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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	)	Chapter 11
RESIDENTIAL CAPITAL, LLC, et al.,	)	Case No. 12-12020 (MG)
Debtors.	)	(Jointly Administered)

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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 DUE 2015 ISSUED BY DEBTOR RESIDENTIAL CAPITAL, LLC, et al., Defendants.	Adv. Case No. 13-01343 (MG)
OFFICIAL COMMITTEE OF UNSECURED CREDITORS, on behalf of the estates of the Debtors, Plaintiffs, v. UMB BANK, N.A., IN ITS CAPACITY AS INDENTURE TRUSTEE FOR THE 9.625% JUNIOR SECURED GUARANTEED NOTES DUE 2015 ISSUED BY DEBTOR RESIDENTIAL CAPITAL, LLC, et al., Defendants.	Adv. Pro. No. 13-01277 (MG)

POST-TRIAL MEMORANDUM OF LAW OF THE AD HOC GROUP OF JUNIOR SECURED NOTEHOLDERS AND UMB BANK, N.A.

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TO THE HONORABLE MARTIN GLENN:

The Ad Hoc Group of Junior Secured Noteholders and UMB Bank, N.A. (collectively, the "Defendants") by and through their undersigned counsel, respectfully submit the following post-trial Memorandum of Law for Phase I of the above-captioned adversary proceedings:

ARGUMENT

Despite the breadth and depth of trial submissions, this consolidated adversary proceeding largely revolves around one section of the Bankruptcy Code—section 506.[1] The quantum and nature of the JSN Claims is governed by section 506(a), which provides:

> An allowed claim of a [secured creditor], . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, . . . and an unsecured claim to the extent that the value of such creditors' interest . . . is less than the amount of such allowed claim.

11 U.S.C. § 506(a)(1). Section I, infra, addresses all issues relating to the calculation of the JSN Claims, issues related to the effect of alleged OID, and whether the JSN Claims and Collateral should be aggregated for the purposes of section 506.

The question of whether the JSN Claims, properly stated, include claims for post-petition interest, fees and charges is governed by Section 506(b) of the Bankruptcy Code. That subsection provides that a secured creditor is entitled to post-petition interest, fees, costs and charges, "[t]o the extent that an allowed secured claim is secured by property the value of which, after any recovery under [section 506(c)], is greater than the amount of such claim[.]" 11 U.S.C. § 506(b). All issues relating to the identity and valuation of the Debtors' property securing the JSN Claims are addressed in Section II, infra.

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[1] Capitalized terms not otherwise defined herein are defined in the Defendants' Proposed Findings of Fact ("FoF"), submitted herewith. Citations to "FoF §_¶ _" are to the sections and numbered paragraphs therein.

Taking into consideration all of the facts and law set forth in Sections I and II, as well as Defendants' Proposed Findings of Fact submitted herewith, there is only one proper conclusion for Phase 1: all JSN Claims, including claims for post-petition interest, default interest, fees, costs and charges, are fully secured claims and should be paid in full.

I.

THE JSNS HOLD AGGREGATE SECURED CLAIMS AS OF THE EFFECTIVE DATE IN THE AMOUNT OF $2.56 BILLION PLUS INDEMNIFICATION RIGHTS FEES, COSTS AND CHARGES

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

Here, there has been no dispute in these Cases that the stated principal face value amount of the Junior Secured Notes, plus all prepetition accrued interest, is $2.222 billion at each of the Debtor Obligor estates. Whether that full claim is subject to an OID challenge is discussed below. Pursuant to the JSN Indenture and the Cash Collateral Order, the Obligor Debtors are also contractually required to pay interest at the contractual rate of 9.625 percent through the assumed Effective Date of the Plan and default interest at the rate of 1 percent through the Effective Date. The total claim for interest accrued after the Petition Date is $341.6 million through December 15, 2013, and the JSNs have additional contractual claims for indemnification, fees, costs and charges through the Effective Date in an amount to be determined in subsequent proceedings.

[2] The burdens with respect to adequate protection, however, are different and are addressed in Section II(A)(3).

These aggregate claims under the Junior Secured Notes (in total the "JSN Claims") arise pursuant to the JSN Indenture and the JSN Pledge Agreement, in which the Borrower and Guarantor Debtors obligated themselves to pay in full all principal, interest, and premiums under the JSN Indenture, and the Guarantor Debtors unconditionally guaranteed the obligations of the Borrower under the JSN Indenture, including the obligation to pay in full all principal, interest (including postpetition interest and default interest), and premiums, if any, in respect of the Junior Secured Notes.[3] (FoF § II ¶¶ 5-9.)

The principal amount and the validity of the JSN Claims as of the Petition Date were further established in the final Cash Collateral Order entered in these Cases. (FoF § II(C)(d).) In paragraph 5(c) of that Order, the Debtors stipulated as follows: "the Junior Secured Notes Obligations constitute legal, valid and binding obligations of Residential Capital LLC and the Junior Secured Notes Guarantors, enforceable in accordance with their terms . . . ." (FoF § II ¶ 132.) Any and all challenges to stipulation 5(c) were required to have been made during the Challenge Period established in paragraph 28 of the Cash Collateral Order. Barring a timely challenge, the stipulations as to the JSN Claims became "binding on all parties in interest, including the Creditors' Committee." (FoF § II ¶ 138.) That result is "not . . . subject to challenge or modification in any respect." (FoF § II ¶ 139.) Only two challenges to the amount of the JSN Claims were timely raised by the Committee: (1) that the JSN Claim should be

[3] The JSN Claims have been partially repaid since the Petition Date. (FoF § II ¶¶ 10-13.) After adjusting for the $1.1 billion that has already been paid, the JSNs' remaining claim amount on the Effective Date will be approximately $1.464 billion, excluding indemnification rights and reimbursement for fees, costs and expenses. The JSN Claims, as existing prior to the Debtors' paydown, are more fully set forth in the JSN Proof of Claim. For consistency, and unless specifically noted, all calculations of claims and collateral are presented without reflecting pay downs.

reduced by OID and (2) that the section 506(b) claim calculation should be performed on a debtor-by-debtor basis rather than in the aggregate.[4] Neither challenge is valid.

A. The JSN Claims Should Not Be Reduced By OID Allegedly Generated By The Exchange

In Count XIII of its Complaint, the Committee alleges that a portion of the JSNs' claims should be disallowed pursuant to Bankruptcy Code section 502(b)(2), as a result of alleged unmatured interest allegedly arising from "Original Issue Discount" ("OID").

The relevant case law and evidence introduced at trial demonstrates that the JSNs' claims should be allowed in full and should not be reduced by any OID. The evidence conclusively establishes that (i) there is no supportable distinction whatsoever between fair and face value exchanges; (ii) the JSNs' receipt of a third lien on the Debtors' assets in exchange for a 20% reduction in the principal amount of their debt and an extension of maturities provides no legal basis for the Court to sidestep the rationale of the Second Circuit's decision in In re Chateaugay; and (iii) a ruling disallowing a portion of the JSNs' claim will absolutely frustrate and deter future out-of-court debt exchanges.

The evidence presented at trial also showed that the economic substance (and accounting treatment) of a debt for debt exchange is completely different than an original cash issue discount bond, and the Committee's argument that the two transactions should be treated consistently in bankruptcy because each creates *tax* OID has already been squarely rejected in Chateaugay.

[4] Despite their stipulation in paragraph 5(c), the Debtors have interposed a challenge to default interest owing as part of the JSN Claims. The Court has deferred resolution of that issue to Phase 2.

1. **In re Chateaugay Supports Allowing The JSN Claims in Full**

Section 502(b)(2) of the Bankruptcy Code provides that a creditor's claim should be allowed in full, except to the extent that "such claim is for unmatured interest." 11 U.S.C. § 502(b)(2). Neither the Bankruptcy Code nor the relevant legislative history defines the term "unmatured interest." In Chateaugay, the Second Circuit expressly held that "face value" debt exchanges do not generate OID that is disallowable as unmatured interest for purposes of section 502(b)(2). LTV Corp. v. Valley Fid. Bank & Trust Co. (In re Chateaugay Corp.), 961 F.2d 378, 383 (2d Cir. 1992). As the Second Circuit explained, "application . . . of OID to exchange offers . . . does not make sense if one takes into account the strong bankruptcy policy in favor of the speedy, inexpensive, negotiated resolution of disputes, that is an out-of-court or common law composition." Id. at 382; accord Texas Commerce Bank, N.A. v. Licht (In re Pengo Indus., Inc., 962 F.2d 543, 549 (5th Cir. 1992) (if OID is disallowed as unmatured interest, "creditors will be disinclined to cooperate in a consensual workout that might otherwise have rescued a borrower from the precipice of bankruptcy"). The Second Circuit explained further:

> If unamortized OID is unallowable in bankruptcy, and if exchanging debt increases the amount of OID, then creditors will be disinclined to cooperate in a consensual workout that might otherwise have rescued a borrower from the precipice of bankruptcy. We must consider the ramifications of a rule that places a creditor in the position of choosing whether to cooperate with a struggling debtor, when such cooperation might make *the creditor's claims* in the event of bankruptcy smaller than they would have been had the creditor refused to cooperate. The bankruptcy court's ruling places creditors in just such a position, and unreversed would likely result in fewer out-of-court debt exchanges and more Chapter 11 filings.

Id. (emphasis added). Thus, the Second Circuit expressly held "that a face value exchange of debt obligations in a consensual workout does not, for purposes of section 502(b)(2), generate new OID." Chateaugay, 961 F.2d at 382.

Section 502(b)(2) was enacted in 1978. The legislative history provides no support for the application of the statute to any kind of debt-for-debt exchanges. It states that disallowed interest shall include "any portion of prepaid interest that represents an original discounting of the claim [but] would not have been earned on the date of bankruptcy," and gives but one example—an original cash issue bond sold at a discount to its face value. H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 352–54 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6308.

At the time that Congress passed section 502(b)(2), debt-for-debt exchanges did not create OID for tax purposes. See Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 101, 92 Stat. 2549 (1978). Thus, it is inconceivable that Congress had OID generated by distressed debt exchanges in mind when it enacted section 502(b). The Internal Revenue Code ("Tax Code") was first amended in 1990 to provide that both distressed face value exchanges and distressed fair value exchanges create taxable OID. See Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11325, 104 Stat. 1388–466 (1990). Since that time, both the Second and Fifth Circuits have found that face value exchanges do not create disallowable unmatured interest, notwithstanding that they may create OID under the Tax Code. See Chateaugay, 961 F.2d at 384; Pengo, 962 F.2d at 550.

Moreover, even though Congress has twice amended section 502(b) of the Bankruptcy Code following the Chateaugay and Pengo decisions and following the change in the tax laws discussed above, it did not make any effort to overrule the decisions or to provide that any type of debt exchanges create OID that should be disallowed as unmatured interest.[5] Any decision to disallow unmatured interest arising from a fair value exchange, or an exchange in which some

[5] See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 201, 119 Stat. 23, 42 (2005); Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 213, 108 Stat. 4106, 4125–26 (1994).

form of security is granted to the tendering noteholders, should come from Congress. Chateaugay, 961 F.2d at 383.

Additionally, consistent with the Second Circuit's holding in Chateaugay, the evidence presented at trial conclusively demonstrates that disallowing OID in fair value exchanges would have a serious chilling effect on out-of-court restructurings that could force companies like ResCap unnecessarily into bankruptcy. FoF §IV ¶¶ 49–52. In fact, the Defendants' expert witness testified that the uncertainty surrounding the decision in this case has already hamstrung potential out-of-court consensual exchanges. Id. at §IV ¶ 55. The Committee did not introduce any evidence to the contrary. Forcing more companies into bankruptcy would be directly contrary to the underlying policy rationale of Chateaugay, which was intended to encourage out-of-court restructurings. Chateaugay, 961 F.2d at 383.

In Chateaugay, the Second Circuit also reasoned that disallowing OID would provide a windfall to other creditors. See Chateaugay at 382 (disallowing OID in a debt exchange "grants a corresponding windfall both to holdouts who refuse to cooperate and to an issuer that files for bankruptcy subsequent to a debt exchange"). The court's reasoning is equally applicable to face and fair value exchanges. Here, the Old Notes tendered for JSNs were sold as par notes, and ResCap received par proceeds. FoF §IV ¶11. As Mr. Finnerty admitted when addressing the Defendants' demonstrative exhibits introduced at trial, if the JSN Claims are reduced in addition to the consensual 20% reduction to disallow alleged unaccreted OID, the result is a windfall for other creditors who will have a greater share of any distributable value. FoF §IV ¶ 53. Such a result would be inequitable and antithetical to the Bankruptcy Code's guiding principal of treating creditors fairly.

2. There Is No Meaningful Distinction Between Face Value And Fair Value Exchanges That Would Justify Finding OID In Fair Value Exchanges

Because the Second Circuit in Chateaugay was presented with a face value exchange, the court did not specifically address whether its decision would extend to a fair value exchange. The evidence presented at trial, however, conclusively demonstrates that the policy concerns forming the backbone of the Chateaugay ruling apply with equal—if not greater—force to fair value exchanges, in which bondholders allow distressed companies to reduce their obligations in an effort to avoid bankruptcy. FoF §IV ¶¶ 46–61. In fact, the Committee's own expert admitted at trial that distinguishing between face value and fair value exchanges is "somewhat arbitrary" and that the policy goals underlying the Chateaugay decision apply to both face value and fair value exchanges. Id. at §IV ¶¶ 40, 46.

The Committee did not provide a viable policy rationale for—or construction of—section 502(b)(2) of the Bankruptcy Code that would justify finding OID created in fair value exchanges but not in face value exchanges. The Committee's own expert did not even provide an opinion as to whether the JSN Claims included OID that is disallowable for bankruptcy purposes. Rather, he narrowly opined that the Exchange created OID as "a matter of economics," a proposition that has been explicitly rejected by the Second Circuit in the case of face value exchanges. FoF §IV ¶ 57; see Chateaugay, 961 F.2d at 382. Moreover, when the Committee's expert tried to distinguish the ResCap Exchange from the Chateaugay exchange, he did not identify the fair value component of the ResCap Exchange as a material distinction between the two exchanges. Id. at §IV ¶ 42.

The Committee seeks to build its case on the vague Chateaugay dicta about what "might make sense" in a fair value exchange, while ignoring the clear and concise rationale for the

court's actual ruling. But "[w]hen an opinion issues for the Court, it is not only the result but also those portions of the opinion necessary to that result by which we are bound." Seminole Tribe v. Florida, 517 U.S. 44, 67 (1996). As Judge Rakoff aptly stated while rejecting an argument based on the dicta in Stern v. Marshall about how "limited" and "narrow" the ruling was, "[w]here the Supreme Court's dicta arguably conflicts with the logic of its holding, lower courts are bound to follow its logic." Sec. Investor Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC, 490 B.R. 46, 51 n.2 (S.D.N.Y. 2013); accord Kirschner v. Agoglia, 476 B.R. 75, 81 (S.D.N.Y. 2012) ("[C]autionary dicta and past practice do not overcome the logic of the Supreme Court's holding in Stern.").

The same holds true here; the rationale of Chateaugay clearly trumps the vague dicta respecting a fair value exchange. The Chateaugay dicta respecting what "might make sense in the context of a fair market value exchange" is rendered even more indecipherable given the Second Circuit's earlier comment that in a fair value exchange the principal amount of the new note is reduced all the way down to "the market value at which the existing instrument is trading." 961 F.2d at 381–382. In such a transaction, no OID of any kind could arise because the principal amount and issue price of the new note would match.

In any event, as the Defendants proved at trial, there is no commercial or business justification, or valid theory of corporate finance, to justify treating claims generated by face value and fair value exchanges differently in bankruptcy. FoF §IV ¶ 39. First, the market value of the old debt is likely depressed in both a fair value and face value exchange. Id. at §IV ¶ 39. Second, OID is created for tax purposes in both fair value and face value exchanges. Third, there are concessions and incentives in both fair value and face value exchanges. Id. at §IV ¶ 39. In addition, both fair and face value exchanges offer companies the opportunity to restructure out-

of-court, avoiding the time and costs—both direct and indirect—of a bankruptcy proceeding. Id. at §IV ¶ 48.

Moreover, nearly all of the features that companies consider in connection with a debt exchange can be used in both face value and fair value exchanges: (1) granting of security in the issuer's collateral; (2) interest rate; (3) maturity date; (4) payment priorities; (5) affiliate guarantees; (6) other lending covenants; (7) redemption features; (8) adding or removing a sinking fund or conversion feature; and (9) offering stock with the new debt. Id. at §IV ¶ 44.

In fact, other than changing the face value of the bond (which by definition is not possible in face value exchanges), an issuer could theoretically adjust every other factor available to it, including providing the exchanging noteholders with security, regardless of whether the exchange was fair or face value. Id. at §IV ¶ 44.

3. A Rule Creating OID In Fair Value Exchanges Would Likely Have Doomed The Exchange And Forced ResCap Into Bankruptcy

The ResCap Exchange is a shining example of the Second Circuit's salient policy objectives in Chateaugay—of encouraging consensual out-of-court restructurings and preventing or delaying companies from filing for bankruptcy. In ResCap's case, the evidence conclusively demonstrated that the Exchange, which reduced the outstanding face amount of ResCap's debt by $2 billion and reduced its current interest expense, was a primary factor in allowing ResCap to avoid bankruptcy in 2008. FoF §IV ¶¶ 8–17. The evidence also shows that ResCap's assets experienced a dramatic increase in value after the Exchange, thus creating value for all stakeholders. Id. at §IV ¶ 16. For example, in 2010 and 2011, approximately $1.6 billion was paid to the SUNs that declined to participate in the Exchange upon their maturity, which payment was facilitated by the concessions made by the JSNs. Id. at §IV ¶ 82. But the

Exchange may never have been successful if the exchanging noteholders knew—or feared—that their claim in the event of a bankruptcy might be reduced by OID. Id. at §IV ¶¶ 49–52.

As the Second Circuit noted in Chateaugay and the Fifth Circuit noted in Pengo, creditors are justifiably concerned about the amount of their claim in the event of a future bankruptcy. See Chateaugay, 961 F.2d at 382; Pengo, 962 F.2d at 544. Here, only approximately 63% of the holders of the Old Notes tendered their notes in the Exchange, despite the inducements provided by ResCap to encourage participation and the threat that the Old Notes would be structurally subordinated. The undisputed evidence showed that 63% is a low level of participation in exchange offers by historical standards. FoF §IV ¶¶ 18–23. That the low level of participation was likely caused by, among other things, the fact that market participants did not ascribe substantial value to the collateral package securing the JSNs.

The evidence introduced at trial also showed that no holder of the Old Notes was warned, or reasonably would have considered, that their claims would potentially be further reduced by unamortized OID in the event of a bankruptcy. FoF §IV ¶¶ 29–38. Given the already relatively low rate of participation in the Exchange, it must be concluded that if the holders of the Old Notes had known or feared that their claims in the event of a bankruptcy would be reduced as a result of disallowable OID, participation would have declined considerably and the Exchange likely would have been doomed, forcing ResCap into bankruptcy. FoF §IV ¶¶ 49–52.

Chateaugay definitively establishes that the possibility that a lender's claim in bankruptcy will be reduced as a result of purported OID would be a significant disincentive to creditors being asked to participate in debt exchanges and would thus discourage out-of-court restructurings. See Chateaugay, 961 F.2d at 382. The Committee's own expert admitted that ResCap's creditors would be very focused on the size of their claim in the event of a bankruptcy,

and that "having a smaller claim in bankruptcy would be less of an incentive to participate" in the Exchange. FoF §IV ¶ 50.

If a fair value exchange creates OID that is disallowed as unmatured interest, bondholders evaluating whether or not to participate in an out-of-court restructuring—such as the holders of ResCap's Old Notes—would be faced with the undesirable prospect of a lower and likely unknown claim in bankruptcy as a result of electing to participate—thereby causing bondholders to either reject fair value exchanges or demand more value and inducements, such as additional bonds, from distressed companies in exchange for their participation. FoF §IV ¶¶ 49–52. Companies making exchange offers often have nothing more to give, and thus will often be precluded from completing an exchange that could reduce their debt levels and prevent bankruptcy. See Chateaugay, 961 F.2d at 382-3.

4. The Record Unequivocally Establishes That a Debt Exchange is Different from a Cash Issue Discount Bond, and As Such Does Not Create Unmatured Interest for Purposes of Section 502(b)(2)

The Committee's contention that debt-for-debt exchanges are no different than original cash issue discount bonds is thoroughly unsupported by the evidence. Disallowable OID is created for bankruptcy purposes when a company issues new debt in an original issuance for less than the debt's face value. FoF §IV ¶ 62. In fact, this is exactly the example provided by Congress when explaining how "an original discounting of the claim" results in unmatured interest. (H.R. Rep. No. 595, 95th Cong., 1st Sess. at 352-353 (1977), reprinted in 1978 U.S.C.C.A.N. 5787, 5963, 6308-09.) But distressed debt exchanges, including (and especially) fair market value exchanges, do not represent an "original discounting of the claim." Rather, fair market value exchanges involve, among other things, the forgiveness of debt and a reduction in the borrower's interest expense to help facilitate a struggling company's ability to survive

without seeking bankruptcy protection. Thus, viewed from the perspective of a creditor's rights in bankruptcy, fair market value exchanges are the exact opposite of a "discount"—they are the creditor's agreement to forego a larger claim in exchange for a smaller one, for the benefit of the company.

Additionally, both experts agreed at trial that new debt issuances are fundamentally different from debt exchanges. FoF §IV ¶¶ 62–67. Most importantly, debt exchanges involve the provision by existing noteholders to issuers of real economic value over and above the market value of the new notes, consisting of the difference between the amount that the issuer would have been obligated to pay if the noteholder had refused to reduce the amount of its debt and the new, reduced liability, along with an extended runway to improve asset values. Id. at §IV ¶ 67.

This difference is reflected in the way in which issuers account for true original issue discount bonds and bonds created by an exchange. Here, ResCap carried the JSNs at their full principal amount of the notes, plus an additional amount representing the concession granted by the tendering noteholders in forgiving a portion of their outstanding debt. Conversely, where a bond is issued for less than its face value, the issuer books liability as the amount of cash actually received, and then increases the liability as the OID accretes—the exact opposite of the accounting method applied by ResCap with respect to the New Notes. Id. at §IV ¶ 64.

Cash issue bonds are also the polar opposite of debt exchanges in terms of a creditor's ability to predict accurately the amount of potential OID. A bondholder participating in a cash issue knows exactly how much OID (if any) will be generated by the issuance, and the schedule on which such OID will accrete, because the issue price is definitively known at the time of the investment. FoF §IV ¶ 66. This is the precise example provided in the legislative history to

section 502(b)(2). (H.R. Rep. No. 595, 95th Cong., 1st Sess. at 352-353 (1977), *reprinted* in 1978 U.S.C.C.A.N. 5787, 5963, 6308-09.) In a fair value debt exchange, however, no issue price (other than the principal amount of the debt) is disclosed, and creditors cannot predict with certainty the amount of purported OID that could be generated. The market value of the notes being exchanged could fluctuate considerably between the time the bondholder decides to tender in the exchange and the time the exchange closes, especially if the risk of OID is injected into the equation. FoF §IV ¶ 75–76.

The foregoing record evidence, largely agreed upon by the experts for both sides, provides a critical interpretive distinction for Section 502(b)(2): debt exchanges are demonstrably different from, and involve a panoply of benefits and consideration not present in a simple cash sale of new bonds at discount. There simply is no basis to interpret the phrase "unmatured interest" as reaching bonds issued in a debt for debt exchange. Indeed, Chateaugay itself has spoken decisively: while the Court first ruled that OID arising in an original cash issue bond does constitute interest within the scope of Section 502(b)(2), it also ruled that a face value debt exchange in the context of a consensual workout creates no OID, and thus no unmatured interest. See Chateaugay, 961 F.2d at 382.

5. The Committee's Arguments Are Seriously Flawed

The Committee attempts to distinguish Chateaugay on the ground that noteholders who tendered their notes into the ResCap Exchange received a third lien collateral position, whereas the noteholders who tendered in Chateaugay obtained an increased coupon and earlier maturity date but no collateral. The grant of security, however, is but one of many incentives that can be utilized in a consensual workout. There is no language in the Chateaugay decision stating or even suggesting that the Second Circuit's holding, premised on its refusal to adopt a rule that

would deter cooperation with a struggling debtor, was in any way limited to the specific inducements utilized in that exchange, or intended to exclude exchanges where other inducements were offered. Rather, the rationale for the Court's holding in Chateaugay undeniably paints with broad strokes designed to foster and protect consensual workouts generally. See Chateaugay, 961 F.2d at 383. Indeed, both experts testified at trial that since Chateaugay there would be no disallowable OID if the JSNs were issued at $1,000 face value, *even though the JSNs were secured while the Old Notes were unsecured*. FoF §IV ¶ 43.

The Committee also contends that a different result than that reached in Chateaugay is warranted here because the "incentives are completely reversed." (Trial Tr. 73:1–18, Oct. 15, 2013 (Opening Statement of Committee.) As the Committee explains it, in Chateaugay, the tendering noteholders would have done better than the non-tendering noteholders if the company had been able to avoid bankruptcy until the notes matured, but would have done worse if the company filed prior to that time. Id. Conversely, here, the tendering noteholders would have done better than non-tendering noteholders if ResCap had filed for a near-term bankruptcy, but would have fared worse if ResCap had avoided bankruptcy long enough for the Old Notes to mature (which is in fact what happened). Id.

This ***cannot*** be the distinction between whether a note exchange does or does not result in disallowable unmatured interest. As Chateaugay explains, the whole purpose of a distressed note exchange is to enable a company to avoid bankruptcy and to align the interests of the company and its creditors in achieving that goal. Chateaugay, 961 F.2d at 381. Chateaugay says nothing that would support an interpretation of section 502(b)(2) that turns on whether the exchangers will or won't do better in a near term bankruptcy.

Additionally, the Committee confuses incentives to tender with actual outcomes known with the benefit of hindsight. As both experts agreed, when deciding whether to tender into an exchange, bondholders do not face a binary choice of immediate bankruptcy or no bankruptcy ever; rather in each case there will be a broad range of recovery scenarios associated with holding out or tendering in terms of timing, pre-bankruptcy cash flows and distributable value. FoF §IV ¶¶ 71, 75. The ipse dixit assertion that the imposition of "OID" in an exchange, in which a noteholder may be better off in a near term bankruptcy than a non-tendering noteholder, will not deter participation in an exchange designed to avoid bankruptcy is thus unsupported and illogical. And the determination of whether a given exchange results in notes with OID disallowable in bankruptcy certainly cannot be made on an ad hoc, case-by-case basis. See Section A.7, below.

To the extent the Committee's "reverse incentive" argument is based on Finnerty Appendix 10, it is deeply flawed. Finnerty Appendix 10 purports to model only the consequences of an immediate ResCap bankruptcy following the Exchange and omits obvious sources of distributable value that would have affected the relative recoveries of the JSNs and the Hold Outs. FoF §IV ¶¶ 70–71. It also assumes—counterfactually—that the pre-Exchange noteholders would have been able to accurately predict the amount of OID embedded in the JSNs when deciding whether to tender, and that such noteholders believed that the third lien collateral position being offered to the then JSNs had material realizable value. In fact, however, as was shown, the pre-Exchange Noteholders could not predict with any certainty the price at which the JSNs would trade following the Exchange (which would determine the amount of any

purported OID), and the market placed little, if any, value on the collateral being offered to the JSNs. FoF §IV ¶¶ 26, 75.[6]

Finally, the Committee also incorrectly argues that this Court should disallow unaccreted OID from the JSN Claims because the JSNs will still do better in this bankruptcy than the Hold Outs who chose not to cooperate in the Exchange. As a factual matter, the Committee is incorrect that the JSNs will receive a higher recovery than the Hold Outs. The evidence demonstrated that since the Exchange, the Hold Outs as a group, including the Hold Outs that were paid out at par in 2010 and 2011, received a greater average weighted recovery than the JSNs' projected recoveries under the Plan. FoF §IV ¶¶ 82–83. The Committee does not dispute that the Hold Outs are collectively projected to receive a weighted average recovery of 64.5% of par, while the weighted average recovery for the JSNs, assuming that none of their claim is reduced by OID, will be 58% of par of the Old Notes. FoF §IV ¶ 84. The weighted average recovery for the JSNs assuming OID would only be 50% of par of the Old Notes.[7] Id. The Committee's tired refrain that the JSNs will do better than the SUNs in this bankruptcy, even if

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[6] Finnerty's expert opinions have been criticized by two Judges in this district. In Allard v Arthur Andersen & Co., Judge Mukasey described Finnerty's analysis of certain issues as "deeply flawed," and stated that Finnerty "seemed to perceive only what he thought supported the position he was advocating and nothing else." 957 F. Supp. 2d 409, 418 (S.D.N.Y. 1997). This observation applies equally to Finnerty Appendix 10 and Finnerty's testimony derived therefrom. See also In re AIG Sec. Lit., 265 F.R.D. 157, 176–78 (S.D.N.Y. 2010), vacated on other grounds, 689 F.3d 229 (2d Cir. 2012) (rejecting Finnerty's opinion that certain AIG bonds traded in an efficient market, and noting Finnerty's troubling failure to explain certain discrepancies in the data he utilized.).

[7] The Committee's expert inappropriately used the Yield to Maturity ("YTM") from the exchange date to measure investor return in the Exchange. Estimating YTM as of the exchange date is not an accurate measure of return for original investors in the JSNs. Certain tendering investors did not purchase the JSNs at the market price of the tendered notes at the time of the exchange. The holders of the JSNs were continuing their investment in ResCap's bonds and they did not invest new money at the time of the exchange. Additionally, distressed bonds often trade not based on YTM but on "yield to recovery," and an investor makes a tender decision based on the pre-petition cash flows of the bond (interest and amortization) and not just bankruptcy recovery. Further, the YTM for a SUN exceeded the YTM of the JSNs because the SUNs did not decrease the principal amount of their debt. By Finnerty's logic, the more distressed a note is, the more attractive it is as an investment because YTM will be higher. FoF §IV ¶ 27.

OID is disallowed as unmatured interest, is a flawed and myopic approach to assess incentives at the time of the Exchange.

The Committee's proposed OID rule also would be completely at odds with the major precept that the Bankruptcy Code does not contemplate the valuation of liabilities in determining a creditor's claim. Marc S. Kirschner et al., Prepackaged Bankruptcy Plans: The Deleveraging Tool of the '90's in the Wake of OID and Tax Concerns, 21 SETON HALL L. REV. 643, 656–57. If an exchanging bondholder's claim in bankruptcy is to be determined based on the trading price of its debt, then exchanging bondholders will be the only creditors whose claim amount is determined based on the trading prices. FoF §IV ¶ 61.

6. This Court Should Not Apply OID Rules Found In The Tax Code And Accounting Rules To Bankruptcy Claims

The Committee urges this Court to apply OID rules found in the Tax Code. But as the Second Circuit recognized in Chateaugay, the motivations leading to the creation of OID as a result of an exchange under the accounting rules and Tax Code are different from the motivations and purposes of the Bankruptcy Code. As such, the tax and accounting treatment of an exchange should have no bearing in bankruptcy. "Congress designed the [Bankruptcy] Code, in large measure, to encourage workouts in the first instance, with refuge in bankruptcy as a last resort." Chateaugay, 961 F.2d at 382. Conversely, tax laws focus on establishing a consistent system of accounting for increases and decreases in taxpayers' wealth, in order to impose a tax on net increases. Marc S. Kirschner et al., Prepackaged Bankruptcy Plans: The Deleveraging Tool of the '90's in the Wake of OID and Tax Concerns, 21 SETON HALL L. REV. 643, 659. In furtherance of these objectives, the tax laws create a complex system respecting the "recognition" of income, in order to determine when taxes must be paid. Id. Congress designed

the tax rules respecting OID in a debt-for-debt exchange as part of this dynamic, in order to "eliminate the distortions caused by the mismatching of income and deductions by lenders and borrowers . . . ." See Staff of Joint Comm. on Taxation, 98th Cong., General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984, JCS 41–84 at 110 (Joint Comm. Print 1984). It does not follow in the least that there should also be a corresponding effect on an exchanging creditor's bankruptcy claim.

The absurdity of the Committee's position is revealed by the following example. Assume an exchange identical to the ResCap Exchange (including the first trades after the Exchange averaging around 49 cents), except that the face amount of the Junior Secured Notes remained at $1,000 instead of being reduced to $800. Under the Tax Code, there would be even more OID, although the Committee concedes that, pursuant to Chateauga*y*, there would be no OID at all for bankruptcy purposes. It is incomprehensible that the result should change simply because the creditors agreed to reduce the amount of the obligation owed to them.

Moreover, the Defendants' expert witness explained that if an exchange offer creates disallowable OID, the valuation placed on the new debt (and its trading price) will be driven by the assumed amount of OID created, which is itself determined from the new debt's trading price. The circular nature of this argument, taken to its extreme, would force the fair market value of the new debt well below the economic value that debt-holders had bargained for in the exchange offer. FoF §IV ¶ 76. As a result, the borrower would need to issue more debt, a higher interest rate or some other additional incentive to entice holders to exchange in order to compensate for having a reduced claim in bankruptcy. That would require the borrower to decrease the discount that it offers, pushing the exchange closer and closer to a face value exchange in which there would be no OID.

Acceptance of the Committee's proposed OID rule also would have two negative impacts: First, it would be nearly impossible for the most severely distressed companies (who are in most need of deleveraging) to engage in fair value exchanges. For example, if debt is trading at severely distressed levels, such as five cents, no noteholder is going to give up its claim in bankruptcy on the face amount of its existing note for the risk of being left with a significantly lower claim in a near-term bankruptcy as a result of OID. Second, the Defendants provided uncontested evidence at trial that restructured bank debt that trades at a discount as well as debt issued pursuant to a Plan of Reorganization that trades at a discount would have OID, which would further impede successful reorganizations. FoF §IV ¶ 54. Such a rule would burden companies with higher debt levels and interest expense, leading to more bankruptcies.

7. The Committee's Proposed OID Rule Would Lead to Increased Litigation and Delays in Bankruptcy Proceedings

As the U.S. Supreme Court has explained, "[b]right line rules upon which the parties' expectations may be firmly established are preferable to the protracted litigation that [a less objective approach] would engender." Bowsher v. Merck & Co., Inc., 460 U.S. 824, 841 n. 18, (1983); see also Quill Corp. v. N.D., 504 U.S. 298, 316 (1992) (explaining that a bright line rule "encourages settled expectations" and "fosters investment by businesses and individuals"). The drafters of the Bankruptcy Code could not have intended that the application of section 502(b)(2) turn on a highly subjective analysis of whether noteholders received sufficient inducements in a given exchange to tender despite a reduction in their claim for OID. See Landreth Timber Co. v. Landreth, 471 U.S. 681, 696–97 (1985) (rejecting proposed interpretation of statute that "would lead to difficult questions of line drawing"). In fact, in Pengo, the Fifth Circuit expressly recognized that "creditors of financially troubled companies are eager for the courts to provide

them with guidance as to the post-bankruptcy ramifications of their workout decisions." Pengo, 962 F. 2d at 548.

Here, a bright line rule is necessary so that creditors can predict their recovery at the time of an exchange if their borrower falls into bankruptcy. See Ralph K. Winter, Paying Lawyers, Empowering Prosecutors, and Protecting Managers: Raising the Cost of Capital in America, 42 DUKE L.J. 945, 962 (1993) (describing the need to craft legal rules with bright lines as a means of reducing the cost of capital; observing that uncertainty deter[s] beneficial conduct and breed[s] costly litigation), cited with approval in Central Bank v. First Interstate Bank, 511 U.S. 164, 189 (1994). But, instead of a bright line rule, the Committee's proposed OID rule adopts a case-by-case analysis that will almost certainly lead to uncertainty in commercial transactions and increased and protracted litigation and delays in bankruptcy proceedings as creditors fight over whether a bond exchange did or did not create OID for bankruptcy purposes. FoF §IV ¶¶ 68–76; Landreth, 471 U.S. at 696–97 (1985) (finding it "daunting" that "parties to a transaction may never know" how a law applies to them "until they engage in extended discovery and litigation); Cf. In re GMC, 407 B.R. 463, 504 (Bankr. S.D.N.Y. 2009), aff'd sub. nom. Campbell v. Motors Liquidation Co. (In re Motors Liquidation), 428 B.R. 43 (S.D.N.Y. 2010). (adherence to *stare decisis* especially important in commercial bankruptcy cases so parties can engage in pre-bankruptcy planning an deal with foreseeable outcomes).[8]

[8] The relief sought by the Committee is also fundamentally unfair, given that the evidence conclusively demonstrates that the holders of the Old Notes were not given any notice that their claims in bankruptcy might be reduced by OID. Moreover, since Chateaugay, the market has assumed that OID generated by debt exchanges would not be disallowed in bankruptcy as unmatured interest. FoF §IV ¶ 37. The Defendants presented persuasive testimony from their expert witness that, since Chateaugay was decided, there has not been one bankruptcy case where claims of the exchanging noteholders were reduced for OID. Similarly, Plaintiffs failed to identify any debt exchange since Chateaugay where OID was disallowed as unmatured interest. Conversely, the SUNs (including

8. Assuming, Arguendo, the Court Disallows a Portion of the JSN Claim as Alleged Unmatured Interest, Such Interest Has Continued to Accrete Since the Petition Date

Assuming, *arguendo*, that a portion of the JSNs' claim is disallowed, OID should be determined based on the use of a semi-annual amortization schedule. FoF §IV ¶¶ 85–86. Further, in the event that the JSNs are oversecured, they are entitled to any accretion of interest that has occurred since the Petition Date. Since the Petition Date, and through December 15, 2013, at least an additional $252 million has accreted and must be paid to the JSNs. FoF §IV ¶ 85. Any such unmatured interest must continue to accrete in full through final payment of the JSN claims.

Pursuant to court orders [Dkt. Nos. 3967, 4404], on June 13, 2013 and July 29, 2013, the Debtors satisfied a portion of the principal amount and accrued prepetition interest of the JSN Claims in the amounts of $800 million and $300 million, respectively (the "Paydowns"). The Paydowns should not affect accretion of OID. Alternatively, if the Court determines that the Paydowns do reduce the continued post-petition accretion of alleged OID, the Paydowns should be allocated first to pre and post-petition interest and then to prinicpal.

B. For The Purposes Of Section 506 Of The Bankruptcy Code, The JSN Claims Should Be Treated As Aggregate Claims Against All Debtor Obligors And Should Not Be Evaluated On A Debtor-By-Debtor Basis

The parties have previously submitted briefs and presented oral argument to the Court with respect to the Debtors' contention that the JSNs must be oversecured at a single Debtor in

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those that have matured) had the opportunity to participate in the Exchange, but chose not to, in full awareness of the risks of differential treatment in a ResCap bankruptcy. FoF §IV ¶ 28.

order to be entitled to post-petition interest;[9] Defendants incorporate here by reference their previous arguments on this issue, and add only the following.[10]

Outside of bankruptcy, the terms of the JSN Indenture and applicable state law would permit the JSNs to levy against the assets of any and all of the Obligors and Guarantors to secure their rights to collect principal and interest. See FoF §IV ¶ 296. Additionally, both the JSN Global Note and the JSN Indenture provide that the JSNs are entitled to collect post-petition interest in the event of bankruptcy. FoF §IV ¶ 297. Unless the Bankruptcy Code explicitly commands a different result, the rights of a creditor under state law should not be disturbed. See Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co., 549 U.S. 443, 452 (2007) ("[W]e generally presume that claims enforceable under applicable state law will be allowed in bankruptcy unless they are expressly disallowed"); see also AmeriCredit Fin. Servs., Inc. v. Tompkins, 604 F.3d 753, 757 (2d Cir. 2010); Ogle v. Fid. & Deposit Co. of Md., 586 F.3d 143 (2d Cir. 2009). Thus, where, as here, the JSNs' state-law and contractual rights permit them to collect post-petition interest from the aggregate value of all collateral held by the Debtors, the Bankruptcy Code does not demand, and the Court should not order, a different result.

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[9] The Court previously ruled that it would defer decision on Plaintiffs' claims for a declaration that the JSNs must be oversecured at a single Debtor to obtain post-petition interest. FoF §IV ¶ 298. The record has now been more fully developed, and shows that the aggregate value of the Notes Collateral exceeds the amount of the JSN Claim.

[10] See Def. Mot. to Dismiss Debtors' First Am. Compl., Jul. 16, 2013, Debtor Adv. Dkt. No. 21-1 at 6–11; Def. Reply Mot. to Dismiss Debtors' First Am. Compl., Aug. 13, 2013, Debtor Adv. Dkt. No. 39 at 1–4; Oral Arg. on Defendants' Partial Mot. to Dismiss Debtors' First Am. Compl., Aug. 28, 2013, Debtor Adv. Dkt. No. 95 at 58:5–79:18, 109:8–113:3; Joint Pretrial Order (Proposed), Oct. 9, 2013, Debtor Adv. Dkt. No. 86 at 98 ¶¶ 111–134

II.

AS OF THE EFFECTIVE DATE OF THE PLAN THE JSN CLAIMS WILL BE SECURED BY COLLATERAL OF A VALUE IN EXCESS OF THE AMOUNT OF THE CLAIMS AND THUS INCLUDE CLAIMS FOR POSTPETITION INTEREST

Once the proper allowed amount of the JSN Claims has been established by the Court, the next steps in the section 506 analysis are to establish (i) the amount of that claim which is secured and (ii) the "extent that the allowed secured claim is secured by property the value of which . . . is greater than the amount of such claim." (See infra at Section II(A)(2).) The process of determining the extent of the JSN Liens on JSN Collateral brings into play two significant disputes between the parties: (1) what actually constitutes JSN Collateral?, and (2) how should the Court address the fact that a significant portion of the JSN Collateral has been sold and used during the pendency of these Cases? With respect to the first issue, certain of the disputes over collateral identification have either been resolved by the Court during motion practice, such as the JSN Claims relating to Collateral released from the "Blanket" and "Revolver" silos, or, in the case of Intercompany Claims and the Ally Contribution, have been deferred to Phase 2. Disputes do remain, however, as to (i) the extent of the JSNs' Liens on proceeds of the Auction Sales, (ii) whether cash and other assets in the "Ally LOC silo" constitute JSN Collateral, and (iii) the value of unsold assets for section 506(b) purposes, all of which are addressed below. (See infra at Sections II(B), (C), and (D).)

The second issue—concerning the Debtors' post-petition conversion of financial and intangible assets into cash collateral that was then consumed prior to the initiation of this proceeding—occupied the substantial portion of the parties' trial presentations. As set forth herein, the trial evidence amply demonstrated that the net fair market value of the JSN Collateral

at the Petition Date, including sold and unsold assets, was $2.79 billion. (FoF § III ¶ 234.) On the Effective Date, because of the incurrence of interest claims, the JSNs' total Claims will be not less than $2.56 billion, before indemnification claims and reimbursement of fees and expenses, but still $200 million less than the Petition Date Collateral value. (FoF § II ¶ 253.) According to the Plaintiffs, however, the JSN Claims are not oversecured because the value of the JSN Collateral is now only approximately $1.88 billion.[11] That math leaves a reduction in security of nearly $1 billion from the proper Petition Date value. (A table appended hereto as Exhibit A shows a comparison of the fair market value of the JSN Collateral as it existed on the Petition Date and the fair market value of the JSN Collateral remaining after the Asset Sales and the Debtors' consumption of Cash Collateral.)

Clearly, there are disputes about a concluded Petition Date collateral value of $2.8 billion, all of which are addressed herein. But there is no dispute that, for purposes of calculating the amount of a secured claim and the extent of over-security of a secured claim under section 506(b), the valuation needs to be run on a fair market value basis in the hands of the Debtors. (FoF § III ¶ 2.) That valuation, under any reasonable adjustment that one might conceivably want to undertake, establishes that the JSNs were secured creditors on the Petition Date, that the JSN Claims were, in fact, oversecured on that date and that, by virtue of the Debtors' consumption of cash and their overly narrow views on the extent of the JSN Collateral, the JSNs are now significantly worse off than they were on the Petition Date. The question is how to fix that inequity and give the JSNs the benefit of their bargain.

[11] This estimate of the JSNs' secured recovery is net of approximately $665 million of costs allocated to the JSN Collateral from the Petition Date through April 30, 2013 and $27 million of costs allocated since April 30, 2013, but excludes an estimated $153 million of additional costs that the Plaintiffs propose deducting from the JSN Collateral in connection with the adversary proceedings. (FoF § II ¶ 175.)

As set forth herein, the JSNs will only receive their rightful recoveries through the following forms of relief: an award of adequate protection (addressed in subsection A, infra), a proper allocation of proceeds from the Auction Sales (addressed in subsection B), a fair valuation of remaining unsold assets (addressed in subsection C), the recognition of a lien on all or a portion of the Ally LOC Collateral (addressed in subsection D), and a finding that the remaining JSN Collateral is not subject to further charges or avoidance claims (addressed in subsection E).

A. The Code And The Cash Collateral Order Entitle The JSNs To Adequate Protection Claims And Liens In The Amount Of Approximately $676 Million

Based on the trial presentations, the single greatest disagreement in Phase 1 is the extent to which the JSNs are entitled to adequate protection, and more particularly, the benchmark from which the Court is to determine any diminution in value. Defendants have, from the moment this issue arose, consistently maintained that "value" under the Cash Collateral Order and section 361 is the same "value" protected under sections 506(a) and (b). That is, in fact, exactly what the Supreme Court has held in U.S. Savings Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365 (1988) and Assocs. Commercial Corp. v. Rash, 520 U.S. 953 (1997) (Ginsburg, J.), discussed herein. Plaintiffs' positions on the matter have constantly shifted in these Cases, and their present articulation—that an oversecured creditor is only entitled to adequate protection for damages related to the imposition of the automatic stay—is based on a dangerous confusion of what adequate protection is and why the Bankruptcy Code requires it.

1. The Plaintiffs Are Simply Wrong In Contending That Adequate Protection Only Applies To Remedy The Automatic Stay

As a matter of simple statutory construction, section 361 of the Code provides three scenarios in which adequate protection is required: (1) "to the extent that the stay under section

362 of this title . . . results in a decrease in the value of [an] entity's interest in [its] property," (2) "to the extent that . . . [the] use, sale or lease under section 363 of this title . . . results in a decrease in the value of [an] entity's interest in [its] property," and (3) "to the extent that . . . any grant of a lien under section 364 of this title results in a decrease in the value of [an] entity's interest in [its] property." See 11 U.S.C. § 361(1). Thus, when subsection (2) speaks to replacement liens "to the extent that such stay, use, sale, lease, or grant results in a decrease in the value" of a security interest, replacement liens need to cover three scenarios—(1) where the imposition of the stay under section 362 causes a decrease in value of collateral, (2) where the use, sale or lease of collateral under section 363 causes a decrease in value, and (3) where the priming of interests under section 364 causes a decrease in value of primed collateral.[12]

Whether by intent or lack of precision in their submissions, the Plaintiffs have sought to convince the Court that there is only ever one need for adequate protection—to compensate a secured creditor for the imposition of the stay and frustration of its state law collection rights. That simply is not true and calls for the Court to ignore the actual circumstances of the Debtors' use and sale of JSN Collateral in these Cases.

Contrary to Plaintiffs' mantra, and as set forth below, Courts routinely award adequate protection for the use of collateral as well as the sale of collateral independent of any compensation for the imposition of the automatic stay. As also set forth below, courts have now rejected the concept that "foreclosure value" is "adequate" under all circumstances and make

[12] Section 507(b), which operates as a failsafe for adequate protection similarly makes clear that there are three interests being protected. 11 U.S.C. § 507(b) ("[I]f, notwithstanding [adequate] protection, such creditor has a [507(a)(2)] claim arising from the stay of action against such property under section 362 of this title, from the use, sale or lease of such property under section 363 of this title, or from the granting of a lien under section 364(d) of this title, then such creditor's claim . . . .) (emphasis added).

clear that "value" under section 361 is to be determined just as it is under section 506, "in light of the purpose of the valuation and of the proposed disposition or use of such property." (See infra Section II(A)(4).)

Ultimately, protection only of "foreclosure value" in this case is absurd—the parties never came close to a foreclosure or forced turnover of JSN Collateral, much less "proposed" to dispose of any collateral by turnover. The record demonstrates that the parties negotiated a detailed set of agreements by which the Debtors would "continue operating in the ordinary course of business, including their loan servicing operations that are necessary to preserve the value of their servicing platform, for the ultimate benefit of their stakeholders pending the closing of the Asset Sales." (FoF § II ¶ 109.) To further that end, the Debtors were authorized to use more than $660 million of the JSNs' Cash Collateral, but importantly, subject to adequate protection. (FoF § II ¶ 57.) What the JSNs seek here is to have the Debtors live up to that bargain and provide the adequate protection ordered by this Court and mandated by the Code and Constitution for the actual use of their collateral.

2. The Cash Collateral Order Memorializes The JSNs' Constitutional And Statutory Right To Adequate Protection For The Debtors' Actual Use And Sale Of Collateral

This Court has previously held that the Cash Collateral Order should be the starting point for the determination of whether and to what extent the JSNs are entitled to adequate protection claims and liens. (FoF § I ¶ 27 ("[T]he Cash Collateral Order controls and limits how the Debtors may use the cash collateral and also provides the JSNs with agreed upon adequate protection[.]").) Specifically, it orders that the JSNs are entitled to "adequate protection of their interests in the Prepetition Collateral, including Cash Collateral, in an amount equal to the aggregate diminution in value of the Prepetition Collateral . . ." (FoF § II ¶ 141.)

Here, the plain meaning of the Cash Collateral Order is clear and in complete accordance with the Bankruptcy Code: to uphold the JSNs' constitutional right to compensation for the Debtors' actual use of the JSN Collateral, and not for the hypothetical recoveries the JSNs could have received had they instead sought to lift the automatic stay and foreclose on the JSN Collateral on the Petition Date.[13] (Id.) Even if the Cash Collateral Order were found to be ambiguous on the meaning of "value"—and neither side has contended that it is—there is absolutely no evidence in the record to support a claim that the JSNs bargained for less than what the Bankruptcy Code and U.S. Constitution require. In fact, the Cash Collateral Motion stated to the contrary: "Pursuant to sections 361 and 363(e) of the Bankruptcy Code, the Adequate Protection Parties are entitled to adequate protection of their interests in the Cash Collateral for, and equal in amount to, the aggregate diminution in the value of such parties' security interests in the Cash Collateral as a result of the Debtors' use, sale or lease of Cash Collateral." (FoF § II ¶ 108 (emphasis added).)

Further, the evidence at trial shows that the Cash Collateral Order was intended to be a "lender-friendly order with traditional protections." (FoF § I ¶¶ 71-72.) Mr. Siegert, the only witness to testify at trial for either side on this subject, recalled the prepetition transaction embodied in the Cash Collateral Order: "Neither the Debtors nor the JSNs contemplated an immediate sale or liquidation of collateral at the Petition Date. To the contrary, the JSNs and

[13] For the purposes of enforcement, a cash collateral order (a form of consent decree) is interpreted according to principles of contract law because it is embodies an agreement between the parties. See United States v. ITT Cont'l Baking Co., 420 U.S. 223, 238 (1975) ("[A consent] order is to be construed for enforcement purposes basically as a contract . . . ."). Bankruptcy courts thus interpret cash collateral orders according to the principles of contract law. See, e.g., Harvis Trien & Beck, P.C. v. Fed. Home Mortg. Corp. (In re Blackwood Assocs., L.P.), 187 B.R. 856, 860 (Bankr. E.D.N.Y. 1995).

[AFI] agreed to a cash collateral order that provided for the on-going operation of ResCap and an orderly, structured sale of the assets[.]" (FoF § II ¶ 130.)

Mr. Siegert's recollection comports with the uncontroverted documentary evidence from the Cash Collateral negotiations and the Debtors' motion seeking approval of the order, which demonstrate that the JSNs consented to the Debtors' use of the JSN Collateral for the purpose of bridging to a going concern sale in exchange for "customary" adequate protection. (FoF § I ¶ 81.) Similarly, Plaintiffs' trial witnesses admitted that the parties never contemplated the foreclosure or turnover of any of the JSN Collateral. All witnesses admitted that the parties intended to use the JSN Collateral to bridge to a going concern sale. (FoF § II ¶¶ 70, 149.) The evidence also showed that, in agreeing to the relief in the Cash Collateral Order, the JSNs never agreed to cede value to unsecured creditors. In fact, the Plaintiffs' theory of protecting JSNs' recoveries only to a floor of foreclosure value was not conceived until nearly a year after the Ad Hoc Group consented to the Cash Collateral Order and after the Debtors had already used the cash at issue. (FoF § II ¶ 194.)

Thus, while the Cash Collateral Order outlines forms of adequate protection, it only does so in the context of what the law provides. In that regard, there is only one case that either party has identified in which a bankruptcy court addressed diminution of collateral in the context of a consensual use of cash collateral that funded a going concern sale. See Salyer v. SK Foods, L.P. (In re SK Foods, L.P.), 487 B.R. 257, 261 (E.D. Cal. 2013). In that case, the bankruptcy court was asked to reject a Rule 9019 settlement that was premised on the secured creditor receiving contractual adequate protection measured against the going concern value of its collateral on the petition date. As found by the district court on appeal,

> the Bankruptcy Court did rely upon the "going-concern" valuation of Debtors' collateral that were "fixed assets." The Bankruptcy Court found that a going-concern sale of those assets: "is what was intended from the outset, it was the basis on which [creditor] had agreed to the debtor's use of cash collateral, and it is the scenario that actually resulted."

Id. The same conclusion can and should be reached here.

3. The Plaintiffs Bear The Burden Of Showing That The JSNs Have Been Adequately Protected

At trial, the Court raised the issue of which side bears the burden of proof on issues related to adequate protection. Under applicable law, a debtor has the burden of proof with respect to whether a secured creditor's interests are adequately protected, and the debtor must detail how such interests are protected. See 11 U.S.C. §§ 363(e), 363(p)(1) ("[T]he trustee has the burden of proof on the issue of adequate protection . . ."); see also In re Swedeland Dev. Grp., Inc., 16 F.3d 552, 564 (3d Cir. 1994). The creditor seeking adequate protection "need only establish the validity[, priority, or extent] of its interest in the collateral, while the Debtor bears the initial burden of proof as to the issue of adequate protection." See Wilmington Trust Co. v. AMR Corp. (In re AMR Corp.), 490 B.R. 470, 477-78 (S.D.N.Y. 2013) (internal quotation marks and citation omitted).

The Bankruptcy Code's imposition of the burden on debtors for the use or sale of a creditor's collateral comports with fundamental constitutional property rights. U.S. Const. amend. V ("No person shall . . . be deprived of . . . property, without due process of law"). See also Wright v. Union Cent. Life Ins. Co., 311 U.S. 273 (1940); S. Rep. No. 95-989 (1978) ("The concept [of adequate protection] is derived from the fifth amendment protection of property interests"); see also In re Carbone Cos., Inc., 395 B.R. 631, 636 (Bankr. N.D. Ohio 2008). Indeed, a debtor's attempt to use a lender's collateral can be held to a stricter standard than a

property taking under the Fifth Amendment. See In re Sheehan, 38 B.R. 859, 865 (Bankr. D. S.D. 1984) ("Whatever adequate protection is or must be, this Court is convinced that it compels a stricter standard than that imposed by the fifth amendment.").[14] Nothing in the Cash Collateral Order purports to shift this burden to the JSNs, and nothing in the record suggests that any party so intended.

In that regard, the Plaintiffs' burden is not abrogated or shifted merely because the JSNs have consented to the use of cash collateral.[15] See In re Erewhon, Inc., 21 B.R. 79, 84 (Bankr. D. Mass. 1982) (criticizing creditor's counsel fees, indicating that, after parties consented to the use of cash collateral, counsel ran up substantial legal fees researching section 363: "The code expressly forbids the use of cash collateral without providing adequate protection, so there really would have been nothing more for . . . any competent bankruptcy counsel to do but to file his simple objection and then sit back and wait and see . . . since the burden of providing adequate protection is substantially that of the Debtor."); Hamilton Bank v. Diaconx Corp. (In re Diaconx Corp.), 69 B.R. 333, 338 (Bankr. E.D. Pa. 1987) (noting that burden of proof on the issue of adequate protection fell upon debtor, even though the creditor had previously consented to the use of cash collateral). Indeed, the Debtors' cited authority in support of their motion for entry of the Cash Collateral Order was sections 361 and 363 of the Bankruptcy Code, both of which place the burden of adequate protection on a debtor seeking to use a creditor's collateral. Where,

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[14] By contrast, a secured creditor bears the burden of establishing a lack of adequate protection as provided under section 361 when the creditor seeks to foreclose on its collateral. See 11 U.S.C. § 362(g); In re Elmira Litho, Inc., 174 B.R. 892, 900–03 (Bankr. S.D.N.Y. 1994). Again, no such foreclosure rights were asserted in these Cases.

[15] This Court's opinion in In re Sneijder, is not to the contrary. 407 B.R. at 55. Sneijder involved the determination of a second lien lender's deficiency claim in a chapter 13 case after the debtor had abandoned the property to the first lien lender. Nothing in the Bankruptcy Code or case law suggests that the burden of proving adequate protection for the use or sale of property shifts when that valuation takes place within the section 506(a) context.

as here, the need to ensure the adequate protection of the secured creditor's interest in collateral arises not from the imposition of the automatic stay under section 362 but rather, as the Debtors pleaded in their cash collateral motion, "as a result of the Debtors' use, sale or lease of Cash Collateral" under section 363, the adequate protection burden belongs to and remains with the Debtors. (FoF § II ¶ 108.)

4. Fair Market Value In The Hands Of The Debtors Is The Appropriate Methodology When Valuing The JSN Collateral

Plaintiffs and Defendants are in substantial agreement that the phrase "aggregate diminution in value" within the meaning of the Cash Collateral Order is to be calculated, pursuant to section 506(a), as the "fair market value" of the JSN Collateral as of the Petition Date compared to the "fair market value" of the remaining JSN Collateral at the Effective Date. (FoF § III ¶ 2.) The parties dispute, however, the appropriate methodologies for determining fair market value at those two end posts. For their valuations, the Defendants' experts assessed the fair market value of the Collateral in the hands of the Debtors in accordance with the Debtors' proposed (and ultimately actual) use and sale of the JSN Collateral at both the Petition Date and the Effective Date. In performing these valuations, they used commonly applied valuation metrics grounded in fact and acknowledged valuation theory discussed below. The Plaintiffs' experts, on the other hand, used two divergent valuation methodologies. Mr. Puntus calculated Petition Date value measured in the hands of various collateral agents in a rapid foreclosure setting. Mr. Renzi then calculated the "recovery value" of the collateral in the hands of the Debtors as of the Effective Date. By comparing "apples to oranges," the Plaintiffs seek to create the illusion of an increase in JSN Collateral value that simply did not occur. Plaintiffs' dual valuation approach, beyond being unsupported in any fact or theory, is wrong as a matter of law.

Fundamentally, Plaintiffs' view of adequate protection methodology is premised on a flawed assumption that there is a creature known as a "section 361 methodology" that is distinct from a "section 506 methodology." No such distinction exists. The U.S. Supreme Court has expressly held that "the phrase 'value of such entity's interest'" in section 361(2) "means the same" as the phrase "value of such creditor's interest" in section 506(a)(1). Timbers, 484 U.S. at 372. When a secured creditor's collateral is proposed to be sold, and is actually sold during the chapter 11 case, the Court must adopt the realized sale value as the best evidence of such assets' fair market value for purposes of sections 506 and 361. See Rash, 520 U.S. at 962–63 (the "proposed disposition or use" language in section 506(a) requires a bankruptcy court to adopt a valuation methodology that reflects the actual use or disposition of those assets during the case). In Rash, a near-unanimous decision, Justice Ginsburg staked the Supreme Court's position on the plain language of section 506(a) in clear and unmistakable terms: "the 'proposed disposition or use' of the collateral is of paramount importance to the valuation question." Id. at 962. Although Rash concerned a chapter 13 case, its direction that bankruptcy courts interpret section 506(a) to require valuation of an asset in accordance with its disposition or use necessarily applies to any valuation under section 506(a). See In re SK Foods, 487 B.R. at 262 n.11 (rejecting an attempt "to distinguish Rash by arguing that it involved a 'cram-down' provision of the Bankruptcy Code" because "the reasoning and holding of Rash applies" to the adequate protection context).

Courts assessing the value of a secured creditor's collateral in the years since Rash have uniformly adopted the actual sale price of an asset as the best evidence of its value under section 506. See, e.g., Prudential Ins. Co. of Am. v. Boston (In re SW Boston Hotel Venture, LLC), 479 B.R. 210, 223 (B.A.P. 1st Cir. 2012) (determining that the sale was "the best evidence of the

value" of the collateral); In re Urban Communicators, PCS Ltd. P'ship, 379 B.R. 232, 241 (Bankr. S.D.N.Y. 2007), rev'd on other grounds, 394 B.R. 325 (S.D.N.Y. 2008) ("The 'disposition or use' of such property was (and with hindsight still is) the eventual sale of that property[.]"). As the court in SW Boston Hotel Venture held:

> This case is similar to Urban Communicators in that . . . an actual postpetition sale of a substantial portion of Prudential's collateral occurred in an arm's length transaction . . . . Under the rationale set forth in Urban Communicators, the Hotel Sale price is the best evidence of the value of the Hotel and establishes that Prudential was oversecured throughout these bankruptcy proceedings.

479 B.R. at 223. Indeed, Judge Gerber followed Rash's instruction when valuing assets sold pursuant to section 363, concluding that the "purpose of the valuation" clause in section 506(a) "brings little to the table" and "does not lead to a specific valuation methodology." In re Motors Liquidation Co., 482 B.R. 485, 490 (Bankr. S.D.N.Y. 2012) (Gerber, J.) (rejecting application of a hypothetical liquidation value, and noting that "because the [secured creditor] did not receive control of the [collateral], each side, understandably, recognizes that the fair market value would not be the value on liquidation.").

Even *Collier*, which the Plaintiffs cited in their Motion in Limine in support of their interpretation of section 506(a), recognizes that the realized sale value is the best evidence of value under section 506(a) for assets sold during a chapter 11 case, "regardless of the purpose" of the valuation:

> [b] Value of Property Disposed of by Sale. Before addressing the application of section 506 in contexts other than the one presented in Rash, it is important to point out that, regardless of the purpose of the valuation, if an actual sale (or equivalent disposition) is to occur, the value of the collateral should be based on the consideration to be received by the estate in connection with the sale, provided that the terms of the sale are fair and were arrived at on an arms-length basis.

4 *Collier on Bankruptcy*, ¶ 506.03[6][b], at 506-37 (16th ed.) (emphasis added); see also id. at ¶ 506.03[4][a], at 506-22 n.60 ("Of course, if the collateral is actually sold during the course of the bankruptcy proceedings or pursuant to a confirmed plan, the consideration received from the sale will almost always resolve the question of value."); id. at ¶ 506.03[4][a][i].

The exact same law and theory apply when a valuation is undertaken in the adequate protection context. Obviously, when a secured creditor seeks to lift the automatic stay and foreclose, foreclosure value might be an appropriate metric. But when a debtor actually uses assets as part of a going concern, it is completely inappropriate to peg value to foreclosure value in the hands of the creditor. See, e.g., Bank R.I. v. Pawtuxet Valley Prescription & Surgical Ctr., 386 B.R. 1, 4 (D.R.I. 2008); In re Savannah Gardens-Oaktree, 146 B.R. 306, 308–10 (Bankr. S.D. Ga. 1992) (construing section 506(a) prior to Rash in the adequate protection context and adopting going concern valuation for collateral to be retained and used); First Trust Union Bank v. Automatic Voting Mach. Corp. (In re Automatic Voting Machine Corp.), 26 B.R. 970, 972 (Bankr. W.D.N.Y. 1983) (for purposes of determining whether secured creditor was adequately protected, rejecting evidence of liquidation value and holding that going concern methodology is appropriate when collateral is to be retained and used); In re Deep River Warehouse, Inc., No. 04-52749, 2005 WL 1287987, at *7–8 (Bankr. M.D. N.C. Mar. 14, 2005) (unpublished) (construing section 506(a) in the adequate protection context, and finding secured creditor to be adequately protected based on real property's going concern value in light of debtor's proposal to retain property as a going concern); In re Davis, 215 B.R. 824, 825-26 (Bankr. N.D. Tex. 1997) (construing section 506(a) in the adequate protection context in light of Rash, and holding that secured creditor was adequately protected based on the car's fair market value as of the petition date when debtor intended to retain and use the collateral).

For example, in Pawtuxet, the District Court affirmed a bankruptcy court's adoption of going-concern value as the appropriate methodology for valuing assets for adequate protection purposes. The bankruptcy court concluded that the "proposed disposition or use" of the assets were of primary importance in an adequate protection valuation: "because the reorganizing debtor proposes to retain and use the collateral, it should not be valued as if it were being liquidated; rather courts should value the collateral 'in light of' the debtor's proposal to retain it and ascribe to it its going concern or fair market value…." Id. at 4 (quotation omitted). Because the assets valued in Pawtuxet were used rather than sold, the District Court approved the bankruptcy court's adoption of going-concern value as the "value" of those assets for adequate protection purposes. Id.

The same principles apply when a debtor actually sells collateral. The caselaw in the adequate protection context is clear that the realized sale proceeds are the best evidence of the collateral's fair market value. See Bank Hapoalim B.M. v. E.L.I., Ltd., 42 B.R. 376, 379 (N.D. Ill. 1984) (affirming bankruptcy court's utilization of an executed sale contract for valuation of sold collateral under section 506(a) to determine whether the secured creditor was adequately protected); In re Eskim LLC, No. 08-509, 2008 WL 4093574, at *2–4 (Bankr. N.D. W. Va. Aug. 28, 2008) (unpublished) (permitting debtor to use collateral to bridge to a going concern sale, and finding secured creditor adequately protected given that "the court's accepted valuation of the property depends on its being sold at a going concern value – not one of foreclosure"); In re Walck, No. 11-37706 (MER), 2012 WL 2918492, at *2 (unpublished) (Bankr. D. Colo. Jul. 17, 2012) (construing section 506(a) in the adequate protection context and holding, in light of Rash, that secured creditor is adequately protected based on the fair market value of collateral projected to be earned by sale); In re Kids Stop of Am., Inc., 64 B.R. 397, 401–02 (Bankr. M.D.Fla. 1986)

(construing section 506(a) in the adequate protection context, and concluding that secured creditor is entitled to adequate protection because the collateral as of petition date was worth the amount actually realized from asset sales during the case). As one court noted, "the evidence of the agreed value of the Property by the parties at the time of the respective acquisitions is the more persuasive evidence of value offered at trial." In re Pelham Enters., Inc., 376 B.R. 684, 690–93 (Bankr. N.D.Ill. 2007) (construing section 506(a) in the adequate protection context in light of Rash and rejecting estimated liquidation value of collateral in the hands of creditor given undisputed evidence that the collateral was actually used as part of debtor's going concern).

In sum, this is not a lift stay case or a foreclosure case. This is a use and sale case in which the Debtors sold $2.8 billion of collateral and used $660 million of proceeds. Thus, the appropriate question for the Court is to determine what was the value of the JSN Collateral as of the Petition Date—the date on which the Debtors first started using that collateral—in light of the uncontroverted proposed disposition of the collateral in a sale of the Debtors' business as a going concern.

5. The Defendants Have Offered Unrebutted Evidence That The Fair Market Value Of the JSN Collateral Was At Least $2.8 Billion On The Petition Date

As the Court is well aware, the Debtors sold significant assets—a substantial portion of which was JSN Collateral—in two auction sales in January and February of 2013. Based on valuations performed by the Defendants' experts from Houlihan Lokey (collectively, "Houlihan"), the experts concluded that the JSN Collateral, including the Sold Assets, was worth at least $2.8 billion as of the Effective Date.

a. The Defendants' Valuation Of Sold Assets In Accordance With 11 U.S.C. § 506

Houlihan valued the Sold Assets based on the going concern sale proceeds obtained on

the Sale Date modified to reflect the gap between the Petition Date and the Sale Date, and also performed a "bottoms up" fair market valuation as of the Petition Date. (FoF § III ¶ 4.) This build-up valuation is consistent with the actual Auction Sales proceeds realized for the Sold Assets and reflects the experts' well-founded views that the market fundamentals for these assets did not change between the Petition Date and the Sale Date. The costs of maintaining the JSN Collateral to sale were outpaced by JSN Collateral receipts, including the Debtors' ability to retain cash generated to closing. (FoF § II ¶ 58.)

The Plaintiffs did not present any evidence on the fair market value of the Sold Assets assuming that they would be used or sold by the Debtors. In rebuttal to Defendants' valuations, the Plaintiffs simply asserted that Houlihan's global valuation conclusion is "too high" in light of the risks of the Case and the costs of administration. That assertion is not evidence. See Murphy v. Valencia (In re Duque Rodriguez), 75 B.R. 829, 833 (Bankr. S.D. Fla. 1987) (declining to "second guess" expert's valuation of loan guarantees where opposing party offered no competing expert opinion to challenge such valuation). In any event, contrary to the Plaintiffs' arguments, Houlihan's experts took into consideration all applicable risks and costs incurred by the Debtors in using the Sold Assets to bridge to the Auctions.

First, Houlihan acknowledged that embedded in the Debtors' assets were certain risks relating to potential RMBS and government setoff claims. Indeed, the Houlihan experts noted that such risks are embedded in all residential servicing businesses and such assets subject to such risks are bought and sold with frequency. Accordingly, Houlihan adjusted their valuations for those risks in accordance with traditional valuation methodologies. (FoF § III ¶¶ 211-12.) The Plaintiffs did not challenge Houlihan's methodology for risk adjustment at trial. Rather, Plaintiffs' cross examination simply established that the Houlihan experts understood the risks

and took them into consideration in setting discount rates. (Id.) To the extent that the Plaintiffs believed that Houlihan's methodology or resulting adjustments were deficient, the remedy would have been to present rebuttal testimony on a discount rate applied to the sale price, not to simply assert that the sales prices are not evidence of value.

Importantly, the Plaintiffs presented no evidence that the risks in this case were greater than in any comparable sale of similar mortgage assets. To the contrary, the unrebutted evidence is that all businesses like the Debtors' bear risks related to peculiarities of the mortgage servicing and origination business. (FoF § III(A)(d).) All such businesses are at risk of GSE action; all such businesses must deal with trustees in RMBS securitizations. Nor did the Plaintiffs offer any evidence to show that the RMBS trustees or the GSEs would be more inclined to exercise setoff rights, withhold consents, or seek other relief in these Cases than in their dealings with any other counterparty. The Plaintiffs' evidence in that regard came only from Mr. Marano and Mr. Puntus—neither of whom had ever sold or valued mortgage assets outside the context of this proceeding. (Id.) Indeed, according to the Houlihan experts, to the extent that the risks associated with the Sold Assets reduced their component value that would not affect the total enterprise value. Instead, the allocation to goodwill reflected in the Asset Sales purchase price would be commensurately increased. (See supra at Section I(B).) In short, GSE and RMBS trustee risks are par for the course in the industry and did not undermine the fair market value of the assets sold. Nor did these risks prevent the assets from being sold on "day one." As Mr. Siegert testified, assets are customarily sold subject to resolution of closing risks, such as by subsequently obtaining certain consents and offsets prior to closing. (FoF § III ¶¶ 212, 215.) Again, Plaintiffs offered no evidence of alternate discounts.

Second, in overemphasizing the role of risk in the Auction Sales, the Plaintiffs' expert improperly assumed a 100 percent likelihood that the RMBS trustees and GSEs would actually exercise setoff rights. This assumption is contrary to the evidence that RMBS trustees and GSEs typically seek to avoid such a result.[16] (FoF § III ¶¶ 212, 215.) In addition, as is typical in the industry and consistent with Houlihan's experience and testimony, the risks did not manifest themselves in these Cases.[17] (FoF § III ¶ 208.) .

Third, with respect to the actual costs of closing the Asset Sales or preparing collateral for such Sales, backing out costs from fair market value is inappropriate. The fair market value of an asset is not diminished by costs and expenses associated with selling those assets. (FoF § III(A)(c).) The Plaintiffs' expert, Mr. Puntus, agreed. (Id.) See also In re Jones, 152 B.R. 155, 187 (Bankr. E.D. Mich. 1993) (stating that "just as a homeowner's equity is not commonly understood to be net of hypothetical sales costs, so too the value of an undersecured creditor's mortgage is generally assumed to be coextensive with the value of the mortgaged home.").[18] Simply, the fair market value of an asset is not diminished because there are standard tasks that have to be performed to effectuate a sale of that asset—IBM has a demonstrable fair market value even though sale might be subject to a whole panoply of closing preconditions, including critical government consents. Moreover, courts that have deducted actual costs of taking an asset

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[16] For example, had the RMBS trustees sought to withhold consent to the transfer of MSRs and servicing advances, they would have had to service the loans themselves or hire a new servicer, which is exactly what the Debtors were effectuating.

[17] Even if setoff had manifested, they would not have reduced the value of the Sold Assets to the grave extent Plaintiffs' valuation suggests. Among other things, a purchaser who was forced to suffer a setoff by the GSEs or the RMBS trustees would have had subrogation rights against the Debtors to recoup what losses they incurred as a result of the setoff.

[18] As discussed, in this case no costs should be backed out of the valuation analysis because the Debtors waived the right to surcharge under section 506(c), and even if the Debtors had not waived such surcharge, section 506(c) only permits the deduction of "reasonable, necessary costs and expenses of preserving, or disposing of, [the collateral]." 11 U.S.C. § 506(c). (FoF § II ¶ 150.)

to close typically have done so only after adopting a valuation in the hands of the debtor and even then only under section 506(c)—which, in this case, has been waived. See Huntington Nat'l Bank v. Pees (In re McClurkin), 31 F.3d 401, 405–06 (6th Cir. 1994) (rejecting the deduction of costs for an undersecured creditor and stating that doing so is only appropriate for an oversecured creditor under section 506(c)).

Finally, as a matter of fact, the only evidence in the record as to the potential costs of the RMBS setoff (there were none), the government setoff (there were none) and the actual costs of reaching closing are contained in the Winn Report. (FoF § I ¶¶ 76-77.) According to Mr. Winn's unrebutted testimony, the costs of bringing the Sold Assets to sale at the Auctions were exceeded by the proceeds generated by the Sold Assets over the same period of time. (FoF § II ¶ 58.) The Debtors' former CEO, Thomas Marano, confirmed that, other than the extraordinary costs of the bankruptcy proceedings, the Debtors' businesses did not run at a loss following the Petition Date. (FoF § III ¶ 285.)

b. The Defendants' Valuations Of Unsold And Other Assets On The Petition Date

In addition to the valuations of Servicing Advances, Held for Sale Loans and Intangibles, Houlihan also properly valued the Debtors' Unsold Assets and Other Assets that comprised the JSN Collateral on the Petition Date. With respect to the unsold FHA/VA loans, Mr. Fazio conducted an analysis based on the Debtors' book value for those assets, concluding that they were worth approximately 95 percent of book value. (FoF § III ¶ 99.) That valuation methodology was based on traditional valuation methodologies and on the Debtors' assertions

that the FHA/VA portfolio will be run off over a period of three years.[19] Indeed, Houlihan's valuation for the Unsold Assets closely aligns with the estimated recoveries ascribed to the FHA/VA Loans in the Plaintiffs' other submissions to the Court. Houlihan concluded that, as of the Petition Date, the FHA/VA loans had a fair market value of approximately $600 million, regardless of whose "hands" those loans were in. (FoF § III ¶ 98-103.)

In addition, Houlihan valued other unsold JSN Collateral in accordance with customary valuation methodologies, including equity pledges of Debtor and non-Debtor subsidiaries as of the Petition Date. In preparing these valuations, Houlihan applied the same 'bottoms up' method as of the Petition Date as applied to the Sold Assets. Applying these methods, Houlihan concluded that the fair market value of the equity pledges granted by Debtor entities and non-Debtor entities was $35 million and $40 million, respectively, as of the Petition Date. (FoF § III ¶¶104-123.)

The valuation performed by Houlihan thus comports with the mandate of section 506(a)—to apply a methodology in light of the "purpose" of the valuation and the "disposition or use" of the collateral. Here, deriving fair market value from the sale proceeds realized as a result of the JSNs' consent under the Cash Collateral Order to the Debtors' use of JSN Collateral to bridge to a going concern sale and ascribing the fair market value of unsold assets without improperly deducting costs. Indeed, the Plaintiffs always intended to sell the FHA/VA Loans and ultimately removed the FHA loans from the auction because they felt that the bids received

[19] While the Debtors assert that the ultimate recovery time may be longer than 30-36 months, the Debtors own filing estimate that FHA/VA mortgage assets typically monetize over a 30-36 month period, with approximately 77% occurring within the first two years. Mr. Fazio calculated that close to 86% of the all the loans would be collected within three years. In addition, Mr. Fazio recognized that the Debtors could choose to monetize the remainder of the FHA portfolio at the end of 36 months as the net present value of the remaining cash flows would be immaterial.

were not high enough. The Plaintiffs have presented no evidence to rebut the conclusions as to Petition Date values ascribed according to the Houlihan methodology.

c. The Plaintiffs' Valuations Do Not Comport With Applicable Law And Fail To Rebut The Defendants' Proper Valuations

In stark contrast to Houlihan and the Defendants, the Plaintiffs took a novel, never-before performed approach to value both sold and unsold JSN Collateral as of the Petition Date to reach a conclusion that the JSN Liens attached to less than $1.753 billion of JSN Collateral as of the Petition Date. (See FoF § III ¶ 199.) The legal authority cited thus far by the Plaintiffs in support of their approach is premised on an outdated line of reasoning previously championed by former Chief Judge of the Bankruptcy Court for the District of Massachusetts, James F. Queenan. Judge Queenan believed that the language in the first sentence of section 506(a), related to the creditor's interest, was determinative and that the second sentence (including the "proposed disposition or use" of the assets to be valued) had no bearing on the appropriate valuation methodology. James F. Queenan, Standards for Valuation of Security Interests in Chapter 11, 92 COM. L.J. 18, 30 (1987) ("We are concerned here not with valuation of the property that constitutes collateral but rather, in the words of the statute, with valuation 'of such creditor's interest in the estate's interest in such property.'"). Judge Queenan thus repeatedly interpreted section 506(a) to require valuation based on the creditor's contractual right to foreclose. See, e.g., In re Ralar Distribs., Inc., 166 B.R. 3, 7 (Bankr. D. Mass. 1994) ("Section 506(a), on the other hand, does refer to the creditor's 'interest in . . . property,' and provides that a claim 'is a secured claim to the extent of the value of such creditor's interest ... in such property' . . . . Because section 506(a) determines the amount of a claim, this reference is clearly not to the value of the collateral.").

This "in the hands of the creditors" approach was rejected by the Supreme Court in Timbers and Rash. In Timbers, the U.S. Supreme Court interpreted section 506(a) and held that "the phrase 'value of such creditor's interest' in section 506(a) means 'the value of the collateral.'" Timbers, 484 U.S. at 372. This conclusion was a direct reproach to the statutory interpretation relied upon by Judge Queenan's minority approach, which had relied on the "creditor interest" sentence in section 506(a) to hold that liquidation value in the hands of the creditor was (absent a sale, of course) always the appropriate valuation methodology for an adequate protection valuation. In the aftermath of Timbers, the First Circuit expressly overruled several of Judge Queenan's pre-Timbers decisions and adopted a fair market value methodology when the collateral to be valued was proposed to be retained and used by the debtor.[20] Winthrop Old Farm Nurseries v. New Bedford Inst. for Sav. (In re Winthrop Old Farm Nurseries), 50 F.3d 72, 74–75 (rejecting Judge Queenan's article and cases); In re Pawtuxet, 386 B.R. at 4, n.3 (listing cases overruled by Winthrop, including those authored by Judge Queenan).

Nine years after Timbers, the Supreme Court revisited section 506(a) and again rejected the Plaintiffs' approach:

> We do not find in the §506(a) first sentence words—"the creditor's interest in the estate's interest in such property"—the foreclosure-value meaning advanced by the Fifth Circuit. Even read in isolation, the phrase imparts no valuation standard: A direction simply to consider the "value of the creditor's interest" does not expressly reveal *how* that interest is to be valued.

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[20] Although, post-Timbers, a handful of bankruptcy courts continued to apply foreclosure value in the hands of the secured creditor for a 506(a) valuation of adequate protection, such cases only involve situations where the debtor proposed to surrender the collateral to the creditor. See, e.g., Sharon Steel Corp. v. Citibank, N.A. (In re Sharon Steel Corp.), 159 B.R. 165, 169 (Bankr. W.D. Pa. 1993) (adopting liquidation value where "any hope of recovery in excess of liquidation value from the Debtor's assets is minimal"); In re Keystone Camera Prods. Corp., 126 B.R. 177, 186 (Bankr. D.N.J. 1991) (adopting liquidation value where "there is not a reasonable chance of reorganization").

Rash, 520 U.S. at 960–61. The Supreme Court then held that the "proposed use or disposition" prong was of "paramount importance to the valuation question." Id. at 962. The Supreme Court ultimately held that, because the debtor intended to retain collateral under a proposed plan, the replacement value standard "rather than a foreclosure sale that will not take place, is the proper guide under a prescription hinged to the property's 'disposition or use.'" Id. at 963. With that, the Supreme Court rendered obsolete the line of cases holding that a section 506(a) valuation in the adequate protection context requires foreclosure value in the hands of the creditor.[21]

Even in the heyday of foreclosure value cases, Judge Queenan recognized that his unique (and now overruled) interpretation of section 506 as always requiring a foreclosure valuation in the hands of the creditor would not apply when the assets to be valued were actually sold. Queenan, Standards for Valuation of Security Interests in Chapter 11, 92 COMM. L.J. 18, 29 (1987) ("If the valuation is in connection with a proposed sale of the collateral, the manner in which the sale is to be conducted should be conclusive upon the standard of valuation employed"). In Judge Queenan's words, "where the valuation is made in the context of the sale of the debtor's business as a going concern and the secured claim is to be paid from the proceeds . . . it would be ludicrous to adopt another standard or, if an actual sale has been negotiated, to use any value other than the agreed price. That seems obvious." In re Tenney Village Co., Inc.,

[21] Aside from overruled cases, the Plaintiffs also rely on an excerpted discussion from *Collier*. (FoF ¶ __ [Rev. PTO ¶¶ 119, 121] (quoting *Collier* ¶ 506.03[7][a]).) However, another portion of the very same section of *Collier* recognizes that a realized sale price is determinative of fair market value even in the adequate protection context. See *Collier* at 506.03[6][b], at 506-37 (looking to sale price "regardless of the purpose of the valuation"). Nor does *Collier* even try to distinguish the myriad authorities cited herein for the proposition that even in the adequate protection context a section 506(a) analysis must be reflective of the collateral's actual use or sale – that rule, of course, is unassailable in light of Rash and subsequent caselaw. Instead, *Collier* cites only a handful of cases reliant on the now-overruled Queenan construct, all of which pre-date Rash. And by focusing exclusively on the "purpose" prong at the expense of the assets' "proposed disposition or use," the excerpted portion of *Collier* repeats the same interpretational mistake that the Supreme Court corrected in Rash.

104 B.R. 562, 566 (Bankr. D. N.H. 1989) (emphasis added).

Importantly, the Plaintiffs have not cited a single case conducting a section 506(a) valuation, whether for adequate protection purposes or not, that disregards going concern sale value in favor of measuring the foreclosure value of sold assets in the hands of creditors. See, e.g., In re Scotia Dev., LLC, No. 07-20027, slip op. at 23–24 (Bankr. S.D. Tex. July 7, 2008) (an unpublished and vacated Texas Bankruptcy Court bench ruling that was not in a sale context, did not construe section 506, and where the reference to foreclosure valuation was dicta) vacated and remanded at Bank of N.Y. Trust Co. v. Pac. Lumber Co. (In re SCOPAC), 624 F.3d 274, 285 (5th Cir. 2010) (concluding that fair market value not foreclosure value "is the proper comparison").[22]

Mr. Puntus' valuation of the Unsold Assets likewise failed to comport with applicable law or any known standards of expert valuation. Plaintiffs have provided no support for using a stalking horse bid that parties objected to and the Court rejected as evidence of fair market value. (FoF § III ¶¶ 199-200.) Mr. Puntus adjusted the book value of all unsold accounts to account for the single bid received by the Debtors for a subset of the FHA Loans in February 2013 – a bid that the Debtors and the Committee rejected as too low. (FoF § III ¶¶ 171-176.) As Mr. Fazio testified, this is not an appropriate methodology per FASB standards. (Id.)

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[22] See also In re Case, 115 B.R. 666, 670 (B.A.P. 9th Cir. 1990) (holding, outside of the sale context in a chapter 12 plan confirmation case, that costs should not be deducted from a fair market valuation when a debtor retains collateral but, in dicta, speculating as to the appropriate methodology in the adequate protection context); In re Ralar Distribs, Inc., 166 B.R. 3, 5 (Bankr. D. Mass. 1994) (evaluating a 507(b) claim related to a piecemeal liquidation of the debtor's assets), aff'd, 182 B.R. 81 (D. Mass. 1995) (affirming on other grounds and ignoring the adequate protection issue), aff'd, 69 F.3d 1200 (1st Cir. 1995) (same); In re Rich Int'l Airways, Inc., 50 B.R. 17, 18 (Bankr. S.D. Fla. 1985) (outside of sale context and outside of 506 context, merely recounting the legislative history of section 361); La Jolla Mortg. Fund v. Rancho El Cajon Assocs., 18 B.R. 283, 289 (Bankr. S.D. Cal. 1982) (outside of sale context, using a fair market valuation).

Nor is Mr. Puntus' "failed bid" valuation supported in the case law. See In re Pullman Const. Indus., Inc., 103 B.R. 983, 986 (Bankr. N.D. Ill. 1989) ("This Court cannot agree that the so-called 'offer' and 'acceptance' letters present probative or useful evidence of market value of the assets in question."); In re Walkup, 28 B.R. 225, 227 (Bankr. N.D. Ind. 1983) ("A mere offer to buy or sell property is . . . incompetent to prove the market value of property because the asking price is only the opinion of one who is not bound by his statement." (quoting State v. Lincoln Memory Gardens, Inc., 242 Ind. 206 (Ind. 1961)).

B. The JSNs Should Be Allocated An Additional $273 Million Of The Net Cash From The Asset Sales Or Provided Adequate Protection Of A Like Amount

Separate and apart from adequate protection, there are additional, significant disputes with respect to the fair market value of the JSN Collateral that will remain in the estates as of the Effective Date. Both sides' experts start with the Debtors' "Recovery Analysis" prepared as part of the Plan process and which lays out, by category, the value ascribed to each class of JSN Collateral. (FoF § III ¶¶ 253-58, 377, 388.) The Debtors' presentation of the JSN Distributable Value is based, in large part, upon the allocation of cash proceeds from the sales of assets to Ocwen and Walter in January and February 2013 (the "Asset Sales"). In that regard, as part of creating a consolidated trial balance sheet of assets and liabilities to support the Plan, the Debtors allocated all net proceeds of the Asset Sales in accordance with the purchase price allocations in the operative Asset Purchase Agreement and allocated immaterial value to any of the Debtors' other Sold Assets to which the JSN Liens attached. (FoF § III ¶ 348.) That allocation, which was made solely to financial assets, is contrary to standard principles of asset allocation, applicable law, the testimony of the purchasers, and the documentation of the transaction. The

import of the Plaintiffs' improper allocation in their balance sheets is clear from the table below:[23]

Allocation of Proceeds from Ocwen/Walter Sale

Asset	**Debtor Allocation** ($ Millions)	**Houlihan Allocation** ($ Millions)
MSRs	911	716
Servicing Advances	1,798	1,692
Developed Software and Know-How	0	220
HARP/Other Refi Oppurtunity (Customer Related Intangibles)	0	129
Tradename/marks, Iconography and Logotype	0	10
Unidentified Intangibles and Goodwill	0	(46)

Allocation of Proceeds from Berkshire Sale

Asset	**Debtor Allocation** ($ Millions)	**Houlihan Allocation** ($ Millions)
JSN Loans	843	909

Under commonly-accepted valuation principles and the operative agreements, the sale of assets to Ocwen and Walter included not just the sale of financial assets, but also the sale of intangible assets, including goodwill, proceeds of HARP refinancings and software, all of which are, as set forth below, subject to the JSNs Liens. (FoF § III ¶ 137.) Importantly, the sale of a business does not "create" goodwill. Rather, goodwill is a component of a going concern business (just as hard assets are components) the value of which may be higher or lower at any given point in time depending on market conditions and other factors that may affect the business. See United States v. Winstar Corp., 518 U.S. 839, 849 (1996) ("the recognition of

[23] Debtor allocation figures from the Ocwen and Walter sales are derived from the Debtors' February 15, 2013 asset balances for Ocwen and December 31, 2012 asset balances for Walter. Debtor allocation figures for the Berkshire Sale are derived from the Debtors' August 31, 2012 asset balances. Houlihan's allocation for Ocwen/Walter and Berkshire are derived from the Expert Reports of John Taylor and Michael Fazio, respectively. (FoF § III ¶ 347-48.)

goodwill as an asset makes sense: a rational purchaser in a free market, after all, would not pay a price for a business in excess of the value of that business's assets unless there actually were some intangible "going concern" value that made up the difference."). Accordingly, goodwill is not a post-petition asset, its existence was co-extensive with the Debtors' operations of their businesses and the sales did not generate goodwill, they simply realized its value.[24]

To determine the value of all assets sold, Houlihan employed an asset level valuation to attribute value to assets that were not recognized on the Debtors' trial balance sheet in accordance with financial reporting standards. (FoF § III ¶ 56, 67.) Houlihan also valued the sold businesses through a market multiples approach. (FoF § III ¶ 57, 158, 206.) Under this approach, the value of the business' intangible assets was obtained by subtracting the fair market value of the business' tangible assets from the value of the business as a whole. (FoF § III ¶ 58.) Their conclusions are set forth in the tables, supra.

In contrast to the Defendants' use of known methodologies, the Plaintiffs did not put forth any evidence on the issue of the proper allocation of the proceeds of the Asset Sales for purposes of calculating the JSN Distributable Value or provide an expert opinion on the proper allocation of the proceeds. Indeed, the Plaintiffs' expert for the calculation of JSN Distributable Value, Mark Renzi, stated explicitly that he did not "render [an] opinion on allocation of purchase price." (FoF § III ¶ 344.) Instead, for purposes of determining the JSN Distributable Value, Mr. Renzi relied entirely on the Debtors' April 30, 2013 trial balance which was not vouched for by any witness. (FoF § III ¶ 346.) Mr. Renzi thus agreed that, if the Debtors'

[24] In any event, post-petition proceeds of JSN Collateral on the Petition Date—including goodwill—are also subject to JSN Liens pursuant to the loan documents, section 552 of the Bankruptcy Code, and the Debtors' unchallenged stipulations in the Cash Collateral Order. 11 U.S.C. § 552. (FoF § II ¶¶ 132-33.)

allocation of the proceeds was not appropriate and needed to be adjusted, such allocation adjustment would necessarily change his calculation of JSN Distributable Value. (FoF § III ¶ 345.) Rather than providing affirmative evidence, Plaintiffs instead challenge the Houlihan sales proceeds allocation on two grounds—(1) that the JSNs do not have liens on intangible assets and (2) that the purchasers expressed the view in negotiations that they did not want to purchase certain assets and thus those assets have no value.

First, under applicable law, liens on intangible assets exist even to the extent that the JSNs do not have a lien on all of the financial assets sold, such as certain master servicing rights. NBD Park Ridge Bank v. SRJ Enters., Inc. (In re SRJ Enters., Inc.), 150 B.R. 933, 940 (Bankr. N.D. Ill. 1993); accord Sprint Nextel Corp. v. U.S. Bank, N.A. (In re TerreStar Networks, Inc.), 457 B.R. 254, 265 (Bankr. S.D.N.Y. 2011); Nationsbank, N.A. v. Goldcoast Partners, Inc. (In re Goldcoast Partners, Inc.), No. 97-10728, 1998 WL 34069489, at *7 (Bankr. S.D. Fla. Feb. 26, 1998) (adopting reasoning of SRJ in context of similar un-lienable franchise agreement); see also Groman v. Watman (In re Watman), 301 F.3d 3, 12 (1st Cir. 2002) ("There is substantial support in the case law for the proposition that such intangible assets as goodwill and overall going concern are valuable and should be preserved for the bankruptcy estate.").

One intangible asset with significant value is the HARP/Other Refi Opportunities, which are derived by originating refinance loans with eligible borrowers and then selling those loans into the market at a profit. (FoF § III ¶ 77.) Any market participant can take advantage of the HARP/Other Refi Opportunities; the value is not dependent on possessing the servicing rights

with respect to the existing or refinanced loans.[25] (FoF § III ¶ 78.) Accordingly, and as identified by Houlihan, the HARP/Other Refi Opportunity is a separately identifiable asset. (FoF § III ¶ 79-80.) See In re SRJ Enters., Inc., 150 B.R. at 940 (separately identifiable intangible assets can be subject to a lien even when the tangible asset underlying the intangible asset is not subject to the same lien.)

Second, Houlihan's allocation is, in fact, consistent with the transaction and the intent of the purchasers as expressed in their written agreements and post-sale financials. The Ocwen APA makes clear that (i) purchasers were buying a standalone "business," including intangible assets and (ii) the purchase price calculation in the Ocwen APA is not binding for allocation purposes. (FoF § III ¶ 243.) Notably, the order approving the Asset Sales made clear that the allocations in the APAs would have no effect on the JSNs' entitlement to adequate protection. (FoF § III ¶ 315.)

In addition, in support of their written agreement, Ocwen and Walter acknowledged that the Asset Sales represented a purchase of a "business." (FoF § III ¶¶ 316-17.) Representatives from both Ocwen and Walter testified that they acquired intangible assets associated with the business that each intended to maintain and/or build upon. (FoF § III ¶ 318, 326.) Indeed, both Ocwen and Walter allocated a portion of the purchase price to goodwill. (FoF § III ¶ 323.) The purchasers also testified to their perception that the Debtors were marketing the Asset Sales as a going concern. (FoF § III ¶¶ 293-94.)

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[25] The Plaintiffs' assertion that the JSNs released liens on the HARP/Other Refi Opportunities is incorrect. The HARP/Other Refi Opportunities exist only with respect to loans owned by Fannie and Freddie. As the Plaintiffs concede, no lien release was ever executed by the JSNs with respect to the MSRs related to Fannie loans and most of the value attributed by Mr. Levine to the HARP/Other Refi Opportunities derives from the Fannie MSRs – approximately $33m to $71m as of February 29, 2013 and approximately $64m to $144m as of August 31, 2012. (FoF § III ¶ 75.)

That testimony is not controverted by the fact that Ocwen may have sold portions of the business shortly after the sales closed or had plans to transition away from a portion of the sold assets. Ocwen's Rule 30(b)(6) witness testified that Ocwen needed all assets including software and other platform assets (even if in the short term) to avoid a default on their assumed servicing obligations. (FoF § III ¶¶ 293-94.) Accordingly, whether used for a day, a year, or in perpetuity, the platform assets were critical to the sale.

C. The Debtors Undervalue The Remaining Servicing Advances And Other Unsold Assets That Constitute Collateral As Of The Effective Date

Included in the Debtors' calculation of JSN Distributable Value are other unsold assets ("Other JSN Collateral"). These assets include certain MSRs and their associated servicer advances, FHA/VA mortgage assets, international HFS loans and other mortgage assets, other Debtors' assets, and equity pledges in Debtor and Non-Debtor subsidiaries. (FoF § III ¶ 354.) The value of the Other JSN Collateral is not insubstantial. Indeed, Houlihan concluded, based upon the debtors' books and records, the fair market value of the Other JSN Collateral, as of Effective Date, is $180 to 220 million.

Instead of calculating the fair market value of these assets, the Debtors' expert, Mr. Renzi, purported to conduct a "recovery analysis" of the JSNs' collateral, including the Other JSN Collateral, by discounting the figures in the Debtors' April 30, 2013 balance sheet for assumed costs of collection. (FoF § III ¶¶ 358.) From the balance sheet, Mr. Renzi then rolled forward adjustments as of the disclosure statement date. (FoF § III ¶ 360) However, the numbers set forth on the Debtors' balance sheet for certain assets were already carried at a discount to account for risks such as the payment of interest on loans. (FoF § III ¶ 359.)

The distinction between Houlihan's fair market value analysis and Mr. Renzi's "recovery analysis" is exemplified by their disparate treatment of the FHA/VA loans which constitute the bulk of the Other JSN Collateral. (FoF § III ¶¶ 368, 373-74) Based upon the Debtors' estimates, Houlihan concluded that these loans would monetize over the course of a 30-36 month period (FoF § III ¶ 37.) Houlihan then discounted the cash flow of these assets over the course of the three-year period. (FoF § III ¶ 372.) Consistent with the Debtors' previous valuation of the FHA/VA loans, Houlihan valued these loans at 95% of book value. (FoF § III ¶ 374.) Mr. Renzi took the value of these loans as they existed on the Debtors' April 30 balance sheet (which had already accounted for certain discounts) and then discounted the value further for additional perceived costs and risks associated with the loans. (FoF § III ¶ 360.)

Even if there are costs in monetizing loans, the JSNs should not be charged with these costs when valuing the amount of their secured claim pursuant to section 506(b). Under section 506(b) postpetition interest, fees, costs and charges may only be offset by the amounts chargeable to collateral under section 506(c). Here, there are no such costs under 506(c) because the Debtors waived their 506(c) rights in the Cash Collateral Order. (FoF § II ¶¶ 149-52). Section 506(c) waivers that are found in final orders are routinely enforced. See *Collier* ¶ 506.05[12] (noting "[a]lthough one court has held that waiver of Section 506(c) is unenforceable, most courts uphold 506(c) waivers"). Challenges to such waivers are generally barred upon res judicata grounds. See id. (noting that most cases upholding such waivers "find that subsequent section 506(c) claims are barred by res judicata"); InteliQuest Media Corp. v. Miller (In re InteliQuest Media Corp.), 326 B.R. 825, 831 (B.A.P. 10th Cir. 2005) (enforcing Section 506(c) waiver and denying challenge to 506(c) waiver on grounds of res judicata). Thus, the premise of

the Recovery Analysis—that assets will continue to generate some expense—runs counter to section 506(b).

D. The Plaintiffs Have Failed To Demonstrate That The Ally LOC Collateral Is Unencumbered By The JSN Liens

A substantial portion of the Debtors' current remaining cash and other assets are pledged to the Ally LOC as collateral (the "Ally LOC Collateral"). (FoF § III ¶ 426.) Certain of these assets which would be subject to the JSN Liens but for prepetition lien releases, and other loans and MSRs pledged as Ally LOC Collateral, should be deemed JSN Collateral as a result of the Cash Collateral Order.

1. Plaintiffs Cannot Properly Avoid Their Stipulation That All Ally LOC Collateral Meeting The Definition Of "Collateral" Is JSN Collateral

For nearly six months now, Plaintiffs have repeated a mantra that the JSNs are seeking to use the Cash Collateral Order to "revive" liens that were released prepetition. They simply miss the point—Defendants are not seeking to "revive" anything, but rather to have the Court require that the Debtors and the Committee live up to Court-ordered stipulations, and not simply seek to disregard them as inconvenient or inequitable. The Cash Collateral Order contains a specific "stipulation" by the Debtors that "the liens and security interests granted to secure the Junior Secured Parties pursuant to the Junior Secured Notes Documents and in connection with the Junior Secured Notes [] are valid, binding, perfected, and enforceable first priority liens on and security interests in the personal and real property constituting 'Collateral' under, and as defined in, the Junior Secured Notes Documents[.]" (FoF § III ¶ 42.) The plain meaning of the Debtors' stipulation is that they agreed that, if an asset of the Borrower or a Debtor Guarantor constitutes "Collateral" under the JSN Indenture or any document that evidences, creates or purports to create a security interest in that Collateral, the JSNs have a lien on it, subject only to the

Committee's challenge rights under paragraph 28 of the Cash Collateral Order. The Committee did not challenge the Debtors' stipulation in paragraph 5(g), and such stipulation became binding on all parties and is "not subject to challenge or modification in any respect." (FoF § II ¶¶ 136-39.)

Although neither party argued that the meaning of paragraph 5(g) was ambiguous, the Court has previously found it to be so and requested that the parties provide the Court with a full evidentiary record. (FoF § I(D).) In assessing that record, the Cash Collateral Order must be interpreted to "give effect to the expressed intentions of the parties." Klos v. Polskie Linie Lotnicze, 133 F.3d 164, 168 (2d Cir. 1997). In the absence of ambiguity, the plain meaning of the written contract controls enforcement and the existence of ambiguity is determined without reference to extrinsic evidence. S. Rd. Assocs., LLC v. IBM, 826 N.E.2d 806, 809 (N.Y. 2005). The test for ambiguity is whether the language within the four corners of the contract is susceptible of more than one reasonable meaning. Mycak v. Honeywell, Inc., 953 F.2d 798, 802 (2d Cir. 1992); Barclays Capital Inc. v. Giddens (In re Lehman Bros.), 478 B.R. 570, 581 (S.D.N.Y. 2012) (reversing bankruptcy court that "relied upon extrinsic evidence to create ambiguity" in a contract drafted by the parties).[26]

In providing the Court with the requested record, the Defendants introduced significant, unrebutted evidence into the record demonstrating that stipulation 5(g) was intended to provide the JSNs with a customary stipulation as to the validity and perfection of JSN Liens on all

[26] The District Court in Barclays observed that, instead of looking to the plain language of the sale agreement and the clarification letter at issue, the bankruptcy judge made a "slice-and-dice finding . . . that it would accept only 'part' of the Clarification Letter on their plain terms," thereby "layer[ing] on top of the Clarification Letter, which allow[ed] it to excise the crystal clear transfer" from the terms of the sale agreement. Id. at 584. The District Court accordingly reversed, because the plain meaning of the parenthetical was "clear" according to the "dictionary definition" of the terms. Id. at 588.

collateral to which a security interest was initially granted, subject of course to the Committee's timely challenge of such liens.

First, the evidence clearly demonstrated that the secured parties (i.e., the JSNs and Ally) consented to the Debtors' use of their collateral subject to "customary," "standard" and "lender-friendly" adequate protection packages. (FoF § II ¶ 70.) Second, the negotiating history demonstrated that, while the Debtors initially sought to exclude JSN liens on the Ally LOC from their stipulations, the Debtors abandoned that objective in later drafts. Specifically, in light of the JSNs' prepetition equitable lien assertions, on March 30, 2012, counsel for the Debtors circulated to counsel for Ally a draft term sheet setting out the terms of cash collateral use that the Debtors sought to obtain from their secured lenders. (FoF § II ¶ 72-75.) That initial draft term sheet proposed that the Debtors stipulate to the validity and perfection of JSN Liens subject to a challenge period, "but not to any equitable liens asserted by the Junior Noteholders." (FoF § II ¶ 75.) In other words, the Debtors' initial proposal contained an explicit, unambiguous carve out that they now contend the Court should imply into the final order. In addition, the carve out for "equitable lien" claims sought to shift the burden to the JSNs to seek to establish liens on the Ally LOC during a "Junior Notes Challenge period."[27] (FoF § II ¶ 75.) Ultimately, AFI understood that one of the consequences of the JSNs making an equitable lien assertion would be the imposition of legal claims that AFI and/or ResCap had breached the Intercreditor Agreement and the Notes Security Agreement. (FoF § II ¶ 90.) Ally therefore sought to forestall such a

[27] Their proposed language was as follows:

> The Junior Noteholders have also asserted that they may have an equitable lien on certain other assets of the Debtors. The Junior Noteholders shall be entitled to bring any proceeding seeking to establish such lien prior to the Junior Notes Challenge Deadline, and any party (including the Debtors) shall be permitted to challenge such liens in any such proceeding. . . . (FoF § _ ¶ _ [3/30/12 email].)

challenge to the prepetition lien releases and rejected the lien carve out initially proposed by the Debtors. (FoF § II ¶ 86.) Thus, when AFI provided the first draft of the Cash Collateral Order on May 11, 2012, Ally proposed that the JSNs liens "would be stipulated as valid by the Debtors upon entry of the interim DIP order, subject to a challenge period for the creditors' committee." (FoF § II ¶ 86.) There was no carve out in that proposal.

In contradistinction to the Debtors' initial carve out proposal, that initial Ally proposal included a stipulation by the Debtors that "liens and security interests granted to the Junior Secured Noteholders pursuant to and in connection with the Junior Secured Notes are valid, binding, perfected, and enforceable first priority liens on and security interests in the personal and real property constituting "Collateral" under, and as defined in, the Junior Secured Notes[.]" (FoF § II ¶ 93.) Based on advice of counsel, AFI's Rule 30(b)(6) witness believed that the Committee would challenge that stipulation during the challenge period set forth in the Cash Collateral Order, and the relevant stipulations in subsequent drafts remained unchanged from those set forth in AFI's initial May 11 2012 draft. (Id.) Thus, the record shows that all parties knowingly had the Debtors agreeing to stipulate to the JSN Liens as established in the grants in the JSN Indenture and JSN Pledge Agreement, and delegating to the Committee the responsibility of bringing a lien challenge.

Conversely, the Plaintiffs introduced no competent evidence in support of their interpretation of stipulation 5(g). The Debtors' Rule 30(b)(6) witness on the subject, James Whitlinger (the CFO who oversaw the negotiations and signed off on the final form of proposed order) testified that he in fact understood that such stipulations typically apply to assets that may in fact not be subject to a properly perfected prepetition lien and was "okay stipulating to saying there was a lien even where one didn't exist because there was a period of time in which people

could object to the existence of a lien." (FoF § II ¶¶ 134, 198.) The Committee offered no witness at all to testify with respect to stipulation 5(g) or the Committee's decision not to include it in its lien challenge.

Instead, the Plaintiffs offered at trial the belated testimony of former CEO Thomas Marano that he did not "believe that any party could reasonably have understood this provision to revive previously released liens." (FoF § II ¶¶ 201, 203.) Beyond blurring the distinct concepts of "reviving" and "stipulating," Mr. Marano's testimony was contrary to the testimony offered by the Debtors' Rule 30(b)(6) witness on the subject of stipulation 5(g) who did participate in negotiations. (FoF § II ¶ 198.) As Mr. Marano himself admitted, he did not participate directly in the negotiations of the Cash Collateral Order (or any cash collateral order) and instead his role was more akin to that of a "coach." (FoF § II ¶¶ 204-05.) As a result, his testimony on his own intent lacks any foundation. In addition, as Mr. Marano readily conceded, he never relayed his personal understanding with respect to the scope of the stipulations to the JSNs or their advisors at the time. (FoF § II ¶ 207.) For these reasons, Mr. Marano's subjective intent cannot change the objective meaning of the Cash Collateral Order. Harvis Trien & Beck, 187 B.R. at 860 (disregarding evidence that the cash collateral stipulation was "not what [a party] meant, not what they thought about, and precisely what they regret," because it was "extraneous" to the "four corners of the [cash collateral] stipulation"); Barclays, 478 B.R. at 581 (unexpressed subjective intent of the debtors was irrelevant in light of their plain language agreement to give margin cash to Barclays).

Finally, Local Bankruptcy Rule 4001 does not limit the import or effect of the Debtors' stipulations in any way. First, the Cash Collateral Order does not create "springing" liens that arise post-petition (other than adequate protection liens as clearly set forth therein). Rather, as

set forth above, it contains simple, "customary" stipulations as to the validity and enforceability of liens which may or may not have otherwise been valid and perfected, subject to the Committee's right to challenge whether, in fact, those liens were valid and perfected. The Debtors' 30(b)(6) witness on this subject testified that that was the Debtors' understanding at the time.

Second, the Debtors amply complied with Local Rule 4001 in their motion seeking entry of the Cash Collateral Order, laying out explicitly the scope of all of their stipulations. Local Bankruptcy Rule 4001 is not applicable where parties in interest have received due and proper notice of the entry of a cash collateral order. See Terlecky v. Peoples Bank (In re Amerigraph, LLC), 456 B.R. 349, 351–52 (Bankr. S.D. Ohio 2011) ("if it was undisputed that parties in interest . . . had received adequate notice of the Cash Collateral Order, the Court would have concluded that the [debtor] is bound by the Debtor's waiver and release."). Nor can this Local Rule operate to modify or vacate a final order of the Bankruptcy Court. In re Buzzworm, Inc., 178 B.R. 503, 508 (Bankr. D. Colo. 1994) ("Stipulated agreements involving cash collateral, such as the one in this case, have been specifically upheld."). The stipulations agreed to in the Cash Collateral Order thereby remain binding on all applicable parties. Hoti Enters., L.P. v. GECMC 2007 C–1 Burnett Street, LLC (In re Hoti Enters., L.P.), No. 12 CV 8030 (VB), 2013 WL 1812197, at *6 (S.D.N.Y. Apr. 26, 2013) (finding that a cash collateral order "was final and binding"). In sum, Plaintiffs have not set forth a single legal, factual or equitable reason why they should be relieved of their Court-ordered stipulations.

2. Plaintiffs Fail To Meet Their Burden Of Showing Proper Lien Releases And Such Undocumented Releases Must Therefore Be Treated As JSN Collateral Under The Cash Collateral Order

The Plaintiffs bear the burden of demonstrating that collateral was properly released from the JSN Liens. A.F.L. Falck, S.p.A. v. E.A. Karay Co., 639 F. Supp. 314, 320 (S.D.N.Y. 1986) ("To prove a release, an obligor must demonstrate that there exists a writing which contains an 'explicit, unequivocal statement of present promise to release [the obligor] from liability.'"); Lison v. Gottsegen (In re Mi-Lor Corp.), 348 F.3d 294, 305 (1st Cir. 2003) ("The fact of a release is an affirmative defense, and the party seeking to have a release enforced usually bears the initial burden of pleading and proving the existence of that release."). This burden requires that the Plaintiffs show (1) that the release of liens was in accordance with the loan documents and (2) which liens the Debtors accordingly released. The Court has held that the Debtors complied with their obligations with respect to the first prong, but did not rule on the second.

The Plaintiffs have failed to carry their burden of showing that all assets listed in the CFDR as pledged to the AFI LOC have been released from the JSN Collateral. The CFDR does not track the release of collateral and consequently does not satisfy the "book and records" definition of Subject Mortgage Loans. (FoF § III ¶ 430.) Instead, the CFDR constitutes an indirect record of collateral movement and reflects what may be in the Debtors' books and records, but leaves open the possibility that collateral identified as pledged to the AFI LOC was recoded as a result of a subordination agreement, a recording error or on some other basis than an intent to release liens. The Debtors' "books and records" indicating the release and pledge of assets from the JSNs to the AFI LOC are (i) the collateral addition notices prepared by the Debtors in connection with non-automatic lien releases, (ii) the asset lists provided to AFI and its

attorneys and (iii) the lists that accompanied officers certificates with respect to automatic lien releases (collectively, the "Asset-Level Release Documents").

The fact that the Debtors did not retain or produce Asset-Level Release Documents (which Ms. Farley testified were always created and maintained by the Debtors) with respect to $910.4 million of assets that would otherwise be JSN Collateral is stark evidence that such collateral was not released. Pursuant to F.R.E. 803(7), the lack of evidence of a regularly conducted transaction is evidence that no such transaction took place, and the burden then falls to the party lacking documentation to prove the existence of the transaction. Silverman v. Sound Around, Inc. (In re Allou Distribs., Inc.), 404 B.R. 710, 721 (Bankr. E.D.N.Y. 2009). Here, to the extent that they cannot identify the release of specific collateral, the Plaintiffs have failed to carry their burden of establishing that the JSNs released their liens over such collateral. See Official Comm. of Unsecured Creditors of Enron Corp. v. Martin (In re Enron Creditors Recovery Corp.), 378 B.R. 54, 58 (Bankr S.D.N.Y. 2007) (finding that evidence of a cost-sharing agreement did not establish payment under such agreement where underlying business records showed no evidence of payment).

E. The Amount Of The JSN Collateral As Of The Effective Date Is Not Subject To Downward Adjustment

While a substantial portion of the trial addressed why the trial addressed why the Debtors have more JSN Collateral than their Recovery Analysis posits, Plaintiffs have sought to reduce even further the quantum of collateral on the Effective Date. The Court should reject any proposed downward adjustment.

1. None of the JSN Collateral Was Obtained in an Avoidable Preference

In Count XI of the Committee Complaint, the Committee seeks to avoid the Alleged Preferential Transfers of certain assets having a book value of $365 million and an alleged fair value of $284 million within the Preference Period. See FoF §IV ¶ 90.

a. The Committee Failed to Make a Prima Facie Case for Avoidance of the Alleged Preferential Transfers

Under Bankruptcy Code sections 547(b) and (g), the Committee bore the burden to demonstrate that the Debtors granted security interests in the Alleged Preference Assets[28] (i) to or for the benefit of the JSNs; (ii) for or on account of an antecedent debt owed by the Debtors before such grant was made; (iii) while the Debtors were insolvent; and (iv) on or within 90 days before the Petition Date. 11 U.S.C. §547(b); see also 11 U.S.C. §547(g) ("the trustee has the burden of proving the avoidability of a transfer under subsection (b) of this section."); Lowrey v. Mfrs. Hanover Leasing Corp. *(*In re Robinson Bros. Drilling, Inc.)*,* 6 F.3d 701, 703 (10th Cir. 1993) (a preference plaintiff "has the burden of proving . . . every essential controverted element … in the preference."). The Committee was further obligated to show that the Debtors' alleged grant of security interests in the Alleged Preference Assets enabled the JSNs to receive more than they would have received in a Chapter 7 liquidation occurring on the Petition Date if such security interest had not been granted. 11 U.S.C. § 547(b)(5); Official Comm. of Unsecured Creditors of 360Networks (USA) Inc. v. AAF-McQuay, Inc. (In re 360Networks (USA), Inc)., 327 B.R. 187, 190 (Bankr. S.D.N.Y. 2005).

[28] For purposes of Bankruptcy Code section 547(b), a grant of a security interest in assets of the debtor constitutes a transfer. Le Cafe Creme v. Le Roux (In re Le Cafe Creme, Ltd.), 244 B.R. 221, 233 (Bankr. S.D.N.Y. 2000) ("'The retention of title as a security interest is a transfer, just as the granting of a lien would be a transfer.'") (citing 2 COLLIER ON BANKRUPTCY ¶ 101(54) at 101-153 (15th ed. 1993). Thus, "transfer" and "grant" of a security interest are used interchangeably.

i. The Committee Made No Showing That The JSNs Were Undersecured At The Start Of The Modified Preference Period

The Committee failed to meet its burden of showing that the JSNs were undersecured as of February 29, 2012—the starting date of the Modified Preference Period. See FoF §IV ¶ 98. The law is well settled that "[u]nder § 547(b)(5), a transfer to a fully secured creditor is immunized from preference attack because the creditor would have been paid in full in a hypothetical Chapter 7 liquidation by virtue of its realization on its collateral." In re 360networks(USA), Inc., 327 B.R. at 190.; see In re Santoro Excavating, Inc., 32 B.R. 947, 948 (Bankr. S.D.N.Y. 1983) ("[A] payment [during the preference period] to a creditor with an allowed fully secured claim is not a preference.") (collecting cases); Batlan v. TransAmerica Commercial Fin. Corp. (In re Smith's Home Furnishings, Inc.), 265 F.3d 959, 966 (9th Cir. 2001) (fully secured creditors cannot be attacked under [section] 547(b)). "If the creditor is fully secured 90 days before the filing of the petition, then that creditor will never be subject to a preference attack." See In re Ebbler Furniture & Appliances, Inc., 804 F.2d 87, 90 (7th Cir. 1986).

Where a creditor asserts that it was oversecured at the time of the alleged preferential transfer, it is the plaintiff's burden to refute that assertion. See Savage & Assocs., P.C. v. Cnty. of Fairfax (In re Teligent, Inc.), No. 01-12974 (SMB), 2006 WL 1030417 at *3 (Bankr. S.D.N.Y. Apr. 13, 2006) ("Teligent II") ("[W]here the defendant in a preference action asserts that it was oversecured, the plaintiff must prove a negative, to wit that the defendant was not oversecured."), aff'd sub nom, In re Teligent Servs. Inc., No. 06 Civ. 03721 (KMW), 2009 WL 2152320 (S.D.N.Y. July 17, 2009) ("Teligent III"); see also Batlan, 265 F.3d at 967 ("a preference plaintiff must effectively prove a negative (that the defendant is not a totally secured creditor)")

(internal quotation marks and citation omitted).[29] A defendant's assertion that it was fully secured is not a defense but a negation of one of the elements of a preference action, pursuant to section 547(b). See Teligent III, 2009 WL 2152320, at *6.

The Notes Trustee has repeatedly asserted that the JSNs were oversecured as of the start of the Modified Preference Period, and demonstrated through the uncontroverted expert testimony of Michael Fazio that the JSNs were oversecured on February 29, 2012 on both a book value and fair market value basis. See e.g., FoF §IV ¶¶ 99–100. The Committee has failed to rebut this assertion, offering no evidence to show (or even allege) that the JSNs were undersecured at the start of the Modified Preference Period, or at any time during the Preference Period. See FoF §IV ¶ 101. Accordingly, judgment must be entered in favor of Defendants on Count XI.

ii. The Committee Failed To Perform A Chapter 7 Liquidation Analysis

The Committee's preference claim fails for the additional and independent reason that the Committee did not perform its own liquidation analysis, relying instead on the flawed liquidation analysis included in the Disclosure Statement. See FoF §IV ¶¶ 104–105.

As the Notes Trustee demonstrated through the expert testimony of Michael Fazio, the Debtors' liquidation analysis could not support the Committee's contentions because, among other reasons, it: (a) ascribes zero value to estate claims against AFI, in which the JSNs hold

[29] See also Mellon Bank, N.A. v. Metro Commc'n Inc., 945 F.2d 635, 644 n.2 (3d Cir. 1991) (noting that preference plaintiff failed to meet its burden of proving that defendant, a secured creditor, was not fully secured); In re Prescott, 805 F.2d 719, 726 (7th Cir. 1986) ("to meet his burden, the trustee must establish that the value of [defendant's] collateral on . . . the date before the first alleged preferential transfer took place—was less than the amount owed by [debtor] to [defendant] on that date."); Lease-A-Fleet,Inc. v. Wolk (In re Lease-A-Fleet, Inc.), 151 B.R. 341, 351 (Bankr. E.D. Pa. 1993) (concluding that because "the Debtor presented no evidence regarding the values of the [collateral] at the time of the alleged preferential payments," the court "[was] unable to hold that [defendant] was an undersecured creditor which received more than it would have under a Chapter 7 liquidation [and] the Debtor failed to meet its preference burden").

security interests, notwithstanding that AFI has agreed to pay $2.1 billion to settle such claims, and that the Examiner appointed by the Court in these cases found that the Debtors or their creditors held approximately $3.1 billion of causes-of-action against AFI that were "likely to prevail" or "more than likely to prevail," and approximately $5.5 billion or more in total causes-of-action, and (b) ascribes zero value to intercompany claims among the Debtors, in which the JSNs also hold security interests. See FoF §IV ¶¶ 105–106.

Further, in assessing whether alleged preferences have enabled a creditor to receive more than it otherwise would in a hypothetical Chapter 7 liquidation, the hypothetical liquidation should be performed as of the Petition Date. See Palmer Clay Prods. Co. v. Brown, 297 U.S. 227 (1936). The liquidation analysis on which the Committee relies was performed as of April 30, 2013, nearly one year after the Petition Date. See FoF §IV ¶ 105.

iii. The Committee's Only Evidence In Support Of Its Preference Claim, The CFDR, Does Not Demonstrate By A Preponderance Of The Evidence That The Debtors Granted Security Interests In The Alleged Preference Assets To The JSNs During the Preference Period

In order to prevail on its preference claim, the Committee must prove that the JSNs were granted security interests in the Alleged Preference Assets during the Preference Period. See Lawson v. Ford Motor Co. (In re Roblin Indus., Inc.), 78 F.3d 30, 34 (2d Cir. 1996); Official Comm. of Unsecured Creditors of Enron Corp. v. Whalen (In re Enron Corp.), 357 B.R. 32, 37 (Bankr. S.D.N.Y. 2006). In order to meet this burden, the Committee relies exclusively on the CFDR. See FoF §IV ¶¶ 109–110. Specifically, the Committee identified the Alleged Preference Assets by performing a rudimentary comparison of CFDR extracts as of February 29, 2012 and the Petition Date. Id. Based on this rote examination, the Committee asserted that any asset

appearing in the CFDR as JSN Collateral during the Preference Period was an Alleged Preferential Transfer. See FoF §IV ¶ 110.

As the Committee's expert, Marc. E. Landy, conceded in identifying the Alleged Preference Assets "[he] did not attempt to understand the circumstances for why each loan may have appeared [in the CFDR] on 5/13 . . . ." and did not "evaluate whether [the Debtors], to use your phrase, 'acquired title.' [He] put together the schedule. Either they were—they were in the May 13th column and they weren't in the 2/29 column." Instead, Mr. Landy simply "put together the schedule. Either they were—they were in the May 13th column and they weren't in the 2/29 column." Trial Tr. 153:10–22, 162:10–15, Oct. 17, 2013 (Landy); see also FoF §IV ¶ 110.

The CFDR contains little to no information, however, explaining why an asset would appear for the first time (or reappear after a period of absence) in the CFDR, and multiple explanations for such appearance or reappearance, in addition to the possibility that the asset was newly purchased by the Debtors, exist. See FoF §IV ¶¶ 122–130, 136. Indeed, the evidence shows that there are several alternative, equally plausible (and in some cases more plausible) explanations as to why certain of the Alleged Preference Assets appear in the CFDR for the first time during the Preference Period, including that the loans were modified, repaid in full and then subsequently drawn upon, or represent refinancing of old loans that formerly constituted JSN Collateral. See FoF §IV ¶¶ 131–134.

Mr. Landy has acknowledged that his preference analysis does not exclude these alternative explanations. See FoF §IV ¶¶ 110–113. At best then, even drawing all inferences in the Committee's favor, the most the Committee has proved is that the appearance of the Alleged Preference Assets in the CFDR *might* show a grant of a security interest to the JSNs during the Preference Period. While that explanation is plausible, it is not more likely than, but merely

stands in equipoise with, the alternative explanations shown by the Notes Trustee. Without more—for example, documents underlying the CFDR identifying the nature of the transactions that caused the Alleged Preference Assets to appear in the CFDR, or some explicit indication to that effect within the CFDR, or witness testimony establishing the same—the Committee has not met its evidentiary burden.

The Committee's shortcomings in this regard are particularly noteworthy with respect to certain classes of Alleged Preference Assets. Specifically:

- The FHA/VA assets for which no Loan Funding Date exists within the CFDR and for which the Debtors have provided no information nor conducted any inquiry as to whether such assets are refinancings (despite the acknowledgment that such assets could be refinancings);

- The approximately $12 million of REO assets which the Committee's expert, Marc E. Landy, concedes were within the CFDR in the JSN Collateral prior to the Preference Period. The Committee seeks to avoid these assets "to the extent . . . ownership of these REO properties was transferred . . . to an REO special purpose vehicle during the preference period," yet offered no evidence that such transfers to special purpose vehicles occurred during the Preference Period;

- The HFS loans appearing for the first time in the CFDR during the Preference Period with Loan Funding Dates prior to the Preference Period, for which neither the Committee nor the Debtors can offer a reasonable and consistent explanation, the majority of which have "Loan Modification Dates" and a portion of which are coded as HELOCs (suggesting that their appearance is the result of loan modifications or draws on HELOCs); and

- The HFS and FHA/VA loans that appeared in the CFDR prior to the Preference Period, disappeared from the CFDR and reappeared within the CFDR during the Preference Period.

See FoF §IV ¶¶ 121, 123, 126, 135. With respect to these Alleged Preference Assets, too many questions and inconsistencies remain to conclude by a preponderance of the evidence that the Debtors first acquired an interest in these assets (and granted the JSNs a security interest therein) during the Preference Period.

As of trial, the Committee had had access to the CFDR and the Debtors' representatives knowledgeable about the CFDR for approximately 14 months. See FoF §IV ¶ 108. By contrast, the Notes Trustee and Ad Hoc Group had had such access (on a more limited basis) for only two months. See FoF §IV ¶ 116. Yet the Notes Trustee's expert, Scott Winn, was able to identify numerous inaccuracies and inconsistencies on Schedule 6, for which the Committee failed to offer reliable or complete explanations. See FoF §IV ¶¶ 119–121. Further, the Debtors' discovery responses to the Notes Trustee were frequently tardy, inconsistent and incomplete, and the Debtors were often unable to answer pointed questions posed by the Notes Trustee's experts at Zolfo Cooper. See FoF §IV ¶¶ 116–117. Given the relative positions of the parties, the Court should be particularly skeptical of adopting the Committee's inference that the Debtors granted the JSNs security interests in the assets appearing within the CFDR during the Preference Period.

b. The Committee's Preference Claim is Barred by the "Improvement in Position Test"

The Committee's preference claim also fails because it is barred by the "improvement in position" test codified by Bankruptcy Code section 547(c)(5).[30] That section provides that a plaintiff may not avoid a transfer:

> that creates a perfected security interest in inventory or a receivable or the proceeds of either, except to the extent that the aggregate of all such transfers to the transferee caused a reduction, as of the date of the filing of the petition and to the prejudice of other creditors holding unsecured claims, of any amount by which the debt secured by such security interest exceeded the value of all security interests for such debt on … 90 days before the date of the filing of the petition …

[30] The secured party bears the burden of showing that its position did not improve, but only if the plaintiff has met its burden under section 547(b) (which, as explained above, the Committee has not done here). See Batlan, 265 F.3d at 966.

11 U.S.C. § 547(c)(5). Here, all of the Alleged Preference Assets are mortgage loans held for sale, real estate assets held for sale, and governmental insurance claims. See FoF §IV ¶ 91. These Alleged Preference Assets constitute receivables under Bankruptcy Code section 547(a)(3) or inventory under Bankruptcy Code section 547(a)(1). See FoF §IV ¶¶ 91–92.

Bankruptcy Code section 547(a)(3) defines a "receivable" as a "right to payment, whether or not such right has been earned by performance," 11 U.S.C. § 547(a)(3) (emphasis added). Several courts, including the U.S. Supreme Court, have held that a mortgage secures a creditor's "right to repayment." See Johnson v. Home State Bank, 501 U.S. 78, 82 (1991); see also In re Smith, 469 B.R. 198, 202 (Bankr. S.D.N.Y. 2012); In re Anderson, No. 10-13924, 2013 WL 3878973, at *1 (Bankr. E.D. La. July 26, 2013); Smoot v. Wachovia Mortg. (In re Smoot), 465 B.R. 730, 732 (Bankr. E.D.N.Y. 2011), rev'd on other grounds, Wachovia Mortg. v. Smoot, 478 B.R. 555 (E.D.N.Y. 2012).[31]

The mortgages within the Alleged Preference Assets were held for sale by the Debtors and, therefore, also fall within the definition of "inventory" under Bankruptcy Code section 547(a)(1). See 11 U.S.C. § 547(a)(1) (defining "inventory" as "personal property leased or furnished, *held for sale* or lease, or to be furnished under a contract for service . . .") (emphasis added).

Assuming the plaintiff has shown that the secured creditor was undersecured at the outset of the preference period, the "two-point net improvement" test of section 547(c)(5) requires a

[31] Moreover, the legislative history to section 547 indicates that the term "receivable" should be defined in its "ordinary sense," H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 372 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6328, and scholars have agreed, see David Gray Carlson, Security Interests in the Crucible of Voidable Preference Law, 1995 U. ILL. L. REV. 211, 317–18 (1995); see also Irving A. Breitowitz, Article 9 Security Interests as Voidable Preferences: Part II, 4 CARDOZO L. REV. 1, 63–64 (1982).

comparison of the amount by which a secured creditor's claim exceeded the value of its collateral ninety days (or, here, seventy-five days) prior to bankruptcy, against the amount by which a secured creditor's claim exceeded the value of its collateral as of the petition date. Wilson v. First Nat'l Bank (In re Missionary Baptist Found. of Am., Inc.), 796 F.2d 752, 759–60 (5th Cir. 1986). Under section 547(c)(5), if the secured party's position does not improve relative to what it was ninety days (or, here seventy-five days) prior to the petition date, there will be no preference. See U.S. Lines (S.A.), Inc. v. United States (In re McLean Indus., Inc.), 162 B.R. 410, 424(S.D.N.Y. 1993), rev'd as time-barred, 30 F.3d 385 (2d Cir. 1994). Application of the test is straightforward, and requires "a computation of (1) the loan balance outstanding ninety days prior to the bankruptcy; (2) the value of the [collateral] on that day; (3) the loan balance outstanding on the day the bankruptcy petition was filed; and (4) the value of the [collateral] on that day." See In re Missionary Baptist Found. of Am., 796 F.2d 752, 760 (5th Cir. 1986); QMECT, Inc. v. Burlingame Capital Partners (In re QMECT, Inc.), 373 B.R. 100, 106 (Bankr. N.D. Cal. 2007) (describing the test as a comparison of the value of an undersecured creditor's collateral on the petition date with the value of its collateral at the beginning of the preference period).

Here, the aggregate value of the JSN Collateral, excluding certain collateral the existence and amount of which is disputed by the Plaintiffs,[32] actually *decreased* during the Modified Preference Period, with (x) the gross and net book value of the JSN Collateral decreasing by $182 million and $128 million, respectively, and (y) the gross and net fair market value of the JSN Collateral decreasing by $137 million and $83 million, respectively. See FoF §IV ¶ 102.

[32] The disputed collateral is the goodwill or going concern value, the value of contracts or agreements and other related non-financial assets, or causes of action against AFI or other parties. See FoF §IV ¶ 100.

And Mr. Fazio showed that the JSN Collateral decreased during the Modified Preference Period even if the flawed valuation methodology employed by Plaintiff expert Marc D. Puntus is applied. See FoF §IV ¶ 149.

Moreover, while the value of the JSN Collateral decreased during the Modified Preference Period, the JSNs' claim amount increased by $42 million as interest payable on May 15, 2012 accrued. See FoF §IV ¶ 147. Far from improving, the JSNs' net position thus decreased during the Modified Preference Period by $175 million at book value and $125 million at fair value. Therefore, under Bankruptcy Code section 547(c)(5), the Alleged Preferential Transfers cannot be avoided as preferences.

Finally, even if the Court were to find that, contrary to the Notes Trustee's unrebutted evidence, the JSN Collateral increased as a result of the Alleged Preferential Transfers, the most that the Committee could recover on account of its preference claim is the net amount by which the JSNs' net position increased as a result of the Alleged Preferential Transfers, taking into account both assets that were added to the JSN Collateral and those which were released and taking into account the increase in the JSNs' prepetition claim.

The law is clear that where a preference transfers occur, the maximum amount that may be avoided is the net improvement in the creditor's position over the preference period. See Wilson v. First Nat'l Bank (In re Missionary Baptist Found. of Am.), 796 F.2d 752, 761 (5th Cir. 1986) ("The figure resulting from this arithmetic process designates the maximum extent of the trustee's power to avoid a security interest in inventory or receivables under section 547(b)."). Bankruptcy Code section 547(b)(5)(B) provides that a transfer can be avoided only where it "enables such creditor to receive more than such creditor would receive if . . . the transfer had not been made."

2. The Contested Assets Are JSN Collateral (Counts I & IV)

Counts I and IV of the Committee Complaint require the Court to determine whether the JSN Liens reach two distinct categories of assets: (i) the Former Bilateral Facilities Collateral, which consists of assets that were carved out of the JSN Collateral as "Excluded Assets" at the time the Notes Security Agreement was executed because they were pledged to Bilateral Facilities, but were subsequently released from such Bilateral Facilities prior to the Petition Date and treated as AFI and JSN Collateral, and (ii) the Reacquired Mortgage Loans, which are assets that were initially JSN Collateral, subsequently released by the Collateral Agent in May 2010 so that they could be sold to a repo facility, and then reacquired by the Debtors during the period between September 2010 and the Petition Date .

In analyzing these questions, the Court must interpret the applicable language of the Notes Security Agreement, in order to discern the intent of the parties as revealed by the agreement. Compagnie Financiere de CIC et de L'Union Europeenne v. Merrill Lynch, Pierce Fenner & Smith, Inc., 232 F.3d 153, 157 (2d Cir. 2000). "A written agreement that is clear, complete and subject to only one reasonable interpretation must be enforced according to the plain meaning of the language chosen by the contracting parties." Dev. Specialists, Inc. v. Peabody Energy Co (In re Coudert Bros.), 487 B.R. 375, 389 (S.D.N.Y. 2013). Where a contract is ambiguous, however, courts may consider extrinsic evidence in order to determine the parties' intended meaning. Such extrinsic evidence may include the testimony of the parties' intent, evidence of their course of conduct and relevant dealings, and custom and usage of particular language or terms within the relevant history. See Webb v. GAF Corp., 936 F. Supp. 1109, 1124 (N.D.N.Y. 1996); Law Debenture Trust Co. v. Maverick Tube Corp., 595 F.3d 458, 466 (2d Cir. 2010).

While the Defendants believe that (1) the broad and continuing nature of the security interest granted under the Notes Security Agreement, (2) the provisional phrasing and obvious purpose of the Excluded Assets definition, and (3) the language and purpose of section 7.01(q) of the AFI Revolver lead to the singular conclusion that the Contested Assets are JSN Collateral as a matter of law, the Court has previously ruled that the Notes Security Agreement is ambiguous with respect to these issues. See Official Comm. Of Unsecured Creditors v. UMB Bank, N.A. (In re Residential Capital, LLC), 495 B.R. 250, 262 (Bankr. S.D.N.Y. 2013). To the extent that the Court continues in this view, then it must examine both the contractual language and the extrinsic evidence to determine whether the Security Interest should be interpreted as extending to the Contested Assets. This evidence leads to the inescapable conclusion that the Security Interest was intended to cover the Contested Assets, and that the Notes Security Agreement should be interpreted accordingly.

a. The Notes Security Agreement Documents an All-Assets Security Interest

As a preliminary matter, there can be no dispute that the express language of the Notes Security Agreement plainly documents a typical all-assets security interest. Indeed, the Court has previously recognized that the agreement includes a broad all-assets granting clause. See In re Residential Capital, 495 B.R. at 261. By its own terms, the granting clause in the Notes Security Agreement reaches all of the Debtors' assets that are legally and practicably available both at the time, and after, the Notes Security Agreement was executed. FoF §IV ¶ 156. In particular, Section 2 of the Notes Security Agreement provides, *inter alia*, that:

> [T]he Company and each of the Guarantors and each other Grantor . . . hereby pledges to the Third Priority Collateral Agent for the benefit of the Secured Parties, and hereby grants a continuing security interest to the Third Priority Collateral Agent for the benefit of the Secured Parties in, all of the Company's, such Guarantor's or any such other Grantor's right, title and interest, in, to, and

> under, ***whether now or hereafter existing, owned or acquired and wherever located and howsoever created, arising or evidenced, all of the following***: (a) ***all Assets***. . .

See Notes Security Agreement § 2 (emphasis added).

Section 2 of the Notes Security Agreement further describes the collateral to which the Security Interest extends with a comprehensive catalog of asset types, including those prescribed by Article 9 of the UCC, such as "General Intangibles," "Goods," "Accounts," "Chattel Paper," "Deposit Accounts," and "Documents." See Notes Security Agreement § 2(a)-(u); see also, id. at §1 (adopting definitions of Article 9 UCC). Moreover, the collateral description includes a catch-all category that encompasses "***all other personal assets and property of any kind or description***," to safeguard against any possibility that the list inadvertently omits a specific asset type. See Id. FoF §IV ¶ 193.

The only assets carved out of the Security Interests are those that fall within the contours of the "Excluded Assets." The "Excluded Assets" definition was designed to exclude from the Security Interest only those assets that, if pledged under the Revolver or Notes Security Agreements, would cause a loss of funding to ResCap or materially devalue the asset. FoF §IV ¶ 160. The plain language of the Notes Security Agreement thus unquestionably evidences a typical all-assets security interest that reflects the parties' intent that the Security Interest would reach as many available assets as possible.

Extrinsic evidence adduced at trial relating to both the intent and course of dealing of the parties that drafted the Notes Security Agreement, and to the custom and practice of parties to typical all-assets secured transactions, indisputably shows that the JSNs have a traditional all-assets security interest. Indeed, the testimony shows that the parties who negotiated and drafted the language of the All-Assets Granting Clause—the Debtors and AFI—understood it to be very

broad, and to extend to all assets of the Debtors then or thereafter existing that were legally and operationally available to be pledged without devaluing the asset itself or interfering with an alternative source of funding for the Debtors. FoF §IV ¶¶ 156, 160. Moreover, as discussed below, the evidence shows that, in actual practice, the Debtors treated the Contested Assets as JSN Collateral.

The custom and practice evidence also confirms the very broad scope of the JSNs' Security Interest. Under New York law, such evidence consists of proof that the meaning of contractual language within a particular trade or industry is "so well settled, so uniformly acted upon, and so long continued as to raise a fair presumption that it was known to both contracting parties and that they contracted in reference thereto." British Int'l Ins. Co. v. Seguros La Republica, S.A. 342 F.3d 78, 84 (2d Cir. 2003). Here, Defendants have introduced the expert testimony of Professor Ronald Mann, who testified that parties to all-assets security agreements drafted in the manner of the Notes Security Agreement customarily intend that the agreement will reach all asset types that are legally and practically available at the time the agreement is documented, as well as any assets that may thereafter come into the borrower's possession or become available to be pledged. FoF §IV ¶¶ 241, 229-39. Typically, the only assets that are carved out of such all-assets security grants are those that cannot be granted for legal or business reasons. FoF §IV ¶ 244. Thus, the Court's determination of whether the Security Interest extends to the Contested Assets must start with the baseline premise that, consistent with industry custom and practice, the parties intended the Security Interest to reach all Debtor assets that could be legally and operationally pledged.

b. The JSNs' Security Interest Extends to the Former Bilateral Facilities Collateral

Plaintiffs contend that because the Former Bilateral Facilities Collateral fell within the Excluded Asset definition as of the Issue Date, it was perpetually excluded from the Security Interest. This contention is inconsistent with the Notes Security Agreement's plain language, custom and practice, and the extrinsic evidence of the parties' actual intent and practice.

i. The Excluded Assets Definition Contemplates Only a Provisional Exclusion

Section 2 of the Notes Security Agreement expressly provides that "the 'Collateral' . . . shall not include Excluded Assets." As relevant to Count I of the Committee Complaint, "Excluded Assets" means:

> (c) any asset . . . ***to the extent that*** the grant of a security interest therein would violate applicable Requirements of Law, result in the invalidation thereof or provide any party thereto with a right of termination or default with respect thereto or ***with respect to any Bilateral Facility*** to which such asset is subject as of the Issue Date . . .

See FoF §IV ¶ 158 (emphasis added). The plain language of this definition— in particular, the phrase "to the extent that"— makes clear that an asset's status as an Excluded Asset by virtue of being subject to a Bilateral Facility was provisional and not intended to impose a permanent exclusion. Id. Whether an asset constituted an Excluded Asset depended on whether certain conditions or restrictions causing that asset to be legally or practically unavailable existed. Id. In the case of the Former Bilateral Facilities Collateral, the relevant issue was whether the grant of a security interest in such assets would result in the termination or default of the financing provided under the applicable Bilateral Facility. Id. The natural and ordinary reading of the Excluded Assets definition is that once a pledge of an asset would no longer result in such termination or default, the asset would not constitute an Excluded Asset," and would fall within the scope of the All-Assets Granting Clause.

Clause (f) of the Excluded Assets definition supports this conclusion. Clause (f) provides that the proceeds of Excluded Assets are carved out of the JSN Collateral only if such proceeds are precluded from being pledged to the JSNs for the reasons set forth in clauses (a) through (e) of the Excluded Assets definition. If the parties had intended that assets subject to a Bilateral Facility as of the Issue Date would constitute Excluded Assets even if the grant of a security interest in such assets would no longer run afoul of any Bilateral Facility, it would be illogical that they would have agreed that the proceeds of such assets would constitute JSN Collateral.[33]

ii. Extrinsic Evidence Supports The JSNs' Position Without Exception

Both Debtor and AFI employees testified that if the Bilateral Facilities had not precluded the Former Bilateral Facilities Collateral from being pledged to AFI and the JSNs, such assets would have been included within the initial security grants. FoF §IV ¶¶ 162, 169. These employees testified further that once an asset that otherwise fell within the scope of the Security Interest was released from a Bilateral Facility, such asset would become part of the JSN Collateral. FoF §IV ¶¶ 169–172.

Additionally, documents created by or for the benefit of the Debtors around the time the Notes Security Agreement was originally executed explicitly state that assets removed from a Bilateral Facility would become Revolver and JSN Collateral. FoF §IV ¶¶ 174–177. The CFDR also conclusively shows that the Debtors treated assets previously pledged to Bilateral Facilities as JSN Collateral once they were released from the Bilateral Facilities. FoF §IV ¶¶ 178–185. Conversely, Plaintiffs failed to introduce a shred of evidence that the parties who drafted the

[33] The temporal limitation "as of the Issue Date" does not in any way suggest the contravening conclusion that the Former Bilateral Facilities Collateral remains forever excluded. Rather, the phrase was clearly intended simply to restrict the universe of excluded assets subject to a Bilateral Facility to those that were pledged to a Bilateral Facility as of the Issue Date.

Notes Security Agreement intended the Former Bilateral Facilities Collateral to permanently remain an Excluded Asset despite being released from the subject Bilateral Facilities.

Relevant custom and practice evidence also shows that the Security Interest extends to the Former Bilateral Facilities Collateral. As Professor Mann testified, the breadth of an exclusion from an all-assets security grant is ordinarily defined by its purpose, and "[t]here would be no reason for such exclusion to reach any more broadly than demanded . . ." FoF §IV ¶ 245. Thus, parties to all-asset security transactions typically expect that when the justification for excluding an asset ceases to exist, that asset automatically falls within the scope of the all-assets security interest absent explicit language to the contrary. Id..

Here, the assets comprising the Former Bilateral Facilities Collateral were excluded because they were already subject to superior financing arrangements. But when these assets "rolled off" the Bilateral Facilities, the justification for their exclusion ceased to exist, and, they became legally and practically available collateral within the automatic reach of the JSNs' perfected Security Interest.[34] Under ordinary custom and practice, this is the only commercially reasonable interpretation of the Notes Security Agreement.

By contrast, Plaintiffs' position that the Notes Security Agreement forever excludes the Former Bilateral Facilities Collateral is commercially unrealistic. To the extent that the Plaintiffs suggest that the parties agreed to permanently exclude Former Bilateral Facilities Collateral in order for the Debtors to "maintain flexibility," that explanation rings hollow, particularly since

[34] Plaintiffs' contention that the JSNs failed to perfect their Security Interest in the Former Bilateral Facilities Collateral is misguided. Unlike the Reacquired Mortgage Loans, the Former Bilateral Facilities Collateral, with the exception of the BMMZ former Bilateral assets, was never the subject of any lien release or UCC-3 amendment. FoF §IV ¶154. Thus, it is indisputable that the initial UCC-1 statements attached to the Former Bilateral Facilities. As Professor Mann testified, the assets subject to an all-assets financing statement can change over time based on the parties' agreement. FoF §IV ¶ 245

the Debtors already had substantial flexibility with respect to these assets. FoF §IV ¶ 137. Further, had the parties in fact agreed to such an unusual outcome, custom and practice indicates they would have documented it with unambiguous explicitness. FoF §IV ¶ 246.

While Plaintiffs offered James Gadsden's opinion that the parties to the Notes Security Agreement could have and should have used explicit "spring back" language to document their intent for the Security Interest to cover the Former Bilateral Facilities Collateral, that opinion is wholly unreliable. Mr. Gadsden's conclusions rest on a tiny sampling of indentures and related security agreements (but not loan agreements), which use language of varying degrees of specificity to address the treatment of discrete asset types, the vast majority of which are completely inapposite to the Former Bilateral Facilities Collateral. FoF §IV ¶¶ 251–257. Such evidence hardly establishes custom and practice.[35] Additionally, Mr. Gadsden conceded that he could not opine that parties who omitted the more specific language for other categories of excluded assets intended to permanently exclude such assets once the basis for their exclusion ceased to exist. FoF §IV ¶ 263.

c. <u>The BMMZ Bilaterals May Not Be Avoided</u>

Independent of the discussion above, the evidence shows that the portion of Count I relating to "BMMZ former Bilateral" must be rejected. Count I of the Committee Complaint alleges that the Former Bilateral Facilities Collateral "remained property of the estates as of the Petition Date," and that the assets listed in the "Ally Revolver" and "Blanket" columns in Exhibit A to the AFI DIP Order include the Former Bilateral Facilities Collateral. FoF §IV ¶¶ 150, 192.

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[35] <u>See Hunter v. Greene</u>, 734 F.2d 896, 900 (2d Cir. 1984) (rejecting trade usage affidavit that price formula was "often used" in industry, as "often used" was insufficient to show usage was "fixed and invariable," and at most showed proffered trade practice was "frequently … used").

At trial, Plaintiffs and Defendants agreed, however, that the $27 million of assets on PX 76, labeled "BMMZ former Bilateral" were not owned by the Debtors on the Petition Date and not listed as JSN Collateral in the "Ally Revolver" or "Blanket" columns. In fact, these BMMZ former Bilateral assets were released by UCC-3 statements and sold to BMMZ pursuant the BMMZ Facility, where they remained until the Petition Date.[36] FoF §IV ¶ 189.

In its Motion to Dismiss ruling, the Court held that the BMMZ facility was a bona fide sale and repurchase agreement. Under the MRA, the Debtors owned the right to repurchase such assets (along with the other mortgage loans previously sold to BMMZ) for $250 million. FoF §IV ¶ 190. As such, the JSNs do not hold direct security interests in the BMMZ former Bilaterals. Rather, as the Debtors stipulated in the AFI DIP Order, the JSNs are entitled to the residual value of the BMMZ former Bilaterals, through their lien on the Debtors' contractual repurchase right, a general intangible covered by the JSNs' perfected Security Interest. FoF §IV ¶ 196. The Court previously dismissed the Committee's claim to avoid the JSNs' liens in such repurchase rights. Memorandum Opinion Granting in Part and Denying in Part UMB Bank's Motion to Dismiss, Aug. 13, 2013, Comm. Adv. Dkt. No. 74. The Committee cannot circumvent this ruling by improperly shoehorning the BMMZ former Bilaterals into Count I.

d. The JSNs Have a Perfected Security Interest In the Reacquired Mortgage Loans

i. The Reacquired Mortgage Loans Are After-Acquired Property

Count IV asserts that the JSNs' Security Interest did not reattach to the Reacquired Mortgage Loans when they were repurchased by the Debtors. This wholly ignores the All-

[36] The loans identified as BMMZ former Bilaterals were listed in the column labeled "BMMZ Repo" on Exhibit A to the AFI DIP Order. FoF §IV ¶ 192. The $27 million value of such loans (on a book value basis) is a fraction of the $387 million (on a book value basis) in total loans sold to the BMMZ Facility. FoF §IV ¶ 188.

Assets Granting Clause, which includes an after-acquired property clause expressly covering all of the Debtors' assets, "whether now or hereafter existing, owned or acquired and wherever located and howsoever created . . ." Notes Security Agreement §2. Such an after-acquired property clause creates a security interest in collateral that the borrower acquires after the execution of the security agreement, and adopts the principle of a "continuing general lien" or "floating lien," which "validates a security interest in debtor's existing and (upon acquisition) future assets." See In re Minor, 443 B.R. 282, 288 n.3 (Bankr. W.D.N.Y. 2011) ("Today, under the Uniform Commercial Code, the proper perfection of a security interest may create an enforceable lien in after-acquired property, without regard to any entitlement to an equitable lien under common law."); Marine Midland Bank v. Dreeden (In re Bennett Funding Group, Inc.), 255 B.R. 616, 638 (N.D.N.Y. 2000) ("A lien in after-acquired property is, in large part, a "floating lien" on property acquired by the debtor following execution of an initial security agreement."); see N.Y. U.C.C. § 9-204(a) (2001); id., cmt. 1.[37] A security interest arising by virtue of an after-acquired property clause is thus "no less valid than a security interest in collateral in which the debtor has rights" at the time of the loan is made: "no further action by the secured party—such as a supplemental agreement covering the new collateral—is required." N.Y.U.C.C. § 9-204 cmt. 2 (2001). A security interest in after-acquired property is "sometimes said to 'float' over all of a particular type of the debtor's property. . . As new collateral crosses the debtor's threshold, the security interest clamps down on the newly acquired collateral,

[37] New York adopted Revised Article 9 of the UCC effective July 1, 2001. N.Y.U.C.C. § 9-701 (2001). References to the UCC herein are to Revised Article 9 as adopted in New York. Indeed, bankruptcy courts often rely on such comments when applying sections of the N.Y.U.C.C. See, e.g., In re Enron Corp., No. 01-16034(AJG), 2005 WL 3873890, at **7-9 (Bankr. S.D.N.Y. June 16, 2005) (citing to official comments in order to determine legal issues); In re Adirondack Timber Enter., Inc., No. 08-12553, 2010 WL 1741378, at *4 (Bankr. N.D.N.Y. Apr. 28, 2010) (same).

securing the sums owed by the debtor." 8 William D. Hawkland UCC Series § 9-204:1 (2013).

Here, there is no language in the Notes Security Agreement providing or even suggesting that the after-acquired property clause does not apply to assets that were formerly owned by the Debtors and released from the JSN Collateral for sale to a third party. Rather, under the after-acquired property clause, the JSNs' Security Interest "clamped down" on the Reacquired Mortgage Loans when the Debtors repurchased them. Indeed, the Debtors' and AFI's employees testified that assets that were sold and repurchased by the Debtors would become JSN Collateral upon their reacquisition, irrespective of whether such assets were released from the JSN Collateral before they were sold. FoF §IV ¶¶ 207–211. Moreover, the Debtors coded Reacquired Mortgage Loans as "Unpledged" (meaning AFI's and JSN's collateral in real time as the loans were reacquired) and then re-coded as "Blanket" collateral as of the Petition Date, conveying the Debtors' view that such assets constituted JSN Collateral. FoF §IV ¶ 284, FoF §I ¶¶ 146, 147" to "FoF §IV ¶ 284, FoF §I ¶¶ 44–46.

Relevant custom and practice evidence also supports the conclusion that the Reacquired Mortgage Loans are JSN Collateral. Parties to all-assets security grants like the one here typically intend for such security grants to extend to all assets owned by the borrower at any given time. FoF §IV ¶ 241. Where parties intend to deviate from this arrangement, they typically document that intention with unambiguous explicitness. FoF §IV ¶¶ 245–246.

ii. <u>The JSNs Hold a Perfected Lien in the Reacquired Mortgage Loans</u>

Plaintiffs assert that even if the JSNs' security interests cover the Reacquired Mortgage Loans, the UCC-3 statements filed in May 2010 terminated the UCC-1 financing statements as to these assets, rendering any security interests in the Reacquired Mortgage Loans unperfected. Plaintiffs' argument fails.

As noted above, the JSNs' all-assets Security Interest was perfected by UCC-1 financing statements that explicitly provided notice of the Security Interest in Debtors' after-acquired property. See, e.g., River Valley Bank v. Ace Sports Mgmt., LLC (In re Ace Sports Mgmt., LLC), 271 B.R. 134, 146 (Bankr. E.D. Ark. 2001) ("The security interest in an after-acquired account becomes effective when the after-acquired account is created, but the date of perfection is the date the financing statement is filed."); see also N.Y.U.C.C. § 9-502 cmt. 2 (2001). Under New York law, such financing statements have broad effect. See Allis-Chalmers Credit Corp. v. Bank of Utica, 441 N.Y.S.2d 852, 854 (Sup. Ct. 1981).

The UCC-3 statements filed in connection with the Released Mortgage Loans did not terminate these UCC-1s; they merely amended them to release the Reacquired Mortgage Loans from the Notes Collateral for sale to a third party. When the Reacquired Mortgage Loans were repurchased by the Debtors, the Security Interest granted under the after-acquired property clause attached, and was automatically perfected by the initial filing of the still-operative UCC-1s, which fulfilled their primary purpose of providing public notice that a party ***may*** have a right to take possession of and sell certain assets. See N.Y.U.C.C. § 9–502, cmt. 2 (2001) ("The notice itself indicates merely that a person may have a security interest in the collateral indicated [and] further inquiry from the parties concerned will be necessary to disclose the complete state of affairs."); Ultimore Inc. v. Bucala (In re Bucala), 464 B.R. 626, 632 (Bankr. S.D.N.Y. 2012). As this Court has previously held, "UCC Article 9 only requires information sufficient to engage in further inquiry. When the authorization underlying a previously filed termination statement matters to a subsequent lender (as it usually will), the lender can simply include any necessary further inquiry as part of its due diligence." Official Comm. v. JPMorgan Chase Bank, NA (In re Motors Liquidation Co.), 486 B.R. 596, 644 (Bankr. S.D.N.Y. 2013)); see also In re A.F. Evans

Co., No. 09-41727 EDJ, 2009 WL 2821510, at *5 (Bankr. N.D. Cal. July 14, 2009) aff'd sub. nom., Official Comm. Of Unsecured Creditors v. City National Bank, N. C09-03817 MMC, 2011 WL 1832963 (N.D. Cal. May 13, 20011) ("Here, CNB's financing statements, as amended by the UCC-3 Amendment statements, each with two conflicting boxes checked, would raise a red flag for any person conducting a search alerting such person of the possibility that a full termination may not have been intended.").[38]

By virtue of the still-operative UCC-1s on file, potential lenders were on notice to investigate the extent of the JSNs' security interest over the Reacquired Mortgage Loans notwithstanding the UCC-3s relating to those assets. See Brace v. United States (In re Brace), 163 B.R. 274, 279 (Bankr. W.D. Pa. 1994) ("We conclude that the financing statements filed by the FmHA were sufficient to place later creditors on notice of the FmHA's security interest in the 'type' of property owned by the Debtors . . ."); FoF §IV ¶ 219. Had any actual or potential unsecured creditor inquired of ResCap into the status of the Reacquired Mortgage Loans pre-petition, they would have been told that such loans in fact were automatically pledged once again to AFI and the JSNs under the Blanket Lien, and were coded as such in the CFDR (originally appearing as unpledged and later as Blanket Lien). FoF §IV ¶ 220.

e. The AFI Revolver Supports the JSNs' Position

Section 7.01(q) of the AFI Revolver also shows that the parties to the AFI Revolver intended that the Revolver Security Agreement and the Notes Security Agreement, would grant a security interest in the Contested Assets. As relevant, section 7.01(q) provides:

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[38] This Court has also stated in this case, "that record ([a financing statement]) puts parties on notice to inquire further to ascertain the complete state of affairs." In re Residential Capital, LLC, 497 B.R. 403, 418 (Bankr. S.D.N.Y. 2013).

> Such Obligor [*i.e.*, ResCap and the other Debtors liable for the AFI Revolver and JSN debt] will, and will cause its Subsidiaries to, use commercially reasonable efforts to grant and perfect a Lien to secure the ***Obligations*** . . . with respect to (i) ***US Mortgage Loans repurchased*** or otherwise acquired by such Obligor or Subsidiary, ***or held by such Obligor or Subsidiary and released from the Liens supporting any other facility*** . . .

FoF §IV ¶ 221 (emphasis added). Thus the parties to the Revolver Security Agreement understood that "US Mortgage Loans repurchased" by the Debtors or "released from the Liens supporting any other Facility" (such as a Bilateral Facility) constituted AFI and JSN collateral, as there can be no question that the provision was intended to ensure that the Obligors took all actions necessary to grant and perfect the security interests that ***had already been granted*** in the Revolver and Notes Security Agreements. Id. And given the defined terms used therein, the provision applies for the benefit of both AFI and the JSNs. Id. ¶¶ 221-28.

3. The Debtors Have No Authority To Spend An Additional $153 Million Of The JSNs' Cash Collateral Without Providing Additional Adequate Protection

In addition, Plaintiffs seek declarations from the Court permitting them to charge up to an additional $153 million in carve-out expenses and thereby reduce further the secured position of the JSN Claims at the Effective Date. The language of the Cash Collateral Order controls the priority of the JSN Liens with respect to the carve out. In re Cal. Webbing Indus., Inc., 370 B.R. 480, 483 (Bankr. D.R.I. 2007). The Final Cash Collateral Order creates a carve out from the JSNs' cash collateral that subjects and subordinates the JSN liens to the carve out amount but does not otherwise affect the validity of the JSN liens on carved out JSN Cash Collateral. (FoF § _ ¶ _ [CCO ¶ 5(g)].) The carve out, in turn, is defined as the sum of: (i) court and United States Trustee fees, (ii) accrued and unpaid professional fees following a termination event in an aggregate amount not exceeding $25 million, and (iii) unpaid professional fees that were allowed prior to the termination event; provided that,

> (A) the Carve Out shall not be available to pay any such Professional Fees incurred in connection with the initiation or prosecution of any claims, causes of action, adversary proceedings or other litigation against the Adequate Protection Parties, (B) so long as no event of default shall have occurred and be continuing, the Carve Out shall not be reduced by the payment of fees and expenses allowed by the Court and payable under sections 328, 330 and 331 of the Bankruptcy Code, and (C) nothing in this Final Order shall impair the right of any party to object to any such fees or expenses to be paid by the Debtors' estates.

(FoF § _ ¶ _ Id. ¶ 16(g).)

The carve out in the Cash Collateral Order is no different from carve outs generally—it does not give general unsecured creditors an unfettered right to dispose of the secured lender's collateral or grant administrative creditors an interest in any cash. See, e.g., 3 COLLIER ON BANKRUPTCY ¶ 364.04[2][d] (Alan N. Resnick & Henry J. Sommer, eds., 16th ed. 2011) ("A carve-out gives the benefitted claimants a priority in the postpetition lender's collateral ahead of the lender's priority and, if the carve-out is for the benefit of only certain named administrative claimants, above other administrative claimants as well."); Richard B. Levin, Almost All You Ever Wanted to Know About Carve Out, 76 AM. BANKR. L.J. 445, 451–52 (2002) ("[A] typical carve out agreement uses 'carve out' as a defined term (i.e., as a noun), and not as an operative provision (i.e., as a verb) of the order . . . . A carve out using the phrase 'subject and subordinate to' contemplates subordination.")

Courts in this Circuit agree that the standard "subject and subordinated to" language in cash collateral orders merely subordinates a secured creditor's lien and does not give the general unsecured creditors property rights to spend that cash. As Judge Gerber explained, "'[B]est practices' (and in certain respects, S.D.N.Y. Local Court Rules) call for the debtor and the DIP lender to make clear the extent to which either or both are subordinate to other things . . . . They're collectively referred to in the bankruptcy community as the 'Carve–Out.'" Official

Comm. of Unsecured Creditors of Motors Liquidation Co. v. U.S. Dept. of Treasury (In re Motors Liquidation Co.), 460 B.R. 603, 609 (Bankr. S.D.N.Y. 2011), vacated sub nom. U.S. Dep't of Treasury v. Official Comm. of Unsecured Creditors of Motors Liquidation Co., 475 B.R. 347 (S.D.N.Y. 2012) ("Thus, the Interim DIP Order unequivocally provided for each of the DIP Lenders' liens and SuperPri to be subordinate to the Carve-Out.") (emphasis added). The Court in In re Haven Eldercare, LLC, evaluated a DIP order with similar language. 395 B.R. 216, 219 (Bankr. D. Conn. 2008). The Eldercare court found the language unambiguous and that "all liens and administrative claims in favor of Prepetition Lenders shall be subject and subordinate to the payment of [such compensation] . . . ." Id. (internal quotations omitted).

Moreover, in the carve out context, the Debtor must look to unencumbered funds before using the carve out amount. See In re Cal. Webbing, 370 B.R. at 488 (discussing, in the context of an administratively insolvent case, "how any fees could be paid by the Debtor [without a carve out] because of the very serious question whether the Debtor had *any* unencumbered funds from which to make such payments"); In re Hotel Syracuse, Inc., 275 B.R. 679, 681 n.3 (Bankr. N.D.N.Y. 2002) (finding that it was "uncertain in the instant Chapter 11 case whether there will ever be any significant unencumbered assets and, thus, the significance of a 'carve out' [and what collateral it may be charged against] becomes the paramount issue for the Court"). Here, the Debtors have ample unencumbered cash to cover these additional expenses, which the Debtors have not even established fall within the carve out provision. Accordingly, to the extent the Debtors are permitted to further use the JSN Cash Collateral, the JSNs are entitled to additional adequate protection claims and liens—the Debtors simply cannot keep spending cash to reduce the secured portion of the JSN Claims.

4. The JSNs Have a Perfected Interest in the Deposit Accounts

Committee alleges in Count VI of its Complaint that the JSNs do not have a perfected security interest in the Deposit Accounts because there are allegedly no control agreements governing the Deposit Accounts in favor of the JSNs. This count fails because (a) control agreements in favor of the JSNs exist for six of the Deposit Accounts; (b) under the Uniform Commercial Code, the JSNs held perfected security interests in the Deposit Accounts as of the Petition Date; and (c) the Committee failed to demonstrate that the Deposit Accounts do not hold the proceeds of Notes Collateral. See FoF §IV ¶ 269.

UCC section 9-312(b)(1) provides that "except as otherwise provided in Section 9-315(c) and (d) for proceeds: (1) a security interest in a deposit account may be perfected only by control . . . ." UCC section 9-104(a)(1) provides that a secured party may affect control where "the secured party is the bank with which the deposit account is maintained." A "secured party" is defined as including a collateral agent. N.Y.U.C.C. § 9-102(a)(72)(E) (2001). Six of the Deposit Accounts are held at Wells Fargo, the Collateral Agent for the Secured Parties. FoF §IV ¶ 274. Accordingly, the JSNs have control of these six Deposit Accounts.[39]

[39] Under N.Y.U.C.C. § 9-104(a)(1) (2001), the JSNs also have control over the Deposit Accounts held at Ally Bank by virtue of the relationship between Ally Bank and AFI and the Intercreditor Agreement. And, the funds in those Deposit Accounts should be deemed to have been paid to AFI in consideration of the amounts outstanding under the AFI Revolver, and should not be deducted from the remaining Notes Collateral. Additionally, control of a deposit account is unnecessary where the funds in the account are the cash proceeds from the disposition of collateral in which a creditor has a perfected security interest. N.Y.U.C.C. § 9-315(c) (2001). The Committee acknowledged that certain of the Deposit Accounts hold proceeds of Notes Collateral, but offered no evidence to show which accounts hold such proceeds. See FoF §IV ¶¶ 276–278. Under these circumstances, all of the Deposit Accounts should be deemed to hold Notes Collateral proceeds.

5. The JSNs Have Perfected Security Interests in Certain of the Alleged Unencumbered Real Property Assets

Count II of the Committee Complaint fails with respect to the REO assets (the "REO Properties"), which are a subset of the assets listed on Schedule 6, and are incorporated by reference into Schedule 2 to the Committee Complaint. The JSNs hold perfected security interests in the REO Properties, by virtue of their security interests in the equity of the special purpose vehicles owning such properties.

The Debtors have stated, and the Committee has not rebutted, that the approximately $4.2 million of REO Properties (on a book value basis) listed in the CFDR as primary collateral are held by special purpose vehicles ("SPVs"), the equity of which has been pledged to the JSNs. See FoF §IV ¶ 281. The Debtors treated the remainder of the REO Properties as Notes Collateral, and the Committee acknowledges that certain of them may also be held by SPVs, but failed to present any evidence demonstrating which are so owned. See FoF §IV ¶ 284. Under these circumstances, all of the REO Properties should be deemed Notes Collateral.

CONCLUSION

For the foregoing reasons, Defendants seek to have the Court enter declarations and grant such other relief necessary to find that, as of the Effective Date of the Plan, the full quantum of the JSN Claims are secured claims pursuant to section 506, and grant such other and further relief as the Court deems just.

Dated: November 1, 2013
New York, New York

Respectfully submitted,

By: */s/ J. Christopher Shore*
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EXHIBIT A

	JSN Collateral As of the Petition Date	**JSN Collateral As of the Effective Date**
Cash & Restricted Cash Proceeds	$574 million	$1.949 billion[40]
HFS Loans	$992 million	$11 million
MSRs	-	-
Servicing Advances	$1.496 billion	$158 million
FHA/VA (Loans & AR)	$598 million	$402 million
Other Assets	$94 million	$14 million
Total Intangible/ Going-Concern	$517 million	$0 million
Hedge Contracts/Positions	$104 million	$0 million
Debtor and Non-Debtor Equity/Interests	$75 million	$100 million
Intercompany Receivables	TBD (Phase II)	TBD (Phase II)
Causes of Action	TBD (Phase II)	TBD (Phase II)
GROSS COLLATERAL	**$4.450 billion**	**$2.634 billion**
Less: Ally Revolver	$(747) million	$(747) million
Less: BMMZ Repo & GSAP Net Collateral	$(912) million	$0 million
NET COLLATERAL	**$2.791 billion**	**$1.88 billion**

[40] $1.872 billion of cash and $53 million of restricted cash as of April 30, 2013, plus $51 million allocated to the JSN Collateral from the Ocwen true-up and $27 million of costs allocated to JSN Collateral subsequent to April 30, 2013.