releasing the security interest in the Released Loan Collateral, that was admitted as PX-134
Blanket Released Collateral	Collectively, the Released Advances and the Released Loan Collateral
Blanket Releases	Collectively, the Blanket Loan Release (admitted as PX 134) and the Servicing Advance Release (admitted as PX-130 at ALLY_0075025-154)
BMMZ	BMMZ Holdings LLC, an indirect, wholly owned subsidiary of AFI
Carve-Out	The carve out for fees and expenses of the estate professionals of the Debtors provided for by the AFI DIP Order
Carve Out Notice	The notice of termination of cash collateral use provided for by the AFI DIP Order
Cash Collateral	The cash collateral securing the Revolver, the LOC Facility and the Notes
Cash Collateral Stipulation	The Stipulation and Order in Respect of the Debtors' Motion for Entry of an Order to Permit the Debtors to Continue Using Cash Collateral [No. 12-12020, Dkt. No. 4193]
Centerview	Centerview Partners LLC
CFDR	The Consolidated Financial Data Repository maintained by the Debtors, which was admitted as PX-139
Chapter 11 Cases	The cases being administered pursuant to chapter 11 of title 11 of the United States Code under the caption *In re Residential Capital, LLC, et al.*, Case No. 12-12020 (MG)
Citi MSR Collateral	The mortgages servicing rights associate with Fannie Mae and Freddie Mac loans, and all books and records associate with those rights
Citi MSR Facility	The loan facility provided by Citibank to ResCap and GMACM pursuant to the September 10, 2007 Loan and Security Agreement between Citibank, ResCap and GMACM, which was admitted as PX-75

Term	**Definition**
Citibank	Citibank, N.A.
Collateral	The collateral securing both the Revolver and the Notes
Committee	The official committee of unsecured creditors appointed in the Chapter 11 Cases by the United States Trustee of the Southern District of New York on May 16, 2012, under section 1102 of the Bankruptcy Code
Committee Action	The adversary proceeding commenced by the Committee against the Defendants by the filing of the Adversary Complaint for Declaratory Judgment, Avoidance of Liens, and Disallowance of Claims, administered under the caption *Official Committee of Unsecured Creditors v. UMB Bank, N.A., et al.*, Adv. Case No. 13-01277
Contested Assets	Collectively, the Released Mortgage Loans and the Excluded Bilateral Facilities Collateral
Controlled Accounts	The Deposit Accounts numbered xxxx7570, xxx6190, xxx8567, xxxx7618, xxxx2763, and xxxx059, that were admitted as DX-AIU, DX-AIV, DX-AIW, DX-AIX, DX-AIY, and DX-AIZ, respectively
Counterclaims	The counterclaims asserted against the Debtors by the Defendants in their answer, affirmative defenses and counterclaims [Adv. Case No. 13-01343, Dkt. No. 14]
Debtor Action	The adversary proceeding commenced by the Debtors against the Defendants by the filing of the Complaint to Determine Extent of Liens and for Declaratory Judgment, administered under the caption *Residential Capital LLC, et al. v. UMB Bank, N.A., et al.*, Adv. Case No. 13-01343
Debtors	Residential Capital, LLC, GMAC Mortgage LLC, Residential Funding Company, LLC, and each of their affiliated debtors and debtors-in-possession under the Bankruptcy Code in the Chapter 11 Cases
Defendants	The Ad Hoc Group, UMB and Wells Fargo
Deposit Accounts	The Deposit Accounts listed on Schedule 5 of the Complaint in the Committee Action, which was admitted as PX-126
Disclosure Statement	The Disclosure Statement for the Plan proposed by the Debtors and the Committee on August 23, 2013 [Case No. 12-12020, Dkt. No. 4819]
Distributable Value	Value of the distributable assets held by the Debtors on the distribution date, as that term is defined in Article I of the Plan, consisting primarily of cash generated from the sale of assets, the compromise of claims against Ally, and other unsold assets, which the Debtors propose to dispose by monetizing over time

Term	Definition
DLJ Consortium	The consortium of four financial bidders led by DLJ Mortgage Capital that bid to purchase the Debtors' Whole Loan Portfolio at a value of $1.339 billion
DOA Holding	DOA Holdings Properties, LLC
DOJ/AG Settlement	The settlement agreement the Debtors entered into with the Department of Justice, the Department of Housing and Urban Development, and the attorneys general of 49 states to resolve potential claims arising out of origination and servicing activities and foreclosure matters
Effective Date	The effective date of the Plan
ETS	Executive Trustee Services, LLC
Equity I	Equity Investment I, LLC
Exchange	The 2008 exchange offering pursuant to which ResCap exchanged approximately $6 billion of Old Notes for approximately $4 billion in Junior Secured Notes and $500 million in cash
Excluded Assets	Those assets that were ineligible to be pledged to the Notes under the terms of the Notes Security Agreement
Excluded Bilateral Facilities Collateral	The assets that are listed on Schedule 1 to the Complaint in the Committee Action that was admitted as PX-123
Fannie Mae	Federal National Mortgage Association
FASB	Financial Accounting Standards Board
FHA/VA	The Federal Housing Administration and Department of Veterans Affairs
FHFA	Federal Housing Finance Agency
Financial Assets	As set forth in the Notes Indenture §1.01, assets such as whole loan mortgages, residual interests, securities (including Equity Interests or Indebtedness of Subsidiaries that are Financing SPVs but excluding Equity Interests of other Subsidiaries) and other financial assets or any related assets, rights or property or the proceeds therefrom
First Priority Collateral Agent	Wells Fargo, in its capacity as the first priority collateral agent and collateral control agent pursuant to the Original Revolver Security Agreement
Fortress	Fortress Investment Group LLC
FRB Consent Order	The consent order settling an investigation by the Federal Reserve arising out of the same general facts as the DOJ/AG Settlement
Freddie Mac	Federal Home Loan Mortgage Corporation
GAAP	Generally accepted account principles

Term	**Definition**
Ginnie Mae	Government National Mortgage Association
Global Settlement	The settlement among the Debtors, the Committee, AFI and the Consenting Claimants set forth in Article IV of the Plan
GMAC Model Home	GMAC Model Home Finance, LLC
GMAC Mortgage or GMACM	GMAC Mortgage LLC
GMAC-RFC	GMAC-RFC Holding Company, LLC
GMAC-RHC	GMAC Residential Holding Company, LLC
GSAP	GMAC Mortgage Servicer Advance Funding Company Ltd.
GSEs	Government sponsored entities, including Fannie Mae, Freddie Mac, Ginnie Mae, and the FHFA
GSE MSRs	Mortgage servicing rights, PLS, and other servicing rights provided by the GSEs
HARP	Home Affordable Refinance Program
HFI	Held-for-investment mortgage loans
HFS	Held-for-sale mortgage loans
HFS Portfolio	The Debtors' HFS assets later sold to Berkshire Hathaway
Hidden Springs	Developers of Hidden Springs, LLC
Homecomings	Homecomings Financial, LLC
Homecomings Financial	Homecomings Financial Real Estate Holdings, LLC
Houlihan	Houlihan Lokey Capital, Inc.
Houlihan Disclosure	Houlihan Public Disclosure, dated May 14, 2012, which was admitted as PX-357
Houlihan Presentation	The May 2012 Houlihan Restricted Presentation to the Ad Hoc Noteholder Group, which was admitted as PX-169
Initial Notes Trustee	U.S. Bank National Association, acting in its role as the original indenture trustee pursuant to the Notes Indenture
Intercreditor Agreement	The Intercreditor Agreement dated June 6, 2008, which was admitted as PX-2
Interim DIP Order	*Interim Order Under Sections 105, 362, 363, and 364 of the Bankruptcy Code and Bankruptcy Rules 2002, 4001, 6004, and 9014 (I) Authorizing the Debtors' to Obtain Postpetition Financing on a Secured Superpriority Basis, (II) authorizing the Debtors to Use Case Collateral, (III) Granting Adequate Protection to Adequate Protection Parties and (IV) Prescribing the Form and Manner of Notice and Setting the Time for Final Hearing* [Dkt. No. 89], entered on May 16, 2012
JSNs	The Ad Hoc Group

Term	**Definition**
JSN PSA	The prepetition plan support agreement entered into between the Debtors, AFI, and certain JSNs, that was admitted as PX-252
Junior Secured Notes	The 9.625% Junior Secured Guaranteed Notes due 2015 issued by ResCap on June 6, 2008
LOC Collateral	The certain mortgage loans and related assets pledged by the Debtors in order to obtain and secure the LOC Facility
LOC Facility	The financing facility that operated pursuant to the LOC Loan Agreement, through which AFI loaned funds to certain Debtors as defined in the LOC Loan Agreement
LOC Lender	AFI, as the initial lender and lender agent under the LOC Loan Agreement
LOC Loan Agreement	The Amended and Restated Loan Agreement by and among RFC, GMACM, ResCap, and GMAC Inc. dated December 30, 2009 that was admitted as PX-9
LOC Security Agreement	The Amended and Restated Pledge and Security Agreement and Irrevocable Proxy, dated December 30, 2009
Local Rules	The Local Bankruptcy Rules for the Southern District of New York
LOI	Letter of intent
May 14 Houlihan Presentation	Houlihan's May 14, 2012 public presentation as to estimates of the Noteholders' recovery on their prepetition collateral, which was admitted as PX-169
Mini Auction	Berkshire Hathaway's post-petition submission of competing bids to become the stalking horse bidder for both sets of assets, which increased the value of the court approve stalking horse bids
Mortgage Loan Release	The Partial Release of Collateral dated May 17, 2010 that was admitted as PX-135
Mr. Siegert Rebuttal Report	The Rebuttal Report of P. Eric Siegert filed in the Debtor Action and Committee Action
MSRs	The Debtors' mortgage servicing rights, PLS, and other servicing rights
Nationstar	Nationstar Mortgage LLC
Nationstar APA	The Asset Purchase Agreement between Nationstar Mortgage LLC and ResCap, dated May 13, 2012 that was admitted as PX-33
Non-Obligor Debtors	The entities listed on PX-248.2

Term	**Definition**
Non-Preference Assets	Collectively, (a) the 18 loans identified as "HFS Revolver" or "HFS Blanket," (b) the two REO properties identified as "HFS Blanket," (c) the Refinanced Mortgages; and (d) the REO properties that were never transferred to or for the benefit of the JSNs during the preference period that were listed on Schedule 6 to the Complaint in the Committee Action, which was admitted as PX-127
Note Guarantors	RFC, GMACM, GMAC-RFC, GMAC-RHC, and Homecomings
Noteholders	The holders of the Junior Secured Note
Notes	The 9.625% Junior Secured Guaranteed Notes due 2015 issued by ResCap on June 6, 2008
Notes Additional Account Parties	Signatories to the Note Security Agreement other than ResCap, the Notes Guarantors, the Notes FABS Grantors, and the Notes Equity Pledgors
Notes Agreements	Collectively, the Notes Indenture and the Notes Security Agreement
Notes Collateral	The assets pledged to secure the obligations under the Notes
Notes Deposit Account Collateral	The subset of Notes Collateral consisting of certain deposit accounts and certain related assets of the Notes Additional Account Parties
Notes Equity Pledgor Collateral	The subset of Notes Collateral comprised of certain equity interests, certain promissory notes and other debt instruments, certain deposit and security accounts, and certain related assets of the Notes Equity Pledgors
Notes Equity Pledgors	The AFI Equity Pledgors in their role as equity pledgors under the Notes Security Agreement
Notes FABS Grantors	The AFI FABS Grantors, as grantors of certain financial asset backed securities, in their role as parties to the Notes Security Agreement
Notes Financial Asset Collateral	The subset of Notes Collateral comprised of all 'Financial Assets" (as defined in Article 8 of the Uniform Commercial Code) and certain related assets of the Notes FABS Grantors
Notes Grantor Collateral	The certain assets and property of ResCap, the Notes Guarantors, and the Additional Notes Grantor that are Notes Collateral
Notes Indenture	The Notes Indenture dated as of June 6, 2008 among ResCap, as issuer, certain other entities as guarantors and obligors, and U.S. Bank, as the original indenture trustee, which was admitted as PX-1

Term	**Definition**
Notes Security Agreement	The Amended and Restated Third Priority Pledge and Security Agreement and Irrevocable Proxy dated December 30, 2009, which was admitted as PX-4
Notes Trustee	UMB, in its role as the successor indenture trustee for the Notes
Ocwen	Ocwen Loan Servicing LLC
Ocwen APA	The Asset Purchase Agreement, dated as of November 2, 2012 among Ocwen, ResCap, and certain other Debtor signatories thereto, and the amendments thereto, which were collectively admitted as PX-19-PX-24
Ocwen Purchase Price Schedule	Schedule 3.1(a) of the Ocwen APA, which was admitted as PX-20
Ocwen Sale	The court approved sale of the debtors mortgage origination and servicing platform assets to Ocwen and Walter
OID	Original issue discount
Old Notes	The unsecured notes issued by ResCap with a $9.537 billion face value that were due to mature from 2010 through 2015 and were outstanding as of May 5, 2008
Original AFI Settlement	The Debtors' prepetition settlement with AFI memorialized in the Plan Sponsor Agreement that the ResCap board of directors approved on May 13, 2012
Original Notes Security Agreement	The Third Priority Pledge and Security Agreement dated June 6, 2008, which was admitted as PX-3
Original Revolver Loan Agreement	The Loan Agreement dated June 5, 2008 and amended from time to time prior to December 30, 2009, which was admitted as PX-5
Original Revolver Security Agreement	The First Priority Pledge and Security Agreement and Irrevocable Proxy dated June 4, 2008, which was admitted as PX-7
PATI	Passive Asset Transactions, LLC
Permitted Funding Indebtedness	As set forth in the Notes Indenture §1.01, Indebtedness incurred in the ordinary course through financing, securitization and hedging activities, including customary lines of credit, repurchase transactions or warehouse financings involving residential mortgage loans, home equity loans or second lien loans (including any reasonable extension or evolution of such activities including for purposes of financing other types of financial assets) and other Indebtedness on terms at least as favorable to the Company or the applicable Subsidiary than would be available on an arms-length basis.

Term	**Definition**
Permitted Liens	As set forth in the Notes Indenture §1.01, the types of liens the Debtors were permitted to create or suffer on the Revolver Collateral
Petition Date	May 14, 2012
Plaintiffs	The Debtors and the Committee
Plan	The Joint Chapter 11 Plan, attached as Exhibit 1 to the Disclosure Statement, proposed by ResCap and the Committee, including all exhibits, addenda, schedules or other attachments, as may be amended, modified, or supplemented from time to time
PLS	Private label securitizations
PLS MSRs	The MSRs associated with the privately owned mortgages
Prepetition Plan Term Sheet	The Plan Term Sheet, dated May 14, 2012, which was admitted as PX-432.
Pretrial Order	The Order entered by the Court on October 18, 2013 in both the Committee Action [Adv. Case No. 13-01277, Dkt No. 161] and the Debtor Action [Adv. Case No. 13-0134, Dkt No. 105]
Primary Collateral	Revolver Collateral defined as "Primary Collateral" pursuant to the Revolver Security Agreement
Proceeds Account	Deposit Account No. xxxx2599, which is listed on Schedule 5 of the Complaint in the Committee Action, which was admitted as PX-126
PSA	The Plan Support Agreement entered into on May 13, 2013 between the Debtors, the Committee, AFI, and certain consenting claimants
Purchased Assets	The assets specified in Section 2.1 of the Ocwen APA
Purchasers	Collectively, Ocwen and Walter
PWC	PricewaterhouseCoopers LLP
RAHI	RFC Asset Holdings II, LLC
Refi Opportunity	The opportunity for a servicer to refinance a borrower's loan
Refinanced Mortgages	The three mortgage loans that were listed on Schedule 6 to the Complaint in the Committee Action that were refinanced with a net book value of $1,021,096
Released Advances	The Notes Collateral that was pledged to the LOC Lender under the LOC Facility that was comprised of certain Freddie Mac servicing advances
Released Loan Collateral	The Notes Collateral that was pledged to the LOC Lender under the LOC Facility that was comprised of certain servicing rights and other assets

Term	**Definition**
Released Mortgage Loans	The loans identified by Schedule 2 to the Complaint in the Committee Action, which was admitted as PX-124
ResCap	Residential Capital, LLC
Residential Funding	Residential Funding Real Estate Holdings, LLC
Residential Mortgage	Residential Mortgage Real Estate Holdings, LLC
Revolver	The revolving loan facility entered into on or about June 4, 2008 between RFC and GMACM, as borrowers, ResCap and certain other entities as guarantors, and certain entities as obligors, which was admitted as PX-5
Revolver Collateral	The assets pledged to secure the obligations under the Revolver
Revolver Documents	Collectively, the Revolver Loan Agreement and the Revolver Security Agreement
Revolver Lender	AFI, as the initial lender and lender agent under the Revolver Loan Agreement
Revolver Loan Agreement	The Amended and Restated Loan Agreement dated December 30, 2009, which was admitted as PX-6
Revolver Security Agreement	The Amended and Restated First Priority Pledge and Security Agreement and Irrevocable Proxy dated December 30, 2009, which was admitted as PX-8
RFC	Residential Funding Company, LLC
RMBS	Residential mortgage-backed securities, notes and certificates issued by the RMBS Trusts
RMBS Settlement	The settlement between the Debtors and the Debtors' institutional investors holding a substantial stake in the RMBS Trusts
RMBS Trustees	The trustees of the RMBS Trusts
RMBS Trusts	All residential mortgage back securitization trusts, net interest margin trusts and similar residential mortgage back trusts for which the Debtors act as sponsor, depositor, servicer, master servicer or in similar capacity
Secured Parties	All parties holding a security interest in the Debtors' assets pursuant to the Notes Security Agreement or the Revolver Security Agreement
September 20 Opinion	The Memorandum Opinion Denying without Prejudice UMB Bank's Motion to Dismiss Counts 3 and 5, and Granting in Part and Denying in Part the Committee's Motion to Dismiss Certain Junior Secured Noteholders Counterclaims, dated September 20, 2013 [Adv. Case No. 13-01343, Dkt. No. 49, Adv. Case No. 13-01277 Dkt. No. 100]

Term	**Definition**
Servicing Advance Release	The Partial Release of Collateral dated May 27, 2011 that was admitted as PX-130, at ALLY_0075025-154
Servicing and Origination Assets	The Debtors' mortgage loan origination and servicing assets
SOX	The Sarbanes-Oxley Act of 2002
Stalking Horse APAs	Collectively, the AFI APA and the Nationstar APA
Third Priorities Secured Parties	The Third Priority Collateral Agent and the other third priority secured parties as defined by the Intercreditor Agreement
Third Priority Collateral Agent	Wells Fargo, in its capacity as the third priority collateral agent and collateral control agent for the Junior Secured Notes
UMB	UMB Bank, N.A.
Unencumbered Real Property	The real property and leasehold interests listed on Schedules 1 and 6 of the Complaint in the Committee Action
UPB	Unpaid principal balance
Walter	Walter Investment Management Corporation
Wells Fargo	Wells Fargo Bank, N.A.
WF Accounts	The Deposit Accounts numbered. xxxx2607, xxxx7877, and xxxx1176 that were listed on Schedule 5 of the Complaint in the Committee Action
Whole Loan Portfolio	The Debtors' whole loan portfolio

Plaintiffs Residential Capital, LLC ("ResCap"), GMAC Mortgage LLC ("GMACM"), Residential Funding Company, LLC ("RFC"), and each of their affiliated debtors and debtors-in-possession (collectively, the "Debtors"), together with Plaintiff the Official Committee of Unsecured Creditors (the "Committee" and, together with the Debtors, the "Plaintiffs"), submit this post-trial brief in connection with the trial on "Phase I" of these consolidated adversary proceedings. References to "Proposed Findings of Fact" or "FOF" herein are to the Plaintiffs' Proposed Findings of Fact, submitted contemporaneously herewith. Terms used herein are defined in the Proposed Findings of Fact.

PRELIMINARY STATEMENT

The record of the Phase I trial reflects a total failure of proof on the part of the Defendants. It supports findings and conclusions by this Court, *inter alia*, that (1) a portion of the JSNs' claim represents disallowable unmatured interest; (2) the Debtors have appropriately identified the scope and value of the JSNs' collateral, which does not include any value for purported liens on intangible assets or goodwill; (3) the projected value of the JSNs' collateral as of the Effective Date of the proposed Chapter 11 Plan is $1.745 billion, after the Debtors properly pay certain professional fees from the JSNs' collateral in accordance with the "Carve Out" agreed to by the JSNs; (4) the JSNs have failed to demonstrate any diminution in the value of their collateral through these bankruptcy proceedings and therefore are not entitled to enhance that collateral through an adequate protection claim; and (5) as a result, the JSNs are not entitled to postpetition interest. These conclusions (subject only to certain discrete issues to be addressed in Phase II) would move these cases closer to resolution by largely determining that the JSNs' treatment under the Plan – payment in full of their allowed claim, including accrued prepetition interest – is the most to which they could be entitled.

At the outset, the JSNs have failed to establish that their base prepetition claim should include interest they had not yet earned as of the Petition Date, reflected in the form of OID. Section 502(b)(2) of the Bankruptcy Code explicitly disallows all claims for "unmatured interest." This unambiguous statutory language should be enforced because it leads to a fair outcome and certainly does not lead to an absurd result. The JSNs' attempt to expand the narrow *Chateaugay* exception to this rule is barred by the plain language of the Code and fails in any event as a matter of policy. The JSNs failed to establish at trial that fair market exchanges like the one here – which obviously benefitted holders, *inter alia*, by providing collateral and enhancing their structural priority position in the event of a bankruptcy – would be chilled unless holders were also offered an exception from the plain language treatment of OID under the Bankruptcy Code.

Next, the JSNs have failed to establish that the Debtors understate in any way the scope of their collateral. The documents governing the Junior Secured Notes provided that the Debtors would track collateral and have broad discretion to release and repledge it for other purposes. The uncontested evidence at trial established that the Debtors did so through the CFDR, which is a reliable, audited, SOX-compliant database. While the JSNs contend that the Debtors have failed to produce a full "paper trail" underlying the release (in 2010 and 2011) of some $910 million of collateral, this is irrelevant as a matter of law; that collateral was expressly covered by broad, blanket releases that this Court has already upheld. The undisputed facts are that this collateral was repledged to the LOC Facility in the CFDR (the Debtors' primary book and record for tracking collateral) and included in the borrowing base for that facility. This evidence dispositively establishes that this collateral was released from any JSN lien.

The JSNs' effort to expand their collateral by altering the negotiated purchase prices specified in the Ocwen and Berkshire Hathaway APAs similarly fails. The JSNs would ignore those negotiated prices – which assigned no value to the intangible assets – in favor of expert-derived values based on inapposite GAAP principles that address financial accounting only. The relevant issue here is not how buyers should record assets on their financial statements, but how much they actually paid for various assets in what all parties agree were arms'-length Court-supervised sales. In any event, the JSNs failed to establish that the Purchasers had any different view of value than the APAs state. The evidence shows that the pricing set forth in the APAs is exactly how the Purchasers valued the assets in formulating their bids – and that the Debtors actually had to offer them a $108 million *credit* as inducement to assume the costs related to the Debtors' platform.

The post-hoc analyses of the JSNs' valuation experts all stand and fall on the false assumption that the JSNs have a lien on *all* intangible assets and goodwill associated with the Purchased Assets. To the contrary, any intangible value would largely (a) derive from MSRs and related books and records as to which the JSNs never had a lien or as to which the lien was released, or (b) represent residual goodwill or other intangible value that did not exist at the Petition Date and is thus a postpetition asset as to which no JSN lien could attach. The JSNs have made no attempt to identify and separately value any intangible asset as to which they might arguably have a lien, another independently dispositive failure of proof.

The JSNs' remarkable contention that their lien on $1.2 billion in released collateral was secretly revived by paragraph 5(g) of the AFI DIP Order fails on multiple grounds. As an initial matter, any such reading of the Order is barred by Local Rule 4001-2(a)(4), which requires express disclosure of "any effect on existing liens of the granting of collateral or

adequate protection provided to the lender and any priority or super priority provisions." In other words, if a cash collateral order is going to grant post-petition liens on previously released collateral, the Court must be informed in no uncertain terms. That, of course, did not happen. No party even suggested to the Court that the Order would somehow revive JSN liens, much less liens of this magnitude. Any such suggestion would have flown in the face of the plain language of paragraph 5(g), which refers to "Junior Secured Notes Documents" that necessarily include all executed releases. The JSNs failed to offer *any* evidence that they actually expressed (rather than secretly harbored) their current view of its meaning at the time the language was negotiated. All other contemporaneous evidence of the parties' understanding is to the contrary.

The JSNs also have failed to make the key showing necessary to prove an adequate protection claim – that the total value of their collateral diminished between the Petition Date and the Effective Date. Because the Effective Date value is largely uncontested, this claim depends on proving that a higher value existed at the outset of these cases. But the JSNs do not even attempt to value the collateral applying the standard relevant for adequate protection purposes: the value that the JSNs themselves could have realized in a foreclosure sale at the Petition Date if not prevented by the automatic stay from enforcing their prepetition legal rights. Only the Plaintiffs' expert, Mr. Puntus, applied the legally controlling standard, which yields Petition Date values ranging from no more than $1.474 to $1.594 billion.

Even if value in the hands of the Debtors were the proper standard, the JSNs' experts do not show what the Debtors could have actually realized in a Petition Date sale, but illogically assume that the collateral could have been instantly liquidated without any of the costs of bankruptcy; with all of the necessary consents obtained and claims resolved; and as if all the benefits of a court-supervised bankruptcy and sale process had already been realized. It is

particularly telling that these new hindsight valuations by a team of Houlihan experts, prepared for litigation purposes, are starkly higher than – and completely irreconcilable with – the contemporaneous advice Houlihan provided to its clients in May 2012 about the value of their collateral as they were considering whether to sign on to the prepetition PSA. At that time, Houlihan told the Ad Hoc Group that the high case expected recovery would be based on achieving the stalking horse sales with no additional haircuts.

The JSNs' experts also value the Debtors' assets based on projected future cash flows associated with their origination and servicing platforms, an assumption flatly contradicted by the facts and circumstances of these Chapter 11 cases and the sale process. In these cases, where the sale of assets was pre-ordained, the more accurate measure of the value of the collateral in the hands of the Debtors is provided by those arms'-length original stalking horse bids, which would yield a valuation of $1.736 billion. Even if, as the JSNs' experts improperly assert, the ultimate sale prices were somehow available to be "unlocked" at the Petition Date and should be used as a baseline for adequate protection purposes, their analysis ignores the budgeted, JSN-consented, and Court-approved expenses of the chapter 11 process that were necessary to accomplish that "unlocking." If those expenses are properly considered, the adequate protection analysis would become a tautology: the value of the JSN collateral at the Petition Date would be the value the Debtors ultimately achieved. In fact, this is exactly how the Debtors' calculated the proposed Effective Date valuation (*i.e.*, actual sale price achieved, less approved expenses plus the proceeds of the JSNs' collateral generated during the case).

Even if the JSNs had demonstrated that they are oversecured based on a global comparison of collateral value to prepetition claim, they would still need to demonstrate *on a debtor-by-debtor basis* that they are oversecured by reference to collateral held by each

particular Debtor. Under any valuation scenario, the JSNs would be unable to demonstrate that they are oversecured without pooling collateral owned by different Debtors and, in fact, they presented no evidence whatsoever of value on a debtor-by-debtor basis that might establish that they are oversecured at an individual debtor. For this reason, too, they are not entitled to postpetition interest.

Finally, notwithstanding the JSNs' failed attempts to expand their collateral beyond the generally agreed, mostly liquidated base amount of $1.888 billion, the trial record supports several challenges to the collateral that reduce this figure. Initially, the JSNs' collateral must be reduced by the Carve Out included in the AFI DIP Order, which provides that the JSNs' liens are subject and subordinate in all respects to payment of $143 million in professional fees and expenses. In valuing the JSNs' collateral, this senior debt must come off the top. Crediting the Carve Out reduces the Effective Date value of the JSNs' collateral to $1.745 billion, rendering the JSNs undersecured based on their current outstanding prepetition base claim of $1.836 billion ($2.222 billion asserted amount less $386 million of OID).

With respect to the Committee's lien challenges, the Committee introduced uncontroverted evidence that the JSNs did not have properly perfected liens on the Deposit Accounts, the Unencumbered Real Property, or the assets or equity of the Non-Obligor Debtors; that a correct reading of the governing documents, in light of industry custom and practice, refutes the JSNs' contentions that they have security interests in certain excluded assets and released collateral based on a springing lien theory; and that the liens obtained on the Adjusted Preference Assets within 90 days of the Petition Date are avoidable as preferences.[1]

[1] In light of the Court's remarks at past hearings, the Plaintiffs have not briefed issues concerning (i) default interest and fees, (ii) liens on intercompany claims, and (iii) liens on the AFI Contribution. Intercompany claims and the AFI Contribution will be addressed in Phase II, and default interest and fees will be addressed if necessary following completion of Phase II.

JURISDICTION

The Court has subject matter jurisdiction over this proceeding pursuant to 28 U.S.C. §§ 157 and 1334(b) and (e); this is a civil proceeding arising under, arising in or related to cases under Title 11 of the United States Code (the "Bankruptcy Code"). This proceeding is referred to this Court pursuant to 28 U.S.C. § 157(a) and the Standing Order of Referral of Cases to Bankruptcy Judges in this District. Venue is proper in this Court pursuant to 28 U.S.C. §§ 1408 and 1409. This proceeding is a core proceeding pursuant to 28 U.S.C. §§ 157(b)(2)(A), (B), (C), (E), (F), (K), (M), and (O). The Court has authority to enter final orders and judgments with respect to all claims asserted by the Plaintiffs against the Defendants and all counterclaims asserted by the Defendants against the Plaintiffs. If the Court determines that, absent consent of the parties, it cannot enter final orders or judgments consistent with Article III of the United States Constitution, Plaintiffs consent to entry of final orders and judgments by this Court with respect to all claims asserted by the Plaintiffs against the Defendants and all counterclaims asserted by the Defendants against the Plaintiffs.

BURDEN OF PROOF

The Defendants bear the burden of proof with respect to both the allowance of their base secured claim and the allowance of any adequate protection claim.

As this Court has held, the Defendants, as secured creditors, have the burden of establishing both the validity and extent of their liens as well as the value of their collateral. *See Off. Comm. of Unsecured Creditors v. UMB Bank, N.A. (In re Residential Capital, LLC)*, 497 B.R. 403, 412 (Bankr. S.D.N.Y. 2013) (the "September 20 Opinion") ("The secured creditor bears the burden of proving, by a preponderance of the evidence, that it is oversecured."); *see*

also In re Sneijder, 407 B.R. 46, 55 (Bankr. S.D.N.Y. 2009) (Glenn, J.) (secured creditor "bears the burden of proof with respect to the amount and extent of its lien under § 506(a)").[2]

The Defendants also have the burden of establishing any diminution in value for purposes of determining the scope and value of the adequate protection liens and superpriority claims the Defendants were granted in the AFI DIP Order. *See* 11 U.S.C. § 363(p)(2) ("In any hearing under this section . . . the entity asserting an interest in property has the burden of proof on the issue of the validity, priority, or extent of such interest"); *Qmect, Inc. v. Burlingame Capital Partners II, L.P.*, 373 B.R. 682, 690 (N.D. Cal. 2007) (secured creditors not entitled to foreclose on replacement liens absent proof that collateral had diminished in value as result of automatic stay or collateral's use).[3]

ARGUMENT

I. ORIGINAL ISSUE DISCOUNT REPRESENTS UNMATURED INTEREST THAT IS EXPRESSLY DISALLOWED UNDER THE BANKRUPTCY CODE AND MUST BE EXCLUDED FROM THE JSNS' CLAIM

The Committee seeks an order disallowing any claims relating to the Notes to the extent the claims are for unamortized OID. (Committee Complaint, Count XIII.) It is well-settled, as a general matter, that OID that has not amortized as of a debtor's bankruptcy filing constitutes unmatured interest that is disallowed pursuant to section 502(b)(2) of the Bankruptcy

[2] The Third Circuit has adopted a variant of this rule, applying a burden-shifting standard to the allowance of a secured claim. *See In re Heritage Highgate, Inc.*, 679 F.3d 132, 139-40 (3d Cir. 2012) (holding, in case not addressing adequate protection, that party objecting to secured creditor's claim has initial burden of coming forward to rebut prima facie validity of claim, which shifts to secured creditor for ultimate burden of persuasion). Even under the Third Circuit's standard (which, of course, is not controlling here), the Plaintiffs have come forward with ample proof to rebut any prima facie validity of the value of the JSNs' liens, and the ultimate burden of persuasion rests with the JSNs. *See, e.g.*, *In re Shaumberg Hotel Owner Ltd. P'Ship*, 97 B.R. 943, 950 (Bankr. N.D. Ill. 1989) (noting objecting party's burden is "easily satisfied"); *In re Hampel*, No. 99-14917, 2000 WL 3441712, at *2 (Bankr. D. Kan. Aug. 1, 2000) (same). In any event, the *Heritage Highgate* rule has no applicability to the standard of proof for adequate protection, discussed immediately below.

[3] *See also Bank of N.Y. Trust Co. N.A. v. Pac. Lumber Co. (In re Scopac)*, 624 F.3d 274, 284 (5th Cir. 2010) (noteholders had burden to prove entitlement to section 507(b) claim), *opinion modified on other grounds on denial of reh'g*, 649 F.3d 320 (5th Cir. 2011); *In re Mary Holder Agency, Inc.*, No. 11-34280 (MBK), 2012 WL 4434362, *2 (Bankr. D. N.J. Sept. 24, 2012) (creditor bears burden of proving entitlement to section 507(b) claim); *In re McFarlin's, Inc.*, 33 B.R. 788, 791 (Bankr. W.D.N.Y. 1983) (same).

Code. *See LTV Corp. v. Valley Fid. Bank & Trust Co. (In re Chateaugay Corp.)*, 961 F.2d 378, 381 (2d Cir. 1992); *Off. Comm. of Unsecured Creditors v. UMB Bank, N.A. (In re Residential Capital, LLC)*, 495 B.R. 250, 262-63 (Bankr. S.D.N.Y. 2013); *In re Solutia, Inc.*, 379 B.R. 473, 486 (Bankr. S.D.N.Y. 2007). A straightforward application of this rule results in the disallowance of the portion of the JSNs' claim – $386 million as of the Petition Date – that constitutes unamortized OID generated in connection with the Exchange through which the Notes were issued.

Seeking to avoid this result, the JSNs ask the Court to extend a narrow policy-based exception that was carved out by the Second Circuit in the unique situation of face-value exchanges and hold that unamortized OID should be treated as principal in every exchange offer. The JSNs' policy arguments are irrelevant in the face of the plain language and legislative history of section 502(b)(2), and wrong in any event. For the reasons set forth below, the Court should decline the JSNs' invitation to expand a narrow policy exception – particularly in a case like this where the Exchange was so clearly beneficial to the exchanging holders of the old notes.

As set forth in the Proposed Findings of Fact, the Exchange involved the swapping of old, unsecured notes issued by ResCap for a lower amount of new secured notes that, unlike the original notes after the Exchange, had the benefit of guarantees from ResCap's significant subsidiaries. FOF ¶¶ 78-86. It is undisputed that the Exchange was a fair market value exchange that created $1.549 billion of OID. As of the Petition Date, unamortized OID on the outstanding Notes was $386 million. FOF ¶ 86, 91. The parties largely agree on these essential facts. FOF ¶¶ 90-91.[4]

[4] As set forth in the Proposed Findings of Fact, the parties differ by approximately $10 million with respect to the amount of unamortized OID as of the Petition Date. FOF ¶ 91.

The OID generated in the Exchange, as an economic matter, is unmatured interest. FOF ¶ 84. It thus falls within the plain language of section 502(b)(2), which disallows claims for "unmatured interest." 11 U.S.C. § 502(b)(2). The legislative history to section 502(b)(2) of the Bankruptcy Code expressly states that "[i]nterest disallowed under this paragraph includes postpetition interest that is not yet due and payable, and any portion of prepaid interest that represents an original discounting of the claim, yet that would not have been earned on the date of bankruptcy." H. Rep. No. 95-595, 95th Cong., 1st Sess., at 352 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6308-09. Accordingly, the JSNs' filed $2.222 billion claim should be reduced by the amount of the OID to $1.836 billion.

The JSNs argue that the Second Circuit's decision in *Chateaugay* suggests that OID generated in connection with any exchange offer, whether face value or fair market, should not count as unmatured interest for purposes of section 502(b)(2) of the Bankruptcy Code. *Chateaugay* makes no such blanket pronouncement. It holds only that, as a matter of policy, OID generated in connection with what is referred to as a "face value exchange" should not be treated as unmatured interest for purposes of section 502(b)(2) because that might chill the market for that particular type of exchange. The Court of Appeals articulated no similar exception for what it referred to as "fair market value exchanges," as in this case – and, indeed, noted that treating OID as unmatured interest "might make sense in the context of a fair market value exchange, where the corporation's overall debt obligations are reduced." 961 F.2d at 382.

This Court should not extend the narrow policy exception articulated in *Chateaugay* to this case. As an initial matter, policy arguments are relevant only where application of unambiguous statutory language would lead to an "absurd" result. *See, e.g.*, *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000) ("[W]hen the

statute's language is plain, the sole function of the courts – at least where the disposition required by the text is not absurd – is to enforce it according to its terms.") (citations and quotations omitted); *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989).[5] Disallowance of the JSNs' OID in this case certainly would not lead to an absurd result, as it was intended that OID would be disallowed under the Bankruptcy Code, and its disallowance would merely prevent the JSNs from receiving an unjustified windfall by collecting interest not yet earned at the Petition Date. Offering special treatment to participants in future exchange offers might or might not be desirable from a policy standpoint, but is by no means necessary to avoid an "absurd" outcome here.

In any event, the public policy concerns articulated by the Second Circuit in *Chateaugay* do not support treating the OID as principal in this case. As discussed in detail in the Proposed Findings of Fact, participation in fair market value exchanges will not be unduly chilled if the OID is disallowed. FOF ¶¶ 93-105. A creditor's participation in a fair market value exchange turns on considerations that extend well beyond the creation and disallowance of OID in a subsequent bankruptcy. Here, among other things, the Exchange traded *unsecured* notes for a lower face amount of fundamentally different *secured* and *structurally senior* obligations. FOF ¶¶ 93, 104. Holders were given ample incentives to tender, including almost certainly improved treatment in the event of a bankruptcy, even with OID treated as unmatured interest pursuant to Bankruptcy Code section 502(b)(2). FOF ¶¶ 93-95, 100. The Defendants' own expert, Mr. Siegert, admitted on cross-examination that the incentives in this case were exactly the *opposite* of the incentives in *Chateaugay* that the Second Circuit found troubling.

[5] *See also Sebelius v. Cloer*, - - U.S. - -, 133 S. Ct. 1886, 1896 (2013) (citing *Hartford*); *Radlax Gateway Hotel LLC v. Amalgamated Bank*, - - U.S. - -, 132 S. Ct. 2065, 2073 (2012) (rejecting policy and pre-Code practice as basis for departing from import of statutory language); *Dodd v. United States*, 545 U.S. 353, 359 (2005) ("Although we recognize the potential for harsh results in some cases, we are not free to rewrite the statute that Congress has enacted.").

FOF ¶ 104. The Court should reject the invitation to expand *Chateaugay*'s narrow policy exception.[6]

The JSNs also argue that in enacting the Bankruptcy Code in 1978, Congress could not have intended that debt-for-debt exchanges be deemed to create OID for purposes of section 502(b)(2), because such exchanges were not deemed to create OID even for tax purposes until the Internal Revenue Code was amended in 1990. The argument is misplaced because it mistakenly assumes that OID is a creature of the tax code and that Congress, in the absence of guidance from the Internal Revenue Code, could never have conceived of the generation of OID in a debt-for-debt exchange. In fact, OID exists or does not exist as a matter of economics regardless of tax policy, and courts recognized long before the 1990 amendments that exchange offerings could generate OID. *See, e.g.*, *Mo. Pac. R.R. Co. v. United States*, 427 F.2d 727, 732-34 (Ct. Cl. 1970) (holding that debt discount may arise in context of bond-for-bond exchange and remanding to trial commissioner to determine amount of any such discount), *modified*, 433 F.2d 1324 (Ct. Cl. 1970).[7] There is no indication in the legislative history that Congress intended to limit the Bankruptcy Code definition of OID to the Internal Revenue Code's treatment of the term.[8]

[6] While the JSNs lament the dire consequences of a ruling that the Exchange generated OID, there are a number of ways in which exchanges can be structured to induce participation. For example, in addition to the inducements offered in the Exchange itself, the issuer could, if it found it necessary, obviate anticipated OID consequences to exchanging holders by imposing a subordination and turnover agreement on holdouts in favor of the new notes as part of the "parting gift" indenture amendments.

[7] *Cf. Atchison, Topeka & Santa Fe R.R. Co. v. United States*, 443 F.2d 147, 153 (10th Cir. 1971) (affirming jury verdict finding $56 million OID arising from what was "in substance" bond-for-bond exchange); *Am. Smelting & Refining Co. v. U.S.*, 130 F.2d 883, 885 (3d Cir. 1942) (recognizing discount arising from preferred stock-for-bonds exchange).

[8] The JSNs have also argued that the legislative history gives only one example of what constitutes OID, and the example does not reference debt-for-debt exchanges. But there is nothing to suggest that this "example" was in any way limiting. *See In re Allegheny Int'l, Inc.*, 100 B.R. 247, 251 (Bankr. W.D. Pa. 1989) (characterizing argument that Congress' "example" of OID was limited in nature to only notes as "implausible and wholly unconvincing").

II. THE DEBTORS HAVE CORRECTLY IDENTIFIED THE SCOPE OF THE JSNS' COLLATERAL

A. The JSNs' Lien Was Expressly Limited in Several Respects, and the Debtors Had Broad Discretion to Release and Repledge Collateral

The JSNs seek to invent additional collateral value by fundamentally rewriting the nature of their collateral package under the Notes. As detailed in the Proposed Findings of Fact, the JSNs' collateral package was limited in important respects.

First, while the JSNs persist in referring to their "all asset" lien, they have nothing of the sort. None of the Debtors granted the JSNs a lien on all of its assets, and the majority of the Debtors granted liens on only certain types of assets, *e.g*. deposit accounts and equity interests. And other Debtors were not signatories to the Notes Security Agreement and didn't grant the JSNs a lien on any of their assets. Broad categories of assets are excluded from the Notes Collateral pursuant to specifically exempted categories of "Excluded Assets." FOF ¶ 114. For example, the definition excludes certain (a) assets for which the grant of a security interest would violate applicable law, (b) assets that are pledged to Bilateral Facilities or other facilities that prohibit junior liens, and (c) specified mortgage loans. *Id.* Other assets were excluded from the grant of Collateral because they were owned by entities that were not obligors under the governing documents. *Id*. ¶ 128.

The Debtors also enjoyed considerable flexibility to *release* Collateral from the JSNs' liens simply by virtue of the nature of their business – they were constantly originating, acquiring, and selling loans (and associated servicing rights). *Id.* ¶ 116. And the Debtors had other secured financing facilities. The Intercreditor Agreement specifically permitted them not only to continue those facilities and maintain the collateral that had been pledged to them, but also to release certain Notes Collateral in order to, among other things, secure what the Intercreditor Agreement defined as "Permitted Indebtedness." *Id*. ¶¶ 115-18.

None of these factors impacting the JSNs' collateral package were lost on investors. For example, a Credit Sights analyst report discussing the Exchange evaluated the Notes' lien package and concluded: "we expect more of ResCap's remaining unencumbered asset base that is supposed to support the new notes will be encumbered away, effectively rendering third lien and perhaps second lien holders as well in a de facto position closer to equity." *Id.* ¶ 125.

The JSNs' arguments in these adversary proceedings must be evaluated against this background. In light of the limitations on the JSNs' collateral package, there was a risk that – as Dr. Finnerty stated at trial – "the collateral might not even reach the third lien at all." Oct. 21 Tr. 78:21-23. Given these risks, the JSNs have done quite well; the Plan offers them *payment in full* with accrued prepetition interest. The JSNs should not be permitted to re-write the collateral package to which they agreed – and from which they are now benefiting – in a manner that creates or revives liens where they have none.

B. The Releases Were Effective to Release the JSNs' Lien on the Disputed $910 Million of Collateral

Through Count III of the Debtors' Amended Complaint, the Debtors seek a declaration that the Blanket Releases were effective and that "the JSNs are not entitled to a lien on the assets that secure the LOC Facility or any other collateral that was released by the collateral agent under the JSN Indenture." Am. Compl. ¶ 69. The JSNs contest that result with respect to approximately $910 million in assets that they argue was not properly released due to a lack of "supporting documentation." PTO at 64 ¶ 11; *see also id*. at 65 ¶ 13.[9]

[9] The JSNs' argument regarding the $910 million they say was impermissibly released from their lien is distinct from the Committee's argument – addressed below – that certain collateral that was not pledged to the JSNs did *not* became pledged to them automatically upon being relinquished from other secured creditors' liens. The JSNs' argument, if successful, would result in a $910 million increase to the Base Collateral; the Committee's argument, if successful, would result in a $10 million *decrease* to the Base Collateral.

The JSNs have no credible challenge to these collateral releases. As detailed in the Proposed Findings of Fact (*see* ¶¶ 143-51), in 2010 and 2011 the Third Priority Collateral Agent consented in writing to the release of a variety of assets from the Notes Collateral that were then pledged to AFI under the LOC Facility. The Third Priority Collateral Agent did so by executing the Blanket Loan Release, which released the security interest of the Third Priority Secured Parties in the Released Loan Collateral, and the Servicing Advance Release, which released the Third Priority Secured Parties' security interest in the Released Advances. *Id.* The Third Priority Collateral Agent then filed UCC-3 amendments that deleted the Blanket Released Collateral from the collateral set forth in the original UCC-1 financing statements (as amended) filed by the Third Priority Collateral Agent. *Id.* ¶ 144.

The JSNs previously contested the effectiveness of releases that the Third Priority Collateral Agent executed. The Court rejected the JSNs' arguments, holding that such releases were "unambiguous," "effective," and "entitled to enforcement." *See* September 20 Opinion, 497 B.R. at 416-17. Specifically reviewing the Blanket Loan Release – which accounts for approximately 97% of the $910 million in dispute (FOF ¶ 150, n. 27) – the Court found that the descriptions of the collateral covered by that release satisfied UCC 9-108(b)'s requirement for reasonably identifying the collateral released, and the UCC-3s "are therefore valid." September 20 Opinion, 497 B.R. at 418; FOF ¶ 145.

Undeterred, at trial the JSNs proffered the expert testimony of Scott Winn, who sought to opine that after reviewing the Debtors' CFDR database he "was unable to identify any evidence supporting the alleged release by the collateral agent of $910.4 million of the transferred or added asset IDs indicated by the CFDR as being pledged to the LOC silo." Winn

Direct ¶ 11.[10] After considering Plaintiffs' motion in limine to exclude Winn from testifying on the subject of the collateral releases, the Court again rejected the JSNs' effort:

> Winn's testimony and report are disingenuous. They ignore the Court's prior ruling. For example, Winn did not include in his analysis any releases such as the LOC blanket release that did not include a schedule of individual asset identification numbers to be released. The Court already rejected that argument in ruling on the motion to dismiss.

Oct. 16 Tr. at 12:8-16. Ultimately, Mr. Winn's testimony was not admitted on this subject (in accordance with a stipulation by the parties). Oct. 23 Tr. at 203:20-206:1; Stipulation [Adv. No. 13-01343, Dkt. No. 117].

In any event, there is no reason for the Court to reconsider its prior ruling that the releases the Collateral Agent executed were effective and should be enforced. September 20 Opinion, 497 B.R. at 416-17. This is true for both the Blanket Loan Release, which the Court examined on the motion to dismiss (*see* Am. Compl., Exs. 5-6), and for the Servicing Advance Release, which the Court examined on the motion in limine (*see* Levitt Decl., Ex. 16).

The Blanket Loan Release released, among other things, "Servicing Rights Collateral" and "Subject Mortgage Loans" (as further described in the findings of fact (¶¶ 143-51)). There were three different sources to determine whether a Subject Mortgage Loan had been released from the Revolver and Junior Secured Notes:

- a "Mortgage Schedule delivered under the LOC Loan Agreement";
- in the backup to the monthly borrowing base reports or monthly collateral reports under the LOC Loan Agreement, which reflected the carrying value of the assets pledged to the LOC Facility; or

[10] While the JSNs sought to challenge whether there was sufficient evidence to track the release of certain collateral, they did not offer any evidence to undermine the Court's previous conclusions that the Third Priority Collateral Agent had authority to release collateral and that the releases were effective. *See* September 20 Opinion, 497 B.R. at 416-17.

- most broadly, any of the Debtors' "books and records" reflecting that a loan had been pledged to the LOC Facility. This category would include, among other things, the CFDR – which tracked various details concerning the Debtors' loans, including the facility (if any) to which such loans were pledged. FOF ¶ 146.

A written description of the released collateral was attached as an exhibit to the UCC-3 amendments, which the Third Priority Collateral Agent also filed to delete the Blanket Released Collateral from the collateral set forth in the original UCC-1 financing statements. FOF ¶ 144. These written descriptions put all potential creditors on notice that the collateral they covered includes certain servicing rights and mortgage loans (among other assets), and that further diligence may be required to determine to whom they are pledged. These descriptions of the released collateral were adequate to effectuate its release. As the Court has explained, the UCC-3s are sufficient to satisfy the lenient description standards outlined in U.C.C. § 9-108(b)(6) because the descriptions of the collateral released "reasonably identif[ied]" the collateral released, satisfying the UCC's permissive standard. *See* September 20 Opinion, 497 B.R. at 418.

The Court's conclusion applies with equal force to the Servicing Advance Release. Like the Blanket Loan Release, the Servicing Advance Release contained a description of various categories of Released Advances that were being released from the Third Priority Secured Parties' liens, which included, among others, any existing and future advances relating to mortgage loans and real estate owned property, made pursuant to certain contracts with Freddie Mac. FOF ¶ 148.

The JSNs contend that other back-up should exist documenting the release of this $910 million of assets, including schedules of mortgage loans, collateral addition notices to the LOC Facility, and electronic templates used to update the CFDR. *Id.* ¶ 150. The Debtors either did not maintain all of these documents or did not locate them in their searches during discovery.

Id.; *see also* Stipulation [Adv. No. 13-01343, Dkt. No. 117]. But there is no need for any such additional back-up. FOF ¶ 151. The Blanket Loan Releases release loans with reference to the Debtors' books and records. *Id.* ¶ 146. The CFDR is the Debtors' primary book and record for tracking assets pledged as collateral. *Id.* ¶ 131. The Court admitted the CFDR into evidence as a business record, finding, based on Ms. Farley's testimony that the business records exception was fully satisfied. *Id.* ¶ 136-37.

There is no dispute that that $910 million of collateral is listed in the CFDR as pledged to the LOC Facility, nor is there any dispute that the $910 million comprises categories of assets that were released under the Blanket Loan Release and the Servicing Advance Release. As a result, there should be no question that the $910 million was effectively released, and no further evidence is necessary to support that conclusion. FOF ¶¶ 150-51.

C. The Debtors Have Appropriately Allocated the Proceeds of the Ocwen Sale

Under the Ocwen APA, the purchasers, in an arms'-length, non-collusive transaction, assigned no value to general intangibles or goodwill. FOF ¶ 153. The JSNs ask the Court to ignore the actual purchase prices set forth under the Ocwen APA and re-allocate $313 million paid for MSRs and Advances to "intangible" assets on which they claim a lien. (*See* Counterclaim 21; Debtors' Complaint, Count I.) In doing so, the JSNs ask the Court to ignore clear and unambiguous transaction terms in favor of a post-hoc, reverse-engineered allocation based on an inapposite GAAP valuation methodology.

The JSNs' request should be denied. As discussed further below, (a) the best evidence of the fair market value of the intangible assets is the purchase price allocation set forth in the Ocwen Purchase Price Schedule, (b) the circumstances surrounding the Ocwen Sale demonstrate that the Purchasers in fact assigned no value to any general intangible assets as to which the JSNs claim to have a lien, (c) the JSNs have not established that their lien actually

extends to any purported intangible value, and (d) the JSNs have failed to satisfy their burden of proving the value of any intangibles that could arguably be subject to their lien.

1. The Negotiated Prices in the Ocwen APA Conclusively Establish the Fair Market Value of the Intangible Assets: Zero

Pursuant to the Ocwen Purchase Price Schedule, the price of the financial assets (*i.e.*, MSRs and Advances) is calculated based on certain formulas, and "goodwill and other intangible assets" are attributed zero value. FOF ¶ 153.

Ignoring the Ocwen Purchase Price Schedule, the JSNs asked a valuation expert, Mr. Taylor, to perform a purchase price allocation analysis applying the principles governing financial accounting for a sale transaction on a purchaser's financial statements. *Id.* ¶ 269. According to Mr. Taylor, under GAAP principles, even in circumstances in which a buyer in fact attributed for bidding purposes more value to tangible assets and less (or no) value to intangible ones, the buyer is still required to report these assets in its financial statements applying financial accounting standards, which can and often does result in a very different value allocation. *Id.* ¶ 271-72.

While perhaps appropriate for financial statements prepared in accordance with GAAP, Mr. Taylor's post-hoc valuation methodology is irrelevant to the issue before the Court. *Id.* ¶ 269. Where, as here, an asset is sold through an arms'-length transaction, the fair market value of such asset is conclusively determined by the negotiated purchase price. *See Romley v. Sun Nat'l Bank (In re Two "S" Corp.)*, 875 F.2d 240, 243 (9th Cir. 1989); *see also Covey v. Davlin (In re Hobbick)*, No. 97-83543, 2001 WL 34076375, at *14 (Bankr. C.D. Ill. Sept. 10, 2001) ("Absent an independent appraisal of the individual assets at the time the agreement was entered into, the best evidence of their market value is an allocation of the purchase price which is agreed to by the purchaser and seller."); *Brandt v. nVidia Corp. (In re 3dfx Interactive, Inc.)*,

389 B.R. 842, 867 (Bankr. N.D. Cal. 2008) ("The price nVidia agreed to pay and 3dfx agreed to accept after arms' length negotiations by sophisticated well-represented parties who were well-informed regarding the market that existed at the time is a better gauge than a theoretical value crafted only in hindsight.").

In *Romley*, the Ninth Circuit resolved an analogous dispute. In that case, the bankruptcy trustee sold certain equipment and a bank with a lien on the equipment asserted a lien on the proceeds. *See Romley*, 875 F.2d at 241. The bank argued that the price obtained at the sale fixed the value of the equipment while the trustee argued that the purchase price also included consideration for intangible assets. *See id.* at 241-42. The trustee submitted pre-sale appraisals showing that the value of the equipment was lower than the ultimate price obtained, and an affidavit from the purchaser stating that he paid a higher price for intangible value associated with the beneficial location of the equipment (which allowed the purchaser to lease the underlying property without incurring costs of removal). *Id.* at 241. The court refused to consider the appraisals or the affidavit and instead held that "value was conclusively determined by the sale price." *Id.* at 244. Affirming the bankruptcy court's decision, the Ninth Circuit noted that the "sale price is better evidence of the property's value than any prior appraisals." *Id.* at 243-44. Rather, the court looked at the bill of sale, which specifically stated that nothing but equipment was being purchased, for evidence of what was purchased and the purchase price.

Here, the Ocwen APA was the result of a highly competitive auction process approved by the Court, and the price paid for the Servicing and Origination Assets was a result of arms'-length negotiations that established the fair market value of such assets. FOF ¶¶ 58-70. Far from providing a liquidated purchase price to be later allocated in an arbitrary manner, Schedule 3.1(a) of the Ocwen APA (*i.e.*, the Ocwen Purchase Price Schedule) established

specific formulas for the calculation of the purchase price. The formulas set forth in the Purchase Price Schedule were not mere suggestions for the allocation of a pre-determined purchase price. FOF ¶ 153. Instead, the formulas *were* the purchase price. The price for each MSR and Servicing Advance was arrived at by applying a specified multiplier to (i) the calculated value of expected servicing fees over the life of the MSR, or (ii) the book value of the Servicing Advance. FOF ¶ 153(a).

The fact that the purchase price was dependent on the underlying value of the assets is easily demonstrated by the true-up mechanism provided for in the Ocwen APA. Because the total notional value of the MSRs and the Servicing Advances was subject to constant adjustment as the underlying balance of the loans fluctuated (changing the value of the corresponding MSRs) and Servicing Advances were generated or satisfied, it was not possible upon the closing of the Ocwen Sale to determine the precise purchase price. Accordingly, section 3.1(b) of the Ocwen APA provided that at the closing of the sale, the purchase price was to be determined using the formulas detailed in the Ocwen Purchase Price Schedule using the prior month's MSR and Servicing Advances balances. Following the closing date, pursuant to section 3.2(b) of the Ocwen APA, the purchase price would be adjusted based on the actual MSR and Servicing Advances balances at the time of closing. To follow the JSNs' suggestion that the Court should undertake to reallocate sale proceeds in the face of the painstaking care the Debtors and the purchasers took in arriving at the purchase price formulas would undermine future confidence in the integrity of a carefully negotiated sale agreement. FOF ¶ 153(a).

Moreover, both Nationstar's original stalking horse bid and Ocwen's winning bid for the Servicing and Origination Assets expressly assigned no value to goodwill, with virtually all of the value assigned to the MSRs and Servicing Advances pursuant to purchase price

calculation formulas detailed in the Ocwen Purchase Price Schedule. FOF ¶ 153. The Ocwen Purchase Price Schedule clearly states that "with respect to the other Purchased Assets set forth in Section 2.1(d) – (v), an amount equal to $0.00." Section 2.1(v) of the Ocwen APA provides that "goodwill and other intangible assets" are Purchased Assets. FOF ¶ 153. Thus, as a matter of law, the fair market value of any intangible assets associated with the purchased assets was determined by their actual sale price – *i.e.*, zero.

Mr. Taylor's valuation does nothing to undermine the foregoing, as he made no attempt to determine the appropriate basis for valuing assets for purposes of establishing a secured claim.[11] The accounting principles utilized by Mr. Taylor were never intended to be applied, and do not control for bankruptcy purposes – as he conceded on cross examination. FOF ¶ 269-271. These principles govern financial reporting alone, not bankruptcy. *See, e.g.*, *EBC I, Inc. v. Am. Online, Inc. (In re EBC I, Inc.)*, 380 B.R. 348, 358 (Bankr. D. Del. 2008) (rejecting GAAP as proper measure of market value of assets for purposes of determining insolvency under section 548 of Bankruptcy Code); *3dfx Interactive*, 389 B.R. at 867 (in context of bankruptcy solvency analysis, "GAAP will not determine what constitutes an asset or the fair market value of an asset"); Robert F. Reilly, *Valuation Analyst Guidelines Related to Bankruptcy Expert Reports and Expert Testimony*, Willamette Mgmt. Assocs. Insights, Spring 2011, at 35 ("GAAP account balances typically do not reflect the current value of an asset for bankruptcy purposes.").

[11] As Mr. Taylor acknowledged at trial, selection of an appropriate valuation methodology depends on the purpose of the appraisal. FOF ¶ 270. As he further acknowledged, valuation analysts practicing in bankruptcy should generally be aware of the legal framework for valuation testimony that is provided by judicial precedent, the Bankruptcy Code, and the Bankruptcy Rules (*id.*), and GAAP account balances typically do not reflect the current value of an asset for bankruptcy purposes. *Id.* ¶ 269. Yet despite his agreement with these concepts, Mr. Taylor did not make any inquiry as to what the legal standard is for valuing a secured lender's collateral in bankruptcy; he simply relied on counsel. *Id.* ¶ 270.

2. The Evidence Demonstrates That the Purchasers Did Not Attribute Any Value to the Intangible Assets

The circumstances surrounding the Ocwen sale also demonstrate that the Purchasers in fact assigned no value to any general intangible assets as to which the JSNs claim to have a lien.

During the Debtors' prepetition marketing process, no bidders expressed any interest in purchasing either the origination or servicing platforms separately from the MSRs. FOF ¶ 30. Nationstar's original February 2012 stalking horse bid (and subsequent APA) did not obligate Nationstar to purchase any of the assets used to operate the platforms. *Id.* ¶¶ 30, 67. In fact, when Nationstar was asked as part of the bid process to allocate its proposed purchase price among the assets, including any value it attributed to the servicing and origination platforms, Nationstar allocated all of the value to the Debtors' MSRs, Advances, and loans – specifically ascribing no value to the platforms. *Id.* ¶ 28. Similarly, Ocwen's October 19, 2013 bid on substantially all of the Debtors' assets did not require Ocwen to assume any of the employees or contracts necessary to operate the platforms (*i.e.*, the general intangibles associated with the MSRs). *Id.* ¶ 67. Instead, Ocwen and Walter focused their efforts on purchasing ResCap's MSRs and associated Advances. *Id.* ¶¶ 154-56. Although the servicing and origination platform was in the pool of auctioned assets, Ocwen expressed no interest in acquiring them. Ocwen and Walter had their own origination and servicing platforms. *Id.*

Far from having value, the origination and servicing platform carried approximately $108 million of *cost* to the Debtors and would have required the Purchasers to assume significant liabilities associated with the platform's staff, IT contracts, real property leases, and other items with no corresponding material benefit. *Id.* ¶¶ 152-57. The Debtors in effect had to *pay* Ocwen and Walter to take the platforms off their hands, by providing the

Purchasers a $108.4 million credit towards their bid to incentivize them to assume the costs associated with certain employee contracts and software that constituted the origination and servicing platform. *Id.* ¶ 152. Ocwen has since moved most of the loans off of the Debtors' platforms onto its own and is scheduled to complete the transition by early next year. FOF ¶ 155. If Ocwen had not agreed to assume the contracts and employees necessary to operate the platforms as part of the auction, it could have required the Debtors to incur substantial costs to retain the loans on their own platforms and transfer them to Ocwen's platforms when ready – costs the Debtors sought to avoid by offering the bid credits at the auction. *Id.* ¶ 152.

Mr. Taylor testified that he either disregarded or was ignorant of many of these facts specific to this transaction, which further discredits his analysis. *Id.* ¶ 272. His methodology purported to strip out all characteristics specific to a particular buyer and perform an analysis based on what he considered a typical market participant. *Id.* ¶ 271. Since Mr. Taylor's analysis was performed based on the wrong legal standard, the Court should disregard it completely.

Nor does Mr. Taylor provide the Court with any reason to depart from *Romley* and the other authorities cited above. To the contrary, his opinion is flawed for all the reasons noted at greater length in the Proposed Findings of Fact including, among other things, that: (i) it is markedly inconsistent with Ocwen's and Walter's 10-Qs, even though they also use GAAP and FASB principles (*id.* ¶ 273); (ii) Mr. Taylor placed greatest weight on a single highly suspect outlier as a putative comparable transaction to reach his $220M valuation, greatly skewing his results in favor of the JSNs (*id.* ¶¶ 278-79); (iii) Mr. Taylor's conclusions were pre-determined by values and figures set by others (*id.* ¶ 281); and (iv) some of the values and figures Taylor

imported from other experts were completely wrong (*id.* ¶¶ 217-30). In sum, the Court should hold that the Ocwen APA governs the allocation of the purchase price.

D. The JSNs' Lien Does Not Extend to Alleged General Intangibles Associated With the Purchased Assets

Even if it were appropriate to reallocate the purchase price in the Ocwen sale to various intangible assets, the JSNs have not identified any intangible assets on which they had a valid postpetition lien. Mr. Taylor identified four categories of intangible assets to which the JSNs contend part of the purchase price for the MSRs and Advances should be reallocated: (1) developed software and know-how (*i.e.*, the intangible value of the servicing and origination platforms), (2) "unidentified intangibles and goodwill" (*i.e.*, senior management, residual goodwill); (3) customer-related intangibles (*i.e.*, value attributable to the opportunity to refinance certain mortgages (the "Refi Opportunities")); and (4) trademarks. FOF ¶ 268. The JSNs did not have a lien on any of the foregoing because they are all intangibles associated with and derived from the Debtors' MSRs, which are not within the JSNs' collateral package.

1. The Blanket Release Extinguished the JSNs' Lien on Developed Software and Know-How

To the extent any of the intangibles identified by Mr. Taylor relate to developed software and know-how, the JSNs' claim to a lien can be summarily dismissed. Under the Blanket Release, the Third Priority Collateral Agent expressly released the JSNs' lien on both PLS MSRs *and* all associated general intangibles. FOF ¶ 147.[12] The released intangibles are defined by reference to the UCC's definition of "general intangible":

> Any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit, money, and oil, gas, or other minerals

[12] The Blanket Release also covered the Debtors' fee-servicing business. The Court has previously determined that the Blanket Release was effective. *See* September 20 Opinion, 497 B.R. at 416-17.

> before extraction. The term includes payment intangibles and software.

UCC § 9-102. All four categories of intangible assets identified by Mr. Taylor are "general intangibles" under the UCC given that they do not fall within any of the other categories of personal property described in section 9-102. The largest subset of Mr. Taylor's valuation relates to "developed software and know-how," which he valued at $220 million. FOF ¶¶ 161, 268. Because such assets are unquestionably used in association with the Debtors' PLS MSRs, they are covered by the Blanket Release and the JSNs have no lien on them.

Moreover, any lien the JSNs may have had on software used in connection with servicing of the GSE MSRs was released along with other general intangibles under the Blanket Release.[13] While the Blanket Release related to the PLS MSRs (not the GSE MSRs), the same software was used with respect to both. Thus, the release of the JSNs' lien on the general intangibles associated with the PLS MSRs was effective to release their lien on the software used in connection with the GSE MSRs as well. *Id.* ¶¶ 161-64. Even assuming a lien on software could be released only in part, the JSNs have not come forward with any evidence to apportion the value of the software among PLS MSRs and GSE MSRs. Instead, Mr. Taylor appraised these assets on an aggregate basis. *See* Taylor Expert Report at 35.

2. The JSNs Have No Lien On Refinancing Opportunities Inherent in the Debtors' GSE MSRs

The Debtors' GSE MSRs are likewise not subject to the JSNs' liens. These MSRs have always been – and remain – "Excluded Assets" under the Notes Security Agreement. In contrast to the PLS MSRs, general intangibles associated with the GSE MSRs were not the subject of an explicit release. Nevertheless, the alleged "customer-related"

[13] As reflected in the language of UCC § 9-102 quoted above, software is a general intangible.

intangibles that Mr. Taylor has identified were not part of the JSNs' lien. These alleged customer-related intangibles are, in fact, the value that Mr. Levine ascribed to the Refi Opportunities of the GSE MSRs (and Mr. Taylor imputed into his analysis). But the JSNs' assertion of a lien on these intangible assets relies on the false premise that such Refi Opportunities exist separate from the underlying MSRs.

The Refi Opportunities inherent in the Debtors' MSRs have no independent significance separate and apart from the MSRs from which they derive. FOF ¶ 166. Even the JSNs' expert, Mr. Levine, conceded that any economic benefit of the Refi Opportunities is an incidental benefit of, and cannot exist independently of, the underlying MSR portfolio. *Id.* ¶ 223-29. The two assets are so inextricably linked that the Debtors' balance sheet did not separately break out the Refi Opportunities value from the associated MSRs. *Id.* Mr. Levine acknowledged that he is not aware of any company that separates the Refi Opportunities on its balance sheet from the underlying MSRs and has never seen a transaction in which Refi Opportunities were sold separately from the MSRs. *Id.*

Moreover, any value relating to the Refi Opportunities is a function of, and inseparable from, access to the books and records associated with the GSE MSRs. *Id.* ¶ 166. As Mr. Taylor explained, Refi Opportunities are based on a customer relationship, which exists only if the entity has information about the customer and has regular contact with the customer and the customer has the ability to make direct contact with the entity. The information necessary to develop and maintain the customer relationships is contained in ResCap's books and records. *Id.* ¶¶ 168-70.[14]

[14] Indeed, without access to the books and records, the valuation analysis of the HARP Refi conducted by the JSNs' expert, Jeffrey Levine, would have been impossible.

As with the underlying GSE MSRs, the books and records associated therewith were excluded from the JSNs' collateral because they had already been pledged in favor of the Citi MSR Facility. *Id.* ¶ 168. Because the key to unlocking value (if any) from the Refi Opportunities was the books and records, and the JSNs had no lien on such books and records, the JSNs had no lien on any Refi Opportunities. *Cf. Baker v. Commissioner of Internal Revenue*, 338 F.3d 789, 793-94 (7th Cir. 2003) (insurance agent who did not own books, records, and customer list could not claim to have received payment for any "goodwill" upon returning such items to State Farm in exchange for payment due upon termination of agency relationship).

3. Any Goodwill Constitutes Postpetition Collateral Not Subject to the JSNs' Prepetition Lien

While Mr. Taylor did not place any value on the Debtors' goodwill (actually finding it had a negative value of $46 million), Mr. Siegert's top-down "Methodology 2" valuation (as based on Mr. Fazio's "Total Enterprise Valuation") suggests that the Debtors could have had goodwill intangible value of $623 million. FOF ¶ 171. For the reasons discussed in detail in the Proposed Findings of Fact (at ¶¶ 172-76; 192-99), this methodology is deeply flawed and does not represent an accurate valuation of the Debtors' business. In any event, any such remaining intangible value of the company is still not subject to the JSNs' liens for two principal reasons.

First, as a general matter, any goodwill or intangible value in the Debtors' origination and servicing platforms is necessarily an extension of the underlying mortgage servicing rights, upon which the JSNs do not have a lien. *Id.* ¶ 171-76. Moreover, goodwill – which is the advantage and opportunity relating to a business – cannot be disposed of separately from the underlying business because goodwill has no value absent the business's existence. *See, e.g., Metro. Nat'l Bank of N.Y. v. St. Louis Dispatch Co.*, 149 U.S. 436, 446 (1893)

(business's goodwill necessarily extinguished when business merged with another company); *Baker*, 338 F.3d at 793 ("Goodwill cannot be transferred a part from the business with which it is connected.") (internal citation omitted); *Terminal Co. v. United States*, 296 F. Supp. 1084, 1087-88 (D. Del. 1969) (holding that taxpayer's goodwill was necessarily transferred with business even though not expressly transferred). Thus, any such goodwill or intangible value is not a separate asset that could be subject to the JSNs' liens.

Second, any goodwill or other intangible value that does exist constitutes "after-acquired" property under section 552(a) of the Bankruptcy Code and thus is not the "proceeds, product, offspring, or profits" of the JSNs' prepetition collateral. As a result, the JSNs' lien on such assets is cut off under section 552(b)(1) of the Code. And even if any such goodwill or intangible value were viewed as "proceeds, product, offspring, or profits," the Court should hold that the "equities of the case" dictate that the JSNs' lien on such assets be relinquished.[15]

Pursuant to section 552(a) of the Bankruptcy Code, "property that the estate acquired after the petition is not subject to the prepetition security agreement, even though the agreement expressly provided that it extends to after-acquired property." *Nanuet Nat'l Bank v. Photo Promotion Assocs., Inc. (In re Photo Promotion Assocs., Inc.)*, 61 B.R. 936, 938 (Bankr. S.D.N.Y. 1986); *see* 11 U.S.C. § 552(a). There is an exception to this rule, under which property that constitutes "proceeds, product, offspring, or profits" of original collateral may be subject to a creditor's lien notwithstanding the intervention of bankruptcy. 11 U.S.C. § 552(b)(1). And there is an "exception to the exception," pursuant to which the Court may nevertheless cut off a

[15] The "equities of the case" argument is advanced solely by the Committee, not the Debtors. Any suggestion by the JSNs that the Committee has waived the equities of the case exception is simply incorrect. Section 18(c) of the AFI DIP Order states that the exception "is hereby waived *by the Debtors* with respect to the Prepetition Collateral." AFI DIP Order ¶ 18(c) (emphasis added). The reference to "the Debtors" (and not the Committee or the estates) is hardly an accident. The same provision in the Interim DIP Order stated, much more broadly, that the exception "is deemed waived with respect to the Prepetition Collateral." Interim DIP Order, Dkt. No. 89. The waiver was narrowed at the behest of the Committee, as the transcript of the June 18, 2012 hearing makes clear. *See* June 18, 2012 Tr. at 36:6-9; 41:15-17 (describing resolution of Committee's objections).

creditor's security interest depending on its weighing of the "equities of the case." As with liens generally (*see* above discussion of burden), "[f]or purposes of section 552(a), the burden of proving that a lien survives postpetition has been placed upon the secured party." 5 Collier on Bankruptcy ¶ 552.01[4] (16th ed. 2013).

Here, the JSNs have not satisfied their burden of demonstrating that any goodwill existed as of the Petition Date. The JSNs' valuation experts admitted that the ultimate transactions that gave rise to the purported goodwill and other intangible value were not possible to achieve as of the Petition Date:

> THE COURT: [W]ithout obtaining the consents and settlements that were achieved in the months following the petition date, you could not have closed the sale; isn't that true?
>
> THE WITNESS: You would need those -- yes, you would need those consents.

Oct. 23 Tr. at 192:6-11 (testimony of P. Eric Siegert).

> Q: So I think you therefore would agree that ResCap couldn't actually have sold these MSRs on May 14th if they hadn't required the consents we just talked about?
>
> A: They could not have closed a transaction on that date.

Oct. 22 Tr. at 64:19-22 (testimony of Jeffrey Levine).

Applying Mr. Siegert's "top-down" approach to estimating intangible assets and goodwill to the stalking horse offers that existed as of the Petition Date, and even to the improved stalking horse bids resulting from the mini-auction, demonstrates that the assets actually had negative goodwill until the Debtors' achieved subsequent value enhancements. FOF ¶ 234. On the Petition Date, the business that existed was subject to shut-down on a moment's notice by the GSEs, RMBS Trustees, or the Debtors' regulators. *Id.* ¶¶ 25, 31, 38. If not for the work performed by the Debtors following the Petition Date to obtain the consents of

such parties to the sales, there would have been little, if any value, for anyone – and certainly not any goodwill. *Id.* ¶¶ 37-41. Accordingly, all such goodwill or "intangible value" that the JSNs identify was generated solely through the bankruptcy process via the Debtors' (i) negotiating over several months with numerous parties, (ii) obtaining the necessary consent of the RMBS Trustees and the GSEs to make the assets saleable, and (iii) marketing the assets and negotiating with purchasers to obtain the highest and best bid (which included offering a credit to compensate for the negative value of the platforms).

Because there was no goodwill on the Petition Date, any goodwill generated during the case is by definition after-acquired property. Under section 552(a) of the Bankruptcy Code, the JSNs' lien does not extend to this value.

Nor is the goodwill or other intangible value properly regarded as "proceeds, product, offspring, or products" of original collateral for purposes of section 552(b). That section "is intended to cover after-acquired property that is directly attributable to prepetition collateral, without addition of estate resources." 5 Collier on Bankruptcy ¶ 552.02[2][a] (16th ed. 2013). Here, any purported goodwill came about solely as the product of the Debtors' efforts to free the assets from encumbrances and threats of litigation, which had rendered them unsaleable prior to the petition date. FOF ¶¶ 37-48. As this Court has held, liens do not attach to property "brought into being solely as the fruit of the subsequent labor of the bankrupt." *In re Barbara K Enters.*, No. 08-11474, 2008 WL 2439649, at *30 (Bankr. S.D.N.Y. June 16, 2008) (quoting *Local Loan Co. v. Hunt*, 292 U.S. 234, 243 (1934)).[16]

[16] *See also First Nat'l Bank of Atlanta v. Willis (In re Jones)*, 908 F.2d 859, 861 (11th Cir. 1990) (increased cash surrender value of life insurance policy over petition date value did not constitute proceeds, product, offspring, or profits); *Bus. Bank v. White (In re Timothy Dean Rest. & Bar)*, 342 B.R. 1, 24 (Bankr. D. D.C. 2006) (room service charges not proceeds of collateral (food inventory) because cost of ordering room service includes far more than value of food and beverages served, namely, service provided by hotel); *Official Comm. of Unsecured Creditors v. UMB Bank (In re Residential Capital, LLC)*, 2013 Bankr. LEXIS 3933, at *27 (Bankr. S.D.N.Y. Sept. 20, 2013) (claims arising postpetition are "after-acquired" property belonging to estate not subject to prepetition liens).

In any event, section 552(b) of the Bankruptcy Code would cut off any lien that the JSNs' claim to have on any such "proceeds." Under the "equities of the case" doctrine, the JSNs should not benefit from the Debtors' postpetition efforts to enhance the value of the assets sold to Ocwen and Walter. *See, e.g.*, *Photo Promotion*, 61 B.R. at 939 (orders for photo prints valueless unless orders could be processed into finished products by debtor's postpetition efforts).

E. The Debtors Have Appropriately Allocated the Proceeds of the Berkshire Sale

As discussed in the Proposed Findings of Fact, the Berkshire Hathaway APA sets forth the purchase prices paid for different categories of whole loans acquired by Berkshire Hathaway. FOF ¶¶ 158-60. The Berkshire Hathaway APA classifies the loans within the HFS Portfolio into six buckets based on certain characteristics, *e.g.*, performing or non-performing, first or second lien. *Id.* ¶ 158. It then assigns differing purchase price percentages to be multiplied by the UPB of the loans in each category to arrive at the purchase price (plus any adjustments for the document deficiency multiplier). *Id.* ¶ 159. Section 3.1(a) of the Berkshire Hathaway APA synthesizes the bucket stratification, purchase price percentages, and multiplier into a detailed purchase price mechanism. *Id.*

The JSNs' expert, Mr. Fazio, unreasonably ignores the negotiated purchase prices that Berkshire agreed to pay for various categories of loans pursuant to section 3.1(a) of the Berkshire Hathaway APA, which were negotiated at arms-length between the Debtors and Berkshire. *Id.* ¶¶ 204-05. Instead, he applies his own methodology to allocate the value of the HFS Portfolio between JSN and non-JSN collateral as of the Petition Date. Rejecting the negotiated prices, Mr. Fazio reclassifies the loans based on almost entirely different characteristics, *e.g.*, origination vintage, product type, adjustable or fixed rate mortgage, and then

values the loans within his classifications based on certain metrics, *e.g.*, borrower credit scores, delinquency rates, and interest rates, to derive his bottom-up valuation. *Id.* Based on his own methodology, which does not rely on the loan classifications and purchase price calculations in the Berkshire Hathaway APA, Mr. Fazio concludes that the overall quality and value of the JSN collateral within the HFS Portfolio is higher than the non-JSN collateral. *Id.* ¶¶ 200-08.

This post-hoc recutting of the negotiated prices is inappropriate. As discussed above in relation to the Ocwen APA, where, as here, an asset is sold in an arms'-length transaction, the fair market value of such asset is conclusively determined by the price paid . *See Romley v. Sun Nat'l Bank (In re Two "S" Corp.)*, 875 F.2d 240, 244 (9th Cir. 1989); *see also Covey v. Davlin (In re Hobbick*), No. 97-83543, 2001 WL 34076375, at *14 (Bankr. C.D. Ill. Sept. 10, 2001). The Berkshire Hathaway APA was the result of a highly competitive auction process approved by the Court, and the price paid for the whole loans was the result of arms'-length negotiations that established the fair market value of each category of loans. FOF ¶¶ 204-05.

Mr. Fazio's analysis is also flawed because it is based on inappropriate assumptions. First, he bases his Petition Date valuation of the sold HFS assets on the $1.5 billion Berkshire sale price (FOF ¶¶ 201-03), which was not available on the Petition Date or even at the Mini-Auction. *Id*. Second, his analysis blindly assumes all of the benefits of a four-months-long § 363 sale process, which included "Centerview identif[ying] 46 potential purchasers for the Whole Loan Portfolio, 22 of which signed non-disclosure agreements" and an 11-round auction. *Id.* ¶ 201. Mr. Fazio unreasonably assumes that in a Petition Date sale of the HFS portfolio all document deficiencies associated with the loans would have been cured as of the Petition Date (just as they would be corrected through the course of a § 363 sale process), and

therefore the document deficiency multiplier in the Berkshire APA would not have reduced the valuation of the whole loans. FOF ¶ 202. He did not know that as of the Petition Date more than twenty percent of the loans in the HFS Portfolio had document deficiencies, or that serious deficiencies remained when the sale closed some nine months later. *Id.* Third, Mr. Fazio assumed that the loans in the HFS Portfolio required no modifications, ignoring that the DOJ/AG Settlement required the Debtors to solicit more than 14,000 loans for potential modifications, resulting in voluntary UPB and interest rate reductions. *Id.*

For all these reasons and as discussed in more detail below, Mr. Fazio's Petition Date valuation is not a reliable indication of value of the JSNs' collateral as of the Petition Date. The JSNs have not offered any competent evidence of the value of the HFS Portfolio as of the sale closing or Effective Date. As a result, there is no basis in the evidentiary record to reallocate the proceeds of the Berkshire Sale in the Effective Date valuation of the JSNs' collateral.

F. The AFI DIP Order Did Not Revive the JSNs' Lien on Released Collateral

The JSNs ask the Court to interpret paragraph 5(g) of the AFI DIP Order ("Paragraph 5(g)") (PX 76) to mean that the Debtors "knowingly" agreed that assets released from the JSNs' liens years earlier were revived, without any disclosure whatsoever, by the AFI DIP Order. The contention that the commonplace language of Paragraph 5(g) conferred on the JSNs an additional *$1.2 billion* of collateral – without any contemporaneous disclosure in any motion, pleading, or hearing transcript – was never credible. Based on the evidence adduced at trial, it is patently frivolous. The JSNs' interpretation of the paragraph fails on multiple grounds.[17]

[17] The Plaintiffs have previously argued in their opposition to the JSNs' motion to dismiss (the "MTD Opposition") that Paragraph 5(g), by its plain terms, did not operate to revive released liens, but the Court indicated it "would benefit from a greater factual record" on the issue. September 20 Opinion, 497 B.R. at 412. Rather than reiterate

1. The AFI DIP Motion Disclosures Are Dispositive Evidence That the AFI DIP Order Did Not Revive Liens on Released Collateral

The Court should not entertain any argument that the AFI DIP Order revived the JSNs' liens on released collateral because the AFI DIP motion failed to disclose any such intent. Under Local Rule 4001-2, if the Debtors had intended to secure prepetition debt with liens on postpetition assets, they would have been required to make conspicuous disclosure of this intent. *See* Local Rule 4001-2(a)(6) (cash collateral motion must include short statement of material terms of order, including "any cross-collateralization that elevates pre-petition debt to administrative expense (or higher) status or that secures pre-petition debt with liens on post-petition assets (which liens the creditor would not otherwise have by virtue of the pre-petition security agreement or applicable law"). The rule reflects the wise principle that whenever a postpetition lien is granted, the Court (and creditors) must be explicitly notified of this important fact. While the Debtors' motion for approval of the AFI DIP Order [Dkt. No. 491] made explicit mention of the Debtors' intent to provide adequate protection liens to the JSNs on the LOC Facility collateral, nowhere in the motion, or the hearings held on May 14, 2012 and June 18, 2012 in connection with the motion, did the Debtors – or any other party – state that the AFI DIP Order would grant the JSNs liens on such collateral for any other purpose.[18] The absence of any such disclosure is independently dispositive evidence that the order was not intended to, and did not, constitute a postpetition revival of previously released collateral.

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their plain language arguments from earlier briefing, the Plaintiffs incorporate them by reference herein. *See* MTD Opposition at 16-23 [Adv. No. 13-01343, Dkt. No. 30].

The Plaintiffs add one additional plain language argument to those set forth in the MTD Opposition: The JSNs' reading of Paragraph 5(g) ignores that the provision does not simply provide that the JSNs have a lien on assets that meet the definition of "Collateral," but instead states that the JSNs have liens on assets "constituting 'Collateral' *under*, and as defined in, the Junior Secured Notes Documents." If the stipulation was meant solely to reference assets meeting the definition of "Collateral," the term "under" would be superfluous. To give the terms "under" any effect, the "Collateral" referred to by the stipulation must be collateral that was currently pledged to the JSNs, not assets that were once "Collateral" but were subsequently released.

[18] The transcripts from the two hearings are available at Docket Numbers 154 and 472, respectively.

2. Abundant Contemporaneous Evidence Supports Plaintiffs' Interpretation of Paragraph 5(g)

As set forth in paragraphs 181-187 of the Proposed Findings of Fact, there are a number of additional indicia of the parties' intent at the time of entry of the AFI DIP Order.

First, the *very next* stipulation in the AFI DIP Order following Paragraph 5(g) provides an overview of the collateral securing the Junior Secured Notes:

> [T]he collateral securing the Junior Secured Notes Obligations includes, among others . . . *the categories of assets under the columns labeled "Ally Revolver" and "Blanket" set forth on Exhibit A to this Final Order* . . .

AFI DIP Order ¶ 5(h) (emphasis added) (PX 76). If, at the time the AFI DIP Order was negotiated, the JSNs actually believed that they were being granted new liens on the LOC Facility collateral, paragraph 5(h) should have included "AFI LOC" in the categories of assets securing the Junior Secured Notes on Exhibit A to the AFI DIP Order.

Second, the Ad Hoc Group's reading of Paragraph 5(g) is also not supported by the language of the AFI DIP Order itself. For example, in Paragraph 5(g), the Debtors acknowledge that the Noteholders' liens are "subject and subordinate *only*" to the liens granted under the Revolver. AFI DIP Order, ¶ 5(g) (emphasis added) (PX 76). Notably this provision does not also subordinate Noteholders' purported lien to the LOC Lender's lien under the LOC Facility. Under the Ad Hoc Group's proposed interpretation of Paragraph 5(g), the Noteholders purportedly revived lien on the LOC Collateral is elevated ahead of the LOC Lenders' (uncontrovertibly senior) lien in such collateral. AFI would clearly not have agreed to such provision, especially since it relied on the LOC Collateral to make the postpetition advances under the AFI DIP Order. Also, it is unreasonable to believe that AFI's counsel, which prepared the AFI DIP Order, would have drafted language reviving liens of a competing creditor on the same assets that were also, in the same document, being pledged to support its client's additional

loans. In addition, in granting the Noteholders a postpetition adequate protection lien on the Revolver Collateral and the LOC Collateral, the AFI DIP Order subordinated such lien to any *existing* liens on such collateral. To that end, with respect to the Noteholders' adequate protection lien on the Revolver Collateral, the order acknowledges that such lien is junior to (among other things) the "*existing liens granted to the Junior Secured Parties*." AFI DIP Order ¶ 16(c)(i)) (emphasis added) (PX 76). However, with respect to the adequate protection lien in the LOC Collateral, the AFI DIP Order does not mention the Noteholders' purported existing lien on such collateral. AFI DIP Order ¶ 16(c)(ii) (PX 76).

Third, the Barclays DIP facility expressly prohibited the granting of additional liens on the LOC Facility collateral. [Docket No. 137; Section 6.02] Thus, if the Debtors had revived the JSNs' liens on such collateral, the Debtors would have been in breach of the Barclays DIP agreement.

Fourth, other documents filed simultaneously in the Bankruptcy Court similarly reflect that the stipulations were not intended to revive previously released liens. For example, in their prepetition plan support agreement, the JSNs preserved the right to make a claim for an equitable lien on the collateral securing the LOC Facility (JSN PSA ¶ 5.6.), thereby confirming that the JSNs did not believe that they had a lien on those assets as of right by operation of Paragraph 5(g). Similarly, the Debtors indicated in their motion seeking approval of the Barclays DIP facility that any purported equitable lien asserted by the JSNs on the assets securing the LOC Facility was not a valid, perfected, and nonavoidable lien or security interest as of the Petition Date. [Dkt. No. 13.]

Finally, the language in Paragraph 5(g) that the JSNs attempt to portray as "heavily negotiated" is duplicated, word for word, in the stipulations relating to the collateral

securing the LOC Facility and the AFI Revolver. *See* AFI DIP Order, ¶¶ 5(e)(ii) & (f). This use of identical, boilerplate language refutes the JSNs' contention that Paragraph 5(g) is a provision specifically negotiated by the JSNs to resurrect their liens on the assets securing the LOC Facility.

3. Trial Testimony Supports Plaintiffs' Interpretation of Paragraph 5(g)

At the start of the Phase I trial, the JSNs' counsel promised that the evidence would support the JSNs' strained interpretation of Paragraph 5(g) and demonstrate that the Debtors "knowingly" granted the JSNs liens on the LOC Facility. Oct. 15 Tr. 105:12-15; *see also* PTO, JSN Contentions ¶ 18. In fact, the evidence established the opposite.

Mr. Marano, the Debtors' former CEO and current Chairman, testified that Paragraph 5(g) referred only to liens held as of the date of the Cash Collateral order, that he did "not believe that any party could reasonably have understood this provision to revive previously released liens," and that in any event the Debtors did not intend or understand that the provision would revive such liens. FOF ¶ 183. On cross-examination, he reiterated this point, stating "there's no way we would have further encumbered this company" and that if his CFO had proposed to revive or restore such liens, he "would have dismissed him." FOF ¶ 183.

The testimony of the JSNs' own witness, Mr. Siegert, confirmed the Plaintiffs' interpretation of the stipulation and demonstrated beyond doubt that the JSNs themselves did not interpret the stipulation differently. FOF ¶ 181. Mr. Siegert's testimony demonstrates that the Ad Hoc Group, which was intimately involved in the negotiations over the AFI DIP Order, did not include the value of the assets securing the LOC Facility in their own contemporaneous analysis of the collateral securing the Notes. On cross-examination, Mr. Siegert was shown the May 14 Houlihan Presentation (PX-169; *see* Oct. 23 Tr. 110:8-23) prepared immediately prior to the Petition Date, which valued the JSNs' collateral, and testified about it as follows:

> Q: But understanding the nature and extent of the JSN collateral was important to the ad hoc group that you were representing during this pre-petition period, right?
>
> A: Yes.
>
> Q: And presenting estimates of the value of the JSN collateral was an important part of Houlihan's task during this period, right?
>
> A: Yes.
>
> Q: And if counsel had concluded that the debtors had stipulated that the JSNs had liens on over a billion dollars of Ally LOC collateral, that would have been a material fact for Houlihan to learn, right?
>
> A: Yes.
>
> Q: And it would have been a material fact for Houlihan to convey to the ad hoc Group, right?
>
> A: Counsel would have conveyed that, but it's an important fact.
>
> Q: Yes. And nothing in the Houlihan May 2012 deck that we've been looking at suggests that the debtors had stipulated to – that the JSNs had a lien on over a billion dollars of assets that had pledged – been pledged to the Ally LOC, right?
>
> A: It does not.

Oct. 23 Tr. 127:25-128:21.

Mr. Siegert gave similar testimony concerning PX-357, a Houlihan presentation that was made public on the Petition Date for the express purpose of ensuring that all material non-public information known to members of the Ad Hoc Group was disclosed. *See* Oct. 23 Tr. 129:1-133:4. Mr. Siegert also confirmed that he had no belief as to whether the stipulation in Paragraph 5(g) had revived liens that were previously released (Oct. 23 Tr. 115:4-8), and that at the time of the stipulation he was not aware of any statements by any party that could support the JSNs' current interpretation. Oct 23 Tr. 115:9-116:17; 120:3-11.[19]

[19] The testimony of Mr. Snellenbarger, the Ad Hoc Group's Rule 30(b)(6) designee, also fails to support their argument. Mr. Snellenbarger admitted that the group did not have specific discussions with the Debtors regarding whether liens on released collateral were revived, and he never testified that he understood the language in the AFI DIP Order to revive the JSNs' liens on released collateral. FOF ¶ 183. In any event, any unexpressed intentions of the Ad Hoc Group or its advisors are irrelevant as a matter of law. *See, e.g.*, *Facetime Commc'ns, Inc. v. Reuters*

In view of the foregoing testimony, including from the JSNs' own expert, it is frivolous for the JSNs to continue to maintain that Paragraph 5(g) restored their lien on over a billion dollars of collateral.

III. THE JSNS FAIL TO PROVE THE DIMINUTION IN COLLATERAL VALUE NECESSARY TO AN ADEQUATE PROTECTION CLAIM AND ARE UNDERSECURED BASED ON THE EFFECTIVE DATE VALUE OF THEIR COLLATERAL

Valuation arises in two contexts in these proceedings. To establish that they are oversecured, the JSNs must prove that the value of their collateral on the Effective Date exceeds the amount of their claim. To establish an entitlement to an adequate protection claim, the JSNs must prove that the value of their collateral has declined since the Petition Date. The JSNs can prove neither.

As set forth below, the value of the JSNs' collateral on the Effective Date – which is largely undisputed – is $1.888 billion before $143 million in professional fees are paid pursuant to the Carve Out, and $1.745 billion after. FOF ¶¶ 254, 258-60. Assuming an allowed claim of $2.222 billion (*i.e.*, OID is allowed as principal), the JSNs are vastly undersecured; assuming an allowed claim of $1.836 (*i.e.*, OID is disallowed), the JSNs are at best marginally oversecured, and are undersecured after the Carve Out (or if the Committee succeeds on any of its lien challenges).

As to the Petition Date value of their collateral, the JSNs have not met their burden of proof, because they use an incorrect valuation standard: going-concern value rather than liquidation value. Moreover, even if some other standard is applicable, the JSNs have not carried their burden because their valuations presuppose a stand-alone reorganization that was

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Ltd., No. 08 Civ. 4730, 2008 WL 2853389, at *5 (S.D.N.Y. July 22, 2008) ("[P]arol evidence about a contract party's unexpressed intentions is inadmissible to vary the plain meaning of the contract's language; in determining the intention of the parties it is their objective manifestations of intent (found in the words of the agreement), not their unexpressed subjective intentions, that control.").

never possible in these Chapter 11 cases and are based on hypothetical transactions that never existed, or actual transactions that did not exist and could not have existed on the Petition Date because, among other things, they required numerous consents and approvals that were obtained only after months of efforts by the Debtors. Having failed to establish the Petition Date value of their collateral, the JSNs cannot show they are entitled to an adequate protection claim.

A. Legal Standard for Petition Date Value of Collateral

Under the language of the AFI DIP Order, and governing law, the JSNs are entitled to an adequate protection claim only if and to the extent they can demonstrate there has been an aggregate diminution in the value of their interests in the Notes Collateral. FOF ¶ 53; September 20 Opinion, 497 B.R. at 420 ("Contrary to the Defendants' position, not every use of Cash Collateral constitutes a per se diminution in the value of the JSNs' collateral. If the value of the JSNs' collateral actually diminishes, then the JSNs may assert an adequate protection claim.") (citation omitted).

Diminution in the aggregate value of a creditor's collateral is measured by comparing the aggregate value of the collateral on the date that adequate protection was provided (here, the Petition Date) to the aggregate value of the collateral on the effective date of the Plan. *See, e.g.*, *Wood v. LA Bank (In re Wood)*, 190 B.R. 788, 792 (Bankr. M.D. Pa. 1996) ("Almost universally, the courts have chosen the date of filing as the appropriate time to value a secured creditor's interests for purposes of adequate protection under § 361 *et seq.*"); 4 *Collier on Bankruptcy* ¶ 506.03[7][a][iv] (16th ed. 2013) ("In general, courts typically hold that, for

purposes of adequate protection, the value of the collateral is to be determined either as of the petition date or as of the date on which the request for adequate protection was first made.").[20]

In valuing the collateral at each point, petition date and plan date, the proper value is net of reasonable expenses that were incurred or would have been incurred in connection with the disposition of the collateral. *See* 4 *Collier on Bankruptcy* ¶ 506.03[7][a][ii] (16th ed. 2013) (noting "it is appropriate to deduct any applicable costs of sale in arriving at the ultimate value" for purposes of adequate protection) (citing cases); *cf. In re Heritage Highgate, Inc.*, 679 F.3d 132, 143 (3d Cir. 2012) ("[T]he projections regarding monies to be realized from the sale of lots over time do not equate to 'value' as of confirmation because they anticipate Debtors spending time and money to realize value at a later date.").[21] The relevant issue is what value would be available to distribute to the secured creditor, not the value in the hands of the debtor if the collateral were never sold.

In determining the proper method to value collateral, section 506(a) of the Bankruptcy Code requires that the court take into account the "purpose of the valuation and of the proposed disposition or use of such property." 11 U.S.C. § 506(a). The purpose of adequate protection is to provide the lender with the benefit of its bargain – and no more. *See In re WorldCom, Inc.*, 304 B.R. 611, 618-19 (Bankr. S.D.N.Y. 2004) ("the purpose of providing adequate protection is to insure that the secured creditor receives the value for which the creditor

[20] The JSNs do not appear to dispute this point. *See* PTO JSN Contentions ¶ 14 ("Plaintiffs and Defendants are in substantial agreement that 'diminution in value' within the meaning of the Cash Collateral Order is to be calculated as the fair market value of the JSN Collateral as of the Petition Date compared to the JSN Distributable Value.").

[21] With respect to expenses, the Court has already noted that the Defendants are not entitled to a declaration of the "exact quantum of the direct costs of liquidating the collateral" because "[t]hat relief would burden the Debtors' estate with a needless expense aimed at reviewing the Debtors' administration of collateral. . . ." September 20 Opinion, 497 B.R. at 420. The actual costs of administrating these Chapter 11 cases and the Debtors' business – spent in accordance with the budget approved by the lenders and not subject to hindsight reapportionment – were all necessary in order to achieve the ultimate recovery that the JSNs are receiving in connection with the Global Settlement and the Plan.

bargained for prior to the debtor's bankruptcy"); H.R. Rep. No. 595, 95th Cong., 1st Sess. 356-57 (1977) ("the purpose of the section is to insure that the secured creditor receives in value essentially what he bargained for").

Outside of bankruptcy, the Third Priority Secured Parties' right upon a default was to foreclose upon their collateral and seek to sell it in a commercially reasonable sale. *See, e.g.*, FOF ¶ 109; Intercreditor Agreement § 3.1(a), (PX 2). The adequate protection provided the JSNs was designed to protect this interest – that is, to ensure they received no less than they would have if the automatic stay had not been extended and they had exercised their contractual remedies. As such, the appropriate standard for valuing the JSNs' collateral for adequate protection purposes is the value of the collateral in the hands of the Collateral Agent – *i.e.*, foreclosure value. *See In re Ralar Distribs, Inc.*, 166 B.R. 3, 7 (Bankr. D. Mass. 1994) ("The value relevant for adequate protection purposes, however, is not book value. It is liquidation value realizable by the creditor."), *aff'd*, 182 B.R. 81 (D. Mass. 1995), *aff'd*, 69 F.3d 1200 (1st Cir. 1995); *Sharon Steel Corp. v. Citibank, N.A. (In re Sharon Steel Corp.)*, 159 B.R. 165, 169 (Bankr. W.D. Pa. 1993) (using liquidation value for adequate protection purposes); *In re Scotia Dev, LLC*, No. 07-20027, slip op. at 23-24 (Bankr. S.D. Tex. July 7, 2008) ("With non-cash property, the interest that secured creditor has a right to is the right to foreclose. Therefore, the case law suggests that the appropriate value to protect is the foreclosure value of the property and not the fair market value of the property.") (attached as **Exhibit A** hereto), *aff'd in part*, *In re SCOPAC*, 624 F.3d 274, 285-86 (5th Cir. 2010).[22]

[22] *See also United States v. Case (In re Case)*, 115 B.R. 666, 670 (9th Cir. B.A.P. 1990) ("If we were attempting to value FmHA's interest in the property for adequate protection purposes, the possibility of forced liquidation would be assumed and a deduction for selling costs would be logical."); *La Jolla Mortg. Fund v. Rancho El Cajon Assocs.*, 18 B.R. 283, 289 (Bankr. S.D. Cal. 1982) ("In this regard, we must evaluate the collateral, being the adequate protection, in the hands of the claim holder. It is the creditors' expected costs to liquidate the property that is relevant, not those of the debtor.").

The foregoing principles are aptly explained in *Collier*:

> As explained in the legislative history to section 361, the purpose of the adequate protection requirement is to protect the creditor from loss occasioned by the debtor's use, sale or lease of the collateral while attempting to liquidate or reorganize. The value to be protected is thus the value of the *creditor's* current interest viewed from the perspective of equivalent value . . .
>
> * * *
>
> [S]electing the creditor's hypothetical use as the appropriate benchmark for resolving the valuation question mirrors the purpose of adequate protection. Selecting the creditor's hypothetical use best ensures that, if the debtor does not pay the secured claim, the secured creditor will be able to receive the same value that the creditor would have received if the secured creditor had exercised its enforcement rights against the collateral. It is not realistic to assume that the secured creditor will be able to recover from the collateral any higher value based on the debtor's use of the collateral if the debtor is not able to reorganize or liquidate in such a way as to obtain that higher value.
>
> * * *
>
> Accordingly, for adequate protection purposes, the better view is that the value of the [collateral] should be determined in accordance with a hypothetical foreclosure sale method. In applying that method, it is appropriate to deduct any applicable costs of sale in arriving at the ultimate value.

4 *Collier on Bankruptcy* ¶ 506.03[7][a][ii] (16th ed. 2013).

Thus, a proper petition date valuation of the collateral for adequate protection purposes cannot take for granted the value attributable to those assets achieved after the petition date as a result of the bankruptcy process. Rather, a proper valuation must assume a commercially reasonable foreclosure sale in the absence of these benefits.

The cases cited by the JSNs are not to the contrary. In support of their adequate protection valuation theory, the JSNs have previously cited cases that do not consider adequate protection claims at all, but instead value secured creditors' claims for other purposes under

section 506 of the Bankruptcy Code. *See Prudential Ins. Co. of Am. v. City of Boston (In re SW Boston Hotel Venture, LLC)*, 479 B.R. 210 (B.A.P. 1st Cir. 2012); *In re Motors Liquidation Co.*, 482 B.R. 485, 493 (Bankr. S.D.N.Y. 2012); *In re Urban Communicators*, 379 B.R. 232 (Bankr. S.D.N.Y. 2007), *rev'd on other grounds*, 394 B.R. 325 (S.D.N.Y. 2008). Nothing in section 506 negates the policies underlying adequate protection or requires the Court to apply the same methodology for adequate protection purposes that it uses to determine the amount of a secured creditor's claim. Such a rule would read out of section 506(a) its requirement that any valuation take into account the "purpose of the valuation."[23]

The JSNs' reliance on *United Savings Ass'n v. Timbers of Inwood Forest Associates*, 484 U.S. 365 (1988), is also misplaced. There, the Supreme Court looked to section 506 of the Bankruptcy Code as a guide to interpreting the term "interest in property" for purposes of adequate protection, but the Court said nothing about the methodology by which value is to be determined.[24] In fact, the Supreme Court emphatically confirmed the well-established principle that the same collateral may be valued differently at different times and for different purposes in a single case. *See Timbers*, 484 U.S. at 377 (section 1129 standard does not control for purposes of adequate protection).[25] Nothing in *Timbers* suggests that the value of a

[23] The court in *Bank Hapoalim B.M. v. E.L.I., Ltd.*, 42 B.R. 376 (N.D. Ill. 1984), on which the JSNs also rely, had no occasion to consider the proper valuation methodology under section 506 or section 361. There, the collateral at issue – bricks – was a commodity subject to preexisting contract for sale. Similarly, the appeal in *Salyer v. SK Foods, L.P. (In re SK Foods, L.P.)*, 487 B.R. 257, 261 (E.D. Cal. 2013), concerned whether, as a matter of fact, the bankruptcy court had properly characterized a sale as a going-concern transaction, rather than a liquidation. Although the district court upheld this factual finding as not clearly erroneous, nowhere did it prescribe the proper methodology to value collateral for adequate protection purposes.

[24] *Bank R.I. v. Pawtuxet Valley Prescription & Surgical Ctr.*, 386 B.R. 1 (D.R.I. 2008), upon which the JSNs have also relied, does not consider the purposes underlying the grant of adequate protection, let alone adjust its valuation methodology to address these purposes.

[25] The legislative history could not be more clear on this point. *See* S. Rep. No. 95-989, 95th Cong., 2d Sess. 68 (1978) (legislative history of section 506(a); describing case-by-case approach to valuation, noting "[t]o illustrate, a valuation early in the case in a proceeding under sections 361-363 would not be binding upon the debtor or creditor at the time of confirmation of the plan"); *see also* 4 Collier on Bankruptcy ¶ 506.03[7][f] (16th ed. 2013) (describing ways in which "the amount of a single item of property may be valued in different ways depending on the context of

secured creditor's prepetition collateral for adequate protection purposes is determined in the hands of the debtors, rather than the secured creditor.

Nor does *Associates Commercial Corp. v. Rash*, 520 U.S. 953 (1997), support the JSNs' arguments. There, the Supreme Court declined to apply the foreclosure standard of valuation, but it did so in the context of valuing property retained by the debtor under a plan of reorganization for cram-down purposes. It said nothing about the proper valuation methodology to assess adequate protection claims after a bankruptcy sale. The cram-down standard is not relevant here. Indeed, the Court in *Timbers* carefully observed that the section 1129 standard does *not* control for purposes of adequate protection. 484 U.S. at 377.[26]

Finally, the AFI DIP Order does not, as the JSNs have suggested, somehow preclude use of the foreclosure value methodology for adequate protection purposes. Nothing in that order even arguably specifies how the JSNs' collateral is to be valued for that purpose. That the JSNs did not seek to foreclose on their collateral prepetition, moreover, does not expand their entitlement to an adequate protection claim. Whether they chose to do so or not, the JSNs' contractual remedy was foreclosure, and that alone fixes the interest that must be adequately protected.

B. The JSNs Have Not Met Their Burden of Proof in Establishing the Petition Date Value of Their Collateral For Purposes of Adequate Protection

Whether the JSNs are entitled to an adequate protection claim depends on whether the aggregate value of their collateral has declined from the date they were granted adequate

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the valuation" and noting "the amount of any claim secured by collateral may be regarded as something of a 'moving target'").

[26] Even if the same valuation standard did apply to both cram-down and adequate protection – a proposition the Supreme Court rejected in *Timbers* – the facts of *Rash* were fundamentally different in that the debtor was retaining the subject property, not disposing of it. As the *Rash* Court noted, "the 'proposed disposition or use' of the collateral is of paramount importance to the valuation question.'" *Rash*, 520 U.S. at 962; see, *e.g.*, *Heritage Highgate*, 679 F.3d at 141 (holding, in light of *Rash*'s focus on "proposed disposition or use" of collateral, that "[i]f that language is to be afforded any significance, [], the appropriate standard for valuing collateral must depend upon what is to be done with the property – whether it is to be liquidated, surrendered, or retained by the debtor").

protection – here, the Petition Date – to the effective date of the Plan. The JSNs have the burden of proving that their collateral has declined in value during this time. They fail to satisfy this burden for a number of reasons.

1. Having Used the Wrong Standard of Valuation, the JSNs Have Not Met Their Burden of Proof, and the Court Need Go No Further

As discussed above, the JSNs' experts use the wrong basis of valuation. As a matter of law, the proper standard for valuing collateral at the time adequate protection was granted (here, the Petition Date) is the price that could be realized by the secured lender upon a foreclosure and commercially reasonable sale of the assets.

The JSNs have not even attempted to value the collateral using this common sense standard. FOF ¶¶ 194, 201-202, 221-222, 232. Instead, they value the collateral on the Petition Date as if it could have been magically liquidated on that date with no costs and as if all the benefits of the Chapter 11 Cases could be (and already had been) realized even in a non-bankruptcy sale. *Id*. These benefits include, among other things: (a) a free-and-clear sale; (b) court approval of DIP facilities required to continue the Debtors' servicing and origination businesses; (c) settlements with the RMBS Trustees and the GSEs, which removed the collateral's enormous representation and warranty liabilities; (d) AFI's agreement to support continued originations; (e) a sixth-month-long postpetition marketing process and auction; (f) GSE consents to the asset sales; (g) continued performance under the DOJ/AG Settlement Agreement and Consent Order; (h) negotiated amendments to pooling and servicing agreements, which Wells Fargo could not have obtained because it was not a party to the agreements; and (i) cleared whole loan exceptions. *E.g.*, *id*. ¶¶ 25, 37-41, 46, 196, 221.

The JSNs could never have obtained these benefits under any realistic scenario. The Defendants' own expert, Mr. Siegert, acknowledged as much at trial:

> THE COURT: Absent the consents and settlements that were achieved, you could not have closed the sale; is that correct?
>
> THE WITNESS: If you commenced the sale process as of that date - -
>
> THE COURT: Mr. Siegert - -
>
> THE WITNESS: I'm sorry.
>
> THE COURT: - - without obtaining the consents and settlements that were achieved in the months following the petition date, you could not have closed the sale, isn't that true?
>
> THE WITNESS: You would need those – yes, you would need those consents.

Oct. 23 Tr. 191:24-192:11.

The JSNs' failure to offer proof using the proper standard of valuation, or any evidence of what the collateral could have actually been sold for as of the Petition Date under any standard, dooms their adequate protection claim. Because the JSNs have failed to affirmatively establish the value of their collateral on the Petition Date, the Court need go no further. *See Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986) ("[A] complete failure of proof concerning an essential element of the nonmoving party's case necessarily renders all other facts immaterial.").[27] Because the adequate protection valuation determination is relevant to no other issue in the case, the Court need not remedy the JSNs' failure of proof by searching the record for other evidence of the Petition Date value of the JSNs' collateral.

[27] *See also Alberts v. HCA, Inc.*, 496 B.R. 1, 19 (D.D.C. 2013) ("Judge Teel felt he had two choices when he concluded as a factual matter that he could not fully credit any of the five projections before him. He took the 'more arduous choice' of crediting the projections in part consistent with the evidence presented at trial, and trying to correct for the errors to derive a usable income valuation. This Court commends Judge Teel for undertaking what had to have been incredibly time-consuming and detail-oriented work. But Judge Teel would have been equally within his rights to take the first option – finding that, 'absent a reliable [discounted cash flow] valuation, Alberts has not proven what a hypothetical purchaser would have paid for Reese Hospital,' and then deciding against Alberts because of a critical failure of proof on a dispositive issue for which Alberts had the burden of proof.").

2. The Plaintiffs' Expert, Mr. Puntus, Has Properly Valued the Collateral as of the Petition Date

If the Court were nevertheless to endeavor to determine the Petition Date value of the JSNs' collateral, it should adopt the Plaintiffs' valuation. The Plaintiffs' expert, Mr. Puntus, has shown that, using the proper turnover standard of valuation, the Petition Date value of the JSNs' collateral was between $1.474 billion and $1.594 billion. FOF ¶ 248. Mr. Puntus valued the collateral using the best and only evidence of value that actually existed as of the Petition Date, the stalking horse bids, as a "Benchmark" and then using his extensive restructuring experience, together with the company-specific knowledge he gained from two years advising the Debtors, to make conservative adjustments to the value of the collateral to reflect what the JSNs could have actually realized if the collateral had been turned over to the Third Priority Collateral Agent. *Id.* ¶¶ 241-250.

Contrary to the JSNs' suggestion, Mr. Puntus's valuation is a straightforward application of one of the three traditional valuation methodologies, specifically the comparable transaction method. *Id.* ¶¶ 251-52. In this case, the comparable transaction upon which Mr. Puntus relied was very comparable indeed: a pair of signed stalking horse agreements to acquire the assets at issue, entered into on precisely the subject valuation date. *Id.* The appropriateness of using a transaction in the subject company as a comparable is recognized in the same valuation treatise by Shannon Pratt that one of the JSNs' own experts, Mr. Taylor, has recognized and even cites in his own report (FOF ¶ 243) as authoritative:

> If the subject company itself has changed control in the last few years, the transaction may be an excellent source of value measures. . . . The value measures indicated by the prior transaction may need some adjustment to reflect internal changes in the company or changes in the industry or market conditions.

Shannon Pratt et al., *Valuing a Business: The Analysis and Appraisal of Closely Held Companies*, at 318 (5th ed. 2008) (excerpts attached as **Exhibit B** hereto).

The need Mr. Pratt identifies to make adjustments "to reflect internal changes in the company" has its analogue here, as Mr. Puntus recognized. The stalking horse agreements, and the Benchmark value that Mr. Puntus derived from those agreements, reflects the value of assets sold in a bankruptcy § 363 sale, conditioned on the Debtors continuing to own and operate the assets through closing and satisfying a number of other conditions through the bankruptcy process. The relevant measure for adequate protection purposes, however, is the entirely different turnover scenario where the JSN collateral is held and disposed by the First Priority Collateral Agent (directed by AFI) and the lenders (Barclays and AFI for GSAP and BMMZ, respectively) without any of the benefits of the Chapter 11 process. Mr. Puntus therefore had to make numerous adjustments, which, as discussed in the Proposed Findings of Fact and his testimony, were carefully explained and justified. FOF ¶¶ 241-50

In making these adjustments, Mr. Puntus had to exercise a significant degree of professional judgment, based in large part upon non-quantitative considerations that are necessarily somewhat subjective. This is neither unusual nor improper in valuation exercises – as indeed was recognized by each of the JSNs' own experts in their various reports.[28] *See, e.g.*, *JPMorgan Chase Bank, N.A. v. Charter Commc'ns Operating, LLC (In re Charter Commc'ns)*, 419 B.R. 221, 236 (Bankr. S.D.N.Y. 2009) ("[Va]luation is a malleable concept, tough to measure and tougher to pin down without a host of explanations, sensitivities and qualifiers. . . . When it comes to valuation, there is no revealed, objectively verifiable truth."); *In re Coram Healthcare Corp.*, 315 B.R. 321, 339 (Bankr. D. Del. 2004) ("Simply put, when it comes to

[28] For example, Mr. Fazio quite explicitly – and unjustifiably – relied upon subjective judgment to defend his failure to make any downward adjustment in his market multiples to reflect Rescap's clear deficiencies compared to the "peer group" of Nationstar, Ocwen, and Walter. *See* FOF ¶¶ 214-15.

valuation issues, reasonable minds can and often do disagree. This is because the output of financial valuation models are driven by their inputs, many of which are subjective in nature."); *In re MarketXT Holdings, Corp.*, 2011 WL 1422012, at *6 (Bankr. S.D.N.Y. 2011) (valuation is "inherently subjective and fact-intensive").

The JSNs have strenuously attacked Mr. Puntus's reliance on unconsummated stalking horse agreements as evidence of fair market value. Here, again, Shannon Pratt provides strong support for Mr. Puntus's methodology:

> Documentable, arm's-length, bona fide offers to buy or sell may also be useful evidence of value. Funded bona fide offers (i.e., offers for which the financing for the offer is already in place) should be given more weight and more consideration than unfunded bona fide offers. It is usually difficult, however, to obtain adequate documentation or to verify the arm's-length relationship of the potential buyer/seller.

Shannon Pratt, *supra*, at 318. The difficulties Mr. Pratt anticipates are, of course, not present here; the Stalking Horse APAs were thoroughly documented, signed contracts, (Nationstar and AFI APAs, PX 33, PX 61) supported by, among others, an Ad Hoc Noteholder group whose arms'-length distance from both buyers and sellers cannot be questioned. *See* JSN PSA, (PX 252).

The stalking horse APAs Mr. Puntus relies upon were more than mere "bona fide offers to buy or sell" (Pratt, *supra*); they were legally binding contracts that bear all of the indicia of fair market value, having been reached at arms'-length, with no duress. FOF ¶¶ 26-33, 35. Nationstar and AFI were willing buyers, which by signing the stalking horse APAs committed themselves to consummate the transactions if the Debtors complied with all conditions.[29] *Id.*

[29] Likewise, Mr. Puntus's use of the unaccepted offer to purchase a portion of the FHA loan portfolio is supportable. The offer on the FHA loan portfolio was a bona fide offer from a willing buyer for the portfolio made after a months' long Court-approved sale process. FOF ¶ 244. While the Debtors ultimately determined not to accept that offer because they believed they could monetize the assets for more value over a seven-year period, that does not

¶ 251. The Debtors, for their part, committed to deliver the assets at the negotiated prices if no higher bids were received – as often occurs in bankruptcy. Nationstar and AFI APAs, (PX 33, PX 61.) *See* Douglas Deutsch et al., ABI/UMKC Midwestern Bankruptcy Institute & Consumer Forum, *Section 363 – An Analysis of Leading Asset Sale Cases and Trends at 195, American Bankruptcy Institute* (citing Houlihan Lokey analysis for proposition that "stalking horse wins 70% of the time");[30] Neil Malcolm, *Inside the Numbers: Neigh Sayers*, The Deal Pipeline Blog (Aug. 25, 2011) (reporting on stalking horse winning percentage, including 78.3% in 2010 and 63.7% in 2011).[31] When bankruptcy is on the horizon, looming liabilities very often – and certainly here – cause buyers to place great value on the ability to obtain assets truly free and clear of liabilities, an assurance that only a bankruptcy sale can deliver. Because a prospective debtor cannot legally commit to such a sale outside of bankruptcy, stalking horse status is the highest and best value such a seller can deliver.

In light of these facts about prepetition stalking horse transactions, courts have repeatedly recognized that stalking horse agreements do in fact represent indications of fair market value. *See In re Boston Generating, LLC*, 440 B.R. 302, 323 (Bankr. S.D.N.Y. 2010) (finding that prepetition sale process leading to stalking horse agreement "represented the highest and best offer after a robust, open and fair process" and therefore "is the best determination of the value of the Debtor's assets"); *In re Remedial (Cyprus) Pub. Co.*, 2010 WL 2881418, at *2 (Bankr. S.D.N.Y. May 27, 2010) (approving stalking horse agreement: "The purchase price to be paid by the Stalking Horse Bidder is fair and constitutes reasonably equivalent value and reasonable market value for the Assets."); *In re Michael Day Enters., Inc.*, 2010 Bankr. LEXIS

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mean that the offer does not reflect a relevant comparable for a potential sale of the assets as of the Petition Date, as Mr. Puntus was tasked to do.

[30] Available at www.abiworld.org/committees/newsletters/assetsales/vol7num9/363.pdf.

[31] Available at http://www.thedeal.com/content/restructuring/inside-the-numbers-neigh-sayers.php.

4381, at *15-16 (Bankr. N.D. Ohio Jan. 13, 2010) ("The consideration provided by the Purchaser for the Assets under the Stalking Horse APA (a) is and shall be deemed to constitute reasonably equivalent value and fair consideration."); *Official Comm. of Unsecured Creditors v. Interforum Holding LLC*, 2011 U.S. Dist. LEXIS 73421, at *17 (E.D. Wisc. July 7, 2011) (crediting testimony that stalking horse sale process was conducted (by Houlihan Lokey) in good faith and resulted in fair market value).

The JSNs' attacks are particularly misplaced in this case where they, too, viewed the stalking horse bids as the best contemporaneous indication of value. FOF ¶¶ 236-38. The Noteholders who signed the prepetition PSA committed to support the sales, and thereby to part with their property interests in the collateral, at the negotiated prices. By their actions, the JSNs thus demonstrated that they would be satisfied with those prices – they were, in other words, willing sellers. Indeed, the Ad Hoc Group's advisors at Houlihan adopted the stalking horse bids as the best indication of market value in the information they conveyed to their clients – information that was prepared and conveyed for the express business purpose of being relied upon to decide whether to support the PSA. *Id.* Houlihan's May 2012 Restricted Presentation to the Ad Hoc Noteholder Group (the "Houlihan Presentation"), (PX 169), which valued the Notes Collateral as part of an analysis of the Noteholders' potential recoveries, presented the stalking horse bids as *"best case"* benchmark values. PX 169, pg. 11 of 34; FOF ¶ 237. Houlihan presented its clients with scenarios, each of which were based on the stalking horse bids, with the latter two reflecting a 5% (base case) and 10% (low case) discount to the bids.

Even under Mr. Puntus's Benchmark value – which does not reflect any of the inevitable impairments in value that would result in a foreclosure – the JSNs would not be entitled to an adequate protection claim. On the Petition Date, the Debtors had stalking horse

offers for their major assets in hand, bids that were arrived at following a thorough marketing process. These offers represented the highest values that the Debtors could have obtained for their assets as of the Petition Date and constitute the best evidence of the Petition Date value of the collateral in the Debtors' hands. That value, however, could only have been realized after months of efforts by the Debtors and their professionals to make the assets saleable.

3. Even if Value in the Hands of the Debtors Were the Appropriate Petition Date Standard of Value, the JSNs Have Not Met Their Burden

If the Court were to value the JSNs' collateral in the hands of the Debtors (as opposed to the Third Priority Secured Parties) as of the Petition Date, the JSNs' valuation would still fall far short of reality. The extensive and pervasive flaws in the JSNs' experts analyses are discussed in detail in the Proposed Findings of Fact. *See* FOF ¶¶ 188-240. These flaws largely fall into three categories: (1) the JSNs' experts posit hypothetical transactions that were not available on the Petition Date (*e.g.*, Mr. Fazio positing sale of MSRs plus platforms in a "Newco" that did not exist and for which the Debtors had unsuccessfully solicited offers (*id.* ¶ 213); (2) the JSNs' experts improperly assume the Debtors could have achieved, on the Petition Date, transaction prices that were actually obtained only after months of effort and expense through the bankruptcy process (*e.g.*, Mr. Fazio applying final Berkshire HFS prices to Petition Date value (*id.* ¶¶ 201-205); Mr. Siegert using Mr. Taylor's allocation of the Ocwen/Walter transaction to infer intangible asset values as of the Petition Date (*id.* ¶ 191)); and (3) the JSNs' experts uniformly ignore all of the expenses that had to be, and were, incurred through the bankruptcy process to ultimately achieve favorable sale results (*id.* ¶ 196).[32]

[32] Even under the JSNs' flawed analysis in which petition date value equals sale date value, once the expenses properly allocated to the JSNs under the AFI DIP Order are considered, the value of the JSNs' collateral remained constant. In fact, this is exactly what is being offered to the JSNs in this case through Mr. Renzi's Effective Date

Houlihan's valuations, as noted above, are contradicted by their contemporaneous advice to their clients that treated the stalking horse bids as the best indications of value. In the May 14 Houlihan Presentation, Houlihan valued the assets by reference to the stalking horse bids as a best case benchmark, even going so far as to present the JSNs with alternative scenarios reflecting a 5% and 10% discount to those bids. PX 169 pg. 11, 24 of 34; FOF ¶ 237. The Houlihan view was shared by the market at large, with contemporaneous analyst reports projecting that the Nationstar stalking horse Bid would prevail. FOF ¶ 239.[33] The JSNs now find it convenient to ignore their advisors' previous views of the market value of their collateral, but the litigation-driven hindsight valuations the JSNs put forward today are simply irreconcilable with Houlihan's more objective contemporaneous analysis.

C. The Court Should Preclude Mr. Winn's Testimony

The Court previously ruled in granting partial dismissal of the Defendants' claims that "[t]he Court agrees with the Plaintiffs that because the Cash Collateral Order controls and limits how the Debtors may use the cash collateral, and also provides the JSNs with agreed-upon adequate protection, the JSNs are not entitled to any further protection concerning the use of the cash collateral. Contrary to the Defendants' position, not every use of Cash Collateral constitutes a per se diminution in the value of the JSNs' collateral." September 20 Opinion, 497 B.R. at 420. The Court went on to state that, "[g]iven that the Cash Collateral Order restricts permissible uses of the JSNs' collateral, the Defendants are not entitled to a declaration of the

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valuation – the actual sale price of the JSNs' collateral less the expenses necessary to realize that value (and with credit given to the JSNs for the proceeds their collateral generated during the case).

[33] The reports are set forth in the Proposed Findings of Fact. Among other things, a May 14, 2012 Citigroup Report stated in evaluating the Nationstar stalking horse bid: "we are hard-pressed to identify another player with scale and capacity to take down this portfolio." FOF ¶ 239. A May 15, 2012 Credit Suisse Report noted that "[w]hile the upcoming auction creates some uncertainty management was confident in the ability to ultimately close the ResCap acquisition." *Id.* And the June 18, 2012 Citigroup Report noted Berkshire's competing bid, but said "[w]e still peg an NSM [Nationstar Mortgage Holdings] win at 75% but our model now assumes they sweeten the bid by 20%." *Id.*

'exact quantum of the direct costs of liquidating collateral'" and that such an endeavor "would burden the Debtors' estate with a needless expense aimed at reviewing the Debtors' administration of collateral even though the Cash Collateral Order already establishes the permissible means for the Debtors to administer the collateral." *Id*. Notwithstanding the Court's ruling, the Defendants put forth the testimony of Scott Winn for the purpose of demonstrating a reallocation of expenses. In response to a motion in limine filed by the Plaintiffs, the Court precluded such testimony.

Undeterred, Defendants again sought at trial to admit this testimony for the alleged "limited" purpose of establishing the value of their Collateral as of the Petition Date – arguing that Mr. Winn's Report is relevant to determine the amount of costs that may be charged against the JSNs' collateral under section 506(c). (Oct. 22 Tr. 18:14-20.) But Mr. Winn's report expressly declines to reach this issue: "I express no opinions regarding what portion of such expense could be properly charged against JSN Collateral pursuant to section 506(c) of the Code or the Cash Collateral Order" (Winn Report at 7) – a point Mr. Winn reiterated at trial. (*See* Oct. 22 Tr. 55:21-25: "Q. [Y]ou expressed no opinion in this report as to what expenses might have been chargeable against JSN collateral pursuant to Bankruptcy Code Section 506(c)? A. That's correct.").

Plaintiffs have already accommodated any asserted relevance of Mr. Winn's administrative expense report by agreeing that the report can be used as expert reliance material, to the extent Defendants' other experts actually rely upon that report. The reason this sensible approach is unacceptable to the JSNs is obvious: other than for one very limited purpose (determining the value of three post-petition contracts), none of the JSNs' experts use Mr. Winn's report for the purpose the JSNs assert, namely, determining the Petition Date value of

their collateral. Instead, the JSNs' expert reports attempt to value the collateral as of the Petition Date *without* reference to the costs necessary to monetize the collateral.

Finally, Mr. Winn's testimony is not reliable evidence of the proper quantum of expenses necessary to maintain and sell the JSNs' collateral. As the testimony of Mr. Marano and Mr. Puntus made clear, the Debtors' postpetition efforts to operate the business and render the assets saleable (*e.g.*, obtaining DIP financing and reaching settlements with the GSEs, RMBS Trustees, and regulators) were all necessary to achieve the purchase price the Debtors ultimately received for the JSNs' collateral. Consistent with the Court's prior rulings, there is no sound way to determine which expenses preserved the JSNs' collateral versus the Debtors' assets in general. Even the JSNs' own expert, Jeffrey Levine, acknowledged as much in testifying that servicing advances (the largest subset of the JSNs' collateral) are always sold with MSRs at par, and, if not sold with MSRs, would be worth less. Thus, the costs of operating the Debtors' servicing and origination business postpetition clearly inured to the benefit of the JSNs and helped maximize the value of their collateral. As such, no reallocation of expenses is appropriate for any purpose.

D. The Effective Date Value of the JSNs' Collateral Renders Them Undersecured

The parties largely agree that (leaving aside two "allocation issues" and certain lien challenges) the value of the JSNs' collateral as of the Effective Date of the Plan is $1.888 billion (the "Base Collateral"). The Base Collateral consists of the recovery value of the JSNs' second lien on the Revolver Collateral, including the equity pledged by certain of the Debtor obligors to the Revolver/JSNs and the JSNs' replacement liens on the equity of the Barclays DIP borrowers. As the JSNs' expert, Mr. Siegert, conceded, "I don't think there's a great deal of

debate about the value on the distribution date, but for some of the allocation issues I speak to . . . ." Oct. 23 Tr. 136:10-13.[34]

The "allocation issues" to which Mr. Siegert alluded are twofold. *First*, the JSNs' experts add to the Base Collateral $313 million – representing the amount they would reallocate from the Ocwen sale proceeds as intangible value – less $40 million for expenses associated with that intangible value. Oct. 23 Tr. 139:6-141:7. This issue has been fully addressed above. As detailed in section IV(D)-(E), the JSNs cannot reallocate the proceeds of the Ocwen sale, nor do their liens extend to any intangible value associated with the purchased assets. Even if the liens did extend to some intangible value, the JSNs have offered no evidence concerning an allocation of such value between JSN intangibles and non-JSN intangibles.

Second, the JSNs dispute Mr. Renzi's deduction from the Base Collateral of the "Carve Out" provided for in the Cash Collateral Order. The JSNs do not dispute the amount of the fees and expenses Mr. Renzi included in his calculation of the Carve Out. Instead, they contend that the "Carve Out does not authorize payment of any expenses," but merely "subordinates the JSN Liens to certain properly documented fees and expenses of the Debtors' professionals." (PTO ¶ 15.)

But the AFI DIP Order need not specifically authorize the charging of the Carve Out for such amount to be deducted from the valuation of the JSNs' collateral. Where, as here,

[34] In addition to the issues Mr.Siegert identified at trial, the JSNs contend that the Debtors' Effective Date valuation omits "a number of prepetition and post-petition variables." (PTO ¶ 11). The JSNs set out the full amount they contend should be added to the Effective Date value in the Pretrial Order (*see id*.). The majority of the JSNs' proposed additions relate to the scope and value of the collateral, issues addressed in Section IV, above. The JSNs also contended in the Pretrial Order that the Debtors' reductions to book value in their valuation of the JSNs' collateral were inappropriate. However, none of the JSNs experts addressed the Effective Date value of the JSNs' collateral at trial, and Mr. Renzi clearly explained the Debtors' basis for their valuation in his testimony. As a result, there is no evidence that any remaining collateral should be ascribed a different value than as asserted by Mr. Renzi. As the JSNs have the burden of establishing the scope and value of their collateral, their failure to rebut Mr. Renzi's valuation is fatal. As a result, we will address in this section only the sole remaining amount the JSNs seek to add to the Effective Date value – the amount attributable to the Carve Out.

the Court is valuing the JSNs' collateral for purposes of Section 506, the Carve Out should be deducted, because it has a more senior right to recovery than the JSNs. (*Id.* ¶ 5(g).)[35] *See e.g.*, *In re West Post Road Props. Corp.*, 44 B.R. 244, 247 (Bankr. S.D.N.Y. 1984) (holding that sale proceeds should be used first to pay sale expenses, then to pay senior lienholder, and thereafter to pay junior lienholders); *In re Sanders*, No. 06-70463, 2006 WL 3386739 at *4 (Bankr. C.D. Ill. Nov. 20, 2006) ("The creditor's interest for purposes of Claim # 3 is a junior interest and, accordingly, the amount of the senior lien must be subtracted from the value of the collateral to obtain the value of the junior interest.")

In the Cash Collateral Order, it is made clear that the JSNs' liens and claims are subject and subordinate to the Carve Out. (*Id.* ¶ 5(g).) As Mr. Siegert himself agreed, "a Carve Out is a provision that allows for some expenditure of administrative – of professional fees for Chapter 11 *before* a secured creditor gets paid on its collateral." Oct. 23 Tr. 137:24-138:3 (emphasis added).[36]

The adjustments the JSNs propose to the Debtors' valuation of the JSNs' collateral as of the Effective Date are therefore unwarranted. The JSNs' collateral is worth $1.745 billion as of the Effective Date (prior to accounting for the lien challenges discussed below).

[35] The AFI DIP Order also does not specify that the AFI Revolver must be paid first in valuing the JSNs' collateral, but obviously, since, like the Carve Out, such debt is senior in right to the JSNs in the collateral, the Revolver balances must be taken into account in valuing the JSNs' collateral.

[36] In the event the Court declines to adopt the Plaintiffs' reading of the AFI DIP Order with respect to the Carve Out for purposes of valuing the JSNs' collateral, the Plaintiffs reserve their right to seek to charge the JSNs for the Carve Out in accordance with Section 506(c) of the Bankruptcy Code, which right was preserved for the estate under Paragraph 22 of the AFI DIP Order. The Plaintiffs also reserve the right to use the JSNs' cash collateral to fund the costs of liquidating the JSNs' collateral following the termination of cash collateral in accordance with the Cash Collateral Stipulation. [Dkt. No. 4193.]

IV. THE JSNS MUST DEMONSTRATE THAT THEY ARE OVERSECURED ON A DEBTOR-BY-DEBTOR BASIS WITHOUT POOLING COLLATERAL BELONGING TO DIFFERENT DEBTORS

In asserting that their claims are oversecured, the JSNs have assumed that their secured status is to be determined by reference to all of the Notes Collateral, no matter which Debtors hold it. Even if this were the test, the JSNs cannot prevail because the value of the collateral identified on the Debtors' books and records is $1.745 billion (before crediting the Committee's lien challenges). Because the current outstanding principal of the JSNs' claims – $1.836 billion net of OID – exceeds the value of their collateral, the JSNs are undersecured under any standard. But in any event, the JSNs' assumption regarding aggregation of collateral is incorrect. The JSNs do not hold a single claim against a unitary estate; they hold individual claims against multiple Debtors. Each of their claims therefore must be evaluated to determine whether it is oversecured by assets at the Debtor against which the claim is asserted. The JSNs have not provided any evidence of their collateral on a debtor-by-debtor basis. As a result, they have failed to demonstrate that they are oversecured at any debtor as required by the Bankruptcy Code.

Absent substantive consolidation, the filing of bankruptcy petitions by affiliated debtors creates a separate estate for each debtor, each with its own assets and liabilities. *See, e.g.*, *Tower Auto. Mexico v. Grupo Proeza (In re Tower Auto., Inc.)*, 356 B.R. 598, 603 (Bankr. S.D.N.Y. 2006) ("It is a basic principle of bankruptcy law that each separate individual or corporate entity must file a separate bankruptcy petition and that each entity is treated separately unless grounds for substantive consolidation are demonstrated.").[37] In keeping with this

[37] Indeed, the bar date order (the "Bar Date Order") entered in this case recognized as much, requiring a creditor to file separate proofs of claim against each Debtor as to which it asserts a claim. *See* Bar Date Order ¶ 5(f) [Docket Nos. 1309, 2093]; *see also* Order Under Bankruptcy Rule 1015 Authorizing Joint Administration of the Debtors' Chapter 11 Cases ¶ 7 [Docket No. 59] ("Any creditors filing a proof of claim against any of the Debtors shall clearly

principle, the Second Circuit has held that the filing of a joint petition by spouses under section 302 of the Bankruptcy Code "does not automatically consolidate their estates," nor does it "allow the property of one spouse to be used to satisfy the debts of the other spouse." *Wornick v. Gaffney*, 544 F.3d 486, 491 (2d Cir. 2008).

The same principle should prevail in the context of section 506(a) of the Bankruptcy Code; indeed, this result flows from the most natural reading of the section. Section 506(b) permits a secured creditor to collect postpetition interest to the extent that its "allowed secured claim is secured by property the value of which . . . is greater than the amount of such claim." 11 U.S.C. § 506(b) (emphasis added). The JSNs read "property" expansively as meaning all of a creditor's collateral, no matter which debtor holds it. To the contrary, on its plain terms section 506(b) requires analysis of "property" on an estate-by-estate basis, such that a creditor is oversecured only if the collateral held by an individual estate exceeds the allowed secured claim asserted against that estate. Section 506(a) establishes the rule governing the securing of claims.

Section 506(a) provides that a creditor's claim is secured "to the extent of the value of such creditor's interest in the estate's interest in [the securing] property." 11 U.S.C. § 506(a)(1). The use of the singular "estate" means that the claim defined in section 506(a) is a secured claim – *i.e.*, an "allowed secured claim" for purposes of section 506(b) – only to the extent of an individual debtor's interest in that specific property, not the aggregate property held by multiple estates. Section 506(b) of the Code is therefore properly read as follows:

> To the extent that an allowed secured claim is secured by property [of the estate] the value of which . . . is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim . . . .

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assert such claim against the particular Debtor obligated on such claim and not against the jointly administered Debtors.").

Even where a creditor's claim is secured by collateral pledged by other debtors, therefore, it is necessary to examine the value of a specific "estate's interest" under section 506(a) to determine whether the secured creditor is entitled to postpetition interest with respect to its claim against that particular debtor under section 506(b).

The Third Circuit embraced Plaintiffs' reading of section 506(b) in *DeNofa v. Nat'l Loan Investors L.P. (In re DeNofa)*, 124 F. App'x 729 (3d Cir. 2005). The secured creditor in that case was secured by assets of a debtor and a non-debtor (as opposed to two debtors), but the Third Circuit's interpretation of the relationship between sections 506(a) and 506(b) is nevertheless instructive:

> Subsections (a) and (b) [of section 506] work closely together, and one cannot correctly understand and apply the latter before understanding and applying the former. Section 506(b) only permits post-petition interest where an "allowed secured claim is secured by property" which exceeds the value of the "allowed secured claim." The meaning of "allowed secured claim" dictates the outcome here. Section 506(a) defines an "allowed secured claim" as a claim secured by "property in which the estate has an interest . . . *to the extent of the value of such creditor's interest in the estate's interest in such property*[.]" 11 U.S.C. § 506(a) (emphasis added). *Thus, quite plainly, the "allowed secured claim" of NLI that we must examine for purposes of postpetition interest under § 506(b) is limited to the extent of the value of the property of the DeNofas' bankruptcy estate which secures it.*

Id. at 731 (second emphasis added). In reading section 506, the Third Circuit made no distinction between "debtor" non-debtors and "non-debtor" non-debtors – and if principles of debtor separateness are to be observed, then, absent substantive consolidation, there should be no distinction between the two.[38]

[38] *See also Official Comm. of Unsecured Creditors of Toy King Distribs., Inc. v. Liberty Sav. Bank (In re Toy King Distribs., Inc.)*, 256 B.R. 1, 187 (Bankr. M.D. Fla. 2000) (as to loan secured by property of debtor and individual guarantors, "only the debtor's property is relevant to the court's determination of the secured status of [secured creditor's] claim against the debtor under Section 506.").

The JSNs have argued that the word "estate's" (singular) in section 506(a) should actually be read as "estates'" (plural), such that a creditor's allowed secured claim is defined with reference to all of the collateral held by jointly administered debtors. The Second Circuit's holding in *Wornick v. Gaffney*, cited above, refutes this reasoning. While section 102(7) of the Bankruptcy Code permits the singular to be read to encompass the plural in some circumstances, *Wornick* makes clear that joint filings do not result automatically in consolidation and that the assets of one debtor should not be presumed to be available to satisfy the debts of another. *See* 544 F.3d at 491.[39]

The JSNs have previously cited several cases in which courts purportedly aggregate the collateral of a secured creditor. None contains any substantive discussion of whether a secured creditor may aggregate collateral held by multiple debtors for purposes of section 506(b), or even any indication that the question was raised. In at least some cases, it appears that the issue could not have arisen because the secured creditor was sufficiently oversecured at any one debtor.[40] Other cases are readily distinguishable because the debtors

[39] Adopting the argument that section 102(7) requires the term "estate" to be read as "estates" in jointly administered cases would effectively read substantive consolidation into nearly every provision of the Bankruptcy Code. For example, section 101(10)(B) defines a "creditor" as an "entity that has a claim against the estate" under section 348(d), 502(f), 502(g), 502(h), or 502(i). Under the JSNs' application of section 102(7), a "creditor" of one estate would automatically be deemed a creditor of all estates in a jointly administered case. This result is at odds with the well-established principle that joint administration is distinct from substantive consolidation, with the latter being an equitable remedy that is to be invoked only sparingly. *See In re Leslie Fay Cos., Inc.*, 207 B.R. 764, 779 (Bankr. S.D.N.Y. 1997) (distinguishing between joint administration and substantive consolidation); *see also FDIC v. Colonial Realty Co.*, 966 F.2d 57, 61 (2d Cir. 1992) (substantive consolidation to be invoked "sparingly because of the possibility of unfair treatment of creditors") (citation omitted).

[40] *See In re Capmark Fin. Grp., Inc*., 438 B.R. 471 (Bankr. D. Del. 2010); *In re Urban Communicators PCS, Ltd*., 379 B.R. 232 (Bankr. S.D.N.Y. 2007), *aff'd in part, rev'd in part sub nom. Urban Communicators PCS Ltd. P'Ship v. Gabriel Capital, L.P.*, 394 B.R. 325 (S.D.N.Y. 2008). In *Capmark*, the primary secured debt consisted of a $1.5 billion term loan (*see In re Capmark Fin. Grp. Inc*., Case No. 09-13684 (CSS) (Bankr. D. Del. Oct. 25, 2009) [Docket No. 13] at 14 (first day affidavit), yet one of the debtors under the term loan had assets in excess of $3 billion (*see In re Capmark Fin. Grp. Inc*., Case No. 09-13684 (CSS) (Bankr. D. Del. July 8, 2011) [Docket No. 3226], Ex. E (disclosure statement liquidation analysis). Similarly, in *Urban Communicators*, the secured debt was approximately $11 million and was secured by a pledge of all of the debtor's assets, including FCC licenses that were held by a single debtor. *See Urban Communicators*, 379 B.R. at 237-38. The licenses were subsequently sold for at least $68.5 million, leaving the secured creditor massively oversecured at a single debtor.

were either substantively consolidated – which by definition aggregates the collateral of multiple debtors – or paying their creditors in full.[41]

The JSNs have also cited two cases that they claim explicitly reject Plaintiffs' contention that the determination of whether a secured creditor is oversecured is to be made only with respect to the collateral at a single debtor. *See In re SW Hotel Venture, LLC*, 460 B.R. 4 (Bankr. D. Mass. 2011), *aff'd in part, rev'd in part and remanded sub nom. In re SW Boston Hotel Venture, LLC*, 479 B.R. 210 (B.A.P. 1st Cir. 2012); *In re Revolution Dairy, LLC*, Case No. 13-20770 (Bankr. D. Utah Apr. 29, 2013) Hr'g Tr. [Docket No. 206] (the "Rev. Dairy Tr.").[42] Both are easily distinguishable.

In *SW Hotel*, the court rejected the debtors' argument that a secured creditor cannot aggregate the collateral pledged by multiple debtors for the purposes of section 506(b), but did so without any textual analysis of the statute. Instead, the court cited two cases in which courts appeared to have aggregated collateral but, like *SW Hotel* itself, did not provide an analysis of section 506(b). *See SW Hotel*, 460 B.R. 4, 26 n.18.[43] Moreover, as the JSNs admit, the debtors in *SW Hotel* were substantively consolidated, and the assets of the debtors were aggregated to satisfy both the claims of their secured and unsecured creditors. *See id.* at 12. At most, the case stands for the uncontroversial proposition that when estates are consolidated, the

[41] *See In re Gen. Growth Props., Inc.*, Case No. 09-11977 (ALG), 2011 WL 2974305 at *2 (Bankr. S.D.N.Y. July 20, 2011) (noting that plan "satisfied the claims of all prepetition creditors in full"); *In re Dana Corp.*, Case No. 06-10354 (BRL), 2007 WL 4589331 at *22 (Bankr. S.D.N.Y. Dec. 26, 2007) (providing for consolidation of debtors); *In re Fiberglass Indus., Inc.*, 74 B.R. 738, 746 (Bankr. N.D.N.Y. 1987) (aggregating collateral pledged by debtors that "operate as an integrated entity, with the parent serving as the major profit center," but excluding property owned by a municipality).

[42] The decision in *SW Hotel* is currently on appeal to the First Circuit, with oral argument scheduled for November 7, 2013. *See Prudential Ins. Co. of Am. v. SW Boston Hotel Venture, LLC (In re SW Boston Hotel Venture, LLC)*, Nos. 12-9008, 12-9009, 12-9011, 12-9012 (1st Cir.).

[43] Indeed, the court acknowledged that in one of the cases on which it relied, the court "did not expressly state that it was considering a total collateral package." *SW Hotel*, 460 B.R. 4, 26 n.18.

secured creditor can look to aggregate collateral of the substantively consolidated estates in determining its secured status under sections 506(a) and (b).

The JSNs' reliance on the questionable logic of *Revolution Dairy* is similarly misplaced. There, three affiliated entities were co-debtors to two secured creditors, who were oversecured on an aggregate basis, but not at any given debtor. At issue was the secured creditors' request for adequate protection payments consisting of postpetition interest and attorneys' fees, *see* Rev. Dairy Tr. at 9:8-12, 11:16-20, 12:1-3 – a request the court denied. *Id*. at 19:12-14. Unlike the debtors in *Revolution Dairy*, though, the Debtors here are not evaluating whether the JSNs should receive adequate protection payments; rather, they are challenging whether the JSNs are entitled to postpetition interest on account of their claims under the Plan. In this context, as discussed above, section 506(b) provides clear guidance.

Unable to identify any case or provision of the Bankruptcy Code that would allow aggregation of collateral for purposes of section 506(b), the JSNs have appealed to policy-based arguments, asserting that a failure to aggregate collateral would have a debilitating impact on the manner in which credit agreements and indentures are drafted. These concerns are overblown and in any event unsupported by any evidence. Faithful application of section 506(b) would reach only a small subset of creditors – purportedly oversecured creditors whose collateral is dispersed across a complex corporate structure. Secured lenders concerned that their collateral at any given obligor will not be sufficient to provide postpetition interest in the event of bankruptcy can structure credit facilities around this problem.[44] Moreover, the JSNs offer no reason to believe that the "risks" they identify are not already anticipated by the market. Given the paucity of case law on this issue and the basic fact that affiliated debtors are only rarely substantively

[44] For example, lenders can require that their collateral be held by special purpose entities at which they are the sole creditor or have a pledge of the entities' stock. They can also structure individual facilities for each borrower or multidraw facilities that require that draws by each borrower not exceeds its assets.

consolidated, there is no reason for secured lenders to assume that section 506(b) permits them to aggregate collateral across debtors.

Adopting the JSNs' suggestion that courts can cavalierly pool collateral from multiple debtors runs contrary to the plain text of the statute and the principle of law "deeply ingrained" in American corporate and bankruptcy jurisprudence that corporate separateness must be respected absent extraordinary circumstances. *See, e.g., United States v. Bestfoods,* 524 U.S. 51, 61 (1998) (refusing to disturb corporate separateness to penalize shareholders of polluting company). Arbitrarily merging the assets and liabilities of multiple distinct entities would upset creditors' expectation that the assets of their debtor will be available to satisfy their claim. *See, e.g., Union Sav. Bank v. Augie/Restivo Baking Co. (In re Augie/Restivo Baking Co.),* 860 F.2d 515, 518-19 (2d Cir. 1988) ("[C]reditors who make loans on the basis of the financial status of a separate entity expect to be able to look to the assets of their particular borrower for satisfaction of that loan."); *In re Tribune Co.*, 464 B.R. 126, 182 (Bankr. D. Del. 2011) ("In the absence of substantive consolidation, entity separateness is fundamental.").[45]

The JSNs have not established that they are oversecured at any single Debtor obligor without reference to the Notes Collateral owned by other Debtor obligors. Accordingly, the JSNs are not entitled to postpetition interest.

V. THE COMMITTEE SUCCESSFULLY CHALLENGED THE JSNS' LIENS ON SEVERAL CATEGORIES OF PROPERTY, FURTHER REDUCING THE VALUE OF THEIR COLLATERAL

As discussed above, the Effective Date value of the Notes Collateral – *i.e.*, the "Base Collateral" – is $1.888 billion. Deducting the Carve Out amount of $143 million

[45] The JSNs' position is also in tension with their oft-stated arguments regarding intercompany claims and inter-debtor conflicts. In their motion to disqualify Debtors' counsel (the "Disqualification Motion"), the JSNs stated: "Since each estate is a separate and distinct entity, in related multi-debtor cases, the fiduciary duties of each debtor-in-possession runs to its own estate and creditors, not to some amorphous combination of the estates of all related debtors." Disqualification Motion ¶ 20 [Dkt. No. 4289].

(discussed in Article III, above), reduces the value of the JSNs' collateral to $1.745 billion. The Committee also successfully established at trial several lien challenges and preference claims that reduce the value of the JSNs' collateral even more.

A. The JSNs Do Not Have a Lien on the Avoidable Deposit Accounts

A security interest in a deposit account can be perfected only by control of the account, unless it contains proceeds of original collateral. U.C.C. §§ 9-312(b), 9-104(a), 9-315(b). Under the Uniform Commercial Code, control is established if the secured party is the bank that maintains the deposit account or if the deposit account is subject to "an authenticated record that the bank will comply with instructions originated by the secured party directing the disposition of funds in the deposit account without further consent by the debtor." U.C.C. § 9-104(a)(2).

No control agreement for any of the Avoidable Deposit Accounts was offered into evidence, except for those pertaining to the Controlled Accounts. FOF ¶¶ 284, 289. With respect to control of the Ally Accounts, Ally Bank is not a secured party under the operative Revolver and Notes agreements or the Intercreditor Agreement, and is thus not a secured party under the Uniform Commercial Code. FOF ¶ 291. There is also no evidence that any Third Priority Secured Party "controlled" the disposition of funds deposited by the Debtors at Ally Bank. A secured party has control of a deposit account under the Uniform Commercial Code if the secured party *is the bank* with which the deposit account is maintained (UCC § 9-104(a)(1)). The JSNs have failed to provide support– either factual or legal – for an expanded interpretation of control that includes depository banks indirectly "on notice" of an alleged security interest (due to a corporate affiliation or otherwise). Further, the JSNs are not perfected by virtue of the Revolver Lender and Ally Bank being affiliates. First, given that they are not the same entity, the Revolver Lender's lien is not perfected under the Uniform Commercial Code through

automatic control. Second, even if it were perfected through automatic control, that would be the case only with respect to its own security interest (under the Revolver). As discussed above, under the Intercreditor Agreement, the first lien priority parties have nearly unfettered rights to dispose of the Collateral, without the consent or authority of the Third Lien Priority Agent, and nothing in the Intercreditor Agreement requires the Revolver Lender (and thus, indirectly, Ally Bank) to comply with the Third Priority Collateral Agent's instructions with respect to Ally Bank, a feature which is necessary of any control agreement under the Uniform Commercial Code. FOF ¶ 291.

Accordingly, the Controlled Accounts and the WF Accounts are the only Deposit Accounts over which the Third Priority Secured Parties have established control. FOF ¶¶ 288-292.

The Notes Trustee contends that the Committee has the burden to prove that the funds in the Avoidable Deposit Accounts are not cash proceeds of the Notes Collateral. (PTO, ¶ 97, 100). The Notes Trustee is wrong.[46] Under U.C.C. § 9-315, the Notes Trustee has the burden of tracing funds to "identifiable cash proceeds" of collateral that would be automatically perfected under U.C.C. § 9-515(c).[47] But even if the Committee had the burden of proof, the

[46] The Notes Trustee relies on *In re CHA Hawaii, LLC,* 426 B.R. 828, 836 (Bankr. D. Haw. 2010), for the proposition that the Committee must show that funds within the Deposit Accounts are not cash proceeds of the Notes Collateral in order to prevail under Count IX of the Committee Action. (PTO ¶ 97). Although *CHA Hawaii* holds that the effectiveness of a control agreement is irrelevant where the funds in a deposit account are identifiable proceeds of collateral, that case does not address the burden of proof regarding identifiable proceeds under U.C.C. 9-315. *Id.* at 836. Moreover, *CHA Hawaii* is distinguishable because in that case (1) there was an effective control agreement, (2) all proceeds that passed through the account were identifiable, and (3) the issue before the court was how much cash collateral had been used by the debtor without the secured creditor's consent. *Id.*

[47] *See, e.g., In re Milton Abeles, LLC,* 2013 WL 5304014 at *2 (Bankr. E.D.N.Y. Sept. 20, 2013) (proceeds are "identifiable" only if secured party identifies proceeds by method of tracing); *Square Mile Structured Debt (One) LLC v. Swig et al.,* 2010 WL 4167253 (N.Y. Sup. Oct. 15, 2010) (bank holding prior perfected security interest was able to trace proceeds by virtue of escrowed accounts containing distributions from limited liability companies); *Marquette Nat'l Bank v. B.J. Dodge Fiat, Inc.,* 475 N.E. 2d 1057, 1062 (Ill. App. 1985) (judgment creditor prevailed over claims of secured creditor that failed to trace account funds to proceeds of its collateral); *Guaranteed Muffler Supply Co., Inc. v. Nat'l Bank of Georgia,* 1 B.R. 324, 330 (Bankr. N.D. Ga. 1979) (secured parties bear the burden of identifying, or tracing, the proceeds obtained upon the sale of property in which they have an interest); *McCourt*

uncontroverted evidence established that the Proceeds Account is the only deposit account that contains proceeds from the sale of JSN collateral. FOF ¶ 293.

After excluding the Controlled Accounts, the WF Accounts, and the Proceeds Account, the amount of funds in the remaining deposit accounts as of the Petition Date (collectively, the "Avoidable Deposit Accounts") was $48,439,532. FOF ¶ 292.

Accordingly, any lien the Third Priority Secured Parties may assert with respect to the Avoidable Deposit Accounts is avoidable pursuant to sections 544(a)(1) and (2) of the Bankruptcy Code, and the property or the value of the property represented by the Avoidable Deposit Accounts should be recovered and/or preserved for the benefit of the Debtors' estates pursuant to sections 550(a) and 551 of the Bankruptcy Code. For the foregoing reasons, the value of the JSNs' collateral should be reduced by $48,439,532, the amount of cash in the Avoidable Deposit Accounts as of the Petition Date.

B. The JSNs Do Not Have a Lien on the Unencumbered Real Property

To perfect a lien on real property, a secured party must execute a mortgage or a deed of trust and duly record it against the title of such real property. *See In re Churchill Mortg. Inv. Corp.*, 233 B.R. 61, 70 (Bankr. S.D.N.Y. 1999) ("Under the New York Real Property Law § 291, a security interest in real property can be perfected only by filing written notice with the Clerk of the County where the property is located so that the lien may be publicly recorded, giving notice of the encumbrance to potential purchasers or future creditors.").

The evidence adduced at trial shows that the Third Priority Secured Parties did not have a properly perfected lien on any of the Unencumbered Real Property because no

v. Triplett, 2010 Ark. App 567 (2010) (testimony regarding collateral without supporting bank records failed to satisfy secured creditor's burden of tracing proceeds).

mortgage or deed of trust was conveyed or recorded with respect to the Unencumbered Real Property. FOF ¶¶ 294-299.

Accordingly, any lien the Third Priority Secured Parties may assert with respect to the Unencumbered Real Property is avoidable pursuant to sections 544(a)(1) and (2) of the Bankruptcy Code, and the property or the value of the property represented by the Unencumbered Real Property should be recovered and/or preserved for the benefit of the Debtors' estates pursuant to sections 550(a) and 551 of the Bankruptcy Code. For the foregoing reasons, the value of the JSNs' collateral should be reduced by $21 million, the fair market value of the Unencumbered Real Property as of the Petition Date. FOF ¶ 295.

C. The JSNs Do Not Have a Lien on the Non-Obligor Debtors

The Non-Obligor Debtors are not parties to, and have no obligations under, any of the Notes Agreements; in addition, the equity interests of the Non-Obligor Debtors were not pledged to secure the Notes obligations. FOF ¶¶ 300-307. For these reasons, the Noteholders have no legal or factual basis to claim a lien in the equity or assets of any of the Non-Obligor Debtors.

Accordingly, any lien the Third Lien Priority Agent may assert with respect to the assets of the Non-Obligor Debtors is avoidable pursuant to section 544(a)(1) and (2) of the Bankruptcy Code, and the property or the value of the property represented by those assets should be recovered and/or preserved for the benefit of the Debtors' estates pursuant to sections 550(a) and 551 of the Bankruptcy Code.

D. The JSNs Do Not Have a Lien on the Contested Assets

Pursuant to the Uniform Commercial Code, a security interest is enforceable if, among other things, the security agreement contains a granting clause describing the collateral. U.C.C. § 9-203(b). Here, the parties do not dispute that the granting clause in the Notes Security

Agreement expressly carved out "Excluded Assets," which as defined include the Excluded Bilateral Facilities Collateral. FOF ¶¶ 310-11. The parties also do not dispute that, unlike the Excluded Bilateral Facilities Collateral, the Notes Security Agreement granted the Third Priority Collateral Agent liens in the Released Mortgage Loans at the time the Notes were issued and such liens were properly perfected.

Section 7.01(q) of the Revolver Loan Agreement provides that the applicable obligor Debtor was required to use commercially reasonable efforts to grant and perfect a lien on any (i) Excluded Bilateral Facilities Collateral to the extent the reason for the exclusion ceased to exist and (ii) Released Mortgage Loans reacquired by the applicable Debtor (*i.e.*, after execution of the Mortgage Loan Release). FOF ¶ 313. The Defendants provided no evidence that the Debtors granted such liens at any time after the Notes were issued nor were any demands ever made by any of the Third Priority Secured Parties or AFI to do so. FOF ¶ 329.

Because no liens were ever granted in the Excluded Bilateral Facilities Assets, either at the time the Notes were issued or thereafter, the Defendants never had a lien on such assets.

While the Defendants had liens on the Released Mortgage Loans at the time the Notes were issued, they subsequently released such liens upon execution of the Mortgage Loan Release. FOF ¶ 325. There is no evidence that any Debtor granted a new lien on any of the Released Mortgage Loans subsequent to the execution of the Mortgage Loan Release.

Further, no "springing lien" exists with respect to the Excluded Bilateral Facilities Collateral or Released Mortgage Loans. The Notes Security Agreement is ambiguous with respect to whether, under the Defendants' "springing lien theory," the Excluded Bilateral Facilities Collateral or Released Mortgage Loans automatically reverted to the Notes' Collateral

prior to the Petition Date when either the reason for the exclusion of the Excluded Bilateral Facilities Collateral no longer existed or when the Debtors reacquired the Released Mortgage Loans. FOF ¶ 315. Testimony did not sufficiently establish a course of dealing among the parties with respect to such issue. FOF ¶ 317.

The Parties could have foreseen the need to provide a temporal limitation or "savings clause" to bring back such collateral into the JSNs' collateral pool. The expert testimony regarding custom and practice provided by Mr. Gadsden established that language was in use at the time the Notes Security Agreement was drafted that could have and should have been included to memorialize any intention by the Defendants for the Contested Assets to return to the collateral pool. FOF ¶¶ 321-22. The Notes Security Agreement contains no such provision. FOF ¶ 323.

Accordingly, the Excluded Bilateral Facilities Collateral and Released Mortgage Loans are not subject to any liens (perfected or unperfected) of the Third Priority Secured Parties and such property does not constitute security for the Notes Obligations.

E. The JSNs Did Not Perfect Their Interests in the Released Mortgage Loans After They Were Reacquired by the Debtors

The Third Priority Secured Parties released their security interest in the Released Mortgage Loans pursuant to the Mortgage Loan Release. FOF ¶ 324-330. Even if the Third Priority Secured Parties retained a continuing security interest in the Released Mortgage Loans when such assets were re-acquired by the Debtors (which they did not), such security interest was never perfected. Therefore it is avoidable.

If the Third Priority Secured Parties intended to re-acquire and perfect their security interest in the Released Mortgage Loans, under the Uniform Commercial Code the Debtors had to have granted a new lien in such re-acquired collateral in their favor (UCC §§ 9-

201, 9-203) and the Third Priority Secured Parties had to have filed a UCC-3 amendment adding back the Released Mortgage Loans covered by the Debtors' new grant. *See* UCC § 9-512; *In re Kerner Printing Co., Inc.*, 178 B.R. 363, 369 (Bankr. S.D.N.Y. 1995) ("If some of the collateral is released, and thereafter the parties wish to have the security interest attach to it again, an amendment is needed to reinstate it.") (citing 9 Hawkland, Miller & Cohen UCC Series § 9-406.01 at 663).

The "after-acquired property" clause in the Notes Security Agreement does not create a lien on assets that have been specifically released from the scope of the Third Priority Secured Parties' collateral. *Bar C Cross Farms & Ranches, Inc. v. Colorado-Kansas Grain Co. (In re Bar C Cross Farms & Ranches, Inc.)*, 48 B.R. 976, 977 (D. Colo. 1985), is instructive. In *Bar C*, the secured creditor relinquished its lien in certain wheat collateral so that another lender could obtain a first lien on such wheat. *Id*. After the new senior lender was paid off, the original secured creditor attempted to assert a claim to the proceeds of the wheat under the after-acquired property clause in the parties' security agreement. *Id*. at 978. The court disallowed the claim:

> [A]n "after acquired property clause" is inapplicable to the proceeds of previously released collateral because there is no longer a foundation upon which the after acquired security interest may attach. The purpose of an after acquired security clause is to maintain the continuity of a secured interest even though the collateral may change form. When the secured interest has been relinquished, the chain is broken and the proceeds of the collateral are also released.

Id. at 979.

The reasoning of *Bar C* is applicable here. Any lien the Third Priority Secured Parties may have had in the Released Mortgage Loans is avoidable under sections 544(a)(1) and

(2) of the Bankruptcy Code[48] because neither the Debtors nor the Third Priority Secured Parties (assuming no new grant of a security interest was necessary) made any UCC-3 filings adding the Released Mortgage Loans back to the Third Priority Secured Parties' collateral. For the foregoing reasons, the value of the JSNs' collateral should be reduced by $10 million, the fair market value of the Released Mortgage Loans as of the Petition Date. FOF ¶ 328.

F. The Committee Can Avoid the Preferential Transfers

The evidence established that assets with a book value of $349,971,942 were transferred to the Notes Collateral during the 90 days prior to the Petition Date.[49] FOF ¶¶ 331-334, 336. As such, the Committee has met its prima facie burden of proof for a preference claim under Bankruptcy Code sections 547(b)(1)-(5). FOF ¶¶ 331-342.[50] Thus, the only remaining issue to be determined in Phase II is whether – after the Third Priority Secured Parties'

[48] "Under section 544(a) of the Bankruptcy Code, the Debtors are granted the rights of a judicial lien creditor under state law. Under New York law an unperfected security interest is subordinate to the rights of a person who becomes a lien creditor before the security interest in perfected." *Marine Midland Bank v. Breeden (In re Bennett Funding Group, Inc.)*, 255 B.R. 616, 633 (N.D.N.Y. 2000); *see also Kraken Inv. Ltd. v. Jacobs (In re Salander-O'Reilly Galleries, LLC)*, 475 B.R. 9, 22 (S.D.N.Y. 2012); UCC § 9-317(a) (unperfected security interest is subordinate to rights of lien creditor).

[49] The attachment of a security interest at the time a debtor acquires rights in collateral constitutes a mode of transfer. Under the Bankruptcy Code, a "transfer" specifically includes the "creation of a lien." 11 U.S.C. § 101(54)(A). Moreover, for purposes of Section 547 of the Bankruptcy Code, "a transfer is not made until the debtor has acquired rights in the property transferred." 11 U.S.C. § 547(e)(3). *See also In re Le Café Crème, Ltd.*, 244 B.R. 221, 233 (Bankr. S.D.N.Y. 2000); UCC § 9-203(b)(2) (security interest enforceable only if "the debtor has rights in the collateral"). Accordingly, the Committee can properly avoid, as a transfer, the attachment of the security interest in the Adjusted Preference Assets (*i.e.*, the enforcement of the "floating lien"). Under section 550 of the Bankruptcy Code, the value of the Adjusted Preference Assets would thus be recovered from the Notes Collateral and correspondingly "subtracted" from the secured portion of the JSNs' claim. 11 U.S.C. § 550(a).

[50] The Committee's hypothetical liquidation analysis was properly performed as of the Petition Date. The Defendants' contention that the analysis must be performed on each transfer date is without merit. 5 *Collier on Bankruptcy* ¶ 547.03[7] (16th Ed.) (citing *Palmer Clay Products Co. v. Brown*, 297 U.S. 227, 229 (1936)). *See also In re CIS Corp.*, 195 B.R. 251, 262 (Bankr. S.D.N.Y. 1996) ("[T]he Code § 547(b)(5) analysis is to be made as of the time the Debtor filed its bankruptcy petition."); *In re Lan Yik Foods Corp.*, 185 B.R. 103, 108 (Bankr. E.D.N.Y. 1995) (same). Moreover, the cases cited by the Notes Trustee stand only for the unremarkable proposition that plaintiff bears the burden of proving that the creditor was not fully secured as of the petition date and, consequently, that such an undersecured creditor would receive less than full payment in a chapter 7 liquidation. *In re Teligent, Inc.*, 2006 WL 1030417 at *3 (Bankr. S.D.N.Y. Apr. 13, 2006), *aff'd* 2009 WL 2152320 (S.D.N.Y. July 17, 2009); *In re Smith's Home Furnishings, Inc.*, 265 F. 3d 959 (9th Cir. 2001); and *Mellon Bank, N.A. v. Metro Communications, Inc.*, 945 F.2d 635, 644 n. 2 (3d Cir. 1991).

remaining legally cognizable assets are identified and valued – the Third Priority Secured Parties were undersecured as of the Petition Date.

The Notes Trustee raised two affirmative defenses to the Committee's preference claim: (1) the "contemporaneous exchange" defense under section 547(c)(1) and (2) the "floating lien" defense under section 547(c)(5) of the Bankruptcy Code. The "contemporaneous exchange" defense applies only to the refinanced mortgage loans required by the Debtors. FOF ¶¶ 343-347. And the "floating lien" defense fails for at least four reasons.

First, the Notes Trustee is the only Defendant to assert the "floating lien" defense. FOF ¶ 344. It is the Third Priority Collateral Agent, however, that is the "secured party" and the transferee of the Adjusted Preference Assets. Thus, the only party that could properly assert the "floating lien" defense is the Third Priority Collateral Agent – not the Notes Trustee –and the Notes Trustee's proffer of evidence in support of that defense should be rejected on that basis alone.

Second, the "floating lien" defense is in any event not applicable here because the Adjusted Preference Assets do not constitute either "inventory" or "receivables" under sections 547(a)(1) and (3) of the Bankruptcy Code. FOF ¶ 346. Section 547(c)(5) carves out an exception for inventory or receivables that protects the transfer of a security interest in after-acquired property, *i.e.*, a "floating lien," provided that the creditor did not improve its position within the 90-day period prior to bankruptcy. *Galloway v. First Alabama Bank (In re Wesley Industries, Inc.)*, 30 F.3d 1438, 1442 (11th Cir. 1994).

The Adjusted Preference Assets, which consist of mortgage instruments, do not constitute "inventory" or "receivables" under the plain meaning of section 547(a)(1) and (a)(3) and are therefore not protected by section 547(c)(5). *See, e.g., Markowitz v. Heritage Bank (In*

re Jefferson Mortgage Co.), 25 B.R. 963, 967 (Bankr. D.N.J. 1982) (ruling that section 547(c)(5) did not apply in case involving tax refund because tax refund is general intangible, not inventory or receivable). The legislative history to section 547 indicates that the terms inventory, new value, and receivable should be construed in accordance with the Uniform Commercial Code. "This section . . . modernizes the preference provisions and brings them more into conformity with commercial practice and the Uniform Commercial Code." S. Rep. No. 95-989, at 372 (1977). Notably, under the Uniform Commercial Code, mortgage loans are considered "instruments," while inventory is defined as "goods, other than farm products." U.C.C. § 9-102(a)(48); Collier on Bankruptcy, ¶ 547.02[1] (16th ed. 2013). "Goods," in turn, specifically excludes instruments. U.C.C. §§ 9-102(a)(2); 9-102(a)(44). Section 547(a) defines inventory to include the basic Uniform Commercial Code definition of inventory, as well as farm products. Hawkland §9-204:4. The definition of receivable under section 547(a)(3) is largely similar to the Uniform Commercial Code definition of "account," which, as with the definition of inventory and goods, specifically excludes instruments. *See* U.C.C. § 9-102(a)(2); Collier ¶ 547.02[3]; Hawkland §9-204:4 ("Subsection 547(a) also defines the term receivable to include the [UCC] definition of an account, as well as a contract right (so the 1962 [UCC] contract rights are included)." *See also Braunstein v. Karger (In re Melon Produce, Inc.)*, 976 F.2d 71 (1st Cir. 1992) (stating that definition of "receivable" under Bankruptcy Code is similar to definition of "account" under Uniform Commercial Code).

The Terms of the Notes Security Agreement further demonstrates that the Mortgage Loans do not constitute inventory or receivables. Mortgage Loans are defined under separately from "Accounts," "Goods," and all other assets covered by such agreement. *See* PX-4 § 2(a)-(u)) and Schedule VI; *see also Jefferson*, 25 B.R. at 967 ("[S]ection 547(c)(5)] concerns a

security interest in inventory or accounts receivable, neither of which is at issue here. The collateral here is a tax refund, which was specifically listed as such on the security agreement and financing statement and . . . can be categorized as a 'general intangible' chattel."). The specific, separate listing of Mortgage Loans reflects the common sense and Uniform Commercial Code definitions of inventory and receivables as contemplated by section 547(c)(5).

Based on the foregoing, the Adjusted Preference Assets are mortgage loan instruments and the proceeds of such instruments, and are not "inventory" or "receivables" for purposes of the section 547(c)(5) defense.[51] FOF ¶ 345.

Third, the Notes Trustee's section 547(c)(5) defense fails as a matter of fact because the Notes Trustee has not satisfied the "improvement in position" test. The Secured Parties' Petition Date valuation was based on the "Berkshire-derived" financial model, a model that should be rejected. The evidence established that Mr. Fazio's section 547(c)(5) analysis, both as to the Petition Date and as to February 29, 2012, was also based in substantial part on the same Berkshire-derived valuation. Because the Notes Trustee's February 29, 2012 valuation is not objectively reasonable, its section 547(c)(5) defense does not exempt the transfer of liens in the mortgage loans or proceeds thereof from avoidance.

Finally, even if the Notes Trustee had proffered an objectively reasonable valuation, Mr. Fazio admitted that it is an incomplete comparison of the value of "all security interests" held by the Collateral Agent for the benefit of the JSNs and, thus, cannot demonstrate that there was no "improvement in position" between February 29, 2012, and the Petition Date.

[51] The cases cited by Defendants are inapposite because they concern whether a mortgage is a "claim" under section 101(5) of the Bankruptcy Code, not a "receivable" under section 547(c)(3). *Johnson v. Home State Bank*, 501 U.S. 78 (1991) (mortgage was a "claim" that could be paid in the subsequent chapter 13 case. The Court applied the definition of a "claim" under section 101(5) of the Bankruptcy Code); *In re Smith*, 469 B.R. 198 (Bankr. S.D.N.Y. 2012) (the mortgage on the debtor's property is a claim that may be paid under a plan in a chapter 13 case).

See 11 U.S.C. § 547(c)(5) (requires comparison on two dates of "amount by which the debt . . . exceeded the value of all security interests for such debt").

Accordingly, the Committee's preference claims should proceed to Phase II for the sole purpose of determining whether the Noteholders were undersecured on the Petition Date.

G. Relief Should be Granted on the Committee's Remaining Causes of Action

Count VII: Based on the applicable agreements, the Third Priority Secured Parties do not have a first priority lien on or security interest in any of the Debtors' assets, and the contrary statement in the AFI DIP Order is clearly a scrivener's error. *Compare* PX-2 § 2.1 *and* PX-4 § 6 *with* AFI DIP Order ¶ 5(g) (referring to "enforceable first priority liens.").

Count VIII: As the Court previously stated, "for liens to attach to commercial tort claims, including avoidance actions, those claims must be listed in the security documents with specificity, which was not the case here." September 20 Opinion at 18. Indeed, the JSNs conceded the point at oral argument. *Id.* at 20.

Count XII: The JSNs' claims are temporarily disallowed in their entirety pursuant to section 502(d) of the Bankruptcy Code until the Committee's claims have been finally resolved.

CONCLUSION

For the foregoing reasons, Plaintiffs respectfully request that the Court enter judgment as follows:

A. In Adversary Proceeding No. 13-01343(MG):

1. On Count I of the Amended Complaint, a declaration that the Defendants do not have a lien on any general intangibles of the Debtors, including but not limited to any intangible value attributable to any of the Debtors' asset sales;

2. On Count II of the Amended Complaint, a declaration that the value of the Defendants' collateral has not diminished during the course of these bankruptcy proceedings and, as a result, the Defendants are not entitled to any adequate protection lien;
3. On Count III of the Amended Complaint, a declaration that the Defendants' lien does not extend to any assets pledged by the Debtors as security to the AFI LOC;
4. On Count IV of the Amended Complaint, a declaration that the Defendants do not have any lien on any avoidance actions that may be brought by the Debtors against any party or parties;
5. On Count V of the Amended Complaint, a declaration that the Defendants (i) have a secured claim of $1.745 billion, subject to the lien challenges brought by the Official Committee of Unsecured Creditors and the resolution of the Phase II issues; and (ii) that the Defendants must demonstrate in Phase II that they are oversecured at a single Debtor to be entitled to post-petition interest.
6. A judgment of dismissal with prejudice of the following counterclaims: 1; 2; 3; 4; 21; 27; 29; 30; 31.

B. In Adversary Proceeding 13-01277(MG):

1. On Count I of the Complaint, a declaration that the Defendants do not have a lien on the Released Bilateral Facilities Collateral;
2. On Count II of the Complaint, a declaration that the Defendants do not have a lien on the Unencumbered Real Property;
3. On Count III of the Complaint, a declaration that the Defendants do not have a lien on any of the assets of the Non-Obligor Debtors;

4. On Count IV of the Complaint, a declaration that the Defendants have not perfected any interest in the Released Mortgage Loans;
5. On Count VI of the Complaint, a declaration that the Defendants do not have a lien on any of the Avoidable Deposit Accounts;
6. On Count VII of the Complaint, a declaration that the Defendants do not have a first priority lien on any of the Debtors assets;
7. On Count VIII of the Complaint, a declaration that the Defendants do not have a lien on any Commercial Tort Claims belonging to the Debtors;
8. On Count IX of the Complaint, a judgment avoiding any unperfected liens asserted by the Defendants against any Deposit Account;
9. On Count X of the Complaint, a judgment avoiding any unperfected liens asserted by the Defendants against any assets of the Debtors;
10. On Count XI, a judgment avoiding $349,971,942.00 in preferential transfers as described above;
11. On Count XII, a judgment that the claims of the Defendants are temporarily disallowed pursuant to Bankruptcy Code Section 502(d); and
12. On Count XIII, a declaration that the Exchange Offer gave rise to original issue discount on the Junior Secured Notes; that as of the Petition Date, $388 million of such original issue discount remained unamortized; and that this unamortized original issue discount constitutes unmatured interest that is not part of the Defendants' allowed claim pursuant to Bankruptcy Code section 502(b)(2).

Dated: November 1, 2013

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EXHIBIT A

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
CORPUS CHRISTI DIVISION

IN RE:	)	**CASE NO: 07-20027**
	)	
	)	**Corpus Christi, Texas**
SCOTIA DEVELOPMENT, LLC,	)	
	)	**Monday, July 7, 2008**
	)	**(5:03 p.m. to 5:42 p.m.)**
Debtor.	)	

RULING

BEFORE THE HONORABLE RICHARD S. SCHMIDT,
UNITED STATES BANKRUPTCY JUDGE

Appearances:	**See next page**
Courtroom Deputy:	**Frances Carbia**
Court Recorder:	**Janet Silika**
Transcribed by:	**Exceptional Reporting Services, Inc.** **14493 S. Padre Island Drive** **Suite A-400** **Corpus Christi, TX 78418-5940** **361 949-2988**

Proceedings recorded by electronic sound recording; transcript produced by transcription service.

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Corpus Christi, Texas; Monday, July 7, 2008; 5:03 p.m.

(Counsel appear in person and telephonically)

(Call to Order)

THE CLERK: All rise.

THE COURT: Be seated. Send in the call.

All right, let's see, Brian Hall?

(No audible response)

THE COURT: Eric Winston?

(No audible response)

THE COURT: David Staber?

MR. STABER: Here, your Honor.

THE COURT: Kathryn Coleman?

MS. COLEMAN: Present, your Honor.

THE COURT: Mark Worden?

MR. WORDEN: Present, your Honor.

THE COURT: Allan Brilliant?

MR. BRILLIANT: Here, your Honor.

THE COURT: Jeffrey Davidson?

MR. DAVIDSON: Good afternoon, your Honor.

THE COURT: Steven Schwartz?

(No audible response)

THE COURT: Jeffrey Spiers?

MR. SPIERS: Good afternoon, your Honor.

THE COURT: Isaac Pachulski?

MR. PACHULSKI: Good afternoon, your Honor.

THE COURT: Alan Tenenbaum?

MR. TENENBAUM: Present, your Honor.

THE COURT: Jeffrey White?

(No audible response)

THE COURT: John Fiero?

MR. FIERO: Good afternoon, your Honor; John Fiero for the Committee.

THE COURT: Eric Fromme?

MR. FROMME: Good afternoon, your Honor.

THE COURT: Jacob Cherner?

MR. CHERNER: Present, your Honor.

THE COURT: Robert Damstra?

MR. DAMSTRA: Present, your Honor.

THE COURT: Craig Druehl?

MR. DRUEHL: Yes, your Honor.

THE COURT: Sharon Duggan?

MS. DUGGAN: Yes, your Honor.

THE COURT: Wendy Laubach?

MS. LAUBACH: Present, your Honor.

THE COURT: Dan Kamensky?

(No audible response)

THE COURT: Stephen Wolpert?

(No audible response)

THE COURT: Todd Hanson?

MR. HANSON: Present, your Honor.

THE COURT: Wei Wang?

MR. WANG: Present, your Honor.

THE COURT: Ephraim Diamond?

MR. DIAMOND: Good afternoon, your Honor.

THE COURT: Kenneth Crane?

MR. CRANE: Ken Crane, and I have Jim Pelke (phonetic) and Richard Higginbotham (phonetic) on the phone.

THE COURT: Thank you. Joli Pecht?

MS. PECHT: Present, your Honor.

THE COURT: Demetra Liggins?

MS. LIGGINS: Present, your Honor, with (***) Herndon (phonetic).

THE COURT: Okay. Heather Muller?

MS. MULLER: Good afternoon, your Honor.

THE COURT: Gary Clark?

MR. CLARK: Present, your Honor.

THE COURT: Frank Bacik?

MR. BACIK: Good afternoon, your Honor.

THE COURT: All right, anyone else on the phone?

MR. LEE: Yes, your Honor.

THE COURT: Go ahead.

MR. LEE: Kyung Lee.

THE COURT: Okay.

MS. WHITE: And this is Jennifer White with Carey Schreiber.

THE COURT: All right. And then in the courtroom we have someone from Marathon.

MR. JORDAN: Your Honor, this is Shelby Jordan and Lucky McDowell on the phone.

MR. PENN: John Penn, and we have Tony Gerber on the phone, your Honor.

THE COURT: Who is that on the phone?

MR. PENN: Toby Gerber.

THE COURT: Thank you. And Pete Holzer is in the courtroom?

MR. HOLZER: Thank you, your Honor.

THE COURT: I'm not sure whether anyone -- I tried to announce earlier in a hearing -- What hearing was that?

MR. SPEAKER: Asarco's hearing.

THE COURT: Oh, was it Asarco's hearing? But not everyone was there, and I see Mr. Tenenbaum is on the line now. I had announced that I had permission to announce that the lawsuit in Brownsville would not be decided during the month of July, so if the parties wanted to get together to work out something, they have that opportunity.

All right, we're here now for my ruling on the administrative claim, alleged administrative claim of the Indenture Trustee.

I'd like to start with background of how we got to this point because I think it's important. The case of course

was filed on June 18th, 2007. The parties have mediated this case with Judge Houser and Judge Isgur. There was a confirmation hearing on April 8th through the 8th, and then a continued confirmation hearing on April 29th through May 2nd.

On May 1st, the IT filed a motion to grant the IT a super priority administrative claim.

On May 2nd, the IT's attorney asked the Court to set the administrative claim for hearing with closing argument. The Court then asked the attorney how much the claim was, and for some reason that wasn't answered. Another question I guess was answered but we never got back around to that, and we discussed the confirmation -- the closing argument.

On May 15th when I set closing argument, we had the closing argument but the IT first filed a motion to reopen the evidence to introduce the Sierra Pacific offer. The motion was granted. No motion was made to reopen the evidence to submit any evidence of an administrative claim.

The IT's proposed findings that they filed, number 297 and 299, were consistent with the motion for the super priority administrative claim that they filed claiming a failure of an equity cushion and a $20 million dollar cash collateral shortage.

On June 6th, 2008, findings of fact and conclusions of law were entered by the Court and a status conference was set. Finding number 286: The Court made a finding that the IT

got 530 million less an adjustment of approximately 13 million, and set a status hearing. The IT then, at the status hearing, announced to the Court that it had an administrative claim that might be as much as $200 million dollars. This was the first the Court had ever heard of that and was concerned that that wasn't brought up in the confirmation hearing, but the Court set the administrative claim hearing for the 9th of June.

IT then asked for a continuance, which the Court granted, and set the hearing on the administrative claim for June 30th through July 2nd.

Now, we should keep in mind that up until the hearing, the IT's administrative claim was based on a finding that it was oversecured at the cash collateral hearing. However, over-security was not the basis of the use of cash collateral.

At the cash collateral hearing, ScoPac attempted to introduce evidence of the value of the timberlands, arguing that a valuation prior to confirmation hearing would be critical to plan negotiations as well as expected upcoming hearings on granting of a priming lien to a DIP lender, et cetera. The Indenture Trustee however, objected, arguing that the valuing evidence was irrelevant.

The Court decided not to hear the valuation testimony regarding the equity cushion over any valuation of their claim. ScoPac relied on its prior record to the effect that the trees

would grow faster if they are cut, and that once cut, they remain subject to Bank of New York's lien and are log inventory and then they become receivables once they're sold. The IT acknowledged that the Court had previously found that the tree growth constituted accurate perception. Ultimately, the Court noted that the value of the timberlands was unclear at that time but nevertheless overruled the IT's objection and approved the use of cash collateral.

Now, it's elementary Chapter 11 law. Section 1129(a)(9) requires the payment in full on the effective date of the plan of all of these administrative claims, any administrative claims. The Court's finding number 286, that the IT got 530 less the adjustment, which the Court believed to include any potential administrative claim, for a total of 517 million. There was no evidence at the confirmation hearing that the property had declined in value.

In Chapter 11, administrative claims are usually dealt with after a confirmation unless an objector is alleging that the plan violates 1129(a)(9), which is perhaps what's being alleged here. Here, the determination of this administrative claim is only a determination vis-à-vis the Marathon/Mendocino plan. Obviously, if the plan is not confirmed or if the case is converted to seven or if the property is foreclosed at a later date or something else traumatic happens at a later date, there could be a different

administrative claim which might be filed, so, any ruling today is only an administrative claim as it concerns this plan.

The super priority status of this claim has absolutely no bearing at this point because all administrative claims must be paid. It obviously might have a significant bearing in a later Chapter 7 case if one ever resulted.

The Court could have ruled that the IT had its shot at confirmation and chose not to litigate it during the confirmation hearing and is barred by the Court's findings. However, because of the unusual way that this whole thing arose and the context of the way it arose, the Court believed that, as a court of equity, that the IT should be given the right to prove its claim.

Now, at the trial of the claim, the IT did produce witnesses as to value but also introduced evidence and took basically an approach that perhaps could be consistent with reconsidering the order of confirmation and perhaps trying the issue as though it were part of the confirmation case.

First of all, the IT asserted that the conduct of Marathon and Mendocino in this case and their presentation in this particular case was an affront to the integrity of the bankruptcy system. They introduced two e-mails; one was a September 7th e-mail. Keeping in mind that this was during the period of this case when there was exclusivity, it was prior to the three mediations, obviously the first one being in November

of 2007. It was in September of 2007, at a time when Marathon was apparently courting Mendocino to be a participant perhaps in a potential plan. However, there was no right to file a plan at that time because there was exclusivity.

In that e-mail, Mr. Dean describes a number of things which, taken out of context, certainly can sound as affronts to the integrity of some jurisdiction systems. However, they have to be kept in mind in the context of this case.

First of all, there was a comment that the log deck, ScoPac getting a log deck and moving the log from PALCO to ScoPac, was a sleight of hand. Well, I mean, perhaps that's a description someone might give of it. If that's the only description of it, I mean, they were describing Mr. Horowitz's conduct in the case, and I can assure you there have been far more colorful descriptions, and I'm not suggesting any of them correct. However, if it were a sleight of hand, it was a sleight of hand that was approved by the Court.

There was no question that the Court was not aware of exactly what happened. All the parties are well represented in this case and had the opportunity to object to the log deck situation. Those objections were made and the Court ruled. So, I mean, it's hard to consider that as something that is an affront to the judicial system.

Then there was the comment about a bogus appraisal. You know, we talked about MAI appraisers in this particular

case, and the Court is mindful of the standard joke that MAI stands for 'made as instructed.' Well, you know, there is no question that businessmen have different impressions about the impacts of appraisals in cases. The statement was made that 'the debtor or Marathon might use a bogus appraisal to cram down the note holders.' Well, that's exactly the concern the Supreme Court had in the *LaSalle* case, and to avoid that possibility, the Court lifted exclusivity.

So, the Court is certainly mindful of the fact that while there's exclusivity, a debtor might try to use appraisals to cram down note holders, and it would be inappropriate under LaSalle, but putting it out into the market by lifting exclusivity does, in fact, provide a mechanism for everyone to be able to avoid the possibility that somebody might use a so-called bogus appraisal to cram down someone in a bankruptcy case.

And then of course, throughout the e-mail there was the notion that Marathon wanted to steal equity. I'm not sure what is meant by 'equity' when Mr. Dean said 'stealing equity', because nobody in this case has any equity. Perhaps maybe Bank of America in the sense, in the traditional sense of having it, and even then - If you mean value over the debt, the debtor certainly had no equity in this case and ultimately gave up because they knew they had no equity.

IT had no equity; that's the certainly the finding

that I've made, and I think that's the position they took early on in the case and throughout the case.

Marathon certainly had no equity in this case. If what he meant when he said 'equity' -- he's not lawyer, he's a businessman; if what he meant was ownership, that they meant to steal ownership, well, by lifting exclusivity, again, everybody then is given equal opportunity to steal the other person's ownership. That's what the effect of lifting exclusivity is. Maybe we don't say it quite that coldly, but that's exactly what happens once you lift exclusivity. It's then everybody's chance to put forth a plan that might give them the best possible situation.

In fact, the IT in this case had a $750 million dollar claim and 510 worth of security as leverage against Marathon, which I think had something in the neighborhood of $125 million dollar claim. And perhaps the important assets, the mill and the electric plant, were worth perhaps 25 million as security. Thus, the IT had perhaps a 20-to-1 leverage advantage over Marathon to propose a buyout of all the assets.

I have no idea why the IT didn't decide to just take some money and buy out the claim of Marathon. I don't know. Obviously they wouldn't have been able to buy it from Marathon but they could cram down Marathon to the value of their claim.

They either relied on the false assumption that the amount of their -- the value of their claim, even as

undersecured, was so high that nobody would possibly try to buy it out, or, more likely, their strategy was to hold out to delay and foreclose their lien. Nothing wrong with that. That's their strategy. If they want to live with it, that's fine. However, if somebody proposed a plan, the Court has a duty to look at the plan to see if it's confirmable.

Second, there was an e-mail later in the case about Mr. Barrett or Dr. Barrett's proffer, from Sandy Dean. In that, he said there was no significant increase in the forest; that they harvested everything; that the roads added no value, they were much like -- I think he said they were like a roof on a house, that it added no value but it's good for the buyer to get -- and that perhaps the watershed analysis might add some value.

Dean's proffer in the case said that the timber prices were higher in 2007 but expected them to climb; that the discount rate had declined, and that the original value of the forest, using his sustained-yield philosophy, was $425 million dollars. I didn't find anything remarkable about the e-mail describing the proffer or, I don't find it to be in conflict to what he testified either in his proffer or in the original court hearing.

Underlying all of this I guess is the notion that laymen, and even lawyers, who don't practice bankruptcy believe that bankruptcy is hocus pocus; that it's smoke and mirrors,

especially to business people and non-bankruptcy lawyers, as I said. Many of the provisions in a bankruptcy are counter-intuitive. But, to the extent it is, it's Congress-mandated hocus pocus. I mean, in the sense that once -- I mean, it's difficult for people to understand that they can have a deal with somebody and go into bankruptcy and it gets turned around. But it happens.

The goal of bankruptcy is to maximize assets for creditors, not to favor any one creditor over another. Secured creditors get significant protections in bankruptcy, but those protections are not the same as outside of bankruptcy. And, to the extent that they change, all of that is counter-intuitive to a businessman. So, it is not surprising to me that businessmen speak in such kinds of terminology during the course of a bankruptcy case.

Another issue that the IT brought up about the affront to the integrity of the case was the conduct of the appraisers. In a complex case like this, appraisers may differ in their valuation, and it is no surprise nor is it any bad faith, that an appraiser's selection of value favors the appraiser's client. Again, that, again, is the problem that *LaSalle* and the Supreme Court have pointed out.

Plenty of reasonable minds have differed as to the value in this case. Let's start with Houlihan. They had two different values from the same firm. In September, the value

was between 250 and 500, Mr. DiMauro. Then at confirmation, Glen Daniels, it was at 589 to 716. Mr. Glen Daniels even invented -- you know, we hear appraisals on property and the three different approaches to value over and over again in a bankruptcy court, and Mr. Daniels created a fourth one, which was a bid procedure.

Now, you know, I think he did a reasonable job. I don't think anything he did was incorrect. I mean, I don't think it was improper what he did, but it certainly did cast question on the weight to be given to his testimony.

Mr. Fleming. Mr. Fleming dated his appraisal in October of 2007, some nine months prior to the confirmation; found a value and held out to the Court that that was the same value nine months later. Yet when he testified in open court on the administrative claim hearing to a time period just ten months before his appraisal -- not nine but ten -- it was $46 million dollars higher. He stayed with the same value at confirmation, but then wanted to change it at the time of the administrative claim hearing, even though the significant market factors had occurred and, significantly, many of them occurred after his appraisal.

Look at Mr. Lamont. He testified that the property was worth between 425 and 430. Mr. Lamont also had difficulty remembering, when he took his deposition, that a chart that he selected -- Let me start over. Mr. Lamont selected for his

valuation a chart of timber prices that he'd never used before and which are about ten percent lower than another chart which he normally uses. That perhaps was favoring his client. And then in a deposition, he forgot that that not all of the prices that he had gotten that he had listed in his report were from that chart even, because the chart was not published after a certain date.

Now, if you look at his notes, it's clear that there was a gap after the date that they were published and then there were new figures after that. I think that ultimately, I don't think he lied on the stand in court; I think he forgot what he had done. All of that goes to the weight to be given to his testimony of course, but, remember, he valued this at 425 to 430. I didn't accept that. I found the value at 510.

Interestingly enough, the values that the Houlihan people came up with, if you average all of them, that's only around 523.

It's significant that Mendocino throughout this case has had a whole different approach to value than some of the other appraisers. Mendocino's philosophy differs; they were a purchaser in this case, and for them to purchase this, the value would be determined by the way they would use it. That may not be the fair value of it -- fair market value of it, but as far as the value for them, it's going to be based upon a discounted cash flow analysis of the amount of timber that they

would harvest with their philosophy, a philosophy that includes a sustained yield, a philosophy that does not include clear-cutting. So, as a result, it seems to me that the Mendocino approach erred in that it erred on the conservative side for value.

The debtor, with perhaps what we would call terminal optimism, believed the value near one billion dollars, based it on artificially high prices with a 4.5 per annum rise in prices, and based on a computer model that harvests a maximum timber, even beyond practicality and beyond sustainability, where they were harvesting sometimes one log. But the model created a timber yield that was artificially high, and I so found.

The Court's duty in determining value, I must consider all the evidence presented and reach my own conclusions. I did not adopt any appraisal. In fact, the Court's figure was almost directly halfway between Mr. Fleming and Mr. Lamont. However, that is not how the Court arrived at its value. The Court used all the appraisals, as pointed out in the opinion, giving appropriate weight to those appraisals and came up with what I believe to be the value. The Court gave various weights and listed various things about all of these appraisers, and I'm not changing any of those findings with respect to the analysis that I did in the opinion on confirmation.

Now, turning to administrative super priority. The law of administrative super priority claims, the burden of proof of course is upon the claimant to establish an administrative super priority claim. For instance, there's the *Rebel Brentz* (phonetic) case out of the Central District of California: The burden of proof is on the claimant.

Section 507(b) affords a super priority claim arising from the failure of adequate protection, and its provisions provide that if the Trustee, or here the debtor, under Section 362(3) or (4), provides adequate protection of the interest of a holder of a claim secured by a lien on property of the debtor, and if, not withstanding such protection, such creditor has a claim allowable under Section (a)(2) of this section arising from the sale, use, or lease of such property under 363, et cetera, then such creditor's claim under said subsection shall have a priority over every other claim allowable under said subsection.

In order to establish a right under 507(b), there of course have been cases that set out three criteria: The debtor or the Trustee must have provided them with adequate protection that proves to be inadequate; that the creditor must have an allowable claim under 507(a)(1), which in turn requires the claim to be allowable as an administrative expense under 503(b); and third, the creditor's claim must have arisen from the use, sale, or lease of the creditor's collateral. And

citing, there's a Fourth Circuit case. There's also Collier's cites to all of that.

Now in this case, the administrative claim is not based upon the normal section in the Code that provides for administrative claims, but rather the cash collateral orders. The cash collateral orders that have been issued in this case each contain a provision which says that each of Bank of America and the Trustee, on its own behalf and on behalf of the Bank of America and the note holders, is also granted a super priority cost of administration priority claim under 11 U.S.C. 507(b) to the extent of the pre-petition diminution of their respective interests in the pre-petition collateral and cash collateral.

In addition to that, the cash collateral order suggests that the administrative cost of administration claim granted by the order shall be subject and subordinate to a carve out for the payment of allowed consultant and professional fees and disbursements incurred by consultants and professionals retained, et cetera. It provides that the expenses of the committee in investigating or reviewing the pre-petition claims of Bank of America and the Trustee and the note holders can be paid out of the cash collateral. It provides that 'the same may be payable, and the amounts so paid shall be free and clear of any liens in the super priority administrative claims of Bank of America and the Trustee.'

So in this case, we have an order which establishes an administrative claim if the note holder can provide -- can prove that a post-petition diminution of their interests in pre-petition collateral and cash collateral. I think it's significant first of all, that it uses the word 'interests', which is the same as the Code.

Now, so it seems to me that in order to determine whether or not the note holders have an administrative claim under this section of the cash collateral order, I must determine whether or not their interests have been diminished. And I think that I have two things that I can look at: the evidence in this case, which the IT has presented, goes to whether there is a potential decrease in the timberland value; and second, whether there is a potential decrease in the other security value. So, I'll analyze those separately, first turning to the timber value.

I believe that the Trustee, the Indenture Trustee, failed to meet its burden of proof or provided insufficient evidence that there was any change in value to the timberlands.

First of all, Mr. Fleming's value at the date of filing was 646 and 605 at confirmation. That was only a difference of 41 million. I mean, that's significant money. If you use my analysis, which I found that the value at confirmation was approximately 84 percent of his 605 figure, that would really -- 84 percent of 41 million is 34.5 million.

The difference was based upon his belief that there are more trees to harvest at filing and therefore it could sustain a higher harvest rate and thus a higher value.

The statement is contrary to all the testimony in this case. All of the other evidence in this case demonstrates that the trees continue to grow, and that even after harvesting, there is either more or, if you believe Sandy Dean's e-mail, there is at least as much, equal to the total volume of timber each year.

There was a mortgage banker who testified that as to macro-economic forces in the market, in the industry of wood there's been a turndown since the filing of this case. However, he was not able to tie that with any specificity to this case, to this county, to the redwood forests, or this industry specifically.

The case law suggests that the Code provision for protection for loss of secured creditors -- the Code protects the loss of secured creditors' interest in the property. With non-cash property, the interest that secured creditor has a right to is the right to foreclose. Therefore, the case law suggests that the appropriate value to protect is the foreclosure value of the property and not the fair market value of the property.

Now, both sides have cited the *In Re: Stembridge* (phonetic) case out of the Northern District of Texas which

states, even though it was reversed on other grounds, it states: 'With regard to the provision of adequate protection, a secured creditor is entitled to have his interest protected against diminution by reason of the estate's ongoing possession and use of creditor's collateral. The interest of the secured creditor is properly valued from the secured creditor's perspective. In other words, the secured creditor must be protected such that the total realizable from its collateral through foreclosure does not decrease as a result of the delay imposed by the bankruptcy case or the enforcement of its rights.'

All of the cases dealing with adequate protection of undersecured creditors, like those that came out before timbers, for instance, based the value of adequate protection on the liquidation or foreclosure value. Here, the plan pays for the payment of fair market value of the IT's lien. No evidence was presented to suggest that the liquidation or foreclosure value at filing was higher than the fair market value at confirmation. In fact, the evidence shows that the liquidation value at filing was in the range of 300 million. Moreover, foreclosing without permits or an adjacent sawmill may lead to an even lower value.

But all of this is speculative, so that it seems to me that the evidence suggests that there has not been a decline from the -- In fact, there's been no evidence as to a decline

in the foreclosure value of the case, but even looking at the fair market value, the evidence showed that from filing to confirmation, the forests grew so that there are more trees. Capital improvements were made -- roads, tree planting, watershed analysis -- which freed more areas for harvesting. Perhaps the roads don't add any value, as Mr. Dean suggested, but the tree planting and the watershed analysis did free up more areas for harvesting, which ultimately will lead to more value. All of this may lead to a value being higher at confirmation, but the Court is not prepared to make that finding that there has been any change in value since the filing.

Significant evidence suggests that the discount rate has gone down since filing. The discount rate, the Court believes, under the appropriate analysis for the value of a forest, the discount rates are a far bigger indicator of a change in value than change in the price of the logs. Because Marathon's expert did a comprehensive analysis of discount rates using sales, publications, and other techniques, because discount rate is a significant driver of value, lowering the discount rate results in a value of the forest being higher at confirmation. Fleming on the other hand, simply used a bond chart to pick a discount rate.

However, despite the increase in the forests and the decrease in the discount rate, the Court believes that the

value of the forests has remained relatively constant since the filing. This is consistent with the long-term approach to valuing commodities like this forest whose worth is based on constantly growing timber, the unique nature of these acres in this place, and with this type of wood.

The question before the Court is whether the value has decreased, and the Court finds it has not. The IT has argued that finding number 158 of my findings was tantamount to a finding that the price of the forests had declined. This is not true. To the extent the finding is unclear, the Court will clarify that this was merely pointing out the fallacy of Mr. Fleming's methodology. Because he chose to use a ten-year rather than a 50-year methodology, the initial price of the timber significantly drives the final outcome of value. The Court was merely pointing out the flaw; not adopting the approach, nor was I opining that his result was reasonable; only pointing out that this small change in price changes the value significantly, from 605 to 452. I did not adopt 452 as a value in this particular case.

Finally, then, if the value of the forests is the same, then the Court has to look at the value of other assets that provide security for the IT to determine whether or not he's being paid an amount in the plan equal to the value of his assets at confirmation and equal to the value of his assets -- equal to or greater than the value of his assets at the

beginning of the case and equal to the value of his assets, or greater than the value of his assets at confirmation.

The undisputed testimony about value of all other security items other than -- I'm not talking about the lawsuit. That's a separate asset that's been dealt with in the confirmation findings. But if you look at the attachments to Mr. Young's testimony and the testimony of the accountant or chief financial officer for ScoPac, you'll find that on the day of filing, in addition to the forests and the lawsuit, that the other assets that were the security for the Indenture Trustee equaled 48.7 million.

However, there was a claim of Bank of America of 36.2 million as of that time, and therefore, the remaining assets were 12.5 million, so that on the date of filing of the bankruptcy, the Indenture Trustee had security of 522.5 million.

At confirmation, it's not clear exactly how much the assets of the Indenture Trustee are worth, for a number of reasons. First of all, there was forests in the same amount, 510; there were other assets of 44.1, although among all of those there's some question as to whether all of those are dollar-for-dollar worth the value, and presumably they're not; and the Bank of America debt was 37.6 at confirmation, so that the net, assuming that all of those properties are equal dollar-for-dollar, the value of their security was 6.5. So, it

in fact was -- the value of their security was less than the amount that they had at filing.

So, for the plan to be confirmable, it has to pay them at least the value of their security at the filing of the case, which was, remember, 522.5.

The Indenture Trustee has already been paid for professional fees 8.9 million, so that that is a total of 518.9 million if they get 510 in cash for the forests and add in the 8.9 million that they've already been paid. That would leave them 3.6 million deficient. So, therefore, I am not -- I don't have to go to the issue of whether or not the auction rate securities are valued or whatever because they don't get those under the plan. All they get is their 510 for the forests under the original order that I contemplated and the 8.9 million that they've already been paid.

So therefore, I will change my order to say that they must pay them a minimum of 513.6 million in order to avoid any administrative claim. That'll be my order.

If there are those contingencies that are still in that confirmation, if Marathon and Mendocino want to go forward with that, then they should submit a confirmation order consistent with that and I'll confirm the plan.

Thank you. You-all are excused.

(This proceeding was adjourned at 5:42 p.m.)

CERTIFICATION

I certify that the foregoing is a correct transcript from the electronic sound recording of the proceedings in the above-entitled matter.



Signed

July 9, 2008

Dated

TONI HUDSON, TRANSCRIBER

EXHIBIT B

Valuing a Business

The Analysis and Appraisal of Closely Held Companies

Fifth Edition

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Chapter 12

Market Approach: Guideline Merged and Acquired Company Method

Overview of the Merged and Acquired Company Method
When Is the Guideline Merged and Acquired Company Method Most Useful?
  Standard of Value
  Going-Concern versus Liquidation Value
  Quantity and Quality of Data Available
Control Transaction (Acquisition) Valuation Multiples
  Announcement versus Closing Date Value
Caveat: Check the Deal Structure
  Deal Terms
  Exactly What Was Transacted?
  Noncompete and Employment or Consulting Agreements
Sources of Merger and Acquisition Data
  Sources for Large Company Transactions
  Sources for Middle-Market and Smaller Company Transactions
Past Subject Company Transactions
  Past Subject Company Changes of Control
  Bona Fide Offers
  Past Acquisitions by the Subject Company
Formulas or Rules of Thumb
Nonoperating Assets, Excess Assets, and Asset Deficiencies
Selecting and Weighting Multiples for the Subject Company Based on Guideline Transactions
  Impact of Guideline Transactional Data Evaluation
  Multiple of Stock Value to Asset Value
Reaching the Value Conclusion
Summary
Bibliography

This chapter was revised from the previous edition by Chad Phillips.

Exhibit 12–2

Comparison of Private and Public Company Transaction Databases as of June 29, 2007

	Pratt's Stats®*	BIZCOMPS®*	IBA	Done Deals	Mergerstat®*
Type of transactions	Private companies	Private companies	Private companies	Private and public	Public companies
Number of transactions	9,933	9,885	30,000	~8,000	5,590
Since	1990	1993	~1980		1998
Median sale price	$1.3M	$160K			$128.2M
Range of sale prices	$3K–$16.6B deal size	$0–$35M	most < $500K revs.	$1M–$1B	$40K–$116B
Median revenues	$1.3M	$368K			$96M
SIC codes	704	445			657
Data points on each transaction	81	21	8(+)	21	56

*Available from BVResources at www.BVMarketData.com.

Exhibit 12–2 presents a side-by-side comparison of the foregoing private company sales databases as of June 29, 2007.

Past Subject Company Transactions

Past transactions involving the subject company may be fruitful subjects to analyze for guidance as to value.

Past Subject Company Changes of Control

If the subject company itself has changed control in the last few years, the transaction may be an excellent source of valuation multiples. The valuation multiples used would generally be the same as those discussed earlier. The valuation multiples indicated by the prior transaction may need some adjustment to reflect internal changes in the company or changes in the industry or market conditions.

Bona Fide Offers

Documentable, arm's-length, bona fide offers to buy or sell may also be useful evidence of value. Funded bona fide offers (i.e., offers for which the financing for the offer is already in place) should be given more weight and more consideration than unfunded bona fide offers. It is usually difficult, however, to obtain adequate documentation or to verify the arm's-length relationship of the potential buyer/seller.