Clerk's Stamp:

JUDICIAL CENTRE OF CALGARY
FILED
May 14, 2020
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May 15, 2020
Justice Eidsvik

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| COURT FILE NUMBER | 2001-05630 |
| COURT | COURT OF QUEEN'S BENCH OF ALBERTA IN BANKRUPTCY AND INSOLVENCY |
| JUDICIAL CENTRE OF | CALGARY |
| APPLICANTS | IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED<br><br>AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF DOMINION DIAMOND MINES ULC, DOMINION DIAMOND DELAWARE COMPANY LLC, DOMINION DIAMOND CANADA ULC, WASHINGTON DIAMOND INVESTMENTS, LLC, DOMINION DIAMOND HOLDINGS, LLC AND DOMINION FINCO INC. |
| DOCUMENT | **BENCH BRIEF AND ARGUMENT** |
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## I. INTRODUCTION

1. Wilmington Trust, National Association, in its capacity as Trustee, Notes Collateral Agent, Paying Agent, Transfer Agent and Registrar (collectively, the "**Trustee**" or "**WT**") under an indenture dated October 23, 2017 (as amended, supplemented or restated, the "**Trust Indenture**"), pursuant to which Northwest Acquisitions ULC (as predecessor-in-interest to Dominion Diamond Mines ULC), as Issuer ("**DDM**"), and Dominion Finco Inc., as Co-Issuer ("**Finco**", and together with DDM, the "**Issuers**"), issued certain 7.125% Senior Secured Second Lien Notes Due 2020 (the "**Notes**"), files this Bench Brief in support of its Application for an Order, among other things:

   (a) authorizing and directing DDM, Dominion Diamond Delaware Company, LLC, Dominion Diamond Canada ULC, Washington Diamond Investments, LLC, Dominion Diamond Holdings, LLC, and Finco (collectively, the "**Applicants**") to pay and reimburse the reasonable post-filing fees and expenses of the Trustee and its counsel, Dentons Canada LLP and Dentons US LLP (together, "**Dentons**"), in connection with and from the date of commencement of these proceedings.

2. The Trustee respectfully submits the payment of its reasonable post-filing fees and expenses, including that of Dentons, is fair and appropriate and it would respect the terms set out in the Trust Indenture and the Intercreditor Agreement and facilitate the Trustee's effective participation in these proceedings on behalf of all Noteholders, including those who are not otherwise represented in these proceedings.

## II. FACTUAL BACKGROUND

3. Capitalized terms used but not otherwise defined in this Bench Brief have the meanings given to them in the affidavit of Kristal Kaye sworn April 21, 2020 in these proceedings (the "**Kaye April 21 Affidavit**"), or in the Trust Indenture, as applicable.

4. The Applicants sought and were granted protection from their creditors under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "**CCAA**") pursuant to the order of this Honourable Court dated April 22, 2020.

5. On May 1, 2020, on the application of the Applicants, this Honourable Court granted the Amended and Restated Initial Order.

6. The Applicants' two primary senior secured debt obligations are in respect of the (i) Revolving Facility, extended pursuant to the Credit Agreement dated November 1, 2017, and (ii) the Notes issued pursuant to the Trust Indenture.

7. As of April 20, 2020, the US$150,000,000 available under the Revolving Facility was fully utilized and the accrued interest on the portion of the Revolving Facility drawn was estimated to be approximately US$178,651.

8. As of April 20, 2020, the amounts owing to the holders of Notes (the "**Noteholders**") pursuant to the Trust Indenture in respect of the Notes, with interest, was approximately US$556,328,125.

9. To secure the obligations under the Credit Agreement, the Applicants granted the Credit Agreement Security. To secure the obligations under the Trust Indenture, the Applicants granted the Trust Indenture Security. The Trust Indenture Security is the same security package as the Credit Agreement Security, except that, pursuant to the Intercreditor Agreement, the Trust Indenture Security ranks in a second lien position behind the Credit Agreement Security.

**The Trustee's Appointment, Roles and Duties**

10. The Trustee was appointed pursuant to the terms of the Trust Indenture to act in a number of capacities, namely as Trustee, Notes Collateral Agent, Paying Agent, Transfer Agent and Registrar under the Trust Indenture.

11. The Trustee acts as a fiduciary for, and in the best interests of, all Noteholders, including those not otherwise represented in the CCAA proceedings. The Trustee is contractually obligated to be involved in these CCAA proceedings.

12. The Trustee derives its rights and powers from the Trust Indenture. Section 7.1 of the Trust Indenture provides that, upon the occurrence of an Event of Default, "the Trustee shall exercise such rights and powers vested in it by [the Trust Indenture] and, in the exercise of its power, use the degree of care and skill of a prudent man in the conduct of his own affairs." Such rights and powers include, among others:

    (a) Section 6.2: declaring all due and outstanding notes payable immediately;

    (b) Section 6.3: proceeding in its own name to protect and enforce its rights and the rights of Noteholders "by such appropriate judicial proceedings as the Trustee shall deem most effectual to protect and enforce such rights";

    (c) Section 6.5: taking directions from the Noteholders "of a majority in the aggregate amount of the then outstanding Notes" regarding the remedies available to the Trustee, "provided that:

        (a) the Trustee may refuse to follow any direction that conflicts with law, its fiduciary duties, [the Trust Indenture] or that the Trustee determines in good faith may be unduly prejudicial to the rights of [Noteholders] not joining in the giving of such direction;

        (b) the Trustee may refuse to follow any direction that the Trustee determines is unduly prejudicial to the rights of other [Noteholders] or would involve the Trustee in personal liability; and

        (c) the Trustee may take any other action deemed proper by the Trustee that is not inconsistent with such direction";

(d) Section 6.8: receiving payment, for the benefit of the Noteholders, from the Issuers in respect of payments of amounts due under the Notes; and

(e) Section 6.9: filing "proofs of claim and other papers or documents as may be necessary or advisable in order to have the claims of the Trustee (including any claim for the compensation, expenses, disbursements and advances of the Trustee, its agents and counsel…) and the [Noteholders] allowed in any judicial proceedings relative to the Issuers or any Guarantor, their creditors or their property…".

**The AHG Application**

13. On May 6, 2020, a group of Ad Hoc Group of Bondholders ("**AHG**") served and filed an application seeking payment of the fees of the advisors to the AHG (the "**AHG Application**"). The AHG had sought for the AHG Application to be heard on May 8, 2020. The AHG Application is currently returnable on May 15, 2020.

14. During the course of the May 8, 2020 hearing, the Court indicated that any other party seeking payment of fees and expenses from the Applicants should have such Application ready to be heard on May 15, 2020.

## III. ISSUE

15. The issue before this Honourable Court is whether the Applicants should be ordered to pay the reasonable fees and expenses of the Trustee and its counsel, Dentons.

## IV. LAW AND ARGUMENT

**The Trust Indenture Provides for Payment**

16. Section 7.2(a) and (c) of the Trust Indenture expressly provide that the Trustee has a right to consult with legal counsel or other professional advisors of its choosing as to any matter relating to the Trust Indenture and the Trust Indenture Security. Section 7.2(c) expressly provides that

such consultation shall be "at the expense of the Issuers, *provided* all fees and expenses are reasonable and documented".

17. Section 7.6 of the Trust Indenture provides as follows in respect of the Trustee's compensation and indemnity in connection with the Trust Indenture and the Trust Indenture Security:

> **7.6 Compensation and Indemnity**
>
> (a) The Issuers shall pay to the Trustee and each Agent from time to time such fees, expenses and compensation as shall be agreed in writing for its services hereunder. The Trustee's compensation shall not be limited by any law on compensation of a trustee of an express trust. The Issuers shall reimburse the Trustee and each Agent upon request for all reasonable expenses incurred or made by it, including costs of collection, in addition to the compensation for its services. Such expenses shall include the compensation and reasonable expenses of the Trustee's and each Agent's agents and counsel.
>
> […]
>
> (d) When the Trustee or any Agent incurs expenses after the occurrence of a Default specified in Section 6.1(a)(ix) or (x) with respect to any Issuer, any Guarantor, or any Restricted Subsidiary, the expenses are intended to constitute expenses of administration under Bankruptcy Law and in any Insolvency or Liquidation Proceeding. [Emphasis added.]

18. These CCAA proceedings constitute an Event of Default (as such term is defined in the Trust Indenture) pursuant to the Trust Indenture. The Trustee's expenses incurred in these CCAA proceedings are expenses incurred after the occurrence of an Event of Default, as specified in Section 6.1(a)(x) of the Trust Indenture and "constitute expenses of administration under "Bankruptcy Law".[1]

19. The Trustee has engaged Dentons to act as its counsel in the within CCAA proceedings.

20. To date, the Applicants have not agreed to pay the fees of the Trustee and its counsel.

21. The Trustee does not have access to independent funding to fund its participation in these CCAA proceedings. The Trust Indenture does not establish any sort of escrow funds from the bond

[1] Pursuant to Section 1.1 of the Trust Indenture, "Bankruptcy Law" means "the Bankruptcy Code and any other federal, state, provincial or foreign law for the relief of debtors, or any arrangement, reorganization, insolvency, moratorium, assignment for the benefit of creditors, any other marshalling of the assets or liabilities of the Parent or any of its Subsidiaries, or similar law affecting creditors' rights generally." The CCAA is clearly within the definition of "Bankruptcy Law".

issuance to be available for use by the Trustee. The AHG is seeking its own fee and expense application and, as such, the Noteholders will not be funding the Trustee.

22. The Trust Indenture further includes the following provisions which are relevant to this Application:

(a) Section 6.6: a Noteholder "may not use this Indenture to prejudice the rights of another [Noteholder] or to obtain a preference or priority over another [Noteholder]";

(b) Section 6:10: subject to the Intercreditor Agreement, any money or property collected pursuant Article 6 of the Trust Indenture, or from the enforcement of the Trust Indenture Security, shall be paid "***First*** to the Trustee, the Notes Collateral Agent and their agents… and attorneys for amounts due under Section 7.6, including payment of all compensation, expenses and liabilities incurred, and all advances made, by the Trustee, the Agents and the Notes Collateral Agent and the costs and expenses of collection";

(c) Section 7.11: "[t]he rights, privileges, protections, immunities and benefits given to the Trustee in this Indenture, including, without limitation, its right to be indemnified and/or secured, are extended to, and shall be enforceable by the Paying Agent(s) (other than the Issuer, the Co-Issuer or any Affiliate of the Issuers acting as Paying Agent), the Transfer Agent(s), any Authenticating Agent, the Notes Collateral Agent and the Registrar as if the Paying Agents(s), the Transfer Agent(s), the Authenticating Agent, the Notes Collateral Agent and the Registrar were named as the Trustee herein."

**The Intercreditor Agreement Permits Payment**

23. With respect to the treatment of the Noteholders under the Trust Indenture Security in relation to that of the senior lenders under the Credit Agreement Security (the "Senior Lenders"), the Section 6.03 of the Intercreditor Agreement states:

> "… to the extent that the [Senior Lenders] are granted adequate protection in the form of payments in the amount of current post-petition fees and expenses, and/or other cash payments [in relation to an insolvency proceeding, which would include these CCAA proceedings], then the [Trustee], for themselves and on behalf of the [Noteholders] under [the Trust Indenture], shall not be prohibited from seeking adequate protection in the form of payments in the amount of current post-petition incurred fees and expenses, and/or other cash payments (as applicable), subject to the right of the [Senior Lenders] to object to the reasonableness of the amounts of fees and expenses or other cash payments so sought by the [Noteholders]."]

24. The cash-flow statement appended to the Monitor's pre-filing report dated April 21, 2020 indicates that the Senior Lenders are being paid post-filing interest and bank charges. Such payments

constitute a form of adequate protection as contemplated by Section 6.03. Therefore, the Trustee is permitted to seek adequate protection for itself and on behalf of the Noteholders.

**The CCAA Permits Payment**

25. Section 11.52 of the CCAA provides this Honourable Court with discretion to “make an order declaring that all or part of the property of a debtor company is subject to a security or charge – in an amount that the court considers appropriate – in respect of the fees and expenses of… (c) any financial, legal or other experts engaged by any other interested person if the court is satisfied that the security or charge is necessary for their effective participation in proceedings under this Act”.

26. While the strict language of section 11.52 provides for security for such fees, this section has been interpreted under the “general jurisdiction under Section 11” to extend to “an order of payment of such amounts”,[2] including to an indenture trustee,[3] ad hoc groups of bondholders,[4] counsel to a large group of employees,[5] counsel to retail purchasers of asset-backed commercial paper[6] and representative counsel to investors,[7] among other interested persons.

27. In many of these cases, the court, often citing the factors considered in *Re Canwest Publishing Inc*,[8] granted the fee payment orders under section 11.52 notwithstanding the absence of any contractual term(s) providing for such payment concerning the party seeking such fees. The Trustee submits that, in the present Application, in addition to the general jurisdiction under

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[2] *Homburg Invest Inc*., Montreal (No. 500-11-041305-117), Reasons for Judgment dated February 17, 2012, at para. 23. **[TAB 1]**

[3] *Ibid*.

[4] See, for example, the authorities cited in the Bench Brief of the AHG dated May 7, 2020 (the “**ADH Brief**”): *Lightstream Resources Ltd*., Calgary 1601-12571 (ABQB) (Order pronounced 26 September 2016) at para 30 [AHG Brief, TAB 2]; *Essar Steel Algoma Inc*., Toronto CV-15-000011169-00CL (Order pronounced 25 February 2016) at para 3 [AHG Brief, TAB 3]; *Jaguar Mining Inc*., Toronto CV-13-1038300CL (ONSC) (Order pronounced 23 December 2013) at para 31 [AHG Brief, TAB 4].

[5] *Re Nortel Networks Corp.*, (2009) 53 C.B.R. (5th) 196 (Ont. S.C.J.), at para. 65 **[TAB 2]**; *Re Target Canada Co*, 2015 ONSC 303 at para. 61. **[TAB 3]**

[6] *Re Metcalfe & Mansfield,* Toronto Court File No. CV-08-CL-7440, Order, Re Appointment of Representative Counsel in ABCP (April 15, 2008) (Ont. S.C.J.) at para. 7. **[TAB 4]**

[7] *Re League Assets Corp*, 2013 BCSC 2043 at para. 79. **[TAB 5]**

[8] *Re Canwest Publishing Inc.*, 2010 ONSC 222 at para. 54 [AHG Brief, TAB 1] (the “***Canwest* Factors**”).

section 11.52, this Honourable Court has an unambiguous basis in contract (i.e. the Trust Indenture) for ordering payment of the Trustee's and Dentons' reasonable fees and expenses incurred in these CCAA proceedings. It is therefore not necessary to consider the *Canwest* Factors in relation to this Application.

**Differentiating the Role of the Trustee from that of the AHG**

28. The Trust Indenture and the Intercreditor Agreement are each governed by, and are to be construed in accordance with, the laws of the State of New York.

29. As noted above, the roles of the Trustee are separate and distinct from the role of any individual Noteholder or any ad hoc group or committee of Noteholders, including the AHG. While there is limited jurisprudence in Canada regarding such roles, courts in the United States have given the issue consideration.

30. Ad hoc groups and committees, unlike indenture trustees, act on behalf of only their members. For example, in *In re Washington Mut., Inc.,*[9] the United Stated Bankruptcy Court, D. Delaware, noted that "[a]d hoc committees, due to their unofficial status, are typically a loose affiliation of creditors. The at-will nature of committee membership is one of the defining characteristics of ad hoc committees. . . . Because membership is at—will, an ad hoc committee cannot bind members absent their consent, and generally all members must agree on any position the committee takes. Otherwise, dissenting members will simply leave the committee [citations omitted]."

31. In contrast, an indenture trustee is charged with carrying out various duties derived from (i) the indenture under which it was appointed, (ii) legislation[10] and (iii) common law, all of which duties are to be carried out on behalf of all bondholders. The general duties of an indenture trustee in

[9] *In re Washington Mut., Inc.,* 419 B.R. 271, 274 (Bankr. D. Del. 2009). **[TAB 6]**

[10] In the United States, e.g., *The Trust Indenture Act of 1939* ("**TIA**"), codified at 15 U.S.C. § 77aaa et seq. In Canada, the *Canada Business Corporations Act*, R.S.C. 1985, c.C-44 (the "**CBCA**"), and certain other provincial corporate statutes, including the *Business Corporations Act* (Alberta), RSA 2000, c B-9 (the "**ABCA**"); the *Loan and Trust Companies Act*, S.C. 1991, c.45, the *Bank Act*, S.C. 1991, c.46 and the *Insurance Companies Act*, S.C. 1991, c.47.

both Canada and the US include observing fiduciary duties, the duty of care and avoiding conflicts of interest.[11]

32. In this case, in addition to the statutory and common law duties imposed on the Trustee, the Trust Indenture mandates that the Trustee:

(a) as Trustee, carry out the various duties prescribed by, *inter alia*, Sections 6 and 7 of the Trust Indenture, including in relation to protecting the interests of all Noteholders in the case of an Event of Default, including the exercise of remedies, reporting to all Noteholders and filing proofs of claim, as may be required in an insolvency proceeding;

(b) as Notes Collateral Agent, exercise rights and duties delegated to it in relation to the Security Documents, including those duties prescribed under Section 11.8 of the Trust Indenture, and elsewhere in the Trust Indenture, Security Documents and Intercreditor Agreement;

(c) as Paying Agent, facilitate payments on and transfers of Notes, among other such duties as are prescribed by, *inter alia*, Sections 2.3 and 2.4 of the Trust Indenture;

(d) as Transfer Agent, facilitate the transfer of Notes, among other such duties as are prescribed by, *inter alia*, Section 2.6 of the Trust Indenture; and

(e) as Registrar, maintain the Security Register, among other such duties as are prescribed by, *inter alia*, Section 2.3 the Trust Indenture.

33. In the context of these CCAA proceedings, the Trustee's duties would also preclude it from acting, for example, as an interim financing ("**DIP**") lender or stalking horse bidder, or from preferring the interests of one Noteholder or group of Noteholders to the interests of any other Noteholder. Such limitations would not be imposed on an ad hoc group or committee of bondholders, including the AHG.

[11] See, for the example, the CBCA, ss.82-93, and the ABCA, ss. 81-92.

34. It is submitted that the Trustee, with advice of its counsel at Dentons, has the institutional and operational capacity required to effectively discharge the Trustee's contractual, statutory, fiduciary and other common law duties to all Noteholders. The discharge of these duties is not only contractually mandated by the Trust Indenture, but is also essential to an effective, fair and transparent restructuring of the Applicants.

**Adequate Protection Considerations**

35. With respect to payment of an indenture trustee's ongoing post-petition professional fees in connection with secured notes or bonds, in a US chapter 11 case, such payment is typically provided as a form of "adequate protection" to the indenture trustee as a secured lender.[12] A debtor may obtain post-petition financing secured by a lien priming an existing first lien lender, only if "there [exists] adequate protection of the interest of the holder of the lien on the property of the estate on which such senior or equal lien is proposed to be granted."[13]

36. The debtor bears the burden of establishing that the holder of an existing lien to be subordinated to post-petition financing is adequately protected from diminution, i.e. erosion, of its collateral value as of the petition date.[14] To make such a showing, a debtor may argue, *inter alia*, that the secured creditor is adequately protected by the existence of an "equity cushion", the amount by which the value of the collateral exceeds the amount of the primed secured claim and that, as a result, no additional financial payments or accommodations beyond contractually timely interest and expense reimbursement are required.[15]

37. To prove the existence of an "equity cushion" the collateral in question necessarily must be valued. When, as is frequently the case, a secured creditor has a blanket lien on substantially all of the debtor's assets, a debtor must engage in an expensive and time-consuming valuation process regarding its entire business either as a going-concern or on a liquidation basis

[12] 11 U.S.C. § 361.
[13] 11 U.S.C. § 364(d)(1).
[14] *In re Swedeland Dev. Grp., Inc.,* 16 F.3d 552, 564 (3d Cir. 1994) (citations omitted). **[TAB 7]**
[15] *Wilmington Trust Co. v. AMR Corp. (In re AMR Corp.)*, 490 B.R. 470, 478 (S.D.N.Y. 2013). **[TAB 8]**

depending upon the use to which the collateral is being put.[16] . In the context of post-petition financing request, if a debtor is unable to prove adequate protection then the bankruptcy court cannot permit a priming lien to be granted. In the context of a lender's request to lift the automatic stay under section 362(a) of the Bankruptcy Code to permit foreclosure under state law, a debtor's failure to establish adequate protections may lead the bankruptcy court to grant the secured creditor's request for relief.[17]

38. In order to avoid such a protracted valuation process in either circumstance, debtors routinely turn to section 361 of the Bankruptcy Code, which provides for alternate means of providing adequate protection. 11 U.S.C. § 361(a) provides that "adequate protection may be provided by . . . requiring the trustee to make a cash payment or periodic cash payments" to a secured creditor. Finally, adequate protection payments under such Bankruptcy Code provision typically include payment of the secured lender's legal fees.[18]

39. As noted, in the present case, the Trust Indenture and the Intercreditor Agreement are each governed by the laws of the State of New York. As such, it is submitted that the foregoing adequate protection principles, as they are understood and applied in the US, were within the contemplation of the parties at the time they entered into these agreements.

40. As these principles can reasonably be applied by analogy in Canada, it is further submitted that there is no policy reason in the present case for this Honourable Court to take a different approach with respect to payment of the Trustee's fees in these CCAA proceedings.

[16] *In re Residential Capital LLC*, 501 B.R. 549, 591-95 (Bankr. S.D.N.Y. 2013) (providing that going-concern valuation was proper). **[TAB 9]**

[17] 11 U.S.C. § 362(d)(1).

[18] See, *e.g., In re Journal Register Co*., Case No. 12-13774-SMB, 2012 WL 5427531, § 2.6.4 (Bankr. S.D.N.Y. Sept. 7, 2012) (postpetition financing order granting secured lender adequate protection in the form of compensation of reasonable legal fees) **[TAB 10]**; *In re Uno Restaurant Holdings Corp.*, Case No. 10-10209-MG, 2010 WL 6826284, ¶ 3 (Bankr. S.D.N.Y. Feb. 18, 2010) (same). **[TAB 11]**

**WT's CCAA Experience in Canada**

41. WT, the Trustee in this case, has in the past acted as indenture trustee in a number of other high profile Canadian CCAA and US Chapter 11 restructuring proceedings. For example, in *Nortel Networks Corp, Re*,[19] WT, acting as an indenture trustee for the Nortel series of notes referred to as "Canada-only" notes", played an active role in advocating on behalf of its noteholders for a *pro rata* distribution (one of only two of a multitude of participants to do so) in respected of the $7.8 billion allocation dispute at issue in that case. The Canadian and US courts ultimately employed a "modified pro rata" decision, largely based on the approach advocated for by WT in that case, ultimately yielding a more favourable result for the "Canada-only" notes than the proposed alternatives espoused by any of the US or UK interests in such proceedings.

42. WT also acted as indenture trustee for the senior secured notes in the Essar Steel Algoma Inc. et al. ("**ESAI**") CCAA proceedings. In those proceedings, the senior notes and ESAI's pre-existing senior secured term lenders exchanged their existing secured claims for equity in the entity (Algoma Steel Inc.) that purchased substantially all of the assets of ESAI. As the only entity that represented all of the noteholders in that case, and due to the ESAI ad hoc group of noteholders not being able to bind all ESAI noteholders, WT, as indenture trustee, was instrumental in effectuating the transactions leading up to the closing of the ESAI sale to Algoma Steel Inc.[20]

**There is no evidence that the Noteholders are "Out of the Money"**

43. The Applicants' disclosure to its stakeholders reveals sufficient available cash in order to fund the Trustee's fees and expenses and those of its counsel.

44. In addition, the Trustee's counsel, Dentons, understands that a number of DIP proposals have been submitted to the Applicants and their financial advisor for review, negotiation and

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[19] *Nortel Networks Corp, Re*, 2015 ONSC 2987 **[TAB 12]**; *In re Nortel Networks, Inc.,* 532 BR 494 (Bankr D Del 2015) **[TAB 13]**; see, also, John A.E. Pottow, "Two Cheers for Universalism: Nortel's Nifty Novelty" 2015 Annual Review of Insolvency Law, Ed: Janis P. Sarra. **[TAB 14]**

[20] *Essar Steel Algoma Inc.,* Toronto, CV-15-000011169-00CL (Order pronounced 21 September 2018) at para 11. **[TAB 15]**

acceptance. It appears that the Applicants will be seeking approval of a chosen DIP proposal in coming days or week, at which time the Applicants will have additional cash available for such fees and expenses.

45. The Kaye April 21 Affidavit, provides that, as at December 31, 2019, the Applicants had total assets worth approximately $1.38 billion, consisting of current assets with a book value of approximately $392 million and non-current assets with a book value of approximately $985 million.

46. As noted above, the only priority creditors to the Noteholders are the Senior Lenders (owed US$178,651,000.64 as of April 20, 2020) and, depending on this Court's determination in the "Diavik JVA Cover Payments Application" and subject to the Monitor's review as to the validity and enforceability of the DDMI security interest, possibly DDMI in respect of the amount to secure any Diavik JVA Payment Obligations.

47. Paragraph 25 of the Kaye April 21 Affidavit indicates that, on July 15, 2017, Washington acquired all of the outstanding common shares of the predecessor of DDM (then a public company) for $1.2 billion.

48. The court materials filed to date show the Applicants' employee amounts as being up-to-date. While there may be certain equipment lease payments and other performance obligations in relation to the operation of the DDM mines, and certain surety bonds, the identifiable priority claims to the Notes, from the Applicants' disclosure to date, are such that the realizable value of the Applicants' assets would need to be less than one-third of their book value (approximately $1.38 billion), or up to one-sixth of such value, in order for the Notes to be completely out of the money.

49. As far as the Trustee is aware, no liquidation analysis of the Applicants has been undertaken. As such, there is no evidence anywhere in the Court record that the Notes are to be considered "out of the money" nor could a reasonable presumption otherwise be drawn from the facts of this case.

## V. RELIEF SOUGHT

50. Payment of the Trustee's reasonable fees and expenses is therefore lawful, fair and appropriate as it:

(a) is in accordance with and not otherwise in violation of the express terms of the Trust Indenture and Intercreditor Agreement; and

(b) would ensure the necessary participation of the Trustee and all Noteholders not otherwise represented in these CCAA proceedings.

51. For the foregoing reasons, the Trustee seeks an order directing and authorizing the Applicants to pay its reasonable fees and expenses, and those of Dentons, in these CCAA proceedings.

**ALL OF WHICH IS RESPECTFULLY SUBMITTED** on May 13, 2020 at Toronto, Ontario.

**DENTONS CANADA LLP**

Per: ______________________________

**JOHN SALMAS / MARK FREAKE**
Counsel for Wilmington Trust, National Association, in its capacity as Trustee, Notes Collateral Agent, Paying Agent, Transfer Agent and Registrar

**INDEX**

# TAB 1

# SUPERIOR COURT
## (Commercial Division)

CANADA
PROVINCE OF QUÉBEC
DISTRICT OF MONTRÉAL
N°: 500-11-041305-117

DATE : February 17, 2012

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**PRESIDING : THE HONOURABLE MARK SCHRAGER, J.S.C.**

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IN THE MATTER OF THE PLAN OF COMPROMISE OR ARRANGEMENT OF :

**HOMBURG INVEST INC.**
**HOMBURG SHARECO INC.**
**CHURCHILL ESTATES DEVELOPMENT LTD**
**INVERNESS ESTATES DEVELOPMENT LTD**
**CP DEVELOPMENT LTD**

Debtors / Petitioners

And

**HOMCO REALTY FUND (52) LIMITED PARTNERSHIP**
**HOMCO REALTY FUND (88) LIMITED PARTNERSHIP**
**HOMCO REALTY FUND (89) LIMITED PARTNERSHIP**
**HOMCO REALTY FUND (92) LIMITED PARTNERSHIP**
**HOMCO REALTY FUND (94) LIMITED PARTNERSHIP**
**HOMCO REALTY FUND (105) LIMITED PARTNERSHIP**
**HOMCO REALTY FUND (121) LIMITED PARTNERSHIP**
**HOMCO REALTY FUND (122) LIMITED PARTNERSHIP**
**HOMCO REALTY FUND (142) LIMITED PARTNERSHIP**
**HOMCO REALTY FUND (199) LIMITED PARTNERSHIP**

Mis en cause

And

**SAMSON BÉLAIR/DELOITTE & TOUCHE INC.**

Monitor

And

**STICHTING HOMBURG BONDS**
**STICHTING HOMBURG CAPITAL SECURITIES**
Trustees

And

**TABERNA EUROPE CDO I PLC**
**TABERNA EUROPE CDO II PLC**
**TABERNA PREFERRED FUNDIND VIII, LTD**
**TABERNA PREFERRED FUNDIND VI, LTD**
Contesting Parties

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## REASONS FOR JUDGMENT

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JS 1319

## INTRODUCTION

[1] The amended motion of Stichting Homburg Bonds and Stichting Homburg Capital Securities (collectively « Stichting ») for the payment of fees of professional advisors was heard on February 13, 2012 at which time the Court indicated that the motion would be granted in part with an order and reasons to follow. These are the reasons for the order which issued on February 15, 2012 a copy of which is annexed hereto.

[2] On September 9, 2011, the Debtor filed and obtained an initial stay order (« Initial Order ») pursuant to sections 4, 5 and 11 of the Companies' Creditors Arrangement Act (« CCAA »)[1].

[3] The stay granted under the Initial Order has been extended several times and the most recent order of this Court extends the protection under the CCAA to March 16, 2012. The Honourable Mr. Justice Louis J. Gouin, j.s.c. is charged with the management of the case but due to a conflict of interest with the attorneys representing the Contesting Parties, the undersigned presided over the hearing of the motion referred to above.

[4] Stichting seeks an order of this Court providing for the advance by the Debtor of the reasonable fees of the trustees of Stichting as well as the attorneys and financial advisors engaged by them to represent Stichting in the matter of the present CCAA filing. The request is limited to fees incurred since December 3,

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[1] R.S.C., (1985), c. C-36.

2011. The advances of these fees will be set-off against payments to be made to Stichting under an eventual plan of arrangement.

[5] One creditor or group of creditors, Taberna Europe CDO 1 PLC and related entities (« Contesting Parties ») contested the motion although one of the main thrusts of such contestation was settled by the parties before the hearing and reflected in the drafting of the proposed order, as will be set forth in more detail herein below.

[6] Both the Debtor and the Monitor consented to the motion.

[7] The matter was heard on the basis of the affidavit supporting the motion and the documentary evidence filed by Stichting. The representative of the Monitor, Mr. Pierre Laporte, C.A., testified briefly before the undersigned.

## FACTS

[8] Petitioners are two entities created under the laws of the Netherlands who act as trustees under three trust indentures which govern the issuance of three series of bonds : (i) corporate bonds, (ii) mortgage bonds and, (iii) capital securities.

[9] The indentures constitute Stichting as the trustee thereunder as the duly authorized representatives of the holders of the debt or bonds with the power to declare default, claim payment and agree to extensions of periods of payment, amongst other things.

[10] Most significantly for present purposes, the trustees also have the right to engage advisors including lawyers and accountants.

[11] The trustees have engaged Canadian litigation and corporate counsel, Dutch attorneys and a Canadian financial advisor.

[12] The trust indentures provide that the trustees' remuneration and that of its professional advisers, including legal fees, are payable by the Debtors.

## POSITION OF THE CONTESTING PARTY

[13] The crux of the contestation by the Contesting Parties is that the holders of the corporate securities have « equity claims » and as such rank subordinate

to all other creditors[2] such that it is extremely unlikely that they will receive the payment of any dividend on their claims. This is significant since the motion is predicated on seeking an advance for purposes of paying professional fees, which advance will ultimately be reimbursed from the proceeds of a distribution by the Debtor.

[14] The Contesting Parties also took the position before the undersigned that notwithstanding the wording of the trust indentures, as a matter of Quebec law, the payment of professional or at least legal fees could not form part of the claims of any of the bondholders in the CCAA proceedings. No claims process has as yet been put in place and in the opinion of this Court, it would be at best, premature to deal with this issue at the present time.

## DISCUSSION

[15] The Monitor indicated and it is common ground that there is presently or will be shortly, cash available to pay professional fees. The Debtor has or will shortly receive substantial funds following the purchase of its holdings in the Canmarc REIT. In any event, with the consent of all parties the order issued reflects that fees can only be paid out of available cash. If the Debtor was put in the position to borrow in order to advance fees to the bondholders, the Court would have been reticent to grant the Motion.

[16] There are approximately 9500 bondholders under the three indentures. They are mainly individuals (as opposed to corporations), resident in Holland. Each of the bonds is in a relatively small amount. The largest is 2,340,000 Euros; the average is 31,999 Euros.

[17] Despite the small individual amounts of the bonds, in the aggregate, this group constitutes the largest single creditor body in the present CCAA filing and may even have sufficient claims in dollars to carry an eventual vote on an arrangement.

[18] In the circumstances described above there is a combination of geographic, linguistic and financial barriers impeding the bondholders from proper representation by the appropriate professionals in this CCAA file. Though nothing might stop individual bondholders from engaging their own counsel, this is clearly unrealistic for the most part, in the circumstances. Without funding this important group of creditors will be denied appropriate representation.

[19] Most significantly, the uncontradicted proof in the record before the undersigned is that there will in all probability be a significant distribution to the

[2] ss. 19 and 2 CCAA and s. 140.1 Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3.

bondholders. The possible exception of course being the holders of the corporate securities who in the submission of the Contesting Parties hold equity claims which would be subordinated to all other claims.

[20] As stated above the request for the advance of fees is premised on a reimbursement. The hesitation of the Court and the preoccupation of the Contesting Parties was that in the event there is no distribution to the holders of the corporate securities then there would be no practical means to seek reimbursement of the advance made to them for fees. This concern has been addressed by the drafting of the order which provides that reimbursement of any fees advanced is to be made by way of set-off (or compensation) against the aggregate payment to the three classes of bondholders. Accordingly should the holders of corporate securities not receive a distribution their share of the advance for fees would be reimbursed to the Debtor by the holders of the other two classes of debt.

[21] The foregoing should not be misinterpreted. The Court makes no determination or finding at this time as to whether the rights under the corporate securities are equity claims. The Contesting Parties or any other party may seek to make such argument at the appropriate time.

[22] The advance of fees sought herein is not strictly provided on a literal reading of the CCAA. Section 11.52(1)(c) provides for the possibility of granting a security or charge over the assets of the Debtor to secure the payment of fees. The rationale is to allow the effective participation of a class of creditors that might otherwise be denied the possibility of representation when such class of creditors is a significant stakeholder[3].

[23] It appears to the Court that the rationale for the payment here is the same as the underpinning of Section 11.52(1)(c). If the Court has the power to grant a charge to secure payment by the Debtor, surely the general jurisdiction under Section 11 allows for an order of payment of such amounts. This is *a fortiori* when the payments to be made will be advances subject to reimbursement.

[24] As stated, the circumstances described above justify the making of such an advance. The group of creditors is significant, if not the most significant group of creditors. Because of the factors enumerated above the group requires professional representation and it is impractical to canvass 9,500 members to contribute to a fund for the payment of the professional fees.

[25] The jurisdiction to order the payment of fees in such circumstances has been recognized by the courts. In *Nortel*[4], the Court ordered the CCAA Debtor to pay the fees of the lawyer of three thousand five hundred employees. In the

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3 Bill C-55 : Industry Canada, clause by clause briefing book.
4 *Re Nortel Networks Corp.*, (2009) 53 C.B.R. (5th) 196 (Ont. S.C.J.).

*ABCP Commercial Paper* case[5], the CCAA Debtor was ordered to pay the fees of counsel to retail purchasers of asset-backed commercial paper. Equally, in *Edgeworth*[6], the Debtor was ordered to pay counsel representing four thousand Asian investors.

[26] The undersigned is aware of the decision of the Hon. Mr. Justice Clément Gascon, j.s.c. in the matter of *Mecachrome*[7] where he refused to allow security for the payment of the legal fees of the board of directors, the banking syndicate and certain other groups of creditors. Mr. Justice Gascon felt that no adequate explanation had been given to justify such treatment and most significantly nothing was demonstrated to him that would indicate that the participation of these groups in the CCAA process would be jeopardized by the failure to grant them the benefit of a charge for the payment of legal fees[8]. In the present case, it has been demonstrated to the undersigned that because of the large number of relatively small denomination of bonds held by foreign individuals, the advances for the fees of professionals appointed to represent such bondholders is essential to their effective participation in the present CCAA process.

## **CONCLUSION**

[27] For all of the foregoing reasons the motion was granted and the attached order was issued.

[28] Costs were not sought and the nature of the contestation by way more of intervention does not merit the awarding of costs against the Contesting Parties.

MARK SCHRAGER, j.s.c.

5 *Re Metcalfe & Mansfield*, n° 08-CL-7440, Order, Re Appointment of Representative Counsel in ABCP, (Ont. S.C.J.), 15 avril 2008, j. Campbell.

6 *Re Edgeworth*, n° CV-11-9409-00CL, Initial Order, (Ont. S.C.J.), 10 novembre 2011, j. Campbell.

7 *Re Mecachrome International Inc.*, C.S. Montréal, n° 500-11-035041-082, 13 janvier 2009, j. Gascon.

8 *Re Mecachrome*, *id.*, par. 79 à 81.

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# SUPERIOR COURT
(Commercial Division)

**C A N A D A**
**PROVINCE OF QUEBEC**
**DISTRICT OF MONTREAL**

**NO: 500-11-041305-117**

**DATE: February 15, 2012**

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**PRESIDING : THE HONOURABLE MARK SCHRAGER, J.S.C.**

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**IN THE MATTER OF THE PLAN OF COMPROMISE OR ARRANGEMENT OF:**

**HOMBURG INVEST INC.**
**HOMBURG SHARECO INC.**
**CHURCHILL ESTATES DEVELOPMENT LTD.**
**INVERNESS ESTATES DEVELOPMENT LTD.**
**CP DEVELOPMENT LTD.**
Debtors

-and-

**HOMCO REALTY FUND (52) LIMITED PARTNERSHIP**
**HOMCO REALTY FUND (88) LIMITED PARTNERSHIP**
**HOMCO REALTY FUND (89) LIMITED PARTNERSHIP**
**HOMCO REALTY FUND (92) LIMITED PARTNERSHIP**
**HOMCO REALTY FUND (94) LIMITED PARTNERSHIP**
**HOMCO REALTY FUND (105) LIMITED PARTNERSHIP**
**HOMCO REALTY FUND (121) LIMITED PARTNERSHIP**
**HOMCO REALTY FUND (122) LIMITED PARTNERSHIP**
**HOMCO REALTY FUND (142) LIMITED PARTNERSHIP**
**HOMCO REALTY FUND (199) LIMITED PARTNERSHIP**
Mis-en-cause

-and-

**SAMSON BÉLAIR/DELOITTE & TOUCHE INC.**
Monitor

-and-

**STICHTING HOMBURG BONDS**
**STICHTING HOMBURG CAPITAL SECURITIES**
Trustees

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**ORDER ON THE TRUSTEES' AMENDED MOTION FOR THE PAYMENT OF FEES, DISBURSEMENTS AND EXPENSES**

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**FURTHER** to the court hearing held on February 13, 2012 and the representations of counsel to Stichting Homburg Bonds and Stichting Homburg Capital Securities (the "**Trustees**") as well as counsel to other interested parties;

**CONSIDERING** the Trustees' *Amended Motion for the Payment of Fees, Disbursements and Expenses of the Indenture Trustees and the Indenture Trustees' Advisors and Related Relief* (the "**Motion**");

**CONSIDERING** the Initial Order issued by the Court on September 9, 2011 (the "**Initial Order**"), as extended and amended by the First Extension Order issued on October 7, 2011 and the Second Extension Order issued on December 8, 2011;

**CONSIDERING** the:

a. Trust Indenture made as of May 31, 2006, between Homburg Invest Inc. ("**HII**") and Stichting Homburg Bonds, as supplemented by several Supplemental Indentures (the "**Corporate Bonds Indenture R-1**"), pursuant to which four series of corporate bonds were issued (the "**Corporate Bonds**");

b. Trust Indenture made as of December 15, 2002, between Homburg ShareCo Inc. and Homburg Stichting Homburg Mortgage Bond, as supplemented by several Supplemental Indentures (the "**Mortgage Bonds Indenture R-2**"), pursuant to which four series of mortgage bonds were issued (the "**Mortgage Bonds**");

c. Trust Indenture made as of February 28, 2009, between HII and Stichting Homburg Capital Securities (the "**Capital Securities Indenture R-3**"), pursuant to which capital debt securities were issued (the "**Capital Securities**");

(the Corporate Bonds, Mortgage Bonds and the Capital Securities, collectively the "**Securities**");

**CONSIDERING** that the Trustees have retained the services of:

a. Mr. Henk Knuvers, Ms. Marian Hogeslag, Mr. Wouter de Jong, Mr. Hendrik Stadman Robaard and Mr. Karel de Vries, to act as directors of each Trustee;

b. Stikeman Elliott LLP ("**Stikeman**") and Cox & Palmer ("**C&P**"), as Canadian counsel, and Van Doorne N.V. ("**Van Doorne**"), as Dutch counsel, in order to assist in connection with these CCAA proceedings and advise the Trustees as to their duties, rights and remedies, as well as, in the case of Stikeman, to represent the Trustees before this Court;

c. PricewaterhouseCoopers Inc. ("**PwC**"), through Stikeman, to act as financial advisors in connection with these CCAA proceedings and assist the Trustees in reviewing financial data, evaluating available options and preparing for discussions and negotiations with the stakeholders involved in these proceedings;

(collectively, and together with any other director, legal, financial, or other advisors of the Trustees, the "**Trustees' Advisors**");

**CONSIDERING** the 5th Report to the Court submitted by Samson Bélair/Deloitte & Touche Inc., in its capacity as Monitor; and

**CONSIDERING** the powers granted to this Court under the *Companies' Creditors Arrangement Act* and more specifically section 11 thereof.

**FOR THESE REASONS, THE COURT:**

[1] **GRANTS** the Trustees' Motion, in part;

[2] **ORDERS** that the Petitioners shall advance from the available cash of the Debtors, on the same payment terms as the fees and disbursements payable by the Petitioners pursuant to paragraph [41] of the Initial Order dated September 9, 2011 as amended and/or restated, amounts equivalent to the reasonable fees and expenses incurred as and from December 3rd, 2011 in connection with the CCAA proceedings and the Restructuring by the Trustees' Advisors, the aggregate of which advances (the "**Stichting Advances**") up to the maximum amount to be distributed or paid (i) shall become due and payable to the Debtors immediately prior to any distribution or payment, including pursuant to a sale of assets, liquidation or realization of security or otherwise (each a "**Distribution Event**"), to be made to or for the benefit of the holders of the Securities, as the case may be, (ii) shall be set-off/compensated against the aggregate of any distribution to be made to or for the benefit of the holders of Securities pursuant to any such Distribution Event and (iii) shall be allocated, as between the holders of Securities, on a pro-rata basis, based on the amount, if any, to be distributed or paid in respect of each of the Corporate Bonds, Mortgage Bonds and Capital Securities as a percentage of the total amount to be distributed in respect of all Securities.

**THE WHOLE WITHOUT COSTS.**

Mark Schrager

**MARK SCHRAGER, J.S.C.**

# TAB 2

2009 CarswellOnt 3028
Ontario Superior Court of Justice [Commercial List]

Nortel Networks Corp., Re

2009 CarswellOnt 3028, [2009] O.J. No. 2166, 177 A.C.W.S. (3d) 634, 53 C.B.R. (5th) 196, 75 C.C.P.B. 206

# IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF NORTEL NETWORKS CORPORATION, NORTEL NETWORKS LIMITED, NORTEL NETWORKS GLOBAL CORPORATION, NORTEL NETWORKS INTERNATIONAL CORPORATION AND NORTEL NETWORKS TECHNOLOGY CORPORATION (Applicants)

APPLICATION UNDER THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED

Morawetz J.

Heard: April 20, 2009
Judgment: May 27, 2009 *
Docket: 09-CL-7950

Counsel: Janice Payne, Steven Levitt, Arthur O. Jacques for Steering Committee of Recently Severed Canadian Nortel Employees
Barry Wadsworth for CAW-Canada, George Borosh, Debra Connor
Lyndon Barnes, Adam Hirsh for Board of Directors of Nortel Networks Corporation, Nortel Networks Limited
Alan Mersky, Derrick Tay for Applicants
Henry Juroviesky, Eli Karp, Kevin Caspersz, Aaron Hershtal for Steering Committee for the Nortel Terminated Canadian Employees Owed Termination and Severance Pay
M. Starnino for Superintendent of Financial Services or Administrator of the Pension Benefits Gurantee Fund
Leanne Williams for Flextronics Telecom Systems Ltd.
Jay Carfagnini, Chris Armstrong for Monitor, Ernst & Young Inc.
Gail Misra for Communication, Energy and Paperworkers Union of Canada
J. Davis-Sydor for Brookfield Lepage Johnson Controls Facility Management Services
Mark Zigler, S. Philpott for Certain Former Employees of Nortel
G.H. Finlayson for Informal Nortel Noteholders Group
A. Kauffman for Export Development Canada
Alex MacFarlane for Unsecured Creditors' Committee (U.S.)

Subject: Insolvency
**Related Abridgment Classifications**
Bankruptcy and insolvency
XIX Companies' Creditors Arrangement Act
XIX.2 Initial application
XIX.2.a Procedure
XIX.2.a.iv Miscellaneous
**Headnote**
Bankruptcy and insolvency --- Proposal — Companies' Creditors Arrangement Act — Miscellaneous issues

  

Appointment of representative counsel — Telecommunication company entered protection under Companies' Creditors Arrangement Act — Telecommunications company ceased paying former employees with unsecured claims — Several groups of employees claimed entitlement to assets of company, including current working employees, and pensioners — Several law firms maintained that different classes should be established representing employees with different interests, with different legal representatives for each — Five law firms brought motions regarding representation — Law firm KM appointed representative for all potential classes of employee — Court has broad power to appoint representative counsel — Employees and retirees were vulnerable creditors, and had little means to pursue claims beyond representative counsel — No party denied choice of counsel as employees entitled to obtain individual counsel — No current conflict of interest between pensioned and non-pensioned employees — Many classes of employee had similar interest in pension plan — Claims under pension, to extend it was funded, not affected by CCAA proceedings — Pension claims by terminated employees creating conflict with other claims was only hypothetical — All former employees had community of interest.

**Table of Authorities**

**Cases considered by *Morawetz J.*:**

*Canadian Airlines Corp., Re* (2000), 19 C.B.R. (4th) 12, 2000 CarswellAlta 623 (Alta. Q.B.) — considered

*Stelco Inc., Re* (2005), 2005 CarswellOnt 6818, 204 O.A.C. 205, 78 O.R. (3d) 241, 261 D.L.R. (4th) 368, 11 B.L.R. (4th) 185, 15 C.B.R. (5th) 307 (Ont. C.A.) — considered

**Statutes considered:**

*Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36

Generally — referred to

s. 11 — considered

*Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.)

Generally — referred to

*Pension Benefits Act*, R.S.O. 1990, c. P.8

Generally — referred to

**Rules considered:**

*Rules of Civil Procedure*, R.R.O. 1990, Reg. 194

R. 10 — referred to

R. 10.01 — considered

R. 12.07 — considered

MOTIONS regarding appointment of counsel in proceedings under *Companies' Creditors Arrangement Act.*

***Morawetz J.*:**

1 On May 20, 2009, I released an endorsement appointing Koskie Minsky as representative counsel with reasons to follow. The reasons are as follows.

2 This endorsement addresses five motions in which various parties seek to be appointed as representative counsel for various factions of Nortel's current and former employees (Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation are collectively referred to as the "Applicants" or "Nortel").

3 The proposed representative counsel are:

> (i) Koskie Minsky LLP ("KM") who is seeking to represent all former employees, including pensioners, of the Applicants or any person claiming an interest under or on behalf of such former employees or pensioners and surviving spouses in respect of a pension from the Applicants. Approximately 2,000 people have retained KM.

  

(ii) Nelligan O'Brien Payne LLP and Shibley Righton LLP (collectively "NS") who are seeking to be co-counsel to represent all former non-unionized employees, terminated either prior to or after the CCAA filing date, to whom the Applicants owe severance and/or pay in lieu of reasonable notice. In addition, in a separate motion, NS seeks to be appointed as co-counsel to the continuing employees of Nortel. Approximately 460 people have retained NS and a further 106 have retained Macleod Dixon LLP, who has agreed to work with NS.

(iii) Juroviesky and Ricci LLP ("J&R") who is seeking to represent terminated employees or any person claiming an interest under or on behalf of former employees. At the time that this motion was heard approximately 120 people had retained J&R. A subsequent affidavit was filed indicating that this number had increased to 186.

(iv) Mr. Lewis Gottheil, in-house legal counsel for the National Automobile, Aerospace, Transportation and General Workers Union of Canada ("CAW") who is seeking to represent all retirees of the Applicants who were formerly members of one of the CAW locals when they were employees. Approximately 600 people have retained Mr. Gottheil or the CAW.

4 At the outset, it is noted that all parties who seek representation orders have submitted ample evidence that establishes that the legal counsel that they seek to be appointed as representative counsel are well respected members of the profession.

5 Nortel filed for CCAA protection on January 14, 2009 (the "Filing Date"). At the Filing Date, Nortel employed approximately 6,000 employees and had approximately 11,700 retirees or their spouses receiving pension and/or benefits from retirement plans sponsored by the Applicants.

6 The Monitor reports that the Applicants have continued to honour substantially all of the obligations to active employees. However, the Applicants acknowledge that upon commencement of the CCAA proceedings, they ceased making almost all payments to former employees of amounts that would constitute unsecured claims. Included in those amounts were payments to a number of former employees for termination and severance, as well as amounts under various retirement and retirement transition programs.

7 The Monitor is of the view that it is appropriate that there be representative counsel in light of the large number of former employees of the Applicants. The Monitor is of the view that former employee claims may require a combination of legal, financial, actuarial and advisory resources in order to be advanced and that representative counsel can efficiently co-ordinate such assistance for this large number of individuals.

8 The Monitor has reported that the Applicants' financial position is under pressure. The Monitor is of the view that the financial burden of multiple representative counsel would further increase this pressure.

9 These motions give rise to the following issues:

(i) when is it appropriate for the court to make a representation and funding order?

(ii) given the completing claims for representation rights, who should be appointed as representative counsel?

**Issue 1 - Representative Counsel and Funding Orders**

10 The court has authority under Rule 10.01 of the *Rules of Civil Procedure* to appoint representative counsel where persons with an interest in an estate cannot be readily ascertained, found or served.

11 Alternatively, Rule 12.07 provides the court with the authority to appoint a representative defendant where numerous persons have the same interests.

 

12 In addition, the court has a wide discretion pursuant to s. 11 of the CCAA to appoint representatives on behalf of a group of employees in CCAA proceedings and to order legal and other professional expenses of such representatives to be paid from the estate of the debtor applicant.

13 In the KM factum, it is submitted that employees and retirees are a vulnerable group of creditors in an insolvency because they have little means to pursue a claim in complex CCAA proceedings or other related insolvency proceedings. It was further submitted that the former employees of Nortel have little means to pursue their claims in respect of pension, termination, severance, retirement payments and other benefit claims and that the former employees would benefit from an order appointing representative counsel. In addition, the granting of a representation order would provide a social benefit by assisting former employees and that representative counsel would provide a reliable resource for former employees for information about the process. The appointment of representative counsel would also have the benefit of streamlining and introducing efficiency to the process for all parties involved in Nortel's insolvency.

14 I am in agreement with these general submissions.

15 The benefits of representative counsel have also been recognized by both Nortel and by the Monitor. Nortel consents to the appointment of KM as the single representative counsel for all former employees. Nortel opposes the appointment of any additional representatives. The Monitor supports the Applicants' recommendation that KM be appointed as representative counsel. No party is opposed to the appointment of representative counsel.

16 In the circumstances of this case, I am satisfied that it is appropriate to exercise discretion pursuant to s. 11 of the CCAA to make a Rule 10 representation order.

**Issue 2 - Who Should be Appointed as Representative Counsel?**

17 The second issue to consider is who to appoint as representative counsel. On this issue, there are divergent views. The differences primarily centre around whether there are inherent conflicts in the positions of various categories of former employees.

18 The motion to appoint KM was brought by Messrs. Sproule, Archibald and Campbell (the "Koskie Representatives"). The Koskie Representatives seek a representation order to appoint KM as representative counsel for all former employees in Nortel's insolvency proceedings, except:

(a) any former chief executive officer or chairman of the board of directors, any non-employee members of the board of directors, or such former employees or officers that are subject to investigation and charges by the Ontario Securities Commission or the United States Securities and Exchange Commission:

(b) any former unionized employees who are represented by their former union pursuant to a Court approved representation order; and

(c) any former employee who chooses to represent himself or herself as an independent individual party to these proceedings.

19 Ms. Paula Klein and Ms. Joanne Reid, on behalf of the Recently Severed Canadian Nortel Employees ("RSCNE"), seek a representation order to appoint NS as counsel in respect of all former Nortel Canadian non-unionized employees to whom Nortel owes termination and severance pay (the "RSCNE Group").

20 Mr. Kent Felske and Mr. Dany Sylvain, on behalf of the Nortel Continuing Canadian Employees ("NCCE") seek a representative order to appoint NS as counsel in respect of all current Canadian non-unionized Nortel employees (the "NCCE Group").

  

21 J&R, on behalf of the Steering Committee (Mr. Michael McCorkle, Mr. Harvey Stein and Ms. Marie Lunney) for Nortel Terminated Canadian Employees ("NTCEC") owed termination and severance pay seek a representation order to appoint J&R in respect of any claim of any terminated employee arising out of the insolvency of Nortel for:

(a) unpaid termination pay;

(b) unpaid severance pay;

(c) unpaid expense reimbursements; and

(d) amounts and benefits payable pursuant to employment contracts between the Employees and Nortel

22 Mr. George Borosh and/or Ms. Debra Connor seek a representation order to represent all retirees of the Applicants who were formerly represented by the CAW (the "Retirees") or, alternatively, an order authorizing the CAW to represent the Retirees.

23 The former employees of Nortel have an interest in Nortel's CCAA proceedings in respect of their pension and employee benefit plans and in respect of severance, termination pay, retirement allowances and other amounts that the former employees consider are owed in respect of applicable contractual obligations and employment standards legislation.

24 Most former employees and survivors of former employees have basic entitlement to receive payment from the Nortel Networks Limited Managerial and Non-negotiated Pension Plan (the "Pension Plan") or from the corresponding pension plan for unionized employees.

25 Certain former employees may also be entitled to receive payment from Nortel Networks Excess Plan (the "Excess Plan") in addition to their entitlement to the Pension Plan. The Excess Plan is a non-registered retirement plan which provides benefits to plan members in excess of those permitted under the registered Pension Plan in accordance with the *Income Tax Act*.

26 Certain former employees who held executive positions may also be entitled to receive payment from the Supplementary Executive Retirement Plan ("SERP") in addition to their entitlement to the Pension Plan. The SERP is a non-registered plan.

27 As of Nortel's last formal valuation dated December 31, 2006, the Pension Plan was funded at a level of 86% on a wind-up basis. As a result of declining equity markets, it is anticipated that the Pension Plan funding levels have declined since the date of the formal valuation and that Nortel anticipates that its Pension Plan funding requirements in 2009 will increase in a very substantial and material matter.

28 At this time, Nortel continues to fund the deficit in the Pension Plan and makes payment of all current service costs associated with the benefits; however, as KM points out in its factum, there is no requirement in the Initial Order compelling Nortel to continue making those payments.

29 Many retirees and former employees of Nortel are entitled to receive health and medical benefits and other benefits such as group life insurance (the "Health Care Plan"), some of which are funded through the Nortel Networks' Health and Welfare Trust (the "HWT").

30 Many former employees are entitled to a payment in respect of the Transitional Retirement Allowance ("TRA"), a payment which provides supplemental retirement benefits for those who at the time of their retirement elect to receive such payment. Some 442 non-union retirees have ceased to receive this benefit as a result of the CCAA proceedings.

31 Former employees who have been recently terminated from Nortel are owed termination pay and severance pay. There were 277 non-union former employees owed termination pay and severance pay at the Filing Date.

32 Certain former unionized employees also have certain entitlements including:

(a) Voluntary Retirement Option ("VRO");

 

(b) Retirement Allowance Payment ("RAP"); and

(c) Layoff and Severance Payments

33 The Initial Order permitted Nortel to cease making payments to its former employees in respect of certain amounts owing to them and effective January 14, 2009, Nortel has ceased payment of the following:

(a) all supplementary pensions which were paid from sources other than the Registered Pension Plan, including payments in respect of the Excess Plan and the SERP;

(b) all TRA agreements where amounts were still owing to the affected former employees as at January 14, 2009;

(c) all RAP agreements where amounts were still owing to the affected former employees as at January 14, 2009;

(d) all severance and termination agreements where amounts were still owing to the affected former employees as at January 14, 2009; and

(e) all retention bonuses where amounts were still owing to affected former employees as at January 14, 2009.

34 The representatives seeking the appointment of KM are members of the Nortel Retiree and Former Employee Protection Committee ("NRPC"), a national-based group of over 2,000 former employees. Its stated mandate is to defend and protect pensions, severance, termination and retirement payments and other benefits. In the KM factum, it is stated that since its inception, the NRPC has taken steps to organize across the country and it has assembled subcommittees in major centres. The NRPC consists of 20 individuals who it claims represent all different regions and interests and that they participate in weekly teleconference meetings with legal counsel to ensure that all former employees' concerns are appropriately addressed.

35 At paragraph 49 of the KM factum, counsel submits that NRPC members are a cross-section of all former employees and include a variety of interests, including those who have an interest in and/or are entitled to:

(a) the basic Pension Plan as a deferred member or a member entitled to transfer value;

(b) the Health Care Plan;

(c) the Pension Plan and Health Care Plan as a survivor of a former employee;

(d) Supplementary Retirement Benefits from the Excess Plan and the SERP plans;

(e) severance and termination pay ; and

(f) TRA payments.

36 The representatives submit that they are well suited to represent all former employees in Nortel's CCAA proceedings in respect of all of their interests. The record (Affidavit of Mr. D. Sproule) references the considerable experience of KM in representing employee groups in large-scale restructurings.

37 With respect to the allegations of a conflict of interest as between the various employee groups (as described below), the position of the representatives seeking the appointment of KM is that all former employees have unsecured claims against Nortel in its CCAA proceedings and that there is no priority among claims in respect of Nortel's assets. Further, they submit that a number of former employees seeking severance and termination pay also have other interests, including the Pension Plan, TRA payments and the supplementary pension payments and that it would unjust and inefficient to force these individuals to hire individual counsel or to have separate counsel for separate claims.

  

38 Finally, they submit that there is no guarantee as to whether Nortel will emerge from the CCAA, whether it will file for bankruptcy or whether a receiver will be appointed or indeed whether even a plan of compromise will be filed. They submit that there is no actual conflict of interest at this time and that the court need not be concerned with hypothetical scenarios which may never materialize. Finally, they submit that in the unlikely event of a serious conflict in the group, such matters can be brought to the attention of the court by the representatives and their counsel on a *ex parte* basis for resolution.

39 The terminated employee groups seeking a representation order for both NS and J&R submit that separate representative counsel appointments are necessary to address the conflict between the pension group and the employee group as the two groups have separate legal, procedural, and equitable interests that will inevitably conflict during the CCAA process.

40 They submit that the pensioners under the Pension Plan are continuing to receive the full amount of the pension from the Pension Plan and as such they are not creditors of Nortel. Counsel submits that the interest of pensioners is in continuing to receive to receive their full pension and survivor benefits from the Pension Plan for the remainder of their lives and the lives of surviving spouses.

41 In the NS factum at paragraphs 44 - 58, the argument is put forward as to why the former employees to whom Nortel owes severance and termination pay should be represented separately from the pensioners. The thrust of the argument is that future events may dictate the response of the affected parties. At paragraph 51 of the factum, it is submitted that generally, the recently severed employees' primary interest is to obtain the fastest possible payout of the greatest amount of severance and/or pay in lieu of notice in order to alleviate the financial hardships they are currently experiencing. The interests of pensioners, on the other hand, is to maintain the status quo, in which they continue to receive full pension benefits as long as possible. The submission emphasizes that issues facing the pensioner group and the non-pensioner group are profoundly divergent as full monthly benefit payments for the pensioner group have continued to date while non-pensioners are receiving 86% of their lump sums on termination of employment, in accordance with the most recently filed valuation report.

42 The motion submitted by the NTCEC takes the distinction one step further. The NTCEC is opposed to the motion of NS. NS wishes to represent both the RSCNE and the NCCE. The NTCEC believes that the terminated employees who are owed unpaid wages, termination pay and/or severance should comprise their own distinct and individual class.

43 The NTCEC seek payment and fulfillment of Nortel's obligations to pay one or several of the following:

(a) TRA;

(b) 2008 bonuses; and

(c) amendments to the Nortel Pension Plan

44 Counsel to NTCEC submits that the most glaring and obvious difference between the NCCE and the NTCEC, is that NCCE are still employed and have a continuing relationship with Nortel and have a source of employment income and may only have a contingent claim. The submission goes on to suggest that, if the NCCE is granted a representation order in these proceedings, they will seek to recover the full value of their TRA claim from Nortel during the negotiation process notwithstanding that one's claim for TRA does not crystallize until retirement or termination. On the other hand, the terminated employees, represented by the NTCEC and RSCNE are also claiming lost TRA benefits and that claim has crystallized because their employment with Nortel has ceased. Counsel further submits that the contingent claim of the NCCE for TRA is distinct and separate with the crystallized claim of the NTCEC and RSCNE for TRA.

45 Counsel to NTCEC further submits that there are difficulties with the claim of NCCE which is seeking financial redress in the CCAA proceedings for damages stemming from certain changes to the Nortel Networks Limited Managerial and Non-negotiated Pension Plan effective June 1, 2008 and Nortel's decision to decrease retirees benefits. Counsel submits that, even if the NCCE claims relating to the Pension Plan amendment are quantifiable, they are so dissimilar to the claims of the RSCNE and

 

NTCEC, that the current and former Nortel employees cannot be viewed as a single group of creditors with common interests in these proceedings, thus necessitating distinct legal representation for each group of creditors.

46 Counsel further argues that NTCEC's sole mandate is to maximize recovery of unpaid wages, termination and severance pay which, those terminated employees as a result of Nortel's CCAA filing, have lost their employment income, termination pay and/or severance pay which would otherwise be protected by statute or common law.

47 KM, on behalf of the Koskie Representatives, responded to the concerns raised by NS and by J&R in its reply factum.

48 KM submits that the conflict of interest is artificial. KM submits that all members of the Pension Plan who are owed pensions face reductions on the potential wind-up of the Pension Plan due to serious under-funding and that temporarily maintaining of status quo monthly payments at 100%, although required by statute, does not avoid future reductions due to under-funding which offset any alleged overpayments. They submit that all pension members, whether they can withdraw 86% of their funds now and transfer them a locked-in vehicle or receive them later in the form of potentially reduced pensions, face a loss and are thus creditors of Nortel for the pension shortfalls.

49 KM also states that the submission of the RSCNE that non-pensioners may put pressure on Nortel to reduce monthly payments on pensioners ignores the *Ontario Pension Benefits Act* and its applicability in conjunction with the CCAA. It further submits that issues regarding the reduction of pensions and the transfers of commuted values are not dealt with through the CCAA proceedings, but through the Superintendent of Financial Services and the Plan Administrator in their administration and application of the PBA. KM concludes that the Nortel Pension Plans are not applicants in this matter nor is there a conflict given the application of the provisions of the PBA as detailed in the factum at paragraphs 11 - 21.

50 KM further submits that over 1,500 former employees have claims in respect of other employment and retirement related benefits such as the Excess Plan, the SERP, the TRA and other benefit allowances which are claims that have "crystallized" and are payable now. Additionally, they submit that 11,000 members of the Pension Plan are entitled to benefits from the Pensioner Health Care Plan which is not pre-funded, resulting in significant claims in Nortel's CCAA proceedings for lost health care benefits.

51 Finally, in addition to the lack of any genuine conflict of interest between former employees who are pensioners and those who are non-pensioners, there is significant overlap in interest between such individuals and a number of the former employees seeking severance and termination pay have the same or similar interests in other benefit payments, including the Pension Plan, Health Care Plan, TRA, SERP and Excess Plan payments. As well, former employees who have an interest in the Pension Plan also may be entitled to severance and termination pay.

52 With respect to the motions of NS and J&R, I have not been persuaded that there is a real and direct conflict of interest. Claims under the Pension Plan, to the extent that it is funded, are not affected by the CCAA proceedings. To the extent that there is a deficiency in funding, such claims are unsecured claims against Nortel. In a sense, deficiency claims are not dissimilar from other employee benefit claims.

53 To the extent that there may be potentially a divergence of interest as between pension-based claims and terminated-employee claims, these distinctions are, at this time, hypothetical. At this stage of the proceeding, there has been no attempt by Nortel to propose a creditor classification, let alone a plan of arrangement to its creditors. It seems to me that the primary emphasis should be placed on ensuring that the arguments of employees are placed before the court in the most time efficient and cost effective way possible. In my view, this can be accomplished by the appointment of a single representative counsel, knowledgeable and experienced in all facets of employee claims.

54 It is conceivable that there will be differences of opinion between employees at some point in the future, but if such differences of opinion or conflict arise, I am satisfied that this issue will be recognized by representative counsel and further directions can be provided.

55 A submission was also made to the effect that certain individuals or groups of individuals should not be deprived of their counsel of choice. In my view, the effect of appointing one representative counsel does not, in any way, deprive a party of their ability to be represented by the counsel of their choice. The Notice of Motion of KM provides that any former employee who does not wish to be bound by the representative order may take steps to notify KM of their decision and may thereafter appear as an independent party.

56 In the responding factum at paragraphs 28 - 30, KM submits that each former employee, whether or not entitled to an interest in the Pension Plan, has a common interest in that each one is an unsecured creditor who is owed some form of deferred compensation, being it severance pay, TRA or RAP payments, supplementary pensions, health benefits or benefits under a registered Pension Plan and that classifying former employees as one group of creditors will improve the efficiency and effectiveness of Nortel's CCAA proceedings and will facilitate the reorganization of the company. Further, in the event of a liquidation of Nortel, each former employee will seek to recover deferred compensation claims as an unsecured creditor. Thus, fragmentation of the group is undesirable. Further, all former employees also have a common legal position as unsecured creditors of Nortel in that their claims all arise out of the terms and conditions of their employment and regardless of the form of payment, unpaid severance pay and termination pay, unpaid health benefits, unpaid supplementary pension benefits and other unpaid retirement benefits are all remuneration of some form arising from former employment with Nortel.

57 The submission on behalf of KM concludes that funds in a pension plan can also be described as deferred wages. An employer who creates a pension plan agrees to provide benefits to retiring employees as a form of compensation to that employee. An underfunded pension plan reflects the employer's failure to pay the deferred wages owing to former employees.

58 In its factum, the CAW submits that the two proposed representative individuals are members of the Nortel Pension Plan applicable to unionized employees. Both individuals are former unionized employees of Nortel and were members of the CAW. Counsel submits that naming them as representatives on behalf of all retirees of Nortel who were members of the CAW will not result in a conflict with any other member of the group.

59 Counsel to the CAW also stated that in the event that the requested representation order is not granted, those 600 individuals who have retained Mr. Lewis Gottheil will still be represented by him, and the other similarly situated individuals might possibly be represented by other counsel. The retainer specifically provides that no individual who retains Mr. Gottheil shall be charged any fees nor be responsible for costs or penalties. It further provides that the retainer may be discontinued by the individual or by counsel in accordance with applicable rules.

60 Counsel further submits that the 600 members of the group for which the representation order is being sought have already retained counsel of their choice, that being Mr. Lewis Gottheil of the CAW. However, if the requested representative order is not granted, there will still be a group of 600 individual members of the Pension Plan who are represented by Mr. Gottheil. As a result, counsel acknowledges there is little to no difference that will result from granting the requested representation order in this case, except that all retirees formerly represented by the union will have one counsel, as opposed to two or several counsel if the order is not granted.

61 In view of this acknowledgement, it seems to me that there is no advantage to be gained by granting the CAW representative status. There will be no increased efficiencies, no simplification of the process, nor any real practical benefit to be gained by such an order.

62 Notwithstanding that creditor classification has yet to be proposed in this CCAA proceeding, it is useful, in my view, to make reference to some of the principles of classification. In *Stelco Inc., Re*, the Ontario Court of Appeal noted that the classification of creditors in the CCAA proceeding is to be determined based on the "commonality of interest" test. In *Stelco Inc., Re*, the Court of Appeal upheld the reasoning of Paperny J. (as she then was) in *Canadian Airlines Corp., Re* and articulated the following factors to be considered in the assessment of the "commonality of interest".

In summary, the case has established the following principles applicable to assessing commonality of interest:

 

1. Commonality of interest should be viewed based on the non-fragmentation test, not on an identity of interest test;

2. The interests to be considered are the legal interests that a creditor holds qua creditor in relationship to the debtor company prior to and under the plan as well as on liquidation.

3. The commonality of interests are to be viewed purposively, bearing in mind the object of the CCAA, namely to facilitate reorganizations if possible.

4. In placing a broad and purposive interpretation on the CCAA, the court should be careful to resist classification approaches that would potentially jeopardize viable plans.

5. Absent bad faith, the motivations of creditors to approve or disapprove [of the Plan] are irrelevant.

6. The requirement of creditors being able to consult together means being able to assess their legal entitlement *as creditors* before or after the plan in a similar manner.

*Stelco Inc., Re* (2005), 15 C.B.R. (5th) 307 (Ont. C.A.), paras 21-23; *Canadian Airlines Corp., Re* (2000), 19 C.B.R. (4th) 12 (Alta. Q.B.), para 31.

63 I have concluded that, at this point in the proceedings, the former employees have a "commonality of interest" and that this process can be best served by the appointment of one representative counsel.

64 As to which counsel should be appointed, all firms have established their credentials. However, KM is, in my view, the logical choice. They have indicated a willingness to act on behalf of all former employees. The choice of KM is based on the broad mandate they have received from the employees, their experience in representing groups of retirees and employees in large scale restructurings and speciality practice in the areas of pension, benefits, labour and employment, restructuring and insolvency law, as well as my decision that the process can be best served by having one firm put forth the arguments on behalf of all employees as opposed to subdividing the employee group.

65 The motion of Messrs. Sproule, Archibald and Campbell is granted and Koskie Minsky LLP is appointed as Representative Counsel. This representation order is also to cover the fees and disbursements of Koskie Minsky.

66 The motions to appoint Nelligan O'Brien Payne and Shibley Righton, Juroviesky and Ricci, and the CAW as representative counsel are dismissed.

67 I would ask that counsel prepare a form of order for my consideration.

*Order accordingly.*

Footnotes

* Additional reasons at *Nortel Networks Corp., Re* (2009), 2009 CarswellOnt 3530 (Ont. S.C.J. [Commercial List]).

# TAB 3

**Most Negative Treatment:** Check subsequent history and related treatments.

2015 ONSC 303
Ontario Superior Court of Justice

Target Canada Co., Re

2015 CarswellOnt 620, 2015 ONSC 303, [2015] O.J. No. 247, 22 C.B.R. (6th) 323, 248 A.C.W.S. (3d) 753

# In the Matter of the Companies' Creditors Arrangement Act, R.S.C., 1985, c. C-36, as Amended

In the Matter of a Plan of Compromise or Arrangement of Target Canada Co., Target Canada Health Co., Target Canada Mobile GP Co., Target Canada Pharmacy (BC) Corp., Target Canada Pharmacy (Ontario) Corp., Target Canada Pharmacy Corp., Target Canada Pharmacy (SK) Corp., and Target Canada Property LLC.

Morawetz R.S.J.

Heard: January 15, 2015
Judgment: January 16, 2015
Docket: CV-15-10832-00CL

Counsel: Tracy Sandler, Jeremy Dacks for Applicants, Target Canada Co., Target Canada Health Co., Target Canada Mobile GP Co., Target Canada Pharmacy (BC) Corp., Target Canada Pharmacy (Ontario) Corp., Target Canada Pharmacy Corp., Target Canada Pharmacy (SK) Corp., and Target Canada Property LLC
Jay Swartz for Target Corporation
Alan Mark, Melaney Wagner, Jesse Mighton for Proposed Monitor, Alvarez and Marsal Canada ULC ("Alvarez")
Terry O'Sullivan for Honourable J. Ground, Trustee of the Proposed Employee Trust
Susan Philpott for Proposed Employee Representative Counsel, for Employees of the Applicants

Subject: Insolvency; Property

**Related Abridgment Classifications**

Bankruptcy and insolvency
XIX Companies' Creditors Arrangement Act
XIX.2 Initial application
XIX.2.e Proceedings subject to stay
XIX.2.e.vi Miscellaneous
Bankruptcy and insolvency
XIX Companies' Creditors Arrangement Act
XIX.2 Initial application
XIX.2.h Miscellaneous

**Headnote**

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Initial application — Proceedings subject to stay — Miscellaneous

Applicant group of companies were involved in Canadian operations of U.S. retailer T Co. — Canadian operations suffered significant loss in every quarter — T Co. decided to stop funding Canadian operations — Applicants sought to wind down Canadian operations and applied for relief under Companies' Creditors Arrangement Act (CCAA) — Application granted — Initial order granted — Stay of proceedings granted — Stay extended to certain limited partnerships, which were related to or carried on operations integral to applicants' business — Stay of proceedings extended to rights of third party tenants against landlords that arose out of insolvency — Stay extended to T Co. and its U.S. subsidiaries in relation to claims derivative of claims against Canadian operations.

 

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Initial application — Miscellaneous

Applicant group of companies were involved in Canadian operations of U.S. retailer T Co. — Canadian operations suffered significant loss in every quarter — T Co. decided to stop funding Canadian operations — Applicants sought to wind down Canadian operations and applied for relief under Companies' Creditors Arrangement Act (CCAA) — Application granted — Initial order granted — Stay of proceedings granted — It was appropriate to grant broad relief to ensure status quo was maintained — Applicants were all insolvent — Although there was no prospect restructured "going concern" solution would result, use of CCAA protection was appropriate in circumstances — Creation of employee trust to cover payments to employees was approved — Key employee retention program (KERP) and charge as security for KERP payments were approved — Appointment of Employee Representative Counsel was approved — DIP Lenders' Charge and DIP Facility were approved — Administration charge and Directors' and Officers' charge approved.

**Table of Authorities**

**Cases considered by *Morawetz R.S.J.*:**

*Canwest Global Communications Corp., Re* (2009), 2009 CarswellOnt 6184, 59 C.B.R. (5th) 72 (Ont. S.C.J. [Commercial List]) — considered

*Canwest Publishing Inc./Publications Canwest Inc., Re* (2010), 63 C.B.R. (5th) 115, 2010 CarswellOnt 212, 2010 ONSC 222 (Ont. S.C.J. [Commercial List]) — followed

*Grant Forest Products Inc., Re* (2009), 2009 CarswellOnt 4699, 57 C.B.R. (5th) 128 (Ont. S.C.J. [Commercial List]) — considered

*Lehndorff General Partner Ltd., Re* (1993), 17 C.B.R. (3d) 24, 9 B.L.R. (2d) 275, 1993 CarswellOnt 183 (Ont. Gen. Div. [Commercial List]) — referred to

*Nortel Networks Corp., Re* (2009), 2009 CarswellOnt 1330 (Ont. S.C.J. [Commercial List]) — considered

*Nortel Networks Corp., Re* (2009), 53 C.B.R. (5th) 196, 75 C.C.P.B. 206, 2009 CarswellOnt 3028 (Ont. S.C.J. [Commercial List]) — referred to

*Priszm Income Fund, Re* (2011), 2011 ONSC 2061, 2011 CarswellOnt 2258, 75 C.B.R. (5th) 213 (Ont. S.C.J.) — considered

*Sierra Club of Canada v. Canada (Minister of Finance)* (2002), 287 N.R. 203, (sub nom. *Atomic Energy of Canada Ltd. v. Sierra Club of Canada)* 18 C.P.R. (4th) 1, 44 C.E.L.R. (N.S.) 161, (sub nom. *Atomic Energy of Canada Ltd. v. Sierra Club of Canada)* 211 D.L.R. (4th) 193, 223 F.T.R. 137 (note), 20 C.P.C. (5th) 1, 40 Admin. L.R. (3d) 1, 2002 SCC 41, 2002 CarswellNat 822, 2002 CarswellNat 823, (sub nom. *Atomic Energy of Canada Ltd. v. Sierra Club of Canada)* 93 C.R.R. (2d) 219, [2002] 2 S.C.R. 522, 2002 CSC 41 (S.C.C.) — followed

*Stelco Inc., Re* (2004), 48 C.B.R. (4th) 299, [2004] O.T.C. 284, 2004 CarswellOnt 1211 (Ont. S.C.J. [Commercial List]) — followed

*Stelco Inc., Re* (2004), 2004 CarswellOnt 2936 (Ont. C.A.) — referred to

*Stelco Inc., Re* (2004), 338 N.R. 196 (note), 2004 CarswellOnt 5200, 2004 CarswellOnt 5201 (S.C.C.) — referred to

*T. Eaton Co., Re* (1997), 1997 CarswellOnt 1914, 46 C.B.R. (3d) 293 (Ont. Gen. Div.) — considered

*Ted Leroy Trucking Ltd., Re* (2010), (sub nom. *Century Services Inc. v. Canada (A.G.))* [2010] 3 S.C.R. 379, [2010] G.S.T.C. 186, 12 B.C.L.R. (5th) 1, (sub nom. *Century Services Inc. v. A.G. of Canada)* 2011 G.T.C. 2006 (Eng.), (sub nom. *Century Services Inc. v. A.G. of Canada)* 2011 D.T.C. 5006 (Eng.), (sub nom. *Leroy (Ted) Trucking Ltd., Re)* 503 W.A.C. 1, (sub nom. *Leroy (Ted) Trucking Ltd., Re)* 296 B.C.A.C. 1, 2010 SCC 60, 2010 CarswellBC 3419, 2010 CarswellBC 3420, 409 N.R. 201, (sub nom. *Ted LeRoy Trucking Ltd., Re)* 326 D.L.R. (4th) 577, 72 C.B.R. (5th) 170, [2011] 2 W.W.R. 383 (S.C.C.) — considered

*U.S. Steel Canada Inc., Re* (2014), 2014 ONSC 6145, 2014 CarswellOnt 16465 (Ont. S.C.J.) — considered

**Statutes considered:**

*Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3

Generally — referred to

s. 2 "insolvent person" — considered

*Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36

Generally — referred to

  

s. 11 — considered

s. 11.02 [en. 2005, c. 47, s. 128] — considered

s. 11.02(1) [en. 2005, c. 47, s. 128] — considered

s. 11.2 [en. 1997, c. 12, s. 124] — considered

s. 11.2(4) [en. 1997, c. 12, s. 124] — considered

s. 11.7(1) [en. 1997, c. 12, s. 124] — considered

s. 11.51 [en. 2005, c. 47, s. 128] — considered

s. 36 — considered

**Rules considered:**

*Rules of Civil Procedure*, R.R.O. 1990, Reg. 194

Generally — referred to

**Words and phrases considered:**

**insolvent**

"Insolvent" is not expressly defined in the [*Companies' Creditors Arrangement Act* (CCAA)]. However, for the purposes of the CCAA, a debtor is insolvent if it meets the definition of an "insolvent person" in section 2 of the *Bankruptcy and Insolvency Act* . . . or if it is "insolvent" as described in Stelco Inc. (Re), [2004] O.J. No. 1257, [Stelco], leave to appeal refused, [2004] O.J. No. 1903, leave to appeal to S.C.C. refused [2004] S.C.C.A. No. 336, where Farley, J. found that "insolvency" includes a corporation "reasonably expected to run out of liquidity within [a] reasonable proximity of time as compared with the time reasonably required to implement a restructuring".

APPLICATION for relief under *Companies' Creditors Arrangement Act*.

***Morawetz R.S.J.*:**

1 Target Canada Co. ("TCC") and the other applicants listed above (the "Applicants") seek relief under the *Companies' Creditors Arrangement Act*, R.S.C., 1985, c. C-36, as amended (the "CCAA"). While the limited partnerships listed in Schedule "A" to the draft Order (the "Partnerships") are not applicants in this proceeding, the Applicants seek to have a stay of proceedings and other benefits of an initial order under the CCAA extended to the Partnerships, which are related to or carry on operations that are integral to the business of the Applicants.

2 TCC is a large Canadian retailer. It is the Canadian operating subsidiary of Target Corporation, one of the largest retailers in the United States. The other Applicants are either corporations or partners of the Partnerships formed to carry on specific aspects of TCC's Canadian retail business (such as the Canadian pharmacy operations) or finance leasehold improvements in leased Canadian stores operated by TCC. The Applicants, therefore, do not represent the entire Target enterprise; the Applicants consist solely of entities that are integral to the Canadian retail operations. Together, they are referred as the "Target Canada Entities".

3 In early 2011, Target Corporation determined to expand its retail operations into Canada, undertaking a significant investment (in the form of both debt and equity) in TCC and certain of its affiliates in order to permit TCC to establish and operate Canadian retail stores. As of today, TCC operates 133 stores, with at least one store in every province of Canada. All but three of these stores are leased.

4 Due to a number of factors, the expansion into Canada has proven to be substantially less successful than expected. Canadian operations have shown significant losses in every quarter since stores opened. Projections demonstrate little or no prospect of improvement within a reasonable time.

 

5 After exploring multiple solutions over a number of months and engaging in extensive consultations with its professional advisors, Target Corporation concluded that, in the interest of all of its stakeholders, the responsible course of action is to cease funding the Canadian operations.

6 Without ongoing investment from Target Corporation, TCC and the other Target Canada Entities cannot continue to operate and are clearly insolvent. Due to the magnitude and complexity of the operations of the Target Canada Entities, the Applicants are seeking a stay of proceedings under the CCAA in order to accomplish a fair, orderly and controlled wind-down of their operations. The Target Canada Entities have indicated that they intend to treat all of their stakeholders as fairly and equitably as the circumstances allow, particularly the approximately 17,600 employees of the Target Canada Entities.

7 The Applicants are of the view that an orderly wind-down under Court supervision, with the benefit of inherent jurisdiction of the CCAA, and the oversight of the proposed monitor, provides a framework in which the Target Canada Entities can, among other things:

a) Pursue initiatives such as the sale of real estate portfolios and the sale of inventory;

b) Develop and implement support mechanisms for employees as vulnerable stakeholders affected by the wind-down, particularly (i) an employee trust (the "Employee Trust") funded by Target Corporation; (ii) an employee representative counsel to safeguard employee interests; and (iii) a key employee retention plan (the "KERP") to provide essential employees who agree to continue their employment and to contribute their services and expertise to the Target Canada Entities during the orderly wind-down;

c) Create a level playing field to ensure that all affected stakeholders are treated as fairly and equitably as the circumstances allow; and

d) Avoid the significant maneuvering among creditors and other stakeholders that could be detrimental to all stakeholders, in the absence of a court-supervised proceeding.

8 The Applicants are of the view that these factors are entirely consistent with the well-established purpose of a CCAA stay: to give a debtor the "breathing room" required to restructure with a view to maximizing recoveries, whether the restructuring takes place as a going concern or as an orderly liquidation or wind-down.

9 TCC is an indirect, wholly-owned subsidiary of Target Corporation and is the operating company through which the Canadian retail operations are carried out. TCC is a Nova Scotia unlimited liability company. It is directly owned by Nicollet Enterprise 1 S. à r.l. ("NE1"), an entity organized under the laws of Luxembourg. Target Corporation (which is incorporated under the laws of the State of Minnesota) owns NE1 through several other entities.

10 TCC operates from a corporate headquarters in Mississauga, Ontario. As of January 12, 2015, TCC employed approximately 17,600 people, almost all of whom work in Canada. TCC's employees are not represented by a union, and there is no registered pension plan for employees.

11 The other Target Canada Entities are all either: (i) direct or indirect subsidiaries of TCC with responsibilities for specific aspects of the Canadian retail operation; or (ii) affiliates of TCC that have been involved in the financing of certain leasehold improvements.

12 A typical TCC store has a footprint in the range of 80,000 to 125,000 total retail square feet and is located in a shopping mall or large strip mall. TCC is usually the anchor tenant. Each TCC store typically contains an in-store Target brand pharmacy, Target Mobile kiosk and a Starbucks café. Each store typically employs approximately 100 - 150 people, described as "Team Members" and "Team Leaders", with a total of approximately 16,700 employed at the "store level" of TCC's retail operations.

13 TCC owns three distribution centres (two in Ontario and one in Alberta) to support its retail operations. These centres are operated by a third party service provider. TCC also leases a variety of warehouse and office spaces.

14 In every quarter since TCC opened its first store, TCC has faced lower than expected sales and greater than expected losses. As reported in Target Corporation's Consolidated Financial Statements, the Canadian segment of the Target business has suffered a significant loss in every quarter since TCC opened stores in Canada.

15 TCC is completely operationally funded by its ultimate parent, Target Corporation, and related entities. It is projected that TCC's cumulative pre-tax losses from the date of its entry into the Canadian market to the end of the 2014 fiscal year (ending January 31, 2015) will be more than $2.5 billion. In his affidavit, Mr. Mark Wong, General Counsel and Secretary of TCC, states that this is more than triple the loss originally expected for this period. Further, if TCC's operations are not wound down, it is projected that they would remain unprofitable for at least 5 years and would require significant and continued funding from Target Corporation during that period.

16 TCC attributes its failure to achieve expected profitability to a number of principal factors, including: issues of scale; supply chain difficulties; pricing and product mix issues; and the absence of a Canadian online retail presence.

17 Following a detailed review of TCC's operations, the Board of Directors of Target Corporation decided that it is in the best interests of the business of Target Corporation and its subsidiaries to discontinue Canadian operations.

18 Based on the stand-alone financial statements prepared for TCC as of November 1, 2014 (which consolidated financial results of TCC and its subsidiaries), TCC had total assets of approximately $5.408 billion and total liabilities of approximately $5.118 billion. Mr. Wong states that this does not reflect a significant impairment charge that will likely be incurred at fiscal year end due to TCC's financial situation.

19 Mr. Wong states that TCC's operational funding is provided by Target Corporation. As of November 1, 2014, NE1 (TCC's direct parent) had provided equity capital to TCC in the amount of approximately $2.5 billon. As a result of continuing and significant losses in TCC's operations, NE1 has been required to make an additional equity investment of $62 million since November 1, 2014.

20 NE1 has also lent funds to TCC under a Loan Facility with a maximum amount of $4 billion. TCC owed NE1 approximately $3.1 billion under this Facility as of January 2, 2015. The Loan Facility is unsecured. On January 14, 2015, NE1 agreed to subordinate all amounts owing by TCC to NE1 under this Loan Facility to payment in full of proven claims against TCC.

21 As at November 1, 2014, Target Canada Property LLC ("TCC Propco") had assets of approximately $1.632 billion and total liabilities of approximately $1.643 billion. Mr. Wong states that this does not reflect a significant impairment charge that will likely be incurred at fiscal year end due to TCC Propco's financial situation. TCC Propco has also borrowed approximately $1.5 billion from Target Canada Property LP and TCC Propco also owes U.S. $89 million to Target Corporation under a Demand Promissory Note.

22 TCC has subleased almost all the retail store leases to TCC Propco, which then made real estate improvements and sub-sub leased the properties back to TCC. Under this arrangement, upon termination of any of these sub-leases, a "make whole" payment becomes owing from TCC to TCC Propco.

23 Mr. Wong states that without further funding and financial support from Target Corporation, the Target Canada Entities are unable to meet their liabilities as they become due, including TCC's next payroll (due January 16, 2015). The Target Canada Entities, therefore state that they are insolvent.

24 Mr. Wong also states that given the size and complexity of TCC's operations and the numerous stakeholders involved in the business, including employees, suppliers, landlords, franchisees and others, the Target Canada Entities have determined that a controlled wind-down of their operations and liquidation under the protection of the CCAA, under Court supervision and with the assistance of the proposed monitor, is the only practical method available to ensure a fair and orderly process for all stakeholders. Further, Mr. Wong states that TCC and Target Corporation seek to benefit from the framework and the flexibility

 

provided by the CCAA in effecting a controlled and orderly wind-down of the Canadian operations, in a manner that treats stakeholders as fairly and as equitably as the circumstances allow.

25 On this initial hearing, the issues are as follows:

a) Does this court have jurisdiction to grant the CCAA relief requested?

a) Should the stay be extended to the Partnerships?

b) Should the stay be extended to "Co-tenants" and rights of third party tenants?

c) Should the stay extend to Target Corporation and its U.S. subsidiaries in relation to claims that are derivative of claims against the Target Canada Entities?

d) Should the Court approve protections for employees?

e) Is it appropriate to allow payment of certain pre-filing amounts?

f) Does this court have the jurisdiction to authorize pre-filing claims to "critical" suppliers;

g) Should the court should exercise its discretion to authorize the Applicants to seek proposals from liquidators and approve the financial advisor and real estate advisor engagement?

h) Should the court exercise its discretion to approve the Court-ordered charges?

26 "Insolvent" is not expressly defined in the CCAA. However, for the purposes of the CCAA, a debtor is insolvent if it meets the definition of an "insolvent person" in section 2 of the *Bankruptcy and Insolvency Act*, R.S.C., 1985, c. B-3 ("BIA") or if it is "insolvent" as described in *Stelco Inc., Re*, [2004] O.J. No. 1257 (Ont. S.C.J. [Commercial List]), [*Stelco*], leave to appeal refused, [2004] O.J. No. 1903 (Ont. C.A.), leave to appeal to S.C.C. refused [2004] S.C.C.A. No. 336 (S.C.C.), where Farley, J. found that "insolvency" includes a corporation "reasonably expected to run out of liquidity within [a] reasonable proximity of time as compared with the time reasonably required to implement a restructuring" (at para 26). The decision of Farley, J. in *Stelco* was followed in *Priszm Income Fund, Re*, [2011] O.J. No. 1491 (Ont. S.C.J.), 2011 and *Canwest Global Communications Corp., Re*, [2009] O.J. No. 4286 (Ont. S.C.J. [Commercial List]) [*Canwest*].

27 Having reviewed the record and hearing submissions, I am satisfied that the Target Canada Entities are all insolvent and are debtor companies to which the CCAA applies, either by reference to the definition of "insolvent person" under the *Bankruptcy and Insolvency Act* (the "BIA") or under the test developed by Farley J. in *Stelco*.

28 I also accept the submission of counsel to the Applicants that without the continued financial support of Target Corporation, the Target Canada Entities face too many legal and business impediments and too much uncertainty to wind-down their operations without the "breathing space" afforded by a stay of proceedings or other available relief under the CCAA.

29 I am also satisfied that this Court has jurisdiction over the proceeding. Section 9(1) of the CCAA provides that an application may be made to the court that has jurisdiction in (a) the province in which the head office or chief place of business of the company in Canada is situated; or (b) any province in which the company's assets are situated, if there is no place of business in Canada.

30 In this case, the head office and corporate headquarters of TCC is located in Mississauga, Ontario, where approximately 800 employees work. Moreover, the chief place of business of the Target Canada Entities is Ontario. A number of office locations are in Ontario; 2 of TCC's 3 primary distribution centres are located in Ontario; 55 of the TCC retail stores operate in Ontario; and almost half the employees that support TCC's operations work in Ontario.

31 The Target Canada Entities state that the purpose for seeking the proposed initial order in these proceedings is to effect a fair, controlled and orderly wind-down of their Canadian retail business with a view to developing a plan of compromise or

 

arrangement to present to their creditors as part of these proceedings. I accept the submissions of counsel to the Applicants that although there is no prospect that a restructured "going concern" solution involving the Target Canada Entities will result, the use of the protections and flexibility afforded by the CCAA is entirely appropriate in these circumstances. In arriving at this conclusion, I have noted the comments of the Supreme Court of Canada in *Ted Leroy Trucking Ltd., Re*, 2010 SCC 60 (S.C.C.) ("*Century Services*") that "courts frequently observe that the CCAA is skeletal in nature", and does not "contain a comprehensive code that lays out all that is permitted or barred". The flexibility of the CCAA, particularly in the context of large and complex restructurings, allows for innovation and creativity, in contrast to the more "rules-based" approach of the BIA.

32 Prior to the 2009 amendments to the CCAA, Canadian courts accepted that, in appropriate circumstances, debtor companies were entitled to seek the protection of the CCAA where the outcome was not going to be a going concern restructuring, but instead, a "liquidation" or wind-down of the debtor companies' assets or business.

33 The 2009 amendments did not expressly address whether the CCAA could be used generally to wind-down the business of a debtor company. However, I am satisfied that the enactment of section 36 of the CCAA, which establishes a process for a debtor company to sell assets outside the ordinary course of business while under CCAA protection, is consistent with the principle that the CCAA can be a vehicle to downsize or wind-down a debtor company's business.

34 In this case, the sheer magnitude and complexity of the Target Canada Entities business, including the number of stakeholders whose interests are affected, are, in my view, suited to the flexible framework and scope for innovation offered by this "skeletal" legislation.

35 The required audited financial statements are contained in the record.

36 The required cash flow statements are contained in the record.

37 Pursuant to s. 11.02 of the CCAA, the court may make an order staying proceedings, restraining further proceedings, or prohibiting the commencement of proceedings, "on any terms that it may impose" and "effective for the period that the court considers necessary" provided the stay is no longer than 30 days. The Target Canada Entities, in this case, seek a stay of proceedings up to and including February 13, 2015.

38 Certain of the corporate Target Canada Entities (TCC, TCC Health and TCC Mobile) act as general or limited partners in the partnerships. The Applicants submit that it is appropriate to extend the stay of proceedings to the Partnerships on the basis that each performs key functions in relation to the Target Canada Entities' businesses.

39 The Applicants also seek to extend the stay to Target Canada Property LP which was formerly the sub-leasee/sub-sub lessor under the sub-sub lease back arrangement entered into by TCC to finance the leasehold improvements in its leased stores. The Applicants contend that the extension of the stay to Target Canada Property LP is necessary in order to safeguard it against any residual claims that may be asserted against it as a result of TCC Propco's insolvency and filing under the CCAA.

40 I am satisfied that it is appropriate that an initial order extending the protection of a CCAA stay of proceedings under section 11.02(1) of the CCAA should be granted.

41 Pursuant to section 11.7(1) of the CCAA, Alvarez & Marsal Inc. is appointed as Monitor.

42 It is well established that the court has the jurisdiction to extend the protection of the stay of proceedings to Partnerships in order to ensure that the purposes of the CCAA can be achieved (see: *Lehndorff General Partner Ltd., Re* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]); *Priszm Income Fund, Re*, 2011 ONSC 2061 (Ont. S.C.J.); *Canwest Publishing Inc./ Publications Canwest Inc., Re*, 2010 ONSC 222 (Ont. S.C.J. [Commercial List]) ("*Canwest Publishing*") and *Canwest Global Communications Corp., Re*, 2009 CarswellOnt 6184 (Ont. S.C.J. [Commercial List]) ("*Canwest Global*").

43 In these circumstances, I am also satisfied that it is appropriate to extend the stay to the Partnerships as requested.

 

44 The Applicants also seek landlord protection in relation to third party tenants. Many retail leases of non-anchored tenants provide that tenants have certain rights against their landlords if the anchor tenant in a particular shopping mall or centre becomes insolvent or ceases operations. In order to alleviate the prejudice to TCC's landlords if any such non-anchored tenants attempt to exercise these rights, the Applicants request an extension of the stay of proceedings (the "Co-Tenancy Stay") to all rights of these third party tenants against the landlords that arise out of the insolvency of the Target Canada Entities or as a result of any steps taken by the Target Canada Entities pursuant to the Initial Order.

45 The Applicants contend that the authority to grant the Co-Tenancy Stay derives from the broad jurisdiction under sections 11 and 11.02(1) of the CCAA to make an initial order on any terms that the court may impose. Counsel references *T. Eaton Co., Re*, 1997 CarswellOnt 1914 (Ont. Gen. Div.) as a precedent where a stay of proceedings of the same nature as the Co-Tenancy Stay was granted by the court in Eaton's second CCAA proceeding. The Court noted that, if tenants were permitted to exercise these "co-tenancy" rights during the stay, the claims of the landlord against the debtor company would greatly increase, with a potentially detrimental impact on the restructuring efforts of the debtor company.

46 In these proceedings, the Target Canada Entities propose, as part of the orderly wind-down of their businesses, to engage a financial advisor and a real estate advisor with a view to implementing a sales process for some or all of its real estate portfolio. The Applicants submit that it is premature to determine whether this process will be successful, whether any leases will be conveyed to third party purchasers for value and whether the Target Canada Entities can successfully develop and implement a plan that their stakeholders, including their landlords, will accept. The Applicants further contend that while this process is being resolved and the orderly wind-down is underway, the Co-Tenancy Stay is required to postpone the contractual rights of these tenants for a finite period. The Applicants contend that any prejudice to the third party tenants' clients is significantly outweighed by the benefits of the Co-Tenancy Stay to all of the stakeholders of the Target Canada Entities during the wind-down period.

47 The Applicants therefore submit that it is both necessary and appropriate to grant the Co-Tenancy Stay in these circumstances.

48 I am satisfied the Court has the jurisdiction to grant such a stay. In my view, it is appropriate to preserve the status quo at this time. To the extent that the affected parties wish to challenge the broad nature of this stay, the same can be addressed at the "comeback hearing".

49 The Applicants also request that the benefit of the stay of proceedings be extended (subject to certain exceptions related to the cash management system) to Target Corporation and its U.S. subsidiaries in relation to claims against these entities that are derivative of the primary liability of the Target Canada Entities.

50 I am satisfied that the Court has the jurisdiction to grant such a stay. In my view, it is appropriate to preserve the status quo at this time and the stay is granted, again, subject to the proviso that affected parties can challenge the broad nature of the stay at a comeback hearing directed to this issue.

51 With respect to the protection of employees, it is noted that TCC employs approximately 17,600 individuals.

52 Mr. Wong contends that TCC and Target Corporation have always considered their employees to be integral to the Target brand and business. However, the orderly wind-down of the Target Canada Entities' business means that the vast majority of TCC employees will receive a notice immediately after the CCAA filing that their employment is to be terminated as part of the wind-down process.

53 In order to provide a measure of financial security during the orderly wind-down and to diminish financial hardship that TCC employees may suffer, Target Corporation has agreed to fund an Employee Trust to a maximum of $70 million.

54 The Applicants seek court approval of the Employee Trust which provides for payment to eligible employees of certain amounts, such as the balance of working notice following termination. Counsel contends that the Employee Trust was developed in consultation with the proposed monitor, who is the administrator of the trust, and is supported by the proposed Representative

 

Counsel. The proposed trustee is The Honourable J. Ground. The Employee Trust is exclusively funded by Target Corporation and the costs associated with administering the Employee Trust will be borne by the Employee Trust, not the estate of Target Canada Entities. Target Corporation has agreed not to seek to recover from the Target Canada Entities estates any amounts paid out to employee beneficiaries under the Employee Trust.

55 In my view, it is questionable as to whether court authorization is required to implement the provisions of the Employee Trust. It is the third party, Target Corporation, that is funding the expenses for the Employee Trust and not one of the debtor Applicants. However, I do recognize that the implementation of the Employee Trust is intertwined with this proceeding and is beneficial to the employees of the Applicants. To the extent that Target Corporation requires a court order authorizing the implementation of the employee trust, the same is granted.

56 The Applicants seek the approval of a KERP and the granting of a court ordered charge up to the aggregate amount of $6.5 million as security for payments under the KERP. It is proposed that the KERP Charge will rank after the Administration Charge but before the Directors' Charge.

57 The approval of a KERP and related KERP Charge is in the discretion of the Court. KERPs have been approved in numerous CCAA proceedings, including *Nortel Networks Corp., Re*, 2009 CarswellOnt 1330 (Ont. S.C.J. [Commercial List]) [*Nortel Networks (KERP)]*, and *Grant Forest Products Inc., Re*, 2009 CarswellOnt 4699 (Ont. S.C.J. [Commercial List]). In *U.S. Steel Canada Inc., Re*, 2014 ONSC 6145 (Ont. S.C.J.), I recently approved the KERP for employees whose continued services were critical to the stability of the business and for the implementation of the marketing process and whose services could not easily be replaced due, in part, to the significant integration between the debtor company and its U.S. parent.

58 In this case, the KERP was developed by the Target Canada Entities in consultation with the proposed monitor. The proposed KERP and KERP Charge benefits between 21 and 26 key management employees and approximately 520 store-level management employees.

59 Having reviewed the record, I am of the view that it is appropriate to approve the KERP and the KERP Charge. In arriving at this conclusion, I have taken into account the submissions of counsel to the Applicants as to the importance of having stability among the key employees in the liquidation process that lies ahead.

60 The Applicants also request the Court to appoint Koskie Minsky LLP as employee representative counsel (the "Employee Representative Counsel"), with Ms. Susan Philpott acting as senior counsel. The Applicants contend that the Employee Representative Counsel will ensure that employee interests are adequately protected throughout the proceeding, including by assisting with the Employee Trust. The Applicants contend that at this stage of the proceeding, the employees have a common interest in the CCAA proceedings and there appears to be no material conflict existing between individual or groups of employees. Moreover, employees will be entitled to opt out, if desired.

61 I am satisfied that section 11 of the CCAA and the *Rules of Civil Procedure* confer broad jurisdiction on the court to appoint Representative Counsel for vulnerable stakeholder groups such as employee or investors (see *Nortel Networks Corp., Re*, 2009 CarswellOnt 3028 (Ont. S.C.J. [Commercial List]) (Nortel Networks Representative Counsel)). In my view, it is appropriate to approve the appointment of Employee Representative Counsel and to provide for the payment of fees for such counsel by the Applicants. In arriving at this conclusion, I have taken into account:

(i) the vulnerability and resources of the groups sought to be represented;

(ii) the social benefit to be derived from the representation of the groups;

(iii) the avoidance of multiplicity of legal retainers; and

(iv) the balance of convenience and whether it is fair and just to creditors of the estate.

62 The Applicants also seek authorization, if necessary, and with the consent of the Monitor, to make payments for pre-filing amounts owing and arrears to certain critical third parties that provide services integral to TCC's ability to operate during and implement its controlled and orderly wind-down process.

63 Although the objective of the CCAA is to maintain the status quo while an insolvent company attempts to negotiate a plan of arrangement with its creditors, the courts have expressly acknowledged that preservation of the status quo does not necessarily entail the preservation of the relative pre-stay debt status of each creditor.

64 The Target Canada Entities seek authorization to pay pre-filing amounts to certain specific categories of suppliers, if necessary and with the consent of the Monitor. These include:

a) Logistics and supply chain providers;

b) Providers of credit, debt and gift card processing related services; and

c) Other suppliers up to a maximum aggregate amount of $10 million, if, in the opinion of the Target Canada Entities, the supplier is critical to the orderly wind-down of the business.

65 In my view, having reviewed the record, I am satisfied that it is appropriate to grant this requested relief in respect of critical suppliers.

66 In order to maximize recovery for all stakeholders, TCC indicates that it intends to liquidate its inventory and attempt to sell the real estate portfolio, either en bloc, in groups, or on an individual property basis. The Applicants therefore seek authorization to solicit proposals from liquidators with a view to entering into an agreement for the liquidation of the Target Canada Entities inventory in a liquidation process.

67 TCC's liquidity position continues to deteriorate. According to Mr. Wong, TCC and its subsidiaries have an immediate need for funding in order to satisfy obligations that are coming due, including payroll obligations that are due on January 16, 2015. Mr. Wong states that Target Corporation and its subsidiaries are no longer willing to provide continued funding to TCC and its subsidiaries outside of a CCAA proceeding. Target Corporation (the "DIP Lender") has agreed to provide TCC and its subsidiaries (collectively, the "Borrower") with an interim financing facility (the "DIP Facility") on terms advantageous to the Applicants in the form of a revolving credit facility in an amount up to U.S. $175 million. Counsel points out that no fees are payable under the DIP Facility and interest is to be charged at what they consider to be the favourable rate of 5%. Mr. Wong also states that it is anticipated that the amount of the DIP Facility will be sufficient to accommodate the anticipated liquidity requirements of the Borrower during the orderly wind-down process.

68 The DIP Facility is to be secured by a security interest on all of the real and personal property owned, leased or hereafter acquired by the Borrower. The Applicants request a court-ordered charge on the property of the Borrower to secure the amount actually borrowed under the DIP Facility (the "DIP Lenders Charge"). The DIP Lenders Charge will rank in priority to all unsecured claims, but subordinate to the Administration Charge, the KERP Charge and the Directors' Charge.

69 The authority to grant an interim financing charge is set out at section 11.2 of the CCAA. Section 11.2(4) sets out certain factors to be considered by the court in deciding whether to grant the DIP Financing Charge.

70 The Target Canada Entities did not seek alternative DIP Financing proposals based on their belief that the DIP Facility was being offered on more favourable terms than any other potentially available third party financing. The Target Canada Entities are of the view that the DIP Facility is in the best interests of the Target Canada Entities and their stakeholders. I accept this submission and grant the relief as requested.

71 Accordingly, the DIP Lenders' Charge is granted in the amount up to U.S. $175 million and the DIP Facility is approved.

  

72 Section 11 of the CCAA provides the court with the authority to allow the debtor company to enter into arrangements to facilitate a restructuring under the CCAA. The Target Canada Entities wish to retain Lazard and Northwest to assist them during the CCCA proceeding. Both the Target Canada Entities and the Monitor believe that the quantum and nature of the remuneration to be paid to Lazard and Northwest is fair and reasonable. In these circumstances, I am satisfied that it is appropriate to approve the engagement of Lazard and Northwest.

73 With respect to the Administration Charge, the Applicants are requesting that the Monitor, along with its counsel, counsel to the Target Canada Entities, independent counsel to the Directors, the Employee Representative Counsel, Lazard and Northwest be protected by a court ordered charge and all the property of the Target Canada Entities up to a maximum amount of $6.75 million as security for their respective fees and disbursements (the "Administration Charge"). Certain fees that may be payable to Lazard are proposed to be protected by a Financial Advisor Subordinated Charge.

74 In *Canwest Publishing Inc./Publications Canwest Inc., Re*, 2010 ONSC 222 (Ont. S.C.J. [Commercial List]), Pepall J. (as she then was) provided a non-exhaustive list of factors to be considered in approving an administration charge, including:

a. The size and complexity of the business being restructured;

b. The proposed role of the beneficiaries of the charge;

c. Whether there is an unwarranted duplication of roles;

d. Whether the quantum of the proposed Charge appears to be fair and reasonable;

e. The position of the secured creditors likely to be affected by the Charge; and

f. The position of the Monitor.

75 Having reviewed the record, I am satisfied, that it is appropriate to approve the Administration Charge and the Financial Advisor Subordinated Charge.

76 The Applicants seek a Directors' and Officers' charge in the amount of up to $64 million. The Directors Charge is proposed to be secured by the property of the Target Canada Entities and to rank behind the Administration Charge and the KERP Charge, but ahead of the DIP Lenders' Charge.

77 Pursuant to section 11.51 of the CCAA, the court has specific authority to grant a "super priority" charge to the directors and officers of a company as security for the indemnity provided by the company in respect of certain obligations.

78 I accept the submissions of counsel to the Applicants that the requested Directors' Charge is reasonable given the nature of the Target Canada Entities retail business, the number of employees in Canada and the corresponding potential exposure of the directors and officers to personal liability. Accordingly, the Directors' Charge is granted.

79 In the result, I am satisfied that it is appropriate to grant the Initial Order in these proceedings.

80 The stay of proceedings is in effect until February 13, 2015.

81 A comeback hearing is to be scheduled on or prior to February 13, 2015. I recognize that there are many aspects of the Initial Order that go beyond the usual first day provisions. I have determined that it is appropriate to grant this broad relief at this time so as to ensure that the status quo is maintained.

82 The comeback hearing is to be a "true" comeback hearing. In moving to set aside or vary any provisions of this order, moving parties do not have to overcome any onus of demonstrating that the order should be set aside or varied.

83 Finally, a copy of Lazard's engagement letter (the "Lazard Engagement Letter") is attached as Confidential Appendix "A" to the Monitor's pre-filing report. The Applicants request that the Lazard Engagement Letter be sealed, as the fee structure contemplated in the Lazard Engagement Letter could potentially influence the structure of bids received in the sales process.

84 Having considered the principles set out in *Sierra Club of Canada v. Canada (Minister of Finance)* (2002), 211 D.L.R. (4th) 193, [2002] 2 S.C.R. 522 (S.C.C.), I am satisfied that it is appropriate in the circumstances to seal Confidential Appendix "A" to the Monitor's pre-filing report.

85 The Initial Order has been signed in the form presented.

*Application granted.*

# TAB 4

Court File No. 08-CL-7440

*ONTARIO*
**SUPERIOR COURT OF JUSTICE**
**(COMMERCIAL LIST)**

| | | |
|---|---|---|
| **THE HONOURABLE** | ) | **TUESDAY, THE $15^{h}$ DAY** |
| | ) | |
| **MR. JUSTICE CAMPBELL** | ) | **OF APRIL, 2008** |

**IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985 c. C-36, AS AMENDED**

**AND IN THE MATTER OF A PLAN OF COMPROMISE AND ARRANGEMENT INVOLVING METCALFE & MANSFIELD ALTERNATIVE INVESTMENTS II CORP., METCALFE & 1VIANSFIELD ALTERNATIVE INVESTMENTS HI CORP., METCALFE & MANSFIELD ALTERNATIVE INVESTMENTS V CORP., METCALFE & MANSFIELD ALTERNATIVE INVESTMENTS XI CORP., METCALFE & MANSFIELD ALTERNATIVE INVESTMENTS XII CORP., 4446372 CANADA INC. AND 6932819 CANADA INC., TRUSTEES OF THE CONDUITS LISTED IN SCHEDULE "A" HERETO**

B E T W E E N:

**THE INVESTORS REPRESENTED ON THE-PAN-CANADIAN INVESTORS COMMITTEE FOR THIRD-PARTY STRUCTURED ASSET-BACKED COMMERCIAL PAPER LISTED IN SCHEDULE "B" HERETO**

Applicants

- and -

**METCALFE & MANSFIELD ALTERNATIVE INVESTMENTS II CORP., METCALFE & MANSFIELD ALTERNATIVE INVESTMENTS III CORP., METCALFE & MANSFIELD ALTERNATTVE INVESTMENTS V CORP., METCALFE & MANSFIELD ALTERNATIVE INVESTMENTS XI CORP., METCALFE & MANSFIELD ALTERNATIVE INVESTMENTS XII CORP., 4446372 CANADA INC. AND 6932819 CANADA INC., TRUSTEES OF THE CONDUITS LISTED IN SCHEDULE "A" HERETO**

Respondents

**O R D E R**
**(RE APPOINTMENT OF REPRESENI'A'I'IVE COUNSEL)**

THIS MOTION MADE by the Ad Hoc Retail Holders Committee (the "**AHRHC**") of Holders of Non-Bank Sponsored Asset-Backed Commercial Paper ("**ABCP**") for an order appointing representative counsel, in these proceedings was heard this day at 330 University Avenue, Toronto, Ontario.

ON READING the Notice of Motion of the AHRHC dated the 15th day of April, 2008 and the affidavits of Eliezer Karp, Henry Juroviesky and Edwin Cohen, affirmed the 11th day of April, 2008 and affirmed/sworn on the 13th day of April, 2008 (the "**Karp Affidavit**", the "**Juroviesky Affidavit**" and the "**Cohen Affidavit**") filed, and on hearing the submissions of counsel for the Committee.

1. **THIS COURT ORDERS** that all parties entitled to notice of this motion have been served with notice of this motion and that the time for service is hereby abridged such that service effected on the parties served with notice of this motion shall be good and sufficient notice of this motion.

2. **THIS COURT ORDERS** that (a) Juroviesky and Ricci LLP ("JR") and (b) Shibley Righton LLP ("SR") are appointed in these proceedings to represent the Ad Hoc Retail Holders Committee (collectively JR and SR are referred to herein as "Representative Counsel") but nothing in this paragraph shall impair the right, if any, of any individual holder of ABCP to retain and instruct counsel in these proceedings on his, her or its own behalf.

3. **THIS COURT ORDERS** that, subject to further order of the Court, the Representative Counsel shall represent the interest of all persons, "family" trusts, or "personal holding" corporations that purchased ABCP from a retail brokerage and shall advise those on whose behalf they are hereby appointed in all aspects of these proceedings, without any obligation to consult with or seek individual instructions from those on whose behalf they have been appointed to represent unless otherwise ordered by the Court.

4. **THIS COURT ORDERS** that the Representative Counsel shall not be liable jointly or severally for any act or omission in respect of their appointment or the fulfillment of their duties in carrying out the provisions of this Order, and that no action or other proceedings shall be commenced against either of the Representative Counsel relating to their acting as such, except with prior leave of this Court, on at least 7 day's notice to the Representative Counsel, as may be applicable, and upon further Order in respect of security for costs, to be given by the plaintiff for the costs, on a substantial indemnity basis, of the Representative Counsel in connection with any such action or proceeding.

5. **THIS COURT ORDERS** that the Representative Counsel may from time to time apply to this Court for advice and directions in respect of their appointment or the fulfillment of their duties in carrying out the provisions of this Order, upon notice to the Applicants, to the CCAA Parties (as defined in the Initial Order in the instant matter) and to other interested parties, unless otherwise ordered by the Court.

6. **THIS COURT ORDERS** that the Representative Counsel shall be given notice of all motions to which holders of ABCP are entitled in these proceedings and that they shall be entitled to represent those on whose behalf they are hereby appointed in all such proceedings.

7. **THIS COURT ORDERS** that Diane Urquhart be appointed as the Financial Analyst for the AHRHC and that she be paid her reasonable fees and disbursements by the CCAA parties from and after March 25th, 2008.

8. **THIS COURT ORDERS** that the paragraphs 32 and 34 of the Order of this Honorable Court dated March 17, 2008 are hereby amended effective March 25th, 2008 and are deemed from and after that time to include Representative Counsel as appointed herein among the parties who shall be paid their reasonable fees and disbursements in connection with these proceedings, in each case at their standard rates and charges, from and after March 25, 2008 and among those who benefit from the Professionals charge as defined therein.

Dacampo J.

APR 15 2008

**SCHEDULE "A"**

Conduit Trusts

APOLLO TRUST

APSLEY TRUST

ARIA TRUST

AURORA TRUST

COMET TRUST

ENCORI/ TRUST

GEMINI TRUST

IRONSTONE TRUS T

MNIAI-I TRUST

NEWSHORE CANADIAN TRUST

OPUS TRUST

PLANET TRUST

ROCKET TRUST

SELKIRK FUNDING TRUST

SILVERSTONE TRUST

SLATE TRUST

STRUC'TURED ASSET TRUST

STRUCTURED INVESTMENT TRUST III

SYMPHONY TRUST

WHITEHALL TRUST

**SCHEDULE "B"**

Applicants

ATB FINANCIAL

CAISSE DE DEPOT' ET PLACEMENT DU QUEBEC

CANACCORD CAPITAL CORPORATION

CANADA MORTGAGE AND HOUSING CORPORATION

CREDIT UNION CENTRAL ALBERTA LIMITED

CREDIT UNION CENTRAL OF BRITISH COLUMBIA

CREDIT UNION CENTRAL OF ONTARIO

DESJARDINS GROUP

MAGNA INTERNATIONAL INC.

NATIONAL BANK FINANCIAL INC., NATIONAL BANK OF CANADA

NAV CANADA

NORTHWATER CAPITAL MANAGEMENT INC.

PUBLIC SECTOR PENSION PLAN INVESTMENT BOARD

UNIVERSITY OF ALBERTA

IN THE MATTER OF THE COMPANIES/CREDITORS ARRANGEMENT ACT5, R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE AND ARRANGEMENT INVOLVING METCALFE & MANSFIELD ALTERNATIVE INVESTMENTS II CORP., *et al.*

**Court File No. 08-CL-7440**

ONTARIO
SUPERIOR COURT OF JUSTICE - COMMERCIAL LIST
Proceeding Commenced at Toronto

**ORDER**
**(RE APPOINTMENT OF REPRESENTATIVE COUNSEL)**

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# TAB 5

2013 BCSC 2043
British Columbia Supreme Court

League Assets Corp., Re

2013 CarswellBC 3408, 2013 BCSC 2043, [2013] B.C.W.L.D. 9463, [2013] B.C.W.L.D. 9464, 234 A.C.W.S. (3d) 837, 7 C.B.R. (6th) 74

# In the Matter of the Companies' Creditors Arrangement Act, R.S.C., 1985,c. C-36, As Amended

In the Matter of the Business Corporations Act, S.B.C. 2002, c. 57, As Amended

In the Matter of the Canada Business Corporations Act, R.S.C. 1985, c. C-44, As Amended

In the Matter of A Plan of Compromise and Arrangement of League Assets Corp. and Those Parties Listed on Schedule "A" Petitioners

Fitzpatrick J.

Heard: October 25, 2013
Judgment: November 8, 2013
Docket: Vancouver S137743

Counsel: D.E. Gruber, T.M. Tomchak, R. Morse, T.C. Louman-Gardiner for Petitioners
J.R. Sandrelli, T.R.M. Jeffries for PricewaterhouseCoopers Inc. as Monitor
C.D. Brousson for Quest Mortgage Corp., Quest Capital Management Corp.
K.E. Siddall for BCMP Mortgage Investment Corporation and Interior Savings Credit Union
Geoffrey Thompson, R.B. Dawkins for TCC Mortgage Holdings Inc. FCC Mortgage Associates Inc., Citizens Bank of Canada, First Calgary Financial Credit Union Limited, Firm Capital Mortgage Fund Inc.
A. Frydenlund for Canadian Western Bank
S.H. Stephens for Romspen Investment Corporation
D.B. Hyndman for Business Development Bank of Canada
William C. Kaplan, Q.C., H. Sevenoaks, for Timbercreek Mortgage Investment Corporation
W.E.J. Skelly for Ad Hoc Committee of Convertible Promissory Noteholders of League Opportunity Fund Ltd.
H. Ferris for Export Development Canada, Bank of Montreal and Churchill Real Estate Inc.
G.J. Gehlen for Whil Concepts Inc., NWM Private Equity LP and NWM Balanced Mortgage Fund (Proposed DIP Lenders)
P.J. Reardon for Maxium Financial Services
D.K. Fitzpatrick for Roynat Inc.
J. Grieve for Proposed Representative / Investors

Subject: Insolvency; Corporate and Commercial
**Related Abridgment Classifications**
Bankruptcy and insolvency
XIX Companies' Creditors Arrangement Act
XIX.3 Arrangements
XIX.3.b Approval by court
XIX.3.b.iv Miscellaneous
Bankruptcy and insolvency
XIX Companies' Creditors Arrangement Act
XIX.5 Miscellaneous

  

**Headnote**

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Arrangements — Approval by court — Miscellaneous

League Group obtained protection under Companies' Creditors Arrangement Act and initial order was granted — Majority of League Group entities were owned by IGW Assets Limited Partnership — League Group sought approval of debtor in possession (DIP) facility from DIP Lenders for operating funding, payment of tax arrears, mortgage payments and to payout existing mortgage lenders — League Group brought application for DIP financing claiming it urgently needed interim funding until comeback hearing — Notice of application for DIP financing was given to secured creditors and secured creditors objected — Proposed DIP lender's charge was to rank after administration charge but before director's charge and any representative counsel charge — Most of assets owned by League Group were complex real estate holdings — Application for DIP facility granted to extent of $1.6 million needed to time of comeback hearing — DIP financing sought on application was urgently needed in order to fund operations within proceedings until comeback hearing — Funding would enhance prospects of arrangement by League Group to creditors — Nature of assets of League Group was such that even if secured creditors were to take steps to realize on their security, they would inevitably be incurring some of same types of expenses as were being proposed to be paid in accordance with cash flow forecast — Secured creditors would suffer some prejudice in terms of delay in realization of their security in event of failure to restructure by League Group — Beyond that there was no material prejudice to secured creditors given debt levels disclosed — Allocation provision proposed would alleviate many of secured creditors' concerns as to how DIP lender's charge might be borne.

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Miscellaneous

Appointment of representative counsel — League Group obtained protection under Companies' Creditors Arrangement Act and initial order was granted — Majority of League Group entities were owned by IGW Assets Limited Partnership — League Group sought approval of debtor in possession (DIP) facility from DIP Lenders for operating funding, payment of tax arrears, mortgage payments and to payout existing mortgage lenders — League Group brought application for DIP financing claiming it urgently needed interim funding until comeback hearing — Notice of application for DIP financing was given to secured creditors and secured creditors objected — Proposed DIP lender's charge was to rank after administration charge but before director's charge and any representative counsel charge — Most of assets owned by League Group were complex real estate holdings — Monitor brought application to appoint representative counsel for investor group — Monitor's application granted — Appointment of representative counsel was appropriate — Monitor was not able to assist any further in alerting investors to proceedings, organizing investor group and advising them of issues that may affect them either as group or individually — Investor group was significant one and it was important that they be properly represented so they could take appropriate positions in insolvency proceedings — It was somewhat imperative that investors obtain legal representation in respect of comeback hearing — Investor group had sufficient commonality of interest that could best be served by one counsel — Appointment of representative counsel would allow their positions to be advanced in efficient manner to benefit of stakeholders.

**Table of Authorities**

**Cases considered by *Fitzpatrick J.*:**

*Canwest Global Communications Corp., Re* (2009), 2009 CarswellOnt 9398 (Ont. S.C.J. [Commercial List]) — considered

*Canwest Publishing Inc./Publications Canwest Inc., Re* (2010), 63 C.B.R. (5th) 115, 2010 CarswellOnt 212, 2010 ONSC 222 (Ont. S.C.J. [Commercial List]) — referred to

*Canwest Publishing Inc./Publications Canwest Inc., Re* (2010), 2010 CarswellOnt 1344, 2010 ONSC 1328, 65 C.B.R. (5th) 152 (Ont. S.C.J. [Commercial List]) — followed

*Catalyst Paper Corp., Re* (2012), 2012 CarswellBC 883, 2012 BCSC 451, 89 C.B.R. (5th) 292, 98 C.C.P.B. 1, 2012 C.E.B. & P.G.R. 8481 (B.C. S.C.) — referred to

*Cliffs Over Maple Bay Investments Ltd. v. Fisgard Capital Corp.* (2008), 2008 BCCA 327, 2008 CarswellBC 1758, 83 B.C.L.R. (4th) 214, 296 D.L.R. (4th) 577, 434 W.A.C. 187, 258 B.C.A.C. 187, 46 C.B.R. (5th) 7, [2008] 10 W.W.R. 575 (B.C. C.A.) — followed

*Eron Mortgage Corp., Re* (1998), 56 B.C.L.R. (3d) 220, [1999] 4 W.W.R. 375, 1998 CarswellBC 1851 (B.C. S.C.) — referred to

*First Leaside Wealth Management Inc., Re* (2012), 2012 CarswellOnt 2559, 2012 ONSC 1299 (Ont. S.C.J. [Commercial List]) — considered

*Fraser Papers Inc., Re* (2009), 2009 CarswellOnt 6169 (Ont. S.C.J. [Commercial List]) — considered

  

*Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 51 B.C.L.R. (2d) 84, 1990 CarswellBC 394, 4 C.B.R. (3d) 311, (sub nom. *Chef Ready Foods Ltd. v. Hongkong Bank of Canada)* [1991] 2 W.W.R. 136 (B.C. C.A.) — referred to

*Nortel Networks Corp., Re* (2009), 53 C.B.R. (5th) 196, 75 C.C.P.B. 206, 2009 CarswellOnt 3028 (Ont. S.C.J. [Commercial List]) — considered

*Pacific Shores Resort & Spa Ltd., Re* (2011), 2011 BCSC 1775, 2011 CarswellBC 3500, 75 C.B.R. (5th) 248 (B.C. S.C. [In Chambers]) — considered

*TBS Acquireco Inc., Re* (2013), 3 C.B.R. (6th) 261, 2013 CarswellOnt 9481, 2013 ONSC 4663 (Ont. S.C.J. [Commercial List]) — referred to

*Ted Leroy Trucking Ltd., Re* (2010), (sub nom. *Century Services Inc. v. Canada (A.G.))* [2010] 3 S.C.R. 379, [2010] G.S.T.C. 186, 12 B.C.L.R. (5th) 1, (sub nom. *Century Services Inc. v. A.G. of Canada)* 2011 G.T.C. 2006 (Eng.), (sub nom. *Century Services Inc. v. A.G. of Canada)* 2011 D.T.C. 5006 (Eng.), (sub nom. *Leroy (Ted) Trucking Ltd., Re)* 503 W.A.C. 1, (sub nom. *Leroy (Ted) Trucking Ltd., Re)* 296 B.C.A.C. 1, 2010 SCC 60, 2010 CarswellBC 3419, 2010 CarswellBC 3420, 409 N.R. 201, (sub nom. *Ted LeRoy Trucking Ltd., Re)* 326 D.L.R. (4th) 577, 72 C.B.R. (5th) 170, [2011] 2 W.W.R. 383 (S.C.C.) — followed

*Timminco Ltd., Re* (2012), 2012 ONSC 506, 95 C.C.P.B. 48, 2012 CarswellOnt 1263, 85 C.B.R. (5th) 169 (Ont. S.C.J. [Commercial List]) — referred to

*Timminco Ltd., Re* (2012), 2012 CarswellOnt 1466, 2012 ONSC 948, 95 C.C.P.B. 222, 86 C.B.R. (5th) 171 (Ont. S.C.J. [Commercial List]) — followed

*Timminco Ltd., Re* (2012), 2 C.B.R. (6th) 332, 2012 CarswellOnt 9633, 2012 ONCA 552 (Ont. C.A.) — referred to

**Statutes considered:**

*Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36

Generally — referred to

s. 2 "debtor company" — considered

s. 3 — considered

s. 11 — considered

s. 11.02(3) [en. 2005, c. 47, s. 128] — considered

s. 11.2 [en. 1997, c. 12, s. 124] — considered

s. 11.2(1) [en. 2005, c. 47, s. 128] — considered

s. 11.2(4) [en. 2005, c. 47, s. 128] — considered

s. 11.52(1)(c) [en. 2007, c. 36, s. 66] — considered

s. 11.52(2) [en. 2007, c. 36, s. 66] — considered

APPLICATION by group of companies for debtor in possession financing; APPLICATION by monitor for appointment of representative counsel for investor group.

***Fitzpatrick J.*:**

**Introduction**

1 This proceeding was recently commenced, on October 17, 2013, under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "*CCAA*"). On October 18, 2013, an Initial Order (the "Initial Order") was granted by Madam Justice Brown of this court. That Initial Order included an Administration Charge of $750,000 and a Directors' Charge of $500,000. PricewaterhouseCoopers Inc. was appointed as Monitor (the "Monitor").

  

2 The organization of the petitioner group of companies (the "League Group") is exceedingly complex, as I will describe in more detail below. In broad terms, there is a complicated corporate structure comprised of real estate investment trusts, limited partnerships and corporations involved in the development and/or management of various real estate projects in British Columbia, Alberta, Ontario and Quebec. The assets of the League Group include certain securities and income producing and development properties which have been said to have an "implied" equity of over $210 million. Liabilities of the League Group are in excess of $410 million, including claims from approximately 3,200 investors who paid approximately $352 million for various interests.

3 The comeback hearing has been scheduled for November 18, 2013. Following the granting of the Initial Order, various secured creditors on individual projects have consolidated their opposition to these proceedings. It is expected that they will raise substantial issues at the comeback hearing.

4 In the meantime, the League Group has brought this application for debtor in possession or "DIP" financing, given its contention that it urgently needs interim funding until the comeback hearing. The Monitor has also brought an application to appoint representative counsel for the investor group.

5 On October 25, 2013, I heard both applications and granted both orders, although on somewhat different terms than those sought. I indicated at that time that my reasons would follow. These are those reasons.

**Background**

6 Emanuel Arruda and Adam Gant started the League Group in 2005 with two projects. Further properties were acquired on the same basis as before, namely using traditional bank financing and individual investor contributions.

7 At present, the majority of the League Group entities are owned by IGW Assets Limited Partnership ("LALP"). The general partner of this limited partnership is owned by two numbered companies, which are owned or controlled by Mr. Arruda and Mr. Gant's family trusts respectively.

8 The League Group, which has sought and obtained protection under the *CCAA* and related entities, and their general business activities can be generally summarized as follows:

a) IGW Real Estate Investment Trust ("IGW REIT"): IGW REIT does business mainly through the IGW REIT Limited Partnership ("IGW LP") which undertakes certain project development directly or through separate limited partnerships located in B.C., Alberta, Quebec and Ontario. IGW REIT has issued various notes totalling approximately $10 million. In addition, there are numerous unsecured loans outstanding and outstanding mortgages in respect of various projects;

b) LALP project specific limited partnerships: LALP also operates another set of such limited partnerships designed for short term investments, located in B.C., Alberta and Ontario. Each project general partner is owned by LALP with investors buying units in the limited partnership. Some of the project entities are said to be solvent and not financially tied to the filing petitioners (such as through guarantees) and are therefore not filing parties themselves;

c) League Assets Corp. ("LAC"): LAC owns various general partners of a number of limited partnerships which are involved in various projects, the main ones being Redux Duncan, Colwood Development and Fort St. John, all located in B.C. There are other entities owned by LAC with diverse, but it seems mostly inactive, operations. As with LALP, a number of LAC related entities (and hence projects) are said to be solvent and not financially tied to the filing petitioners. They are therefore not filing parties themselves;

d) "Other" project limited partnerships: these have a similar structure to that of LAC and LALP, save that Mr. Gant and Mr. Arruda own the general partners for the project specific limited partnerships in B.C., Quebec and Ontario. This is said to be an oversight and in any event, these "other" limited partnerships are managed within the League Group, with LAC providing management services for these projects;

  

e) League Opportunity Fund ("LOF"): LOF is wholly owned by LALP. It is a vehicle for investors and it has issued promissory notes of approximately $13.5 million. The money was loaned by LOF to other members of the League Group. IGW LP(majority owned by IGW REIT) and LAC have guaranteed these notes;

f) investment and wealth management: there are a number of entities within the League Group's investment division which relate to investment and wealth management, including the Harris Fraser Group Limited which was recently acquired in July 2013; and

g) asset management: LAC is retained by IGW REIT, IGW LP and various project limited partnerships to provide asset management, for which it charges fees.

9 The causes of the League Group's financial difficulties have been attributed to a number of factors. Firstly, the 2008 worldwide financial crisis caused a number of delays to certain projects; reduced demand resulted in increased borrowing costs in the long term. Secondly, the recovery from the financial downturn has resulted in many investors seeking to redeem their investments with the League Group to look for higher risk/higher return investments. Thirdly, financing difficulties have been experienced on some projects, such as Redux Duncan and Colwood Development. Generally speaking, Mr. Gant states that the League Group has outgrown both its current corporate structure, which is too complex, and also its project by project funding model.

10 The League Group currently has approximately 105 employees in various roles in Victoria, Vancouver, Toronto and Calgary. The fairly recent acquisition of the Harris Group is adding a further 20 employees in Hong Kong.

11 There has been substantial evidence introduced in Mr. Gant's affidavits regarding the value of the various assets and projects and the secured debt against them. Aside from some Marketable Securities, there are 17 income producing properties and four development properties, for a total of 21 properties.

12 There are 34 mortgage lenders and some have charges on multiple properties. Exhibit "E" to Mr. Gant's affidavit #2 sets out a summary of the various properties or projects, including the appraised values ($395.6 million), the outstanding mortgage debt ($184.6 million) and the "implied equity" in those properties or projects. I will revisit the reliability of this document in further detail below, but it will suffice at this stage to refer to the indicated "implied equity" in the Marketable Securities ($5.8 million), Income Producing Properties ($76.2 million) and Development Properties ($128.9), for a total of approximately $211 million.

13 Unsecured creditors include the note holders in the various project limited partnerships and IGW REIT, inter-corporate debt primarily between IGW LP and other members of the League Group, trade creditors (mostly relating to Colwood Development) and professional service firms (although some of them recently obtained security for their debts just before the filing).

14 Mr. Gant indicates that government remittances are substantially up to date, including those owed to Canada Revenue Agency and the British Columbia government. Income taxes are paid in full for 2012. All of these amounts continue to be paid in the ordinary course of business. However, property taxes are substantially in arrears.

15 Finally, the investor group is comprised mostly of individuals and Mr. Gant believes that some of them have invested a significant portion of their net worth in the League Group. There are also some institutional investors. As of September 2013, IGW REIT ceased making distributions to its investors.

16 Mr. Gant states that the League Group has already taken steps to attempt a restructuring but has been hampered by the lack of funds. He states that any restructuring would likely involve: simplifying the corporate structure, divesting underperforming projects, seeking a stable and comprehensive funding for the various projects, changing the IGW loan process and finally, a potential public offering to increase equity and reduce credit requirements.

**Secured Creditor's Objections**

 

17 It quickly became apparent during this hearing that a substantial number of the secured creditors were opposed to these proceedings generally and also specifically opposed to the relief sought on these applications. The secured creditors appearing on these applications included BCMP Mortgage Investment Corporation, Interior Savings Credit Union, Firm Capital Mortgage Fund Inc., Citizens Bank of Canada, First Calgary Financial Credit Union Limited, Canadian Western Bank, Romspen Investment Corporation, Business Development Bank of Canada, Timbercreek Mortgage Investment Corporation, Export Development Canada, Bank of Montreal, Churchill Real Estate Inc., Maxium Financial Services and Roynat Inc.

18 I will not address the complaints or arguments of each individual secured creditor. Many of the arguments are interrelated. Those arguments can be generally summarized in the broad categories as follows:

a) Service/notice: despite the preamble to the Initial Order stating that the court was advised "that the secured creditors and others who are likely to be affected by the charges created herein were given notice", many of the secured creditors state that they did not receive any notice of that hearing or that notice was sent directly to the general offices of the secured creditors which inevitably meant that it was not addressed by them after the hearing had taken place.

No evidence was before me concerning service/notice to the secured creditors. It is apparent that many of the secured creditors intend to argue at the comeback hearing that the Initial Order was granted on an *ex parte* basis and is therefore subject to being set aside for material non-disclosure, including that there was no true urgency in hearing the matter on an *ex parte* basis. It is now generally agreed that the comeback hearing will be heard on a *de novo* basis with the League Group having the onus of justifying to the court the continuation of the provisions in the Initial Order in accordance with the *CCAA*, s. 11.02(3).

b) Statutory Prerequisites: it is argued that individual entities within the League Group do not meet the definition of "debtor company" in s. 2 of the *CCAA* (i.e. they are not "insolvent") and therefore, those entities do not qualify to file for protection under s. 3. I note, however, that this particular issue was addressed before Brown J. prior to the granting of the Initial Order.

In addition, at least one secured creditor intends to argue that the Initial Order should be set aside because the plan of arrangement was doomed to fail (see for example, *Hongkong Bank of Canada v. Chef Ready Foods Ltd.*, [1990] B.C.J. No. 2384 (B.C. C.A.));

c) The Enforcing Mortgagees: The secured creditors argue that there was no justification for two of the secured creditors, being TCC Mortgage Holdings Inc. ("TCC") and Quest Mortgage Corp. ("Quest"), being exempted from the stay under the Initial Order (para. 18).

TCC had commenced foreclosure proceedings in May 2013 in respect of the Redux Duncan property. An Order Nisi of foreclosure was granted in August 2013 with the redemption period due to expire in January 2014. Apparently, TCC had brought an application for the appointment of a receiver about the time that the Initial Order was granted. In addition, Quest's mortgages over the Colwood Development property were in default and demands for payment were served in early October 2013. The time for enforcement of those demands would have expired just before the granting of the Initial Order. It is my understanding that Quest has now also commenced a foreclosure proceeding against the Colwood Development.

Unfortunately, the exclusion of these "Enforcing Mortgagees" has engendered a response by the other secured creditors who, not surprisingly, wish to be treated in the same fashion. The fact that they are being treated differently has given rise to the other secured creditors taking the position that these proceedings are, unfairly, affecting only them in terms of their ability to enforce their security. In addition, it is only their security which is being primed by the various charges granted in these proceedings, since the security of the Enforcing Mortgagees has been exempted from the Administration Charge and the Directors' Charge and it is also proposed to be exempted from any DIP Lender's Charge or Representative Counsel Charge.

  

In many *CCAA* proceedings, foreclosing mortgagees are stayed in a variety of circumstances including when they have already begun enforcement proceedings. Although it was described as an"Enforcing Mortgagee" in the Initial Order, Quest had not yet commenced any foreclosure proceeding or at best, had only recently filed the action. Reasons for the exclusion of these parties were said to be not only that there were monetary defaults under their security, but also to avoid arguments by them as to the appropriateness of this *CCAA* proceeding, based on well-known British Columbia authorities such as *Cliffs Over Maple Bay Investments Ltd. v. Fisgard Capital Corp.*, 2008 BCCA 327 (B.C. C.A.). Accordingly, while the League Group may have avoided that argument from the Enforcing Mortgagees, the decision to exempt them has resulted in the other secured creditors now being resolved to make those same arguments, in addition to arguing that the League Group was not acting in good faith by agreeing to that exemption.

My only preliminary comment on the issue at this point is that while the court strives to achieve fairness in the proceedings, the task of the court in imposing the stay is in part to ensure that it is "appropriate": *CCAA*, s. 11.02(3)(a). As Deschamps J. stated in *Ted Leroy Trucking Ltd., Re*, 2010 SCC 60 (S.C.C.), appropriateness in part extends to treating stakeholders "as advantageously and fairly as the circumstances permit": para. 70. Often there are good reasons to depart from a blanket stay affecting various stakeholders, as is evidenced from the provisions of the model order. Typical examples would include payment of employees and critical suppliers. However, in respect of stakeholders having what seems to be a commonality of interest (and commonality of potential prejudice), I would expect that there would be cogent and compelling evidence to support an order that treated them differently.

d) The "White Boxes" Entities: The secured creditors also make certain arguments in respect of certain members of the League Group who are *not* part of the petitioning group. I have already referred to the extremely complex structure of the League Group. The organizational chart includes various entities marked in yellow which are part of the League Group and who are also petitioning debtors. Many other entities are identified in what have been called the "white boxes" on the organization chart which include those entities that were not part of the petitioning debtor group. I have already referred to some of these "white box" entities above, but it is said by Mr. Gant that they also generally include firstly, shell companies where there are no assets and secondly, entities where the sole liability is to investors and as such, they are not insolvent.

The secured creditors argue that the exclusion of these "white box" entities is suspicious in that there has been inadequate disclosure of the financial circumstances relating to them. In particular, the suggestion has been made that there may be sufficient income or assets in those other entities to support the operations of the League Group in these proceedings without the necessity of priming charges which prejudice their security. If these entities are indeed solvent, then this argument would appear to be diametrically opposed to the other argument of some secured creditors (discussed above) that only *insolvent* entities should be petitioning debtors.

Despite these objections, and for the purposes of these applications, I am satisfied that the materials generally disclose the circumstances relating to these "white box" entities and why these entities have not been included in the *CCAA*filing. I do, however, appreciate that the stakeholders, including the secured creditors, may require further information about these "white box" entities beyond what is contained in Mr. Gant's affidavits. I expect that the League Group, possibly with the assistance of the Monitor, can provide reasonable and relevant material to them so that they might explore this matter. At present, I simply acknowledge that this may be the basis for arguments to be advanced by the secured creditors at the comeback hearing in respect of whether the League Group is operating in a *bona fide* manner.

e) Conflicts: Last, but not least, the secured creditors have raised a number of conflicts on the part of counsel involved in these proceedings. It is clear to me that these conflicts have significantly coloured the perceived fairness of these proceedings from the outset. The original counsel for the League Group (who has since withdrawn) disclosed, after the Initial Order was granted, that she has also acted in the past for Quest. Some of the secured creditors intend to argue at the comeback hearing that there was material nondisclosure of this conflict to Brown J. and that this relationship between the law firm and Quest may have affected the League Group's decision to exclude Quest from the stay.

  

In addition, in the days following the granting of the Initial Order and in the face of the League Group's application for DIP financing, it was disclosed that the law firm acting for the Monitor (who ceased to act at the end of this hearing) had also undertaken to act for the DIP Lenders in respect of the preparation of financing documents. The explanation is that the DIP Lenders urgently required counsel to address the League Group's pressing need for this DIP financing. Although screens were put in place between the individual lawyers at the law firm, it has unfortunately resulted in the perception that the Monitor's support of the DIP financing, or at least the legal advice relating to the Monitor's support, has been influenced by that relationship. This turn of events was extremely unfortunate, particularly in light of the unquestioned duties of the Monitor as an officer of this court and its overriding duty to act fairly in respect of all stakeholders, whether they are in support of or opposed to the DIP financing.

Finally, current counsel for the League Group has disclosed that his law firm is an unsecured creditor. I am not aware of any objections arising from this fact. However, it does appear that the law firm was giving legal advice to the DIP Lenders at one point.

19 I am advised that all of the issues above may be raised at the comeback hearing. In addition, the secured creditors raised these issues on this application arguing that, in these circumstances, the court should be extremely reluctant to authorize DIP financing and grant a DIP charge or any other charge based on the substantial attacks that will be made on the Initial Order and on the continuation of this proceeding. It is no doubt the strategy of the secured creditors at this time to attempt to inject sufficient uncertainty into these proceedings such that any DIP lender will be reluctant to advance monies to the League Group.

20 It not my intention or role at this time to revisit the basis upon which the Initial Order was granted. Presumably, the Initial Order was granted having regard to the statutory requirements under the *CCAA* and based on well-known principles applicable on such applications, including those set out in *Century Services Inc.* at paras.15-18, 57-71. I appreciate that the issues raised by the secured creditors are significant and if substantiated, may have serious consequences. Nevertheless, I am not convinced that these arguments are sufficient to dissuade the court from granting interim relief at this time, simply to see the League Group through to the comeback hearing, some 24 days away at the time of this hearing.

21 Accordingly, it is my intention to proceed to hear and decide these applications before me based on the Initial Order being extant and based on the updated and current circumstances of the League Group. I have specifically rejected the suggestion of one of the secured creditors to grant these orders on a "without prejudice" basis.

**DIP Financing**

22 In its application materials, the League Group sought approval of a DIP facility in the amount of $31.5 million from Whil Concepts Inc., NWM Private Equity LP and NWM Balanced Mortgage Fund (whom I will collectively call the "DIP Lenders"). This proposed facility was not only for what was said to be operating funding for the next 13 weeks ($5 million), but for other purposes such as payment of tax arrears ($3.5 million), mortgage payments for 13 weeks($5 million) and to payout one of the existing mortgage lenders, TCC ($18 million).

23 Despite this, the League Group only sought a DIP Lender's Charge of $1.6 million which was said to be the amount of emergency funding that was urgently needed to get to the comeback hearing on November 18. The DIP Lenders supported this restricted charge, based on their submissions that they had no intention of funding, save and except with a DIP Lender's Charge. I understand that given the urgency, and despite the objections of the secured creditors, the DIP Lenders are prepared to immediately fund this amount and in doing so, waive the following conditions: that advances would only be made after expiry of the appeal period and that certain administrative matters, such as insurance, be in place.

24 The test for DIP funding is now mandated by the *CCAA*, s. 11.2:

**Interim financing**

  

11.2 (1) On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, a court may make an order declaring that all or part of the company's property is subject to a security or charge — in an amount that the court considers appropriate — in favour of a person specified in the order who agrees to lend to the company an amount approved by the court as being required by the company, having regard to its cash-flow statement. The security or charge may not secure an obligation that exists before the order is made.

**Priority — secured creditors**

(2) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

**Priority — other orders**

(3) The court may order that the security or charge rank in priority over any security or charge arising from a previous order made under subsection (1) only with the consent of the person in whose favour the previous order was made.

**Factors to be considered**

(4) In deciding whether to make an order, the court is to consider, among other things,

(a) the period during which the company is expected to be subject to proceedings under this Act;

(b) how the company's business and financial affairs are to be managed during the proceedings;

(c) whether the company's management has the confidence of its major creditors;

(d) whether the loan would enhance the prospects of a viable compromise or arrangement being made in respect of the company;

(e) the nature and value of the company's property;

(f) whether any creditor would be materially prejudiced as a result of the security or charge; and

(g) the monitor's report referred to in paragraph 23(1)*(b)*, if any.

25 In accordance with the *CCAA*, s. 11.2(1), the League Group has filed a cash flow forecast to the date of the comeback hearing.

26 As a preliminary matter, no one has challenged the adequacy of the efforts by the League Group to obtain satisfactory interim financing. Nor is there any challenge to the appropriateness of the business terms arranged with the DIP Lenders, including the term, interest rate and level of various fees for monitoring the commitment itself and professionals. The Monitor comments favourably on the process by which the DIP financing was sought by the League Group and the reasonableness of the terms proposed by the DIP Lenders.

27 It is proposed that the DIP Lender's Charge would rank after the Administration Charge but before the Directors' Charge and any Representative Counsel Charge.

28 Notice of this application for DIP financing has been given to secured creditors likely to be affected, as required by the *CCAA*, s. 11.2(1). The secured creditors attending on this application object to the financing for a variety of reasons (as discussed above), and also on the basis that this funding is not urgent, there is an insufficient evidentiary basis for the relief sought and that they will be prejudiced by the DIP Lender's Charge ranking ahead of their security.

29 I will address each of the factors identified in *CCAA*, s.11.2(4).

***(a) The period during which the League Group is expected to be subject to proceedings under the CCAA***

 

30 The DIP financing that is sought today is simply to allow the League Group to continue its operations until the comeback hearing on November 18 by allowing it to make certain core payments.

***(b) How the League Group's business and financial affairs are to be managed during the proceedings***

31 Mr. Gant states in his affidavit that the League Group has been working closely with the Monitor regarding its financial affairs, including reviewing all payments made by the League Group. The Monitor similarly says that it has been working cooperatively with the League Group in terms of preparing the cash flow forecast and other financial documentation.

32 In addition, the League Group had already made certain efforts to reduce operating expenses in anticipation of the *CCAA* filing.

***(c) Whether the League Group's management has the confidence of its major creditors***

33 Not surprisingly, most of the counsel for the secured creditors appearing on this application voiced their clients' lack of confidence in the League Group's management. However, these types of bald assertions, without more, and without evidence, do little to provide the court with a satisfactory basis upon which to assess this factor. In addition, the position of the secured creditors must be considered in the context of other evidence that suggests that they are fully secured and that payments owed to them by the League Group are current: *Pacific Shores Resort & Spa Ltd., Re*, 2011 BCSC 1775 (B.C. S.C. [In Chambers]) at para. 49(c).

34 Counsel for certain noteholders of LOF raised the matter of governance of the League Group during his submissions. While supporting the application for DIP financing, it appears that those stakeholders are considering whether an application for a chief restructuring officer (CRO) might be appropriate in the circumstances. I do not wish or need to predict what might happen at the comeback hearing or any later court application but presumably, if an application for such relief is brought, it will be based on evidence as to the willingness and/or ability of the current management of the League Group to proceed with its restructuring efforts.

***(d) Whether the loan would enhance the prospects of a viable compromise or arrangement being made by the League Group***

35 Substantial arguments were advanced, by a number of the secured creditors, that the DIP funding was not necessary or urgent. With respect, I disagree.

36 The cash flow forecast indicates that in the period leading up to November 18, approximately $1.6 million will be required in respect of corporate operating expenses. A large portion of that amount, $1.1 million, will be required for payroll, with the first payroll of approximately $550,000 due the very date of the hearing and the second payroll being due on November 8, 2013. The cash flow forecast indicates proposed payments of $339,000 for "project funding" which I am advised relates to supporting certain income producing properties which are operating on a negative cash flow basis. Notwithstanding that the evidence on the project operating expenditures is somewhat thin, in my view, it is reasonable to expect that the League Group has some ongoing operations in the specific projects that require support in this interim period. Again, I would emphasize that it is the overarching intention of the League Group to conduct business in the ordinary course, at least in the initial period of the restructuring until a longer term strategy can be formulated.

37 The anticipated cash receipts of approximately $1.9 million over this time frame are clearly not sufficient to fund the anticipated costs of approximately $3.5 million. Nor is the timing of some of those receipts during the week of October 28 certain in terms of making the payroll as soon as possible after it was due on October 25.

38 Finally, the cash flow forecast anticipates restructuring and financing costs of $1.45 million until the comeback hearing. There are strenuous objections to payment of these amounts; however, it cannot be argued that professionals who are assisting in the restructuring of these proceedings should be denied payment of their reasonable remuneration on an ongoing basis, if such payments are possible: *Timminco Ltd., Re*, 2012 ONSC 506 (Ont. S.C.J. [Commercial List]) at para. 66. The amounts are large but not unusual given the complexity of these proceedings and the issues raised. These professionals should not be required to

 

simply rely on a court ordered charge to protect their outstanding fees. The Administration Charge in any event would not have been sufficient to cover the amounts expected to be incurred to the date of the comeback hearing.

39 Further, if they wish, the stakeholders will have the opportunity to review all professional fees at the end of this matter. In particular, paragraph 34 of the Initial Order provides that the Monitor and its legal counsel will pass their accounts before this court. Paragraphs 6 and 7 of the Initial Order provide for the payment of *reasonable* fees and disbursements to the League Group's counsel.

40 Without the proposed DIP funding, the League Group readily admits that it will be unable to continue. The Monitor states:

> ... If the financing is not approved, the current liquidity situation is such that League will not be able to fund payroll on Friday, October 25th, which will require an immediate cessation of operations and the accompanying liquidation of its assets in a forced and distressed manner.

41 I am satisfied that the DIP financing sought on this application is urgently needed in order to fund operations within these proceedings until the comeback hearing. Accordingly, I agree that such funding will enhance the prospects of an arrangement by the League Group to its creditors.

***(e) The nature and value of the League Group's property***

42 As I have stated numerous times, many of the secured creditors oppose the continuation of this proceeding and wish to take steps to realize on their security.

43 Most of the assets owned by the League Group are complex real estate holdings including income producing properties and development properties, some of which are not yet completed.

44 The Monitor points out what might be said to be fairly obvious; namely, that such a realization scenario is not in the interests of the creditors, including even these secured creditors, or the numerous other stakeholders in these proceedings:

> A forced and distressed liquidation is clearly not in the interests of the creditors or Investors, nor is it in the interests of many of the mortgage lenders who do not enjoy first mortgage security and whose security is spread across multiple properties and assets. Such lenders will then be compelled to deal with complicated scenarios where their recovery on one property will determine the extent to which they must rely on another property for the recovery of their loans. If a liquidation of League's assets is to occur, it is imperative that such a liquidation should occur on an orderly and controlled basis.

45 In addition, as pointed out by counsel for the League Group, the nature of the assets is such that even if the secured creditors were to take steps to realize on their security, they would inevitably be incurring some of the same types of expenses, including professional fees, as are currently being proposed to be paid in accordance with the cash flow forecast: *Pacific Shores Resort & Spa Ltd.* at para. 49(f).

***(f) Whether any creditor would be materially prejudiced as a result of the DIP Lender's Charge***

46 The issue of material prejudice to the secured creditors was largely focused on the evidence as to the value of the secured assets and the "implied equity" which was calculated based on certain mortgage amounts stated to be outstanding.

47 Again, I do not intend to focus on each individual secured creditor. Many of the secured creditors take issue with what has been described as the appraised value of the various projects over which they hold security and also with what is calculated to be the mortgage debt outstanding on those projects.

48 The League Group and the Monitor do not dispute that this calculation of $210.9 million of "implied equity" is not a certain calculation. In particular, the Monitor emphasizes that it has only, to this time, performed a "high level review" of the calculation of equity in the various projects. The Monitor notes:

 

a) Marketable Securities: those amounts are based on recent trading prices of units in the Partners REIT, which are publicly traded;

b) The Income Producing Properties: the ascribed values of these properties are supported by appraisals, although it is apparent that some of those appraisals are dated. In addition, the Monitor notes that most of the appraisals have been prepared for financing purposes which in their experience, tend to be higher than values recoverable in the market. Nevertheless, the Monitor concludes that there appears to be "significant positive equity available in these properties"; and

c) The Development Properties: the values ascribed are based on book values which represent the monies the League Group has spent to date to develop the properties. Again, based on the Monitor's experience, if the development is not completed, the recovery for these projects will be substantially less than the costs incurred to date. With respect to the Colwood Development specifically, the Monitor is of the view that even if the League Group completes the project, it is unlikely that the project costs will be fully recovered. Accordingly, the Monitor states that the $129.9 million "implied" equity in the development properties is overstated, although it is unclear at this time to what degree.

49 I agree that the exact financial position of the League Group in the income producing and development properties is unknown to some extent. These proceedings have only begun and the Monitor is no doubt continuing its investigation and analysis of the various projects. I anticipate that the equity position in these properties will be further clarified in the near future and that this further information can be communicated to the stakeholders. The Monitor points to the fact that after the granting of the Initial Order, the mortgage lenders needed "time and a better understanding of League's complexity and possible restructuring plan to consider supporting this refinancing".

50 In the meantime, despite the shortcomings in the financial calculations, there appears to be substantial equity in those properties. Most of the secured creditors appearing on the application did not have any more reliable information towards a calculation of the equity in the projects. When asked about their own specific secured positions, most were not able to state convincingly or conclusively that their loans were in jeopardy, although some submissions were made that certain loan positions were "on the bubble". Even if any of the secured creditors are in or close to a deficit position, the intention of the League Group is to continue funding the mortgage payments, subject to obtaining further DIP financing to do so. In that event, any further prejudice will be lessened. None of the secured creditors were able to say that their loans were subject to any financial defaults, although I am assuming that given the *CCAA* filing, there are likely to be many non-financial defaults in accordance with the usual security documentation.

51 As I noted in *Pacific Shores Resort & Spa Ltd.* atpara. 49(f), material prejudice to secured creditors is only one factor to be considered in equal measure with the others listed in the *CCAA*, s. 11.2(4).

52 On the basis of the evidence presented, I am satisfied that at the very least, the secured creditors will suffer some prejudice in terms of delays in realization of their security in the event of a failure to restructure by the League Group. Beyond that, I am not satisfied that there is *material* prejudice to the secured creditors given the asset/debt levels disclosed to date. Further prejudice may arise in the event that the "implied equity" amounts are reduced or perhaps eliminated.

53 Based on the current values disclosed, it is, as Mr. Gant suggests, really the unsecured creditors and the investor group who are facing the material prejudice at this time and any prejudice to the secured creditors must also be considered in light of that material prejudice. As I have noted above, there are also a substantial number of employees.

54 In light of the concerns expressed by the secured creditors, the League Group, with the support of the Monitor, has proposed certain allocation provisions in the order authorizing DIP financing, should an allocation issue arise in the future. In accordance with these provisions, costs that may be specifically attributed to a certain asset shall be allocated to that asset. Costs that are not attributable to any asset are to be allocated as follows: firstly, to unencumbered or not fully encumbered assets and secondly, to assets generally based on a *pro rata* allocation based on the actual value of an asset.

 

55 I agree that this allocation provision should alleviate many of the secured creditors concerns as to how the DIP Lender's Charge may be borne. It remains to be seen, of course, whether any allocation issues will in fact arise as that will be dependent on the success of the restructuring.

***(g) The Monitor's report***

56 The Monitor's first report to the court is dated October 23, 2013. The Monitor supports the proposed DIP financing and the granting of a DIP Lender's Charge, having reviewed the financial terms of the DIP Lenders and being satisfied that those are reasonable terms and the bestavailable in the marketplace.

57 The Monitor is also satisfied that the restriction of the DIP Lender's Charge to $1.6 million will allow for the minimum cash requirements for the League Group to meet its operating and restructuring obligations until the time of the comeback hearing.

58 Finally, the Monitor has expressed the view that it supports both the DIP Lender's Charge and the Representative Counsel Charge referred to below to a total of $1.85 million notwithstanding that those charges would prime the existing secured creditors, other than the Enforcing Mortgagees. The Monitor states that it is sensitive to concerns being raised by the mortgage lenders as a result of the priming but that it supports the priming on the basis that there appears to be equity in the properties such that it is unlikely the mortgage lenders will ultimately be impacted by these priority charges.

59 As the Monitor notes, it is usual in these types of cases that a DIP Lender will advance monies into those proceedings only where the loans are supported by a court ordered priority charge over existing charge holders. All of the parties who submitted offers to the League Group to provide DIP financing required such a priority charge. In *Timminco Ltd., Re*, 2012 ONSC 948 (Ont. S.C.J. [Commercial List]), aff'd 2012 ONCA 552 (Ont. C.A.), Mr. Justice Morawetz stated:

> [49] In the absence of the court granting the requested super priority, the objectives of the CCAA would be frustrated. It is neither reasonable nor realistic to expect a commercially motivated DIP lender to advance funds in a DIP facility without super priority. The outcome of a failure to grant super priority would, in all likelihood, result in the Timminco Entities having to cease operations, which would likely result in the CCAA proceedings coming to an abrupt halt, followed by bankruptcy proceedings. Such an outcome would be prejudicial to all stakeholders ...

60 The same considerations discussed in *Timminco Ltd.* are at play here. It is unreasonable to expect that any DIP lender would advance the required DIP financing, save and except with a charge having priority over existing creditors. As stated by the League Group and as confirmed by the Monitor, this DIP financing is necessary and urgently required to continue the operations of the League Group for a very short period of time until the comeback hearing. Failure to obtain that financing will result in a liquidation scenario - one which, given the different stakeholder groups and the complexity of the assets, will no doubt result in a multiplicity of realization proceedings at great cost. In that liquidation scenario, there will likely be prejudice to those who are said, at this time, to be the stakeholders who have significant equity in the assets.

61 It is a fundamental objective of the *CCAA* to avoid such an outcome if at all possible.

62 In conclusion, the DIP financing is urgently required by the League Group and is necessary to fund the operations for a very short period of time to the comeback hearing. The order approving the DIP facility is granted. However, in my view, there is no need to approve any DIP facility beyond the $1.6 million financing needed to the time of the comeback hearing. The League Group is at liberty to bring a further application in respect of any further DIP financing.

**Representative Counsel**

63 The Monitor applies for the appointment of Fasken Martineau DuMoulin LLP ("Faskens") as representative counsel for the investor group. In addition, the Monitor seeks an order that Faskens be granted a charge in the amount of $250,000 in respect of its fees and disbursements. The proposed ranking of that charge is that it will stand in priority to all of the security and charges (including the Director's Charge) but be subordinate to the Administration Charge, the DIP Lender's Charge and the security of the Enforcing Mortgagees.

 

64 As noted above, the investor group has been identified as comprising approximately 3,200 individuals and some institutional investors who have supplied approximately $352 million to the League Group to fund its real estate properties and business operations. Generally speaking, these investors have contributed funds in the form of secured notes, unsecured notes and equity to IGW REIT, LOF and to individual project limited partnerships, either directly or through an RRS Peligible investment vehicle. I understand that the various investment vehicles have different conversion, redemption or retraction features.

65 The Monitor advises that while there are certain common attributes amongst the investor group, there are other circumstances relating to the various investments that would suggest that some individuals or sub-groups may have positions that may differ from others within the overall group. For example, it may be such that different project specific investments have equity, while others do not.

66 The Monitor has already fielded over 100 enquiries from various investors. On October 23, 2013, the Monitor scheduled and held a conference call for the purpose of informing investors of the *CCAA*proceedings and the anticipated process and also to answer any questions. I am advised that over 460 investors participated in that call. At that time, the investors were introduced to counsel from Faskens and the concept of a representative counsel was discussed.

67 If representative counsel is to be appointed, there is no opposition to the appointment of Faskens given their extensive experience in insolvency matters and in particular, matters involving large and disparate stakeholder groups where representative counsel were appointed, such as in the Eron Mortgage Corporation proceedings.

68 The Monitor states that it is unlikely that many of the individual investors will either have the financial wherewithal or means to engage legal counsel to provide for their meaningful participation in these insolvency proceedings. In addition, if a number of separate law firms are retained by investors, a multiplicity of representation by those having a commonality of interest will add to the cost and therefore the complexity of the proceedings. Finally, the Monitor notes that these investors are the stakeholders to be "most keenly affected by this restructuring" and representation of their interests may be beneficial so as to ensure that all stakeholders have adequate input into the course of these proceedings.

69 I am satisfied that the Monitor is not in a position to assist any further in alerting the investors to these proceedings, organizing the investor group and advising them of issues that may affect them either as a group or individually.

70 The statutory jurisdiction upon which such representative charges are considered is found in the *CCAA*, s. 11, which provides that the court may make any order that it considers "appropriate" in the circumstances:

> **General power of court**
>
> 11. Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.

71 The appropriateness of such orders has been considered numerous times by the Ontario Superior Court of Justice (Commercial List): see *Nortel Networks Corp., Re* (2009), 53 C.B.R. (5th) 196, 2009 CarswellOnt 3028 (Ont. S.C.J. [Commercial List]), *Fraser Papers Inc., Re*, 2009 CarswellOnt 6169 (Ont. S.C.J. [Commercial List]), *Canwest Global Communications Corp., Re*, 2009 CarswellOnt 9398 (Ont. S.C.J. [Commercial List]), and *TBS Acquireco Inc., Re*, 2013 ONSC 4663 (Ont. S.C.J. [Commercial List]) and by this court: *Catalyst Paper Corp., Re*, 2012 BCSC 451 (B.C. S.C.).

72 In *Canwest Publishing Inc./Publications Canwest Inc., Re*, 2010 ONSC 1328 (Ont. S.C.J. [Commercial List]), Pepall J. (as she then was) summarized many of the factors that have been considered in granting these types of order:

> [21] Factors that have been considered by courts in granting these orders include:

• the vulnerability and resources of the group sought to be represented;

• any benefit to the companies under CCAA protection;

• any social benefit to be derived from representation of the group;

• the facilitation of the administration of the proceedings and efficiency;

• the avoidance of a multiplicity of legal retainers;

• the balance of convenience and whether it is fair and just including to the creditors of the Estate;

• whether representative counsel has already been appointed for those who have similar interests to the group seeking representation and who is also prepared to act for the group seeking the order; and

• the position of other stakeholders and the Monitor.

73 The stakeholder groups for which representative counsel were appointed in *Nortel Networks Corp.*, *Fraser Papers Inc.*, *Canwest Global Communications Corp.* and *Canwest Publishing Inc.* were current and former employees of the debtors. In those cases, the Ontario court noted the particular vulnerability of certain of those stakeholders. The vulnerability of the investor group here has not yet been fully investigated, but the Monitor and Mr. Gant certainly suggest that similar concerns arise in relation to the individuals who have invested a significant portion of their net worth in the League Group. In addition, the indications of equity in the League Group's assets would also suggest that their interests in these proceedings are real and not merely illusory.

74 In *First Leaside Wealth Management Inc., Re*, 2012 ONSC 1299 (Ont. S.C.J. [Commercial List]), Mr. Justice D.M. Brown appointed representative counsel in those *CCAA* proceedings for some 1,200 clients who were investors in one of the debtor companies (para. 38). Representative counsel were also appointed in the Eron Mortgage Corporation proceedings for certain investor groups: see *Eron Mortgage Corp., Re* (1998), [1999] 4 W.W.R. 375 (B.C. S.C.) at para. 3.

75 I am satisfied that the appointment of representative counsel in this case is appropriate for the reasons stated by the Monitor. As matters stand, the investor group is a significant one and it is important that they be properly represented so that they can take appropriate positions in these insolvency proceedings. From a timing perspective, it is somewhat imperative that the investors obtain some legal representation in respect of the comeback hearing which, as I have alluded to, is expected to be highly contentious principally from the perspective of the secured creditors.

76 At this point in time, the investor group has a sufficient "commonality of interest" that can be best served by one counsel: *Nortel Networks Corp.* at paras. 62-63, *Fraser Papers Inc.* at paras. 11-12. The appointment of representative counsel will allow their positions to be advanced in an efficient manner, to the benefit of all stakeholders. Separate representation may be required at a later time once Faskens has had an opportunity to investigate the claims of the investors and determine what positions might be advanced in these proceedings. That matter can be addressed if and when it arises.

77 The statutory jurisdiction to order that the fees and disbursements of any representative counsel be secured by a charge is found in the *CCAA*, s. 11.52(1)(c):

**Court may order security or charge to cover certain costs**

**11.52** (1) On notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring that all or part of the property of a debtor company is subject to a security or charge — in an amount that the court considers appropriate — in respect of the fees and expenses of

. . .

  

(*c*) any financial, legal or other experts engaged by any other interested person if the court is satisfied that the security or charge is necessary for their effective participation in proceedings under this Act.

**Priority**

(2) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

78 Having forecast to the secured creditors my conclusions with respect to the DIP financing, I encouraged the parties to discuss what interim accommodations could be agreed upon in order that representative counsel could be retained for the investors in the short period of time leading up to the comeback hearing.

79 As a result of those discussions, it was generally agreed and subsequently ordered that Faskens would be appointed as representative counsel with authorized fees of $125,000. The League Group was authorized to pay a retainer of $75,000. It was also recognized that a charge would be necessary in order to allow for Faskens' "effective participation" in the proceedings and a Representative Counsel Charge was ordered to the extent of $50,000, with priority save and except with respect to the Administration Charge, the DIP Lender's Charge and the security of the Enforcing Mortgagees.

80 This modest cost for representative counsel at this stage is fair and reasonable and is intended to benefit the proceedings generally. Therefore, the Representative Counsel Charge is properly borne by stakeholders based on the proposed priority: *Canwest Publishing Inc./Publications Canwest Inc., Re*, 2010 ONSC 222 (Ont. S.C.J. [Commercial List]) at para. 54.

81 It is anticipated that the Representative Counsel will have met at least to some degree with the investor group prior to the comeback hearing and will be in a position to report to the court on what efforts have been made to organize the group. It is also hoped that by then, the Representative Counsel will have assessed the investor group's interests so as to be able to advise, if possible, what issues might be raised by the investor group. Finally, it is anticipated that Faskens will make efforts to determine whether it is possible to raise retainer funds within the investor group itself for any representation beyond the comeback hearing, rather than securing further amounts from the League Group.

**Disposition**

82 The Initial Order is amended and restated on the terms proposed with respect to the DIP financing and the DIP Lender's Charge, save and except that the authorized credit facility shall not exceed $1.6 million. The League Group and the DIP Lenders are to file a copy of the amended commitment letter in this court once that is signed.

83 The order is granted appointing Faskens as Representative Counsel for the investor group on the terms proposed. The authorized fees for the Representative Counsel will be $125,000, to be secured by a retainer of $75,000 paid by the League Group and a Representative Counsel Charge of $50,000 with the indicated priority.

84 The remainder of the applications, including the applications of FCC Mortgage Associates Inc. and Export Development Canada, are adjourned to November 18, 2013 to be heard at the same time as the comeback hearing.

*Order accordingly.*



  

# TAB 6

KeyCite Yellow Flag - Negative Treatment
Disagreed With by In re Premier Intern. Holdings, Inc., Bankr.D.Del., January 20, 2010

419 B.R. 271
United States Bankruptcy Court, D. Delaware.

In re WASHINGTON MUTUAL, INC., et al., Debtors.

No. 08–12229 (MFW).
|
Dec. 2, 2009.

**Synopsis**

**Background:** Creditor moved to compel noteholders group to comply with its disclosure obligations under Bankruptcy Rule, and noteholders group resisted on theory that it was not ad hoc committee subject to provisions of Rule, but only a loose affiliation of creditors.

**[Holding:]** The Bankruptcy Court, Mary F. Walrath, J., held that noteholders group consisting of multiple creditors holding similar claims, whose members had filed pleadings and appeared in debtors' jointly administered Chapter 11 cases collectively and not individually, qualified as "ad hoc committee," for purposes of Bankruptcy Rule governing disclosure obligations of official and ad hoc committees.

Motion granted.

West Headnotes (3)

**[1]** **Bankruptcy** Creditors' and equity security holders' committees and meetings

Noteholders group consisting of multiple creditors holding similar claims, whose members had filed pleadings and appeared in debtors' jointly administered Chapter 11 cases collectively and not individually, qualified as "ad hoc committee," for purposes of Bankruptcy Rule governing disclosure obligations of official and ad hoc committees, despite fact that membership in group was at-will, that group had no ability to bind its members without their consent, and that members of group elected to characterize themselves, not as committee, but as loose affiliation of creditors. Fed.Rules Bankr.Proc.Rule 2019, 11 U.S.C.A.

4 Cases that cite this headnote

**[2]** **Statutes** Plain, literal, or clear meaning; ambiguity

Generally, legislative history should not be relied upon where language of statute or rule is clear.

2 Cases that cite this headnote

**[3]** **Bankruptcy** Creditors' and equity security holders' committees and meetings

Bankruptcy Rule governing disclosure obligations of official and unofficial committees of creditors and equity holders is not limited in its application only to bodies that purport to speak on behalf of entire class or broader group of stakeholders in fiduciary capacity, with power to bind stakeholders that are members of such body. Fed.Rules Bankr.Proc.Rule 2019, 11 U.S.C.A.

3 Cases that cite this headnote

**Attorneys and Law Firms**

***272** Andrew C. Irgens, Richards, Layton & Finger, Chun I Jang, Cory D. Kandestin, Lee E. Kaufman, Mark D. Collins, Richards, Layton & Finger, P.A., Neil Raymond Lapinski, Rafael Xavier Zahralddin–Aravena, Elliott Greenleaf, Wilmington, DE, for Debtors.

***OPINION*** [1]

MARY F. WALRATH, Bankruptcy Judge.

Before the Court is the Motion of JPMorgan Chase Bank, National Association ("JPM") to Compel the Washington Mutual, Inc., Noteholders Group (the "WMI Noteholders Group") to Comply with Rule 2019 of the Federal Rules of Bankruptcy Procedure. For the reasons set forth below, the Court will grant the Motion.

I. *FACTUAL BACKGROUND*

Prior to filing its chapter 11 petition, Washington Mutual, Inc. ("WMI") was a savings and loan holding company, [2] which owned Washington Mutual Bank ("WMB"). WMB owned a subsidiary bank, Washington Mutual Bank fsb ("WMBfsb"). Before failing, WMB was the nation's largest savings and loan association, with over 2,200 branches and $188.3 billion in deposits.

Beginning in mid–2007, the slowdown in the nation's economy and, in particular, the deterioration in the residential housing market resulted in decreased revenue and earnings at WMI and trouble in the asset portfolio of WMB. By September 2008, in the midst of a global credit crisis of unprecedented proportions, WMI and WMB faced a wave of ratings downgrades by the major credit-rating agencies. Deteriorating confidence in WMB fueled a run on the bank, during which $16.7 billion in deposits was withdrawn over a ten-day period beginning September 15, 2008.

On September 25, 2008, WMB's primary regulator, [3] the Office of Thrift Supervision (the "OTS"), seized WMB and appointed the Federal Deposit Insurance Corporation (the "FDIC") as receiver. WMB's takeover by the FDIC was the largest bank failure in the nation's history. Immediately ***273** after its appointment as receiver, the FDIC sold substantially all the assets of WMB to JPM. On September 26, WMI filed a chapter 11 petition, together with its affiliate, WMI Investment Corporation.

The WMI Noteholders Group first appeared in this case when its counsel (Bayard, P.A. and White & Case LLP) filed a notice of appearance dated October 20, 2008, on behalf of the Group. Contemporaneously with the notice of appearance, counsel filed a Verified Statement of White & Case LLP (the "W & C 2019 Statement") listing the names and addresses of 23 entities participating in the Group as of that date which collectively held over $1.1 billion in principal amount of notes issued by WMI. [4] In addition, the Statement represented that each entity "participating in the WMI Noteholders Group makes its own decisions as to how it wishes to proceed and does not speak for, or on behalf of, any other creditor, including the other participants participating in the WMI Noteholders Group in their individual capacities."

Through counsel, the WMI Noteholders Group has been active in these cases. Counsel for the WMI Noteholders Group has filed responsive pleadings relating to several contested matters [5] and appeared at numerous hearings.

On August 6, 2009, JPM filed a Motion to compel the WMI Noteholders Group to comply with Bankruptcy Rule 2019. The WMI Noteholders Group opposed the Motion. The Court held a hearing on August 24, 2009, at which the parties presented oral argument. At the conclusion of the hearing, the Court took the matter under advisement. The matter is ripe for decision.

*II. JURISDICTION*

This Court has jurisdiction over this matter, which is a core proceeding pursuant to 28 U.S.C. §§ 1334 and 157(b)(2)(A).

*III. DISCUSSION*

Rule 2019(a) provides in relevant part:

> In a chapter 9 municipality or chapter 11 reorganization case, except with respect to a committee appointed pursuant to § 1102 or 1114 of the Code, *every entity or committee representing more than one creditor or equity security holder* ... shall file a verified statement setting forth (1) the name and address of the creditor or equity security holder; (2) the nature and amount of the claim or interest and the ***274** time of acquisition thereof unless it is alleged to have been acquired more than one year prior to the filing of the petition; (3) a recital of the pertinent facts and circumstances in connection with the employment of the entity or indenture trustee, and, in the case of a committee, the name or names of the entity or entities at whose instance, directly or indirectly, the employment was arranged or the committee was organized or agreed to act; and (4) with reference to the time of the employment of the entity, the organization or formation of the committee, or the appearance in the case of any indenture trustee,

> the *amounts of claims or interests owned by the entity, the members of the committee* or the indenture trustee, *the times when acquired, the amounts paid therefor, and any sales or other disposition thereof.* The statement shall include a copy of the instrument, if any, whereby the entity, committee, or indenture trustee is empowered to act on behalf of creditors or equity security holders. *A supplemental statement shall be filed promptly, setting forth any material changes in the facts contained in the statement* filed pursuant to this subdivision.

Fed. R. Bankr.P.2019(a) (emphasis added).

The WMI Noteholders Group does not dispute that the disclosure in the W & C 2019 Statement of only the names of the participants and the aggregate holdings of the WMI Noteholders Group is insufficient to comply with Rule 2019. The WMI Noteholders Group argues instead that Rule 2019 is inapplicable, because it is not an "entity or committee representing more than one creditor." Rather, the WMI Noteholders Group asserts that it is "simply a loose affiliation of creditors who, in the interests of efficiency are sharing the cost of advisory services in connection with the case."

A. *Plain Language of Rule 2019*

**[1]** The Rule requires disclosure from any "entity or [unofficial] committee representing more than one creditor or equity security holder." Counsel to the WMI Noteholders Group contends that the Group is neither an entity nor an ad *hoc* committee within the meaning of the Rule because the Group is:

> simply a loose affiliation of WMI creditors who, in the interest of efficiency, are sharing the cost of advisory services in connection with the case. The Noteholders do not speak for, have no ability to bind and owe no duties to anyone who is not a Noteholder. Perhaps as importantly, the Noteholders don't even have the right to speak for or bind individual Noteholders absent their individual consent. Each Noteholder acts in its own right and on its own behalf; issues are discussed and negotiated among the individual Noteholders, who often hold competing views about certain issues, and ultimately agreed to before a position is formally taken by the Noteholders.

Counsel's argument proves too much; the above statement applies with equal force to *ad hoc* committees as well as to the WMI Noteholder Group.

*Ad hoc* committees, due to their unofficial status, are typically a "loose affiliation" of creditors. The at-will nature of committee membership is one of the defining characteristics of *ad hoc* committees. *See* Robert J. Rosenberg, *et al., Ad Hoc Committees and Other (Unofficial) Creditor Groups: Management, Disclosure and Ethical Issues,* ABI Business Reorganization Committee Newsletter (June 2008), *available* at http:// www.abiworld. org/committees/newsletters/ busreorg/vol7num2/AdHoc.pdf (noting that "[b]ecause membership ***275** in an ad *hoc* committee is at will, the roster of members can change frequently and radically over the course of a bankruptcy"). Because membership is at—will, an *ad hoc* committee cannot bind members absent their consent, and generally all members must agree on any position the committee takes.[6] Otherwise, dissenting members will simply leave the committee.

Here, the WMI Noteholders Group possesses virtually all the characteristics typically found in an *ad hoc* committee, save the name. The WMI Noteholders Group consists of multiple creditors holding similar claims. The members of the WMI Noteholders Group filed pleadings and appeared in these chapter 11 cases collectively, not individually. The WMI Noteholders Group retained counsel, which takes its instructions from the Group as a whole. While counsel contends that it speaks only for the members of the WMI Noteholders Group that agree with the filing of each pleading or position taken in each appearance, counsel for the Group has never advised this Court that it is representing less than all the Group. Rather the pleadings and appearances by counsel demonstrate that the Group and counsel represent not each individual member in its individual capacity, but rather the

Group as a whole. In fact, it is the collective $1.1 billion in holdings of the members of the Group that counsel uses to argue in favor of the Group's position, not each individual's separate holding.

Under the plain language of Rule 2019, therefore, the Court finds that although the WMI Noteholders Group call themselves a Group, they are in fact acting as an ad *hoc* committee or entity [7] representing [8] more than one creditor. The WMI Noteholders Group, therefore, must comply with Rule 2019.

B. *Case Law*

The case law supports the Court's conclusion that the WMI Noteholders Group ***276** is an ad *hoc* committee or entity representing more than one creditor and, therefore, covered by Rule 2019. *See In re Northwest Airlines Corp.,* 363 B.R. 701 (Bankr.S.D.N.Y.2007) ("*Northwest I* "). In *Northwest I,* the debtors moved to require an ad *hoc* committee of equity security holders to comply with the disclosure requirements of Rule 2019, including the disclosure of the amount of claims or interests owned by committee members, the time of acquisition, and amounts paid for the interests. *Id.* at 701. The ad *hoc* committee argued that Rule 2019 did not apply because no member of the committee represented any party other than itself and only the law firm appearing on behalf of the committee represented more than one equity security holder. *Id.* at 703. Thus, according to the *ad hoc* committee, only the law firm appearing on behalf of the committee was required to comply with the disclosure requirements of Rule 2019. *Id.*

Judge Gropper disagreed, finding that Rule 2019 applied to the *ad hoc* committee:

> Rule 2019 more appropriately seems to apply to the formal organization of a group of creditors holding similar claims, who have elected to consolidate their collection efforts. That is exactly the situation in this case, except that here there are shareholders rather than creditors. Where an *ad hoc* committee has appeared as such, the committee is required to provide the information plainly required by Rule 2019 on behalf of each of its members.
>
> *Ad hoc* or unofficial committees play an important role in reorganization cases. By appearing as a "committee" of shareholders, the members purport to speak for a group and implicitly ask the court and other parties to give their positions a degree of credibility appropriate to a unified group with large holdings. Moreover, the Bankruptcy Code specifically provides for the possibility of the grant of compensation to "a committee representing creditors or equity security holders other than a committee appointed under section 1102 of this title, in making a substantial contribution in a case under chapter 9 or 11 of this title." 11 U.S.C. § 503(b)(3)(D). A committee purporting to speak for a group obviously has a better chance of meeting the "substantial contribution" test than an individual, as a single creditor or shareholder is often met with the argument that it was merely acting in its own self-interest and was not making a "substantial contribution" for purposes of § 503(b)(3).

*Id.* at 703 (internal quotations and citations omitted).

The WMI Noteholders Group relies on an order entered in the *Scotia Development* case in which the court denied a motion to compel an *ad hoc* noteholder group to comply with Rule 2019, finding the noteholder group was "not a 'committee' within the meaning of Bankruptcy Rule 2019." *In re Scotia Development LLC,* No. 07–20027, 2007 WL 1192137 (Bankr.S.D.Tex. Apr. 18, 2007) (order denying motion to compel Rule 2019 disclosures). However, the order only sets forth the court's conclusion, with no supporting authority or legal reasoning. Accordingly, the Court does not find the *Scotia Development* order persuasive. *See generally, In re Charter Behavioral Health Sys., LLC,* 292 B.R. 36, 39 n. 5 (Bankr.D.Del.2003) (noting the Court "consistently refuse[s] to consider bench rulings ... because they often do not have the benefit of reflection and many times do not articulate all of the reasons behind the decision"). Rather, the Court agrees with the well-reasoned decision of Judge Gropper in *Northwest I* and concludes that Rule 2019 ***277** requires disclosure from the members of the WMI Noteholders Group.

C. *History of Rule 2019*

**[2]** The WMI Noteholders Group argues, however, that the history of Rule 2019 supports its argument that its members should not be required to make the disclosure mandated by that Rule. Generally, legislative history should not be relied upon where the language of a statute or rule is clear. *See Hay Group, Inc. v. E.B.S. Acquisition Corp.,* 360 F.3d 404, 406 (3d Cir.2004) ("The Supreme Court has repeatedly explained that recourse to legislative history or underlying legislative intent is unnecessary when a statute's text is clear and does not lead to an absurd result.") (*quoting United States ex rel. Mistick PBT v. Housing Authority of City of Pittsburgh,* 186

  

F.3d 376, 395 (3d Cir.1999)). Even if the language of Rule 2019 were not clear and unambiguous, however, its history does not support the WMI Noteholders Group's argument.

The disclosure requirements of Rule 2019 have a lengthy history in corporate reorganization cases. The direct antecedent of Rule 2019 was Rule 10–211 under former Chapter X of the Bankruptcy Act, which was adopted following a comprehensive report on committees in corporate reorganizations authored by Professor (later Justice) William O. Douglas in the 1930's. *See* Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees (1937) (hereafter the "SEC Report"). *See also In re Northwest Airlines Corp.,* 363 B.R. 704, 707 (Bankr.S.D.N.Y.2007) ("*Northwest II* ").

Prior to the enactment of Chapter X, reorganization as a practical matter was unavailable under the Bankruptcy Act of 1898. Daniel Bussel, *Coalition–Building Through Bankruptcy Creditors' Committees,* 43 UCLA L.Rev. 1547, 1552 (1996). Absent a statutory reorganization scheme, federal courts created what was known as federal equity receivership. *See* Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States,* 3 Am. Bankr.Inst. L.Rev. 5, 21–22 (1995). Equity receiverships were subject to many abuses, however, which were the subject of the SEC Report.

The WMI Noteholders Group argues that the primary evil which the SEC Report identified (and which Rule 2019 was meant to remedy) was the use of deposit agreements by unofficial committees in equity receiverships (whereby creditors deposited their securities with a designated institution and gave up control of their rights in the reorganization to the committee). *See generally* Evan D. Flaschen and Kurt A. Mayr, *Ad Hoc Committees and the Misuse of Bankruptcy Rule 2019,* 16 Norton J. Bankr.L. & Prac. 6 Art. 3, at 2–3 (2007) (asserting that the predecessor of Rule 2019 was adopted to combat only the abuse of deposit agreements in committee formation); Sparkle L. Alexander, Note, *The Rule 2019 Battle: When Hedge Funds Collide With The Bankruptcy Code,* 73 Brook. L.Rev. 1411, 1420 (2008) ("[I]t is clear that [Rule 2019] was enacted to specifically address abuses by protective committees in the 1930s that solicited deposit agreements from investors."); James M. Shea, Jr., Note, *Who Is at the Table? Interpreting Disclosure Requirements for Ad Hoc Groups of Institutional Investors Under Federal Rule of Bankruptcy Procedure 2019,* 76 Fordham L.Rev. 2561, 2594 (2008) ("Rule 2019 applies to those in fiduciary/agency relationships who are not otherwise under the supervision of the court."); 9 King *et al., Collier on Bankruptcy,* ¶ 2019.01 (15th ed.2009) (noting Rule 2019 "covers entities which act in a fiduciary capacity that are not otherwise ***278** subject to the control of the court," but adding that "[t]he scope of [Rule 2019] is facially broader, however, reaching any entity having multiple representations").

Although this interpretation of history has gained significant support in academic research, it overlooks the significant fact that the SEC Report envisioned a comprehensive legislative scheme to combat a variety of problems related to the committee system in equity receiverships and reorganizations. After a thorough study of the state of reorganization and perceived problems and abuses with equity receiverships, the SEC Report identified several recommendations for improvement, only one of which was the inspiration for what is presently Rule 2019. [9] In addition to the disclosure recommendation which eventually became Rule 2019, however, the SEC Report specifically *recommended the elimination of deposit agreements.* [10]

Thus, history confirms that Rule 2019 was not limited to deposit agreements. The predecessor of Rule 2019 was designed to "provide a routine method of advising the court and all parties in interest of the actual economic interest of all persons participating in the proceedings." SEC Report at 902. The mere fact that the SEC Report made other recommendations to combat different problems does not change the scope or applicability of Rule 2019 to the case at bar.

**[3]** The WMI Noteholders Group contends, however, that the Rule was only intended to apply to "a body that purports to speak on behalf of an entire class or broader group of stakeholders in a fiduciary capacity with the power to bind the stakeholders that are members of such a committee." The WMI Noteholders Group's argument is premised on the erroneous assumption that the Group owes no fiduciary duties to other similarly situated creditors, either in or outside the Group. The case law, however, suggests that members of a class of creditors may, in fact, owe fiduciary duties to other members of the class. *See Young v. Higbee Co.,* 324 U.S. 204, 210, 65 S.Ct. 594, 89 L.Ed. 890 (1945) (finding that stockholders, "by appealing from a judgment which affected a whole class of stockholders owed an obligation to them, the full extent of which we need not now delineate. Certainly, at the very least they owed them an ***279** obligation to act in good faith."); *Official Committee of Equity Security Holders of Mirant Corp. v. The Wilson Law Firm, P.C. (In re Mirant Corp.),* 334 B.R. 787, 793 (Bankr.N.D.Tex.2005) ("It is a well established principle of bankruptcy law that when a party purports to act for the benefit of a class, the party assumes a fiduciary role as to the class.") Indeed, Judge Gropper in *Northwest II,* while not expressly finding that fiduciary duties existed between the members of the *ad hoc* committee and the rest of the class, noted the importance of the relationship between the committee and other similarly situated shareholders:

> By acting as a group, the members of the shareholders' Committee subordinated to the requirement of Rule 2019 their interest in keeping private the prices at which they individually purchased or sold the Debtors' securities. This is not unfair because their negotiating decisions as a Committee *should be based on the interest of the entire shareholders' group, not their individual financial advantage.*

363 B.R. at 708 (emphasis added). It is not necessary, at this stage, to determine the precise extent of fiduciary duties owed but only to recognize that collective action by creditors in a class implies some obligation to other members of that class.

D. *Proposed Amendment of Rule 2019*

Recently efforts have been made to repeal Rule 2019. *See* Letter from Securities Industry and Financial Markets Association and The Loan Syndication and Trading Association to Peter G. McCabe, Secretary, Committee on Rules of Practice and Procedure of the Judicial Conference of the United States 1 (November 30, 2007) (*available at* http://www.uscourts.gov/rules/BK% 20 Suggestions% 202007/07–BK–G–.pdf).

In response, however, the Advisory Committee has recommended changes to the Rule that require more, rather than less, disclosure. The proposed amended Rule would still require that "every entity, group, or committee that consists of or represents more than one creditor or equity security holder and, unless the court directs otherwise, every indenture trustee," make certain disclosures. The Rule, however, has expanded the disclosures required to include information of the parties' "disclosable economic interest" which is "intended to be sufficiently broad to cover any economic interest that could affect the legal and strategic positions a stakeholder takes in a chapter 9 or chapter 11 case." Report of the Advisory Committee on Bankruptcy Rules, Appendix B, Committee Notes to Rule 2019 (May 11, 2009) (*available* at http://www.uscourts.gov/rules/proposed0809/BK_Rules_Forms_Amendments.pdf).

Although much has changed in the financial universe since 1937, concerns regarding the actual economic interests of creditors participating in bankruptcy cases still exist. The proliferation of short-selling and the advent of myriad derivative products now allow creditors to take multiple stakes in the capital structure of debtors. Such varied holdings have the potential to create complex, conflicting incentives for large creditors. In addition, collective action by creditors through the use of *ad hoc* committees or groups allows creditors to utilize other group members' holdings to obtain a greater degree of influence in a bankruptcy case than single creditors acting alone. As such, the policies behind the disclosure requirements of Rule 2019 are as relevant today as they were 70 years ago.

The implications of creditors holding claims at different levels of the debtors' capital structure is an issue that has risen ***280** to prominence in recent years. *See* James M. Shea, Jr., Note, *Who Is at the Table? Interpreting Disclosure Requirements for Ad Hoc Groups of Institutional Investors Under Federal Rule of Bankruptcy Procedure 2019,* 76 Fordham L.Rev. 2561, 2622 (2008) (noting that "one major issue in both [the *Adelphia* and *Northwest* ] cases was the cross-structure holdings of the investors involved in ad hoc groups because these cross-structure holdings were believed to influence the positions taken by the parties"); Kevin J. Coco, *Empty Manipulation: Bankruptcy Procedure Rule 2019 and Ownership Disclosure in Chapter 11 Cases,* 2008 Colum. Bus. L.Rev. 610, 619–22 (2008) (discussing various hypothetical scenarios where a creditor's net economic interest is in conflict with its position as a creditor in the bankruptcy case); Henry T.C. Hu & Bernard S. Black, *Equity and Debt Decoupling and Empty Voting II: Importance and Extensions,* 156 U. Pa. L.Rev. 625, 728–35 (2008) (noting the theoretical possibility of the "empty creditor" scenario in bankruptcy cases where a creditor appears to hold a substantial claim but really has no interest at stake); Stephen

  

J. Lubben, *Credit Derivatives and the Future of Chapter 11*, 81 Am. Bankr.L.J. 405, 407 (2007) (stating issues in chapter 11 cases arise when creditors no longer have motivation to act as such). The proliferation of complex financial instruments results in a situation where, although a creditor is nominally a member of a certain class of creditors through ownership of securities in that class, the creditor may in fact have a total economic interest adverse to the class as a whole.

While this possibility is a strong argument in favor of disclosure of the total economic interest of *all* creditors, the unique problems associated with collective action by creditors through *ad hoc* committees or groups requires disclosure for those groups in particular. Collective action of creditors through the use of an ad *hoc* committee or group is a form of leverage, wherein the parties utilize other group members' holdings to obtain a greater degree of influence on the case. This enables theoretically better returns than if creditors were to act individually in a case. This is especially true, for example, where a group or committee controls one-third of a class of claims, which might allow the group to block confirmation of a plan. *See* 11 U.S.C. § 1126(c) (requiring two-thirds in amount voting of a class of creditors to accept a plan).

The Advisory Committee on Bankruptcy Rules recognized the potential problems posed by this and has proposed an amended Rule 2019 to modernize the rule. While existing Rule 2019 may not require the disclosure of all the types of economic interests that exist in the modern financial system, that is not a reason to fail to enforce the existing Rule as written.

IV. *CONCLUSION*

For the reasons set forth above, the Court will grant the Motion of JPM.

An appropriate order is attached.

## ORDER

**AND NOW,** this **2nd** day of **DECEMBER, 2009,** upon consideration of the Motion filed by JPMorgan Chase Bank, National Association and for the reasons set forth in the accompanying Opinion, it is hereby

**ORDERED** that the Motion is **GRANTED.**

**All Citations**

419 B.R. 271, 62 Collier Bankr.Cas.2d 2024, 52 Bankr.Ct.Dec. 141

Footnotes

1 This Opinion constitutes the findings of fact and conclusions of law of the Court pursuant to Rule 7052 of the Federal Rules of Bankruptcy Procedure, which is made applicable to contested matters by Rule 9014 of the Federal Rules of Bankruptcy Procedure.

2 *See* 12 U.S.C. § 1467a.

3 WMB was also subject to regulatory oversight by the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System (the "Fed"), and the FDIC.

4 On November 6, 2008, a notice of appearance was filed by Kasowitz, Benson, Torres & Friedman LLP as co-counsel to the WMI Noteholders Group stating that a list of participants in the WMI Noteholders Group was being provided, although no such statement was attached or filed with the Court.

5 *See* Joinder of the Washington Mutual, Inc., Noteholders Group to the Debtors' Objection to the Motion Pursuant to 11 U.S.C. § 554(b) for an Order to the Debtor in Possession to Abandon Certain Multidistrict Prepetition Derivative Claims Pending in the U.S. District Court for the Western District of Washington (D.I.506); Joinder of the Washington Mutual, Inc., Noteholders Group to Debtors' Objection to Proof of Claim Number 8 Filed by the Internal Revenue Service (D.I.590); Objection by the Washington Mutual, Inc., Noteholders Group to Debtors' Motion Pursuant to Section 105(a) of the Bankruptcy Code and Bankruptcy Rule 9019(a) for Approval of Settlement with JPMorgan Chase Bank, N.A. (D.I.1324); Statement of the Washington Mutual, Inc., Noteholders Group in Opposition to (a) the Motion of Intervenor–Defendant Federal Deposit Insurance Corporation, as Receiver for Washington Mutual Bank, to Stay or Dismiss the Adversary Complaint, and (b) the Motion of Defendant JPMorgan Chase Bank, N.A. for Stay of Debtors' Adversary Proceeding (D.I.1132).

  

6 Of course, *ad hoc* committees may voluntarily agree to formalize their relationship through committee bylaws. In such a situation, membership may cease to be at-will and certain issues may be governed in advance by agreement of the committee members.

7 The Bankruptcy Code defines the term "entity" to include any "person, estate, trust, governmental unit, and United States trustee." 11 U.S.C. § 101(15). The term "person" is defined to include an "individual, partnership, and corporation." 11 U.S.C. § 101(41). By use of the word "includes," the definition of "entity" is non-exclusive. Black's Law Dictionary defines an "entity" as "an organization (such as a business or a governmental unit) that has a legal identity apart from its members." *Black's Law Dictionary* 573 (8th ed.2004). *See also Merriam–Webster's Collegiate Dictionary* 387 (10th ed.1997) (defining "entity" as "(1)(a) being, existence; especially: independent, separate, or self-contained existence (b) the existence of a thing as contrasted with its attributes; (2) something that has separate and distinct existence and objective or conceptual reality"). The WMI Noteholders Group is an "entity" within the meaning of Rule 2019 because it is an organization that has an identity apart from its individual members.

8 Although not defined in the Bankruptcy Code, "representing" requires that one simply act on behalf of another. *See Black's Law Dictionary* 1328 (8th ed.2004) (defining "representative" as "[o]ne who stands for or acts on behalf of another [the owner was the football team's representative at the labor negotiations]. See agent."); *Merriam–Webster's Collegiate Dictionary* 993 (10th ed.1997) (defining "represent" as "to take the place of in some respect [or] to act in the place of or for usually by legal right"). That is exactly the situation here. The WMI Noteholders Group counsel has repeatedly filed papers and made appearances at various hearings representing the constituent members as part of the WMI Noteholders Group.

Accordingly, the WMI Noteholders Group was "representing more than one creditor or equity security holder."

9 The SEC Report recommended:

> Every person who represents more than twelve creditors or stockholders (including committees and indenture trustees) and who appears in the proceedings shall file with the court a sworn statement setting forth the amount of securities or claims owned by him, the dates of acquisition, the amounts paid therefor, and any sales or transfers thereof. Attorneys who appear in the proceedings should be required to furnish similar information respecting their clients. *This will provide a routine method of advising the court and all parties in interest of the actual economic interest of all persons participating in the proceedings.*

SEC Report at 902 (emphasis added). *See also Northwest I,* 363 B.R. at 704 (noting that the purpose of Rule 10–211, and later 2019, is to ensure "disclosure of the 'personnel and activities of those acting in a representative capacity' in order to help foster fair and equitable plans free from deception and overreaching." *(quoting* 13A King *et al., Collier on Bankruptcy,* ¶ 10–211.04 (14th ed.1976))).

10 The SEC Report stated:

> [W]e recommend at this time that with respect to all such reorganizations, legislation be adopted which will provide ... [t]hat deposit agreements be outlawed, except where it may be shown that physical possession of the security is necessary in order to protect adequately the interests of investors; and that the powers contained in deposit agreements, in the cases where their use is authorized, be limited both in duration and in scope to the particular needs of the occasion.

SEC Report at 906.

**End of Document**

# TAB 7

KeyCite Yellow Flag - Negative Treatment
Declined to Follow by In re Olde Prairie Block Owner, LLC, N.D.Ill., September 30, 2011

16 F.3d 552
United States Court of Appeals,
Third Circuit.

In re SWEDELAND DEVELOPMENT GROUP, INC., Debtor.
The RESOLUTION TRUST CORPORATION, as Conservator of Carteret Federal Savings Bank
v.
SWEDELAND DEVELOPMENT GROUP, INC.; Haylex Acquisition Company; Unsecured Creditors Committee; First Fidelity Bank, National Association.
Swedeland Development Group, Inc., Appellant.

No. 92–5552.
|
Argued June 7, 1993.
|
Decided Feb. 25, 1994.

**Synopsis**

Chapter 11 debtor-in-possession filed motion for authorization to obtain postpetition loans on superpriority basis. Mortgagee filed motion for relief from automatic stay. The United States Bankruptcy Court for the District of New Jersey granted debtor-in-possession's motions, but denied mortgagee's motion. Mortgagee appealed. The District Court, Dickinson R. Debevoise, denied debtor-in-possession's motion to dismiss appeals, reversed bankruptcy court's orders, and remanded. Debtor-in-possession appealed. A panel of the Court of Appeals reversed and remanded. Subsequently, the Court of Appeals, 9 F.3d 11, granted rehearing en banc, vacating the panel's opinion and judgment. The Court of Appeals, Greenberg, Circuit Judge, held that: (1) appeal from one postpetition financing authorization order was moot, but appeal from another authorization order was not moot; (2) mortgagee was not provided adequate protection, and, thus, superpriority postpetition financing should not have been authorized; and (3) debtor-in-possession did not make showing that effective reorganization was in prospect, and, thus, mortgagee was entitled to relief from automatic stay.

District court affirmed in part, vacated in part, and remanded.

West Headnotes (26)

[1] **Bankruptcy** Finality

Bankruptcy court order denying mortgagee relief from automatic stay was not interlocutory, but, rather, was final and appealable to district court. 28 U.S.C.A. § 158(a).

1 Cases that cite this headnote

[2] **Bankruptcy** Conclusions of law; de novo review

**Bankruptcy** Particular cases and issues

Plenary review would be exercised by Court of Appeals with respect to district court orders, which reversed bankruptcy court orders granting Chapter 11 debtor-in-possession's motions for superpriority postpetition financing and denying mortgagee's application for relief from automatic stay; thus, in effect, Court of Appeals would review bankruptcy court's findings with respect to whether mortgagee had adequate protection and whether mortgagee should be granted relief from automatic stay under clearly erroneous standard. Bankr.Code, 11 U.S.C.A. §§ 362(d), 364(d)(1).

11 Cases that cite this headnote

[3] **Bankruptcy** Effect of want of stay; conclusiveness of sale

Dismissal of appeal of order granting authorization for superpriority postpetition financing is not required merely because prepetition creditor does not obtain stay of that order, pursuant to Bankruptcy Code section providing that reversal or modification on appeal of authorization to obtain credit or incur debt, or of grant of priority or lien, does not affect validity of debt or any priority or lien so granted unless such authorization and incurring of such debt, or granting of such priority or lien, were stayed pending appeal. Bankr.Code, 11 U.S.C.A. § 364(d, e).

6 Cases that cite this headnote

[4] **Bankruptcy** Effect of want of stay; conclusiveness of sale

Although disbursement of postpetition loan authorized by bankruptcy court creates superpriority lien insulated from effects of modification or reversal on appeal absent stay, appeal from authorization order following disbursement is not necessarily moot in absence of stay. Bankr.Code, 11 U.S.C.A. § 364(d, e).

2 Cases that cite this headnote

[5] **Bankruptcy** Moot questions

In determining whether prepetition mortgagee's appeal from bankruptcy court order authorizing superpriority postpetition financing for Chapter 11 debtor-in-possession was moot, district court was required to consider whether prepetition mortgagee could obtain effective relief on appeal even though superpriority status of postpetition lenders' loans had to be preserved. Bankr.Code, 11 U.S.C.A. § 364(d, e).

2 Cases that cite this headnote

[6] **Bankruptcy** Effect of want of stay; conclusiveness of sale

Bankruptcy Code section stating that, absent stay pending appeal, authorization for postpetition financing is not subject to reversal or modification on appeal, should not be understood to protect postpetition lender with respect to money it has not disbursed. Bankr.Code, 11 U.S.C.A. § 364(d, e).

1 Cases that cite this headnote

[7] **Bankruptcy** Moot questions

Prepetition mortgagee's appeal from bankruptcy court order granting authorization for superpriority postpetition financing for Chapter 11 debtor-in-possession was not moot at time of district court's reversal of that order, even though mortgagee had not obtained stay pending appeal, where not all loan proceeds had been disbursed, and, thus, mortgagee could be granted effective relief simply by district court prohibiting postpetition lender from making further advances. Bankr.Code, 11 U.S.C.A. § 364(d, e).

9 Cases that cite this headnote

[8] **Bankruptcy** Credit with priority or security

Reversal of bankruptcy court order authorizing superpriority postpetition financing will not necessarily in every case lead to barring of all further disbursements to debtor by postpetition lender, since it is possible that lender's initial disbursement might have left particular facility uncompleted so that additional funds would be required to protect disbursement made before reversal. Bankr.Code, 11 U.S.C.A. § 364(d, e).

2 Cases that cite this headnote

[9] **Bankruptcy** Moot questions

Prepetition mortgagee's appeal from bankruptcy court order authorizing superpriority postpetition financing for Chapter 11 debtor-in-possession was moot, where proceeds of loan had been immediately distributed to debtor-in-possession, mortgagee had not obtained stay pending appeal, and it appeared that debtor-in-possession had expended entire loan proceeds. Bankr.Code, 11 U.S.C.A. § 364(d, e).

3 Cases that cite this headnote

[10] **Bankruptcy** Moot questions

Existence of interest reserve for postpetition financing did not provide basis to find that prepetition mortgagee's appeal from bankruptcy court order authorizing postpetition financing was not moot notwithstanding disbursement of loan proceeds and mortgagee's failure to obtain stay pending appeal, where reserve was established for postpetition lender's benefit, and voiding reserve upon reversal of authorization would impair postpetition lender's security. Bankr.Code, 11 U.S.C.A. § 364(d, e).

1 Cases that cite this headnote

[11] **Bankruptcy** Cause; Grounds and Objections

Prepetition lender can be granted relief from automatic stay only if predicates for lifting stay set forth in Bankruptcy Code provision on relief from stay are satisfied. Bankr.Code, 11 U.S.C.A. § 362(d).

1 Cases that cite this headnote

[12] **Bankruptcy** Moot questions

Possibility that prepetition mortgagee could be granted relief from automatic stay did not provide basis for finding that mortgagee's appeal from bankruptcy court order authorizing superpriority postpetition financing for Chapter 11 debtor-in-possession was not moot notwithstanding disbursement of loan proceeds and mortgagee's failure to obtain stay pending appeal, since, if mortgagee was entitled to relief from stay, its right to relief would not be dependent on reversal of postpetition financing authorization order. Bankr.Code, 11 U.S.C.A. §§ 362(d), 364(d, e).

8 Cases that cite this headnote

[13] **Bankruptcy** Proceedings

Debtor seeking authorization for superpriority postpetition financing has burden to establish that holder of prepetition lien to be subordinated has adequate protection. Bankr.Code, 11 U.S.C.A. § 364(d)(1).

6 Cases that cite this headnote

[14] **Bankruptcy** Indubitable equivalent; replacement lien

**Bankruptcy** Obtaining Credit

**Bankruptcy** Adequate protection requirement

**Bankruptcy** Adequate protection; sale free of liens

Under Bankruptcy Code section stating that adequate protection may be provided by periodic cash payments, additional or replacement liens, or other relief resulting in "indubitable equivalent" of secured creditor's interest in such property, the last possibility is regarded as "catch all," allowing courts discretion in fashioning protection provided to secured party. Bankr.Code, 11 U.S.C.A. § 361.

24 Cases that cite this headnote

[15] **Bankruptcy** Credit with priority or security

Determination of whether there is adequate protection for prepetition lienholder so as to allow superpriority postpetition financing is made on case-by-case basis. Bankr.Code, 11 U.S.C.A. §§ 361, 364(d)(1).

[16] **Bankruptcy** Credit with priority or security

Among ways that debtor may demonstrate existence of adequate protection for prepetition lienholder so as to permit superpriority postpetition financing is by supplying lienholder with new third-party guaranty or with substitute collateral; however, third-party guaranty will not be sufficient in all cases, since sufficiency of guaranty will depend, inter alia, on financial strength of guarantor. Bankr.Code, 11 U.S.C.A. §§ 361, 364(d)(1).

2 Cases that cite this headnote

[17] **Bankruptcy** Credit with priority or security

Proposal for adequate protection of prepetition secured creditor as part of superpriority postpetition financing arrangement should provide prepetition creditor with same level of protection it would have had if there had not been superpriority postpetition financing. Bankr.Code, 11 U.S.C.A. §§ 361, 364(d)(1).

12 Cases that cite this headnote

[18] **Bankruptcy** Credit with priority or security

Requirement that money in cash collateral account be turned over to prepetition mortgagee did not provide mortgagee with adequate protection so as to allow superpriority postpetition financing, where bankruptcy court previously had granted mortgagee a lien on postpetition proceeds, and, thus, mortgagee already was entitled to that money. Bankr.Code, 11 U.S.C.A. §§ 361, 364(d)(1).

[19] **Bankruptcy** Credit with priority or security

Requirement that Chapter 11 debtor-in-possession pay to prepetition mortgagee future release prices for every unit it sold in mortgaged development did not provide basis for finding that mortgagee would be adequately protected following authorization of superpriority postpetition financing; proposal actually reduced amount that mortgagee was entitled to receive under mortgage from sale of each housing unit, and fact that development's golf course was not to be sold did not justify reduction, since golf course already was subject to mortgagee's lien. Bankr.Code, 11 U.S.C.A. §§ 361, 364(d)(1).

1 Cases that cite this headnote

[20] **Bankruptcy** Credit with priority or security

Prepetition mortgagee was not adequately protected, so as to permit superpriority postpetition financing, through increased value of mortgaged development through contemplated continuing construction, where evidence did not establish that property had increased in value to compensate mortgagee for loss of its priority; there was testimony that discounting of projected eight-year cash flow to present value did not show that mortgagee's interest had been increased by amount of postpetition financing. Bankr.Code, 11 U.S.C.A. §§ 361, 364(d)(1).

6 Cases that cite this headnote

[21] **Bankruptcy** Credit with priority or security

Continued construction based on projections and improvements to property does not alone constitute adequate protection for prepetition secured creditor so as to permit superpriority postpetition financing. Bankr.Code, 11 U.S.C.A. §§ 361, 364(d)(1).

15 Cases that cite this headnote

[22] **Bankruptcy** Credit with priority or security

Continued existence of personal guaranties and mortgage on Chapter 11 debtor-in-possession's property did not constitute adequate protection for prepetition mortgagee so as to permit superpriority postpetition financing, since mortgagee was entitled to mortgage and guaranties anyway. Bankr.Code, 11 U.S.C.A. §§ 361, 364(d)(1).

1 Cases that cite this headnote

[23] **Bankruptcy** Credit with priority or security

Prepetition secured creditor, particularly one undersecured by many millions of dollars, may not be adequately protected when superpriority lien for postpetition financing is created without provision of additional collateral by debtor. Bankr.Code, 11 U.S.C.A. §§ 361, 364(d)(1).

15 Cases that cite this headnote

[24] **Bankruptcy** Necessity for reorganization or rehabilitation

When there was no equity in mortgaged property, Chapter 11 debtor-in-possession had burden to prove that property was necessary to effective reorganization to maintain automatic stay. Bankr.Code, 11 U.S.C.A. § 362(d).

8 Cases that cite this headnote

[25] **Bankruptcy** Unlikelihood of reorganization; lack of plan

Chapter 11 debtor-in-possession did not make showing that effective reorganization was in prospect, and, thus, mortgagee was entitled to relief from automatic stay, where debtor had fallen short on sales projections, debtor indicated that it could not obtain any financing except on superpriority basis, net present cash flow was insufficient to satisfy mortgagee's secured claim, debtor could not receive necessary affirmative vote of class of unsecured creditors without mortgagee's acceptance of plan, and mortgagee asserted that it would oppose any proposed plan. Bankr.Code, 11 U.S.C.A. § 362(d).

20 Cases that cite this headnote

[26] **Bankruptcy** Unlikelihood of reorganization; lack of plan

Debtor cannot achieve effective reorganization, and thereby preclude secured creditor from obtaining relief from automatic stay, by diminishing value of its prepetition creditor's lien interest. Bankr.Code, 11 U.S.C.A. § 362(d).

6 Cases that cite this headnote

**Attorneys and Law Firms**

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Argued June 7, 1993.

Before GREENBERG, NYGAARD, and LEWIS, Circuit Judges.

Reargued in banc Feb. 2, 1994.

Before SLOVITER, Chief Judge, and BECKER, STAPLETON, MANSMANN, GREENBERG, HUTCHINSON, SCIRICA, COWEN, NYGAARD, ALITO, ROTH, and LEWIS, Circuit Judges.

**OPINION OF THE COURT**

GREENBERG, Circuit Judge.

**I. INTRODUCTION**

Swedeland Development Group, Inc., a debtor in possession under Chapter 11 of the Bankruptcy Code, appeals from a district court order entered on September 17, 1992, which reversed three orders of the bankruptcy court. Two of the orders of the bankruptcy court authorized Swedeland to obtain post-petition loans on a superpriority basis pursuant to 11 U.S.C. § 364(d)(1) for use in construction of Swedeland's golf course and residential development. The third order denied an application by Carteret Federal Savings Bank, [1] Swedeland's principal prepetition creditor, for relief from the automatic stay which arose when Swedeland filed its Chapter 11 petition. Carteret sought relief pursuant to 11 U.S.C. § 362(d) so that it could foreclose on Swedeland's assets on which it held a mortgage securing Swedeland's indebtedness.

***556** Swedeland argued in the district court that Carteret's appeals from the orders authorizing the loans on a superpriority basis should be dismissed, as pending the appeals Carteret had not obtained a stay of the orders authorizing the loans as provided in 11 U.S.C. § 364(e). But the district court rejected that argument and decided the appeals on the merits. We agree with Swedeland that the appeal from one of the bankruptcy court orders authorizing a post-petition loan was moot in the district court and should have been dismissed, but we determine that the appeal from the other order was not moot. We further conclude that the district court correctly held that the bankruptcy court erred in entering the non-moot order authorizing a post-petition loan. Finally, we agree with the district court that the bankruptcy court erred in denying Carteret relief from the automatic stay. Consequently, to the extent that the district court should have dismissed the appeal, we will vacate its order, but we otherwise will affirm the order of the district court.

## II. BACKGROUND

This case arises from Swedeland's development of a 508–acre golf course and residential project located in Hardystown Township, Sussex County, New Jersey, and known as Crystal Springs. Swedeland acquired the property in April 1989 and began construction later that year. The plans for the project included homes, a golf course, tennis courts, and an infrastructure such as roads and sewers. The golf course with its clubhouse opened on Memorial Day in 1991.

The project was very large and required substantial financing for acquisition of the property and construction of the improvements. Carteret supplied the financing through a series of loans totaling $37,000,000.[2] For security, Carteret obtained a first mortgage on Swedeland's real estate in the Crystal Springs project, personal guarantees from Swedeland's principals, and a mortgage on real estate Swedeland owned which was located in Jefferson Township, Morris County, New Jersey, and known as the Bowling Green Golf Course. The terms of the Carteret–Swedeland loan provided for the first $42,100 from the sale of each residential unit at Crystal Springs to be paid to Carteret, $12,100 to be applied to the loan for the Crystal Springs Golf Course and the balance to be applied to the other acquisition and construction loans.

Unfortunately, the project ran into financial difficulty which led Swedeland to seek additional financing from Carteret in April 1991. But Carteret was barred from granting that financing by restrictions in the Financial Institutions Reform, Recovery and Enforcement Act of 1989. Carteret, however, permitted Swedeland to use $2,250,000 from a collateral security escrow account established pursuant to the Swedeland–Carteret loan agreement to cure Swedeland's potential monetary defaults.

Apparently this additional financing was insufficient, for on August 2, 1991, Swedeland filed a petition under Chapter 11 in which it showed its debt to Carteret as being slightly in excess of $36,000,000. While Carteret contends that somewhat more was due, we are not concerned with the difference as it is undisputed that Carteret's security has been valued at all times since the filing of Swedeland's Chapter 11 petition at far less than Swedeland's debt to it. Indeed, the parties have accepted an appraisal obtained by Carteret, stating that the value of the Crystal Springs property is $18,495,000. When Swedeland filed the petition, 900 residential units remained to be built. Following the filing of the petition and a series of hearings, the bankruptcy court allowed Swedeland, over Carteret's objections, to use Carteret's cash collateral for operating expenses pursuant to 11 U.S.C. § 363. This cash collateral was derived from the proceeds of sales of units in the development.

Not surprisingly, in the fluid situation presented by the ongoing construction of a major real estate project, events moved rapidly in the bankruptcy court. Swedeland filed a motion pursuant to 11 U.S.C. § 364(d)(1) to ***557** obtain working capital and construction financing on a superpriority basis from Haylex Acquisition Company, L.P. for construction of the development. Section 364(d)(1) provides that the court, after notice and hearing "may authorize the obtaining of credit or the incurring of debt secured by a senior or equal lien on property of the estate that is subject to a lien only if": (1) the trustee is unable to obtain such credit otherwise, and (2) "there is adequate protection of the interest of the holder of the lien on the property of the estate on which such senior or equal lien is proposed to be granted." Such financing would, of course, have subordinated Carteret's lien to a lien securing Haylex's loan. Swedeland justified its motion by urging that the Crystal Springs Golf Course would generate a positive cash flow, the residential units could be completed and sold, and the completion of the project by the end of the century would result in Carteret being paid in full. Thus, Swedeland argued that Carteret was adequately protected.

While Carteret seems not to have contended that Swedeland could obtain the post-petition financing without the creation of a superpriority lien, it nevertheless opposed Swedeland's application for authority to obtain the Haylex loan, as it disputed the assumptions underlying the application. In addition, Carteret sought relief from the automatic stay so it could foreclose on its mortgage. The bankruptcy court held an evidentiary hearing on the cross-applications, and on March 6, 1992, authorized Swedeland to borrow $840,000 from Haylex on a superpriority basis. On March 9, 1992, the bankruptcy court denied Carteret's motion for relief from the automatic stay, concluding that Carteret was adequately protected since there was a reasonable possibility that Swedeland could reorganize successfully. *See* 11 U.S.C. § 362(d). Carteret appealed to the district court from the orders of March 6 and March 9, 1992, and unsuccessfully sought a stay of the March 6 order from both the bankruptcy court and the district court. Following denial of the stay, Haylex disbursed its loan in full to Swedeland which has expended the funds.

Prior to the entry of the above orders, Swedeland had filed an application to obtain other superpriority financing from First Fidelity Bank. Once again, Swedeland was successful and on April 10, 1992, the bankruptcy court authorized it to borrow up to $3,160,000 from First Fidelity on a revolving basis. Though Carteret appealed from that order, it did not seek to have it stayed pending the appeal. The parties agree that First Fidelity has disbursed some, but not all, of its loan as authorized by the April 10, 1992 order. We understand that the Haylex funds were used for working capital and the First Fidelity funds were used for construction.

The district court, exercising jurisdiction under 28 U.S.C. § 158(a), reversed the three bankruptcy court orders in a comprehensive memorandum opinion dated September 16, 1992. In its discussion, the district court first dealt with Swedeland's argument, advanced in a motion to dismiss Carteret's appeals, that the appeals from the orders of March 6 and April 10, 1992, authorizing the Haylex and First Fidelity loans were moot. Swedeland predicated this motion principally on 11 U.S.C. § 364(e) which provides as follows:

> The reversal or modification on appeal of an authorization under this section to obtain credit or incur debt, or of a grant under this section of a priority or a lien, does not affect the validity of any debt so incurred, or any priority or lien so granted, to an entity that extended such credit in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and the incurring of such debt, or the granting of such priority or lien, were stayed pending appeal.

Swedeland reasoned that the appeals were moot as the district court could not alter the priority of the Haylex and First Fidelity liens because Carteret did not obtain a stay of either financing order pending appeal.

The district court, however, rejected the mootness argument, observing that the plain language of 11 U.S.C. § 364(e) provided that orders under 11 U.S.C. § 364(d) are subject to "reversal or modification on appeal." Thus, it determined that while section 364(e) ***558** limited "the relief available in the absence of a stay by protecting the validity of any debt incurred and the priority of any lien granted to a good faith lender under Section 364(d), it does not prohibit appeals of orders granted." The district court cited *Miami Center Ltd. Partnership v. Bank of New York,* 820 F.2d 376, 379 (11th Cir.1987), *cert. denied,* 488 U.S. 823, 109 S.Ct. 69, 102 L.Ed.2d 46 (1988), and *In re AOV Indus., Inc.,* 792 F.2d 1140, 1147 (D.C.Cir.1986), in support of this holding.

The court next stated that if "a reviewing court is able to provide effective relief, the mootness doctrine simply does not apply." The court then indicated, recognizing that it intended to remand the matter, that the bankruptcy court, subject to the limitations in section 364(e) protecting the interests of a post-petition lender when a stay has not been granted, might grant relief in various ways. Thus, the district court stated that relief might be granted enjoining Swedeland from utilizing any proceeds of the loans, ordering it to return funds it borrowed, prohibiting First Fidelity from making additional advances, voiding the interest reserves established under the financing orders, voiding Haylex's and First Fidelity's future obligations, granting Carteret relief from the automatic stay, and granting any further relief as may be just and proper.

The district court next addressed the March 6 and April 10, 1992 orders on the merits, in particular considering whether Carteret had adequate protection as required by section 364(d). The court recognized that the bankruptcy court's conclusion that Carteret had adequate protection was a factual finding which it thus reviewed using the deferential clearly erroneous standard. *See In re O'Connor,* 808 F.2d 1393, 1397 (10th Cir.1987). Ultimately the district court held that the bankruptcy court's conclusions were clearly erroneous "because [they] rested on the conferral of benefits upon Carteret to which Carteret was already entitled, and because the build-out does not contain the kind of assurance necessary under the Bankruptcy Code and the cases to constitute adequate protection."

Finally the district court addressed Carteret's appeal from the order denying relief from the automatic stay. The court noted that under 11 U.S.C. § 362(d)(2), Carteret could obtain relief from the automatic stay if Swedeland did not have equity in the property and the property was not necessary to an effective reorganization. Obviously, Swedeland had no equity as its obligation to Carteret was approximately double the

Crystal Springs appraisal value of $18,495,000. The court, after recognizing that there was no equity, indicated that there "is no evidence in the record that an effective reorganization is in progress." Consequently, it concluded that the bankruptcy court's decision denying relief from the automatic stay was clearly erroneous. [3]

In accordance with its opinion, on September 17, 1992, the district court entered an order denying Swedeland's motion to dismiss Carteret's appeals from the financing orders and reversing the orders of March 6, March 9, and April 10, 1992. The district court remanded the case to the bankruptcy court to grant Carteret relief consistent with the district court's opinion "taking into account the circumstances as they may exist at the time such relief is granted." By a supplemental letter of September 23, 1992, the district court indicated that the "superpriority liens perfected prior to the date of the reversal of the Bankruptcy Court's order providing for such liens remain in effect." Accordingly, the court stated that vacation of the bankruptcy court's orders "should only affect creation of future superpriority liens and would not impair vested rights already in existence."

Swedeland appealed to this court from the district court's order of September 17, 1992, and it then moved for a stay of that order. The district court granted the stay, but only to the extent of allowing First Fidelity to ***559** advance funds for the completion of the 19 residential units then under construction. The balance of the First Fidelity funds could not be advanced. Accordingly, we calculate that Swedeland has not constructed approximately 881 units projected for the development.

**[1]** **[2]** We have jurisdiction under 28 U.S.C. § 158(d). [4] We exercise plenary review over all aspects of the district court's orders. In effect, we therefore review the bankruptcy court's findings with respect to whether Carteret had adequate protection and whether Carteret should be granted relief from the automatic stay under the clearly erroneous standard. *See In re Sharon Steel Corp.,* 871 F.2d 1217, 1222–23 (3d Cir.1989); *Resyn Corp. v. United States,* 851 F.2d 660, 664 (3d Cir.1988).

## III. DISCUSSION

**1.** ***Mootness***

**[3]** Initially we observe that we are concerned in this case with mootness predicated on statutory and prudential considerations. [5] *See In re AOV Indus., Inc.,* 792 F.2d at 1147. Thus, we start our discussion by referring to section 364(e), the source of Swedeland's mootness argument. That section does not, in itself, suggest that an appeal from an order authorizing the creation of a superpriority lien under section 364(d) should be dismissed by reason of mootness when an appellant fails to obtain a stay pending an appeal. Indeed, section 364(e) never mentions that an appeal may be dismissed if a stay is not obtained.

In fact, we draw the exact opposite inference from section 364(e), for it provides that the "reversal or modification on appeal of an authorization under this section to obtain credit or incur debt, or of a grant under this section of a priority or a lien, does not affect the validity of [the] debt ... or any priority or lien so granted ... unless such authorization and the incurring of such debt, or the granting of such priority or lien, were stayed pending appeal." While the section only protects "an entity that extended such credit in good faith," this requirement is not germane to a mootness analysis turning on an appellant's failure to obtain a stay pending appeal. Furthermore, Carteret challenges neither Haylex's nor First Fidelity's good faith.

Thus, it seems to us that there is no escape from the logic that inasmuch as section 364(e) provides for the consequences of the reversal or modification of an order under section 364(d) when the order has not been stayed pending appeal, it is impossible to conclude that section 364(e) in itself requires that an appeal be dismissed if a stay is not obtained. After all, neither Swedeland nor anyone else can explain how there can be a "reversal or modification" of an order, if the appeal from the order has been dismissed.

**[4]** Yet this exercise in logic is not dispositive of the mootness issue for even though section 364(e) standing alone does not require dismissal of an appeal when a stay is not granted, it might establish circumstances which under law other than section 364(e) require dismissal of the appeal. Thus, in our consideration of the mootness argument we cannot limit our inquiry to an examination of section 364(e). In expanding our mootness analysis we start with ***560** *Church of Scientology v. United States,* 506 U.S. 9, ——, 113 S.Ct. 447, 450, 121 L.Ed.2d 313 (1992), in which the Supreme Court emphasized that an appeal is not to be dismissed as moot merely because a court cannot restore the parties to the *status quo ante.* Rather, when a court can fashion "*some* form of meaningful relief," even if it only partially redresses the grievances of the prevailing party, the appeal is not moot.

*Id.* (emphasis in original). *See also General Elec. Co. v. Cathcart,* 980 F.2d 927, 934 (3d Cir.1992) (" 'an appeal will be dismissed as moot when events occur during [its] pendency ... which prevent the appellate court from granting *any* effective relief ' ") (emphasis added) (quoting *In re Cantwell,* 639 F.2d 1050, 1053 (3d Cir.1981)). Thus, it is evident that although the disbursement of a loan under a section 364(d) order creates a superpriority lien insulated from the effects of a modification or reversal on appeal absent a stay, an appeal from the section 364(d) order following the disbursement is not necessarily moot in the absence of a stay.

**[5]** Accordingly, the district court took precisely the correct approach when it recognized that a mootness analysis required it to consider whether Carteret could obtain effective relief even though the superpriority status of Haylex's and First Fidelity's loans had to be preserved. In exercising our plenary review, we will take the same approach.

We initially consider the First Fidelity loan. It is undisputed that some, but not all, of that loan had been disbursed before the district court reversed the April 10, 1992 order, and Carteret acknowledges that to the extent that the loan was disbursed, the validity of the debt incurred and the priority of the superpriority lien securing it cannot be affected. The argument as to that loan centers on the undisbursed funds. Swedeland contends that it may draw down those funds, and, if it does, First Fidelity will have a priority over Carteret as to all the funds First Fidelity disburses. As Swedeland sees the situation, the appeal to the district court was therefore moot because the district court could not affect any portion of the First Fidelity loan as authorized by the bankruptcy court. Thus, according to Swedeland, the district court should not have decided the appeal on the merits. This point is critical for if Swedeland is successful in its argument, it will have access to additional funds so that it can attempt to continue the project.

Swedeland explains that section 364(e) supports its argument, as it must be construed to protect post-petition lenders as to all disbursed or projected loans authorized by the section 364(d) order, unless the order is stayed pending appeal. [6] Therefore it urges that even though section 364(e) does not mention the dismissal of an appeal it has that effect. Swedeland contends that post-petition lenders must be given this protection as they will not want to complete only a portion of a loan transaction. If we accept the analysis that a post-petition lender must be protected as to its entire contemplated loan, we would be holding that while section 364(e) *in terms* would not require a dismissal of an appeal if a stay is not granted, the relief which could be granted upon reversal of a section 364(d) order would be limited greatly, at least when an initial disbursement is made. [7] Our acceptance of the argument, ***561** however, would not necessarily moot the appeal for, as our analysis below of the Haylex order demonstrates, the court might nevertheless be able to grant Carteret some effective relief upon reversal of the 364(d) order.

**[6]** But we reject Swedeland's contention. There is, of course, no doubt that, as set forth in *Matter of EDC Holding Co.,* 676 F.2d 945, 947 (7th Cir.1982), section 364(e):

> seek[s] to overcome people's natural reluctance to deal with a bankrupt firm whether as purchaser or lender by assuring them that so long as they are relying in good faith on a bankruptcy judge's approval of the transaction they need not worry about their priority merely because some creditor is objecting to the transaction and is trying to get the district court or the court of appeals to reverse the bankruptcy judge.

Yet we see no reason why section 364(e) should be understood to protect a lender with respect to money it has not disbursed. Surely if a section 364(d) order is reversed and thereafter the lender makes no further disbursements, the lender does not need protection for the funds which it has retained. At most, the lender has lost the expectation of making a loan on terms which it has found acceptable.

We acknowledge that a lender might be disappointed in its expectations by a reversal of a section 364(d) order but there is nothing unusual in such frustration. In other contexts, a lender that has given a loan commitment could be frustrated in its expectations if the borrower for any of many reasons does not complete the transaction either before or after taking an initial disbursement. A borrower, among other things, could die, abandon a project, become insolvent, or go bankrupt. Such events are commonplace, and lenders surely recognize that they can happen. In short, we see no reason to rule that upon its first disbursement of funds, First Fidelity acquired such rights that it would be unfair to grant relief to Carteret upon reversal of the April 10, 1992 order.

**[7] [8]** Overall we conclude that application of general mootness principles to the First Fidelity loan clearly establishes that the appeal from that order was not moot when the district court reversed the April 10, 1992 order. In light of our analysis of mootness principles, we hardly could reach any other conclusion as it is obvious that following reversal of the April 10, 1992 order, the court could grant Carteret effective relief simply by prohibiting First Fidelity from making further advances. [8]

We reject any suggestion that our result is unfair. While Swedeland understandably focuses on the rights of the post-petition lenders, who we observe seem not to be overly concerned about their positions as they have not participated in this appeal, a pre-petition lender has rights as well. It does, after all, lend its money on the strength of particular security and it is hardly fair to deprive it of that security. Furthermore, our result is bolstered by the practical consideration that it may be impossible for a pre-petition creditor with a meritorious appeal to obtain a stay of a section 364(d) order. In fact, that is exactly what happened in this case, for while Carteret could not obtain a stay of the March 6, 1992 order from the district court, it later convinced that court to reverse the order.

Though we hold that the appeal from the April 10, 1992 order was not moot in the district court, we acknowledge that there is some support in cases cited by Swedeland from the Courts of Appeals for the Sixth and Ninth Circuits for a contrary holding predicated ***562** on the ground that some of the funds authorized to be lent by that order were disbursed before the reversal. *See In re Adams Apple, Inc.,* 829 F.2d 1484, 1489 (9th Cir.1987); *In re Revco D.S., Inc.,* 901 F.2d 1359, 1364 (6th Cir.1990); and *In re Ellingsen MacLean Oil Co.,* 834 F.2d 599 (6th Cir.1987), *cert. denied,* 488 U.S. 817, 109 S.Ct. 55, 102 L.Ed.2d 33 (1988). [9] We need not, however, analyze these cases in depth because they do not seem to us to address the principle that an appeal is not moot if some meaningful or effective relief can be granted to the appellant even if the parties cannot be returned to the *status quo ante* upon a reversal. *See Church of Scientology v. United States,* 506 U.S. at ——, 113 S.Ct. at 450.

Furthermore, the courts in the above cases have not read section 364(e) as we did above. Thus, after quoting section 364(e) in full, the court in *Revco* indicated: "[t]here is language then, that absent a stay pending appeal, we may not reverse an authorization to obtain credit or incur debts unless the lender did not act in good faith." 901 F.2d at 1363. Similarly, in *Adams Apple* the court, after referring to section 364(e) indicated that: "[a]n appellate court may not reverse the authorization to obtain credit or incur debts under section 364 if the authorization was not stayed pending appeal unless the lender did not act in good faith." 829 F.2d at 1487–88. As we already have set forth, in our view section 364(e) does not preclude a court from reversing an authorization absent a stay. What it limits is the effect of a reversal. [10]

On the other hand, some cases support our result that the appeal from the April 10, 1992 order was not moot in the district court. *See In re Sun Runner Marine, Inc.,* 945 F.2d 1089, 1095 (9th Cir.1991); *Bank of New England v. BWL, Inc.,* 121 B.R. 413, 417 (D.Me.1990); *In re Blumer,* 66 B.R. 109, 113 (Bank.App.Panel, 9th Cir.1986) (mootness for purposes of section 364 is defined as a situation in which "funds have been disbursed to persons who are not parties to the appeal or if failure to obtain a stay has permitted such a comprehensive change as to render it inequitable to consider the merits of the appeal"). While we do not discuss these cases at length, we do point out that in *In re Sun Runner Marine, Inc.,* the court distinguished its earlier opinion in *Adams Apple,* and rejected a post-petition lender's argument that an appeal from a bankruptcy court's order which could have been authorized by section 364 was moot, as it reasoned that the order provided for ongoing financing. 945 F.2d at 1095.

**[9]** Though we hold that the appeal from the April 10, 1992 order was not moot, we reach a different result with respect to the March 6, 1992 order authorizing the Haylex loan. The parties agree that Haylex disbursed the proceeds of that $840,000 loan to Swedeland immediately after the bankruptcy court and district court denied a stay of the March 6, 1992 order. Further, while we have some difficulty in drawing definitive conclusions on this point from the voluminous record, we believe that Swedeland expended the entire proceeds of the Haylex loan for ***563** working capital before the district court reversed the March 6, 1992 order. [11] In these circumstances, the bankruptcy court could not on remand enjoin Swedeland from using the proceeds of the Haylex loan nor could it order Swedeland to return the proceeds, as they were gone. The only other particularized possibilities for relief which the district court mentioned were to void the interest reserve established under the March 6, 1992 order, to void Haylex's future obligations under the order, or to grant Carteret relief from the automatic stay.

**[10]** The interest reserve to which the court referred was established pursuant to paragraph 4 of a letter agreement of February 21, 1992, between Haylex and Swedeland, as amended by a letter agreement of March 3, 1992. This agreement provided that an "interest reserve of $100,000 will be deposited by [Swedeland] to be held by [Haylex's] counsel." While the interest reserve was Swedeland's property, it clearly was established for Haylex's benefit, as upon the happening of certain events, which we need not detail, the reserve could be released to Haylex. In these circumstances, we believe that voiding the reserve would impair the security for which Haylex bargained and thus would be inconsistent with the protection afforded it by section 364(e). Therefore, while we do not doubt that Carteret would obtain effective relief by the voiding of the reserve, in view of section 364(e) it cannot be done.

The district court also suggested that the bankruptcy court on remand could void Haylex's future obligations. While this suggestion may have been legally sound, we find no future obligations in Haylex's agreement with Swedeland that, if voided, would grant effective relief to Carteret. While it certainly would be in Carteret's interest to preclude Haylex from making further advances to Swedeland, by the time the district court ruled, there were none to be made.

**[11]** **[12]** Finally, the district court suggested that Carteret could be granted effective relief upon the reversal of a section 364(d) order if the bankruptcy court granted it relief from the automatic stay. While we do not doubt that such relief would be effective, we nevertheless cannot accept this possibility for we believe that a pre-petition lender can be granted relief from the automatic stay only if the predicates for lifting the stay set forth in section 362(d) are satisfied. If the pre-petition lender establishes that it is entitled to relief from the automatic stay, its right to the relief will not be dependent on a reversal of a section 364(d) order. [12]

In its brief, Carteret vigorously supports the district court's ruling that the appeal from the March 6, 1992 order was not moot in the district court. Yet it makes no specific suggestions as to what meaningful or effective relief the bankruptcy court could afford Carteret upon the reversal of that order. Rather, it simply indicates that the district court found that effective relief could be given. But, as we have indicated, we do not see how that can be done on any basis the district court suggested without either infringing Haylex's protections under section 364(e) or exceeding the court's powers to grant relief following the reversal of a section 364(d) order. Accordingly, we conclude that we must vacate the order of the district court of September 17, 1992, to the extent that it reversed the bankruptcy court's order of March 6, 1992, and we must remand the matter to the district court to dismiss the appeal to it from that order. [13]

**2. *Adequate protection***

Our determination that the appeal from the April 10, 1992 order was not moot in the ***564** district court leads us next to consider the district court's reversal of that order on its merits. As we have indicated, we exercise plenary review of the district court's order which in turn requires us to consider the bankruptcy court's order under the clearly erroneous standard.

Section 364(d)(1) of the Code provides that the bankruptcy court may authorize post-petition financing supported by a superpriority lien only if "there is adequate protection of the interest of the holder of the lien on the property of the estate on which such senior or equal lien is proposed to be granted." Thus, for the bankruptcy court to have approved First Fidelity's lending money to Swedeland on a superpriority basis, the court had to find that Carteret's interests were adequately protected.

**[13]** **[14]** **[15]** A debtor has the burden to establish that the holder of the lien to be subordinated has adequate protection. *See In re Grant Broadcasting of Philadelphia, Inc.,* 71 B.R. 376, 386 (Bankr.E.D.Pa.), *aff'd,* 75 B.R. 819 (E.D.Pa.1987). *See also* 11 U.S.C. § 363(*o* )(1). The Code does not expressly define adequate protection, but section 361 states that it may be provided by (1) periodic cash payments; (2) additional or replacement liens; or (3) other relief resulting in the "indubitable equivalent" of the secured creditor's interest in such property. 11 U.S.C. § 361. The last possibility is regarded as a catch all, allowing courts discretion in fashioning the protection provided to a secured party. Therefore, a determination of whether there is adequate protection is made on a case by case basis. *In re O'Connor,* 808 F.2d at 1397.

**[16]** **[17]** Among the ways a debtor may demonstrate the existence of adequate protection is by supplying the pre-petition lender with a new third-party guaranty or with substitute collateral. [14] These new protections might be sufficient for "[t]he whole purpose of adequate protection for a creditor is to insure that the creditor receives the value for which he bargained prebankruptcy." *Id.* at 1396. Accordingly, a proposal depending upon a pre-petition lender having adequate protection, no matter its form, " 'should as nearly as possible under the circumstances of the case provide the creditor with the value of his bargained for rights.' " *In re Martin,* 761 F.2d 472, 476 (8th Cir.1985) (quoting *In re American Mariner Industries, Inc.,* 734 F.2d 426, 435 (9th Cir.1984)). Whether protection is adequate "depends directly on how effectively it compensates the secured creditor for loss of value" caused by the superpriority given to the post-petition loan. *In re American Mariner,* 734 F.2d at 432. In other words, the proposal should provide the pre-petition secured creditor with the same level of protection it would have had if there had not been post-petition superpriority financing.

The bankruptcy court concluded that Swedeland demonstrated that Carteret had adequate protection based upon four factors: (1) Swedeland would turn over to Carteret approximately $1,250,000 in the cash collateral account; [15] (2) Swedeland would pay Carteret future release prices for every unit it sold; (3) the increased value of the Crystal Springs property due to the continued construction; and (4) the continued existence of Carteret's lien and security interest in the Bowling Green Golf Course and the personal guaranties given by Swedeland's principals. [16] The district court ruled that the bankruptcy court's findings were clearly erroneous because Swedeland offered no new consideration to Carteret to offset its diminution of ***565** interest as a result of the superpriority lien given to First Fidelity. Accordingly, none of the factors the bankruptcy court enumerated showed Carteret had adequate protection. We agree with the district court.

A. *Cash Collateral*

**[18]** The April 10, 1992 order did not provide Carteret with increased protection when it required that the money in the cash collateral account be turned over to Carteret because Carteret was entitled to those monies even without the order. Prior to Swedeland's filing of the Chapter 11 petition, Carteret had a first mortgage on the Crystal Springs property and a lien on the proceeds from the sale of individual residential units. Under the Carteret–Swedeland agreement, Carteret agreed to release its lien on each unit upon the payment by Swedeland of a release price of $42,100 for the unit released. After filing for Chapter 11 protection, Swedeland requested permission to use the cash proceeds from the sale of the units to finance the continued construction of the project. It is these proceeds which we have been terming "the cash collateral." Carteret objected to this application, but the bankruptcy court granted the request.

The bankruptcy court, however, recognized Carteret's liens and granted Carteret a continuing lien and security interest in and to all future sales proceeds and all other assets as adequate protection for allowing Swedeland to use the cash collateral to continue construction until December 31, 1991. Accordingly, Carteret previously had been granted a lien on these post-petition proceeds. Therefore, inasmuch as the bankruptcy court already had recognized and granted Carteret a continuing lien on the cash proceeds, it erred in considering those same proceeds to be additional protection permitting the section 364(d) authorization.

B. *Release Prices*

**[19]** We reiterate that Carteret's mortgage entitled it to be paid the first $42,100 from the sale of each housing unit as a release price, with $30,000 to be applied to the balance due under the construction loan and $12,100 to be applied to the balance due under the golf course loan. In its post-petition proposal, Swedeland produced six scenarios providing for varying release prices, but only two contemplated Carteret being paid $42,100. Averaging the other four situations, Carteret was to be paid only $28,000 from the proceeds of the sale of each unit. Swedeland justified this reduction in the release price by contending that inasmuch as the Crystal Springs Golf Course was not to be sold and would be generating income, it did not have to be adequately protected. Accordingly, Swedeland believed the proposed release prices did not have to take the golf course into account.

The bankruptcy court accepted this proposal to pay reduced release prices on a theory that Swedeland's projections showed that the residential debt could be satisfied. In considering this aspect of the bankruptcy court's decision, the district court indicated that the bankruptcy court "did not explain why the reduced price should be allowed or how the reduced prices would conceivably provide adequate protection to Carteret." While, unlike the district court, we read the bankruptcy court's opinion to set forth an explanation of why the reduced release prices adequately protected Carteret, we reject the explanation. We believe that Swedeland did not provide adequate protection to Carteret by proposing to reduce the payments which would be made to Carteret, particularly in the inherently risky circumstances of this Chapter 11 proceeding.

Furthermore, the reductions in the release price could not be justified on a theory that the Crystal Springs Golf Course was not to be sold. There was nothing new in

Swedeland's undertaking to retain this asset as the original financing agreement between Swedeland and Carteret did not contemplate a sale of the golf course. Instead, it envisioned that Swedeland would own the course and Carteret's lien against it would be released on the sale of each residential unit. We are at a total loss to understand how a court can suggest that a pre-petition creditor with a lien being subordinated to a superpriority lien can be thought to have adequate protection because an asset encumbered by its lien will remain so encumbered. Of course, ***566** Swedeland's argument that the golf course did not have to be adequately protected misses the point for it is the interest of the pre-petition lender, not a particular asset, which must be adequately protected. This principle is demonstrated plainly by the recognition in section 361 that a secured lender may be adequately protected by a replacement lien. At bottom, the record does not support the bankruptcy court's view that the payment of the release price offered Carteret additional protection. Instead Swedeland's proposal placed Carteret in a worse situation than it was in before the Chapter 11 filing.

C. *Increased Value of the Property*

**[20]** The bankruptcy court was also wrong in finding that Carteret derived adequate protection from the increased value of the Crystal Springs project through the contemplated continuing construction. As we have indicated, Carteret presented evidence, which Swedeland did not dispute, that the value of the Crystal Springs property was $18,495,000. Under the superpriority lien awarded to First Fidelity, it obtains $3,160,000 before Carteret receives anything. Thus, the only way to justify First Fidelity's superpriority lien based on the value of the property is to show that somehow Carteret's interest in the collateral ($18,495,000) has been increased by $3,160,000. The bankruptcy court apparently believed that the construction of the development and the potential sales increased the value of the property by this amount.

**[21]** Yet, the evidence does not establish that the property has increased in value to compensate Carteret for the loss of its priority to First Fidelity. In the first place, continued construction based on projections and improvements to the property does not alone constitute adequate protection. *See Town of Westport v. Inn at Longshore,* 32 B.R. 942, 946 (Bankr.D.Conn.1983). Those cases which have considered improvements to be adequate protection have done so only when the improvements were made in conjunction with the debtor's providing additional collateral beyond the contemplated improvements. *See, e.g., In re O'Connor,* 808 F.2d at 1396 (grant of additional, unencumbered collateral); *In re 495 Central Park Avenue Corp.,* 136 B.R. 626 (Bankr.S.D.N.Y.1992) (projected property improvements constituted adequate protection where annual rental income of $180,000 from an existing lease conditioned on improvements would increase value of real estate securing pre-petition loan by at least $800,000, and superpriority post-petition loan financing the projected improvements amounted to only $650,000). We reject the notion that development property is increased in value simply because a debtor may continue with construction which might or might not prove to be profitable.

Neither does the possibility of selling the units show that the value of the property has increased to protect Carteret adequately. [17] Indeed, as the district court pointed out, Swedeland's projections concerning how many units it will sell were belied by its historical performance. Swedeland already had defaulted on the loan to Carteret, the five-month sales projections for the period between August through December 1991 were below expectations, and the cash flow projections upon which the bankruptcy court relied were deficient as they did not provide for a reasonable developer's profit nor discount the projected eight-year cash flow to present value. In fact, the testimony showed that discounting would yield only a net present value of $14,340,303. The district court correctly found that this amount was insufficient to protect Carteret adequately. In this regard, we cannot resist pointing out that we ***567** do not doubt that Swedeland's original projections certainly could not have contemplated that within 28 months of acquiring the Crystal Springs property it would file a Chapter 11 petition.

D. *Personal Guarantees and Mortgage on Bowling Green*

**[22]** Finally, the bankruptcy court erred in concluding that the continued existence of the personal guarantees and the mortgage on the Bowling Green property constituted adequate protection. As with the cash collateral, Carteret was entitled to these anyway. Moreover, the lien on Bowling Green is worth only $6,715,000. Thus, even without the superpriority lien reducing Carteret's interest, this collateral undersecured Carteret.

**[23]** In sum, even under the clearly erroneous standard, the district court correctly rejected the bankruptcy court's finding that there was adequate protection justifying the superpriority financing. It is clear that Swedeland failed to offer anything significant that would adequately protect Carteret. The law does not support the proposition that a creditor, particularly one like Carteret undersecured by many millions of dollars, may be adequately protected when a superpriority lien is created without the provision of additional collateral by the debtor. Based on all the above, the bankruptcy court erred in authorizing the post-petition financing on a superpriority basis.

We cannot close this portion of our opinion without pointing out that what happened here is quite disturbing. There, of course, is no doubt that the policy underlying Chapter 11 is quite important. Nevertheless, Congress did not contemplate that a creditor could find its priority position eroded and, as compensation for the erosion, be offered an opportunity to recoup dependent upon the success of a business with inherently risky prospects. We trust that in the future bankruptcy judges in this circuit will require that adequate protection be demonstrated more tangibly than was done in this case.

**3. *Relief from the Automatic Stay***

**[24]** **[25]** Carteret moved for relief from the automatic stay pursuant to section 362(d). That section provides that relief from the stay should be granted:

> (1) for cause, including the lack of adequate protection of an interest in property of such party in interest; or
>
> (2) with respect to a stay of an act against property ..., if—
>
> > (A) the debtor does not have an equity in such property; and
> >
> > (B) such property is not necessary to an effective reorganization.

Inasmuch as there is no equity in the property, Swedeland had the burden to prove that the property was necessary to an effective reorganization to maintain the automatic stay. But it had to do more than make a mere assertion to that effect or show that "there is conceivably to be an effective reorganization." *United Savings Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd.,* 484 U.S. 365, 375, 108 S.Ct. 626, 633, 98 L.Ed.2d 740 (1988). Rather, it had to show "that the property is essential for an effective reorganization *that is in prospect.*" *Id.* at 376, 108 S.Ct. at 633 (emphasis in the original). From this requirement, it follows that "[i]f no reorganization of the debtor is feasible, then no property of the debtor can be necessary for that end." *In re Dublin Properties,* 12 B.R. 77, 80 (Bankr.E.D.Pa.1981). The district court correctly found that Swedeland did not make a showing that an effective reorganization is in prospect. [18]

The bankruptcy court concluded that Swedeland had the ability to reorganize because: (1) it demonstrated post-petition performance in accordance with its projections; (2) it obtained a commitment for post-petition financing; (3) it established that in eight years it could build out the project and satisfy Carteret's lien; (4) the projections were based on the historical costs of another project, Swedeland had been on target to date and its projections were credible; and (5) Swedeland had not acted in bad faith.

**[26]** But Swedeland had fallen short on its sales projections. Furthermore, its ability to obtain post-petition financing should not ***568** be considered, inasmuch as that authorization was inappropriate and, with respect to First Fidelity, the larger source of financing, has been set aside. We will not hold that a debtor can achieve an effective reorganization by diminishing the value of its pre-petition creditor's lien interest. We also point out that Swedeland's evidence at the bankruptcy court hearing indicated that it could not obtain any financing except on a superpriority basis. As the attempt to obtain that financing should not have been successful, and now has been terminated, Swedeland cannot continue building. Additionally, Swedeland did not refute Carteret's evidence showing that the net present value of Swedeland's projected cumulative cash flow would be insufficient to satisfy Carteret's secured claim. Thus, there was no prospect of an effective reorganization in this case.

There is another reason why an effective reorganization was not in prospect. We recently held that the deficiency claim of an undersecured mortgagee could not be classified separately from the claims of other unsecured creditors of the debtor, and therefore when the mortgagee opposed the plan, there was "no reasonable prospect of confirmation" of a plan. *John Hancock Mutual Life Ins. Co. v. Route 37 Business Park Assocs.,* 987 F.2d 154, 161 (3d Cir.1993). Here Carteret is undersecured by approximately $20 million. [19] The remaining unsecured claims against Swedeland in the aggregate are far less than that amount. [20] Thus, Swedeland cannot receive the necessary affirmative vote of the class of unsecured creditors without Carteret's acceptance of the plan. *See* 11 U.S.C. § 1126(c) requiring acceptance by two-thirds in amount of claims in a class of interests.

Carteret asserts that it will oppose any proposed plan and cannot foresee that Swedeland will make any proposal which it would consider acceptable. Thus, for this reason alone, an effective reorganization of Swedeland is not realistically possible. Accordingly, the district court properly found the Swedeland has not carried its burden to prove that the property is necessary to an effective reorganization that is in prospect.

### IV. CONCLUSION

For the reasons set forth above, we will vacate the order of September 17, 1992, of the district court to the extent that it reversed the order of the bankruptcy court of March 6, 1992, and will remand the case to the district court so that it can dismiss the appeal from that order. We will affirm the order of the district court of September 17, 1992, to the extent that it reversed the orders of the bankruptcy court of March 9 and April 10, 1992, and will remand the matter to the district court so that it in turn may remand the matter to the bankruptcy court which then will vacate its orders of March 9 and April 10, 1992, and will enter an order granting Carteret relief from the automatic stay so that it may proceed with a foreclosure action.

### All Citations

16 F.3d 552, 62 USLW 2579, 30 Collier Bankr.Cas.2d 1034, 25 Bankr.Ct.Dec. 486, Bankr. L. Rep. P 75,803

Footnotes

1 The Resolution Trust Company is the conservator for Carteret but inasmuch as there are no special issues in this case attributable to its presence, as a matter of convenience we will omit further reference to it.

2 The agreement provided for a loan of $51,800,000, but the outstanding balance was not to exceed $37,000,000.

3 The district court also indicated that Carteret was entitled to relief from the automatic stay under 28 U.S.C. § 362(d)(1) as it did not have adequate protection. We need not address that aspect of its opinion as we are satisfied that Carteret was entitled to relief under section 362(d)(2). Thus, we do not consider how an adequate protection analysis under section 362(d)(1) could differ from an adequate protection analysis under section 364(d).

4 The orders of the bankruptcy court were final so that the district court had jurisdiction under 28 U.S.C. § 158(a) without granting leave to Carteret to appeal. While Swedeland suggests that the order denying relief from the automatic stay was interlocutory in the district court, we reject that contention. *See John Hancock Mutual Life Ins. Co. v. Route 37 Business Park Assocs.,* 987 F.2d 154, 157 (3d Cir.1993); *Matter of West Electronics Inc.,* 852 F.2d 79, 82 (3d Cir.1988) (order denying motion to lift stay final because in bankruptcy court's view, moving party was not entitled to relief when it filed its motion).

5 As we will demonstrate below, we can perceive of no relief which can be granted Carteret from a reversal of the March 6, 1992 order, and therefore the appeal from it may have been moot in the district court on Article III constitutional grounds as well as on statutory and prudential grounds. *See North Carolina v. Rice,* 404 U.S. 244, 246, 92 S.Ct. 402, 404, 30 L.Ed.2d 413 (1971). However, inasmuch as we conclude that that appeal was moot in the district court for the latter reasons we have no need to make a separate constitutional analysis of that order. On the other hand a contention that the appeal from the April 10, 1992 order was constitutionally moot would not be substantial.

6 In its brief, Swedeland discusses 11 U.S.C. § 363(m), which provides in language similar to that in section 364(e) that the reversal or modification on appeal of an authorization for the sale or lease of property does not affect the validity of a sale or lease under such authorization to a good faith purchaser or lessee absent a stay pending appeal. The reference is not particularly helpful because a consideration of whether a successful appellant can be granted effective relief upon the reversal of an order depends on the circumstances in each case. Obviously it might be more difficult to fashion effective relief in the case of a completed and unassailable sale or lease of a property than in a case involving a loan in which the transaction is partially executory.

7 Having rejected the contention that by force of section 364(e) alone an appeal is moot if a stay is not granted, we can conceive of no reasonable argument that an appeal can be moot on general mootness principles before a post-petition lender makes any disbursement if a stay is not granted. After all if, as is the case, a post-petition lender who makes no disbursement is not protected if a stay is granted, it is an order of a court following the entry of the section 364(d) order that deprives the lender of that protection. We cannot imagine why an order of reversal prior to the disbursement of funds should in this respect have less effect than an order for a stay. In this regard, we acknowledge that while an application for a stay usually would be made promptly after entry of a section 364(d) order, there is no time limit in section 364(e) when the stay can be sought or granted so that a reversal or modification can affect what otherwise would be a superpriority lien.

8 We are not suggesting that in every case a reversal of a section 364(d) financing order will lead to the barring of all further disbursements by the post-petition lender. It is possible that the lender's initial disbursements might have left a particular facility uncompleted so that additional funds would be required to protect the disbursements made before the reversal. While it is obvious that First Fidelity did not need such protection as its superpriority lien would have been secured adequately even if the 19 units under construction had not been finished, we nevertheless think that the district court's partial stay demonstrates the common sense approach to be followed after the reversal of a 364(d) order.

9 Obviously these cases also would give support to the conclusion that the appeal from the March 6, 1992 order is moot, but we need not consider them in that context as we are holding that appeal moot because we can conceive of no effective relief which could be granted to Carteret upon the reversal of that order.

10 Swedeland also relies on *In re Joshua Slocum Ltd.,* 922 F.2d 1081, 1085 (3d Cir.1990), and *In re Highway Truck Drivers & Helpers Local Union No. 107,* 888 F.2d 293, 297 (3d Cir.1989). In *Slocum* we set forth that section 364(e) is only one of two provisions in the Bankruptcy Code that "specifically require that a party seek a stay pending appeal" and in *Local 107* we indicated that section 364(e) was one of "only two statutory provisions in the Bankruptcy Code where a stay is specifically required to preserve a position pending appeal." These cases do not help Swedeland as they were made in the context of appeals from orders under sections of the Code in which stays pending appeal were not required specifically. Thus, *Slocum* and *Local 107* cited section 364(e) to contrast it to those other sections. There is, of course, no doubt that under section 364(e) a stay is required, except in cases in which the post-petition lender makes no disbursements before the district court decides the appeal on the merits, if the party appealing from a section 364(d) order seeks to preserve its position completely. What we are holding is that Carteret's failure to obtain the stay does not bar the court from granting it any relief from the April 10, 1992 order. There is nothing in that holding inconsistent with *Slocum* or *Local 107.*

11 Carteret does not make a contrary contention in its brief, and at the argument before us its attorney conceded that the Haylex monies had been expended at least by that time.

12 Of course, it is not conceivable that a bankruptcy court would authorize creation of a section 364(d) superpriority lien on an asset and simultaneously permit a pre-petition lender to foreclose on the same asset.

13 While we have not suggested that the appeal from the March 6, 1992 order was moot simply because all of the funds in the Haylex loan were advanced and apparently spent before the reversal, the cases we cite seem to be unanimous that an appeal is moot in that situation. *See, e.g., In re Blumer,* 66 B.R. at 113. Thus, our analysis goes beyond that made in other cases.

14 Obviously we are not suggesting that in all cases a third-party guaranty would be sufficient. The sufficiency of the guaranty would depend, *inter alia,* on the financial strength of the guarantor.

15 The district court noted that in fact on or about April 1, 1992, Swedeland turned over $988,818.74, and there was no indication the balance had been paid.

16 In addition, the bankruptcy court found that Swedeland's obligation to supply Carteret with regular reports and the court's intention to conduct a status conference in seven months contributed to Carteret's adequate protection. While we do not doubt that such procedural steps would be helpful to a pre-petition creditor, we do not regard them as substitutes for the more concrete items listed in section 361. To put it bluntly, Carteret could not convert them into cash.

17 Swedeland relies on *In re Snowshoe Co.,* 789 F.2d 1085 (4th Cir.1986), for the proposition that "[o]perating projections may serve as a valid basis of adequate protection." But in that case the operating projections related to the debtor's ability to pay the superpriority loan which, as here, was much smaller than the subordinated debt. Furthermore, in *Snowshoe* the pre-petition creditor, unlike Carteret, had a secured loan for considerably less than the value of the property. We do not, however, imply by this observation that a creditor no matter how great its security can be adequately protected without receiving additional collateral or guarantees if the creation of a superpriority lien decreases its security. Of course, in this case unlike the debtor in *Snowshoe,* Swedeland is attempting to use operating projections to establish adequate protection of the pre-petition lien.

18 The court used the word "progress." We are confident it meant "prospect."

19 Even if the Bowling Green property is taken into account, Carteret is undersecured by over $13,000,000.

20 According to the bankruptcy judge's opinion, the unsecured creditors other than Swedeland shareholders were owed $2,695,389. The shareholders were owed approximately $737,000.

**End of Document**

# TAB 8

KeyCite Yellow Flag - Negative Treatment
Declined to Extend by In re Residential Capital, LLC, Bankr.S.D.N.Y., November 15, 2013

490 B.R. 470
United States District Court,
S.D. New York.

In re AMR CORPORATION, et al., Debtors.
Wilmington Trust Company, as collateral trustee, and U.S. Bank National Association, as Indenture Trustee, Appellants,
v.
AMR Corporation, et al., Appellee.

No. 12 Civ. 3967.
|
April 3, 2013.

**Synopsis**
**Background:** Indenture and collateral trustee moved for adequate protection, or in alternative for relief from stay to exercise their rights in collateral. The Bankruptcy Court denied motion, and trustees appealed.

**Holdings:** The District Court, Sweet, J., held that:

[1] bankruptcy court's err in requiring creditors moving for adequate protection to make initial showing that their collateral was declining, or at real risk of declining, in value was harmless;

[2] court did not need to hold evidentiary hearing prior to ruling on creditors' request for adequate protection; and

[3] lack of hearing did not violate due process.

Affirmed.

West Headnotes (15)

**[1]** **Bankruptcy** Clear error

District court reviews bankruptcy court's findings of fact for clear error, and will not reverse unless it is left with definite and firm conviction that mistake has been committed. Fed.Rules Bankr.Proc.Rule 8013, 11 U.S.C.A.

7 Cases that cite this headnote

**[2]** **Bankruptcy** Conclusions of law; de novo review

District court reviews bankruptcy court's conclusions of law de novo.

8 Cases that cite this headnote

**[3]** **Bankruptcy** Conclusions of law; de novo review

Bankruptcy court's interpretation of the Bankruptcy Code, the Federal Rules of Bankruptcy Procedure, and local bankruptcy rules is subject to de novo review.

1 Cases that cite this headnote

**[4]** **Bankruptcy** Discretion

District court reviews matters within bankruptcy court's discretion under "abuse of discretion" standard, based not on what it would have done under the same circumstances, but on whether, in light of the record as whole, the bankruptcy court's decision was reasonable.

2 Cases that cite this headnote

**[5]** **Bankruptcy** Relief from automatic stay

Bankruptcy court's order denying motion for relief from stay was "final order," from which appeal would lie as of right. 28 U.S.C.A. § 158(a)(1).

**[6]** **Bankruptcy** Finality

Bankruptcy court's order denying a motion seeking adequate protection was "final order," appealable as of right, though bankruptcy court, in recognition of fact that any denial of adequate protection is without prejudice to party's ability to file another such motion in future, expressly invited movants to renew their motion if circumstances changed. 28 U.S.C.A. § 158(a)(1).

[7] **Bankruptcy** Adequate protection in general

Denial of motion for adequate protection is, by definition, without prejudice, since such protection is available whenever the circumstances dictate a need for it. 11 U.S.C.A. § 363(e).

[8] **Bankruptcy** Creditor's or Movant's Burden

**Bankruptcy** Adequate protection

In order for secured creditor to establish "cause" for relief from automatic stay based upon lack of adequate protection for its interest, creditor must satisfy initial burden of showing that there has been decline, or at least a real threat of decline, in value of collateral at issue; only on such a showing does burden shift to debtor to prove that collateral at issue is not, in fact, declining in value. 11 U.S.C.A. § 362(d)(1).

3 Cases that cite this headnote

[9] **Bankruptcy** Adequate protection in general

When secured creditor moves for adequate protection under Bankruptcy Code provision governing use, sale, or lease of estate property, it need only establish validity of its interest in collateral, and it is debtor that bears initial burden of proof as to issue of adequate protection. 11 U.S.C.A. § 363(e).

5 Cases that cite this headnote

[10] **Bankruptcy** Harmless error

Bankruptcy court's error in requiring creditors moving for adequate protection to make initial showing that their collateral was declining, or at real risk of declining, in value was harmless, where parties agreed that property securing creditors' claim had a value which was, at minimum, at least 120% of debt which it secured. 11 U.S.C.A. § 363(e).

2 Cases that cite this headnote

[11] **Bankruptcy** Adequate protection in general

Existence of equity cushion can be sufficient, in and of itself, to constitute "adequate protection." 11 U.S.C.A. § 363(e).

1 Cases that cite this headnote

[12] **Bankruptcy** Adequate protection in general

Bankruptcy court did not need to hold evidentiary hearing prior to ruling on creditors' request for adequate protection, where parties agreed that property securing creditors' claim had a value which was, at minimum, at least 120% of debt that it secured. 11 U.S.C.A. § 363(e).

1 Cases that cite this headnote

[13] **Bankruptcy** Nature and form; adversary proceedings

**Bankruptcy** Evidence; witnesses

It is not necessary to conduct evidentiary hearing on contested matter unless there are disputed issues of material fact that bankruptcy court cannot decide based on record.

6 Cases that cite this headnote

[14] **Bankruptcy** Nature and form; adversary proceedings

**Bankruptcy** Pleading; dismissal

**Bankruptcy** Evidence; witnesses

If parties do not request an evidentiary hearing or core facts are undisputed, bankruptcy court is authorized to determine contested matters on the pleadings and arguments of parties, drawing necessary inferences from record.

3 Cases that cite this headnote

[15] **Bankruptcy** Adequate protection in general

**Constitutional Law** 🔑 Bankruptcy

Bankruptcy court's denial of secured creditors' request for adequate protection, without benefit of evidentiary hearing, based on fact that property securing creditors' claim had value that was at least 120% of debt that it secured, did not violate creditors' due process rights, where creditors had opportunity to present arguments in support of their motion, and bankruptcy court considered, but ultimately rejected, those arguments. U.S.C.A. Const.Amend. 5; 11 U.S.C.A. § 363(e).

2 Cases that cite this headnote

**Attorneys and Law Firms**

***471** Milbank, Tweed, Hadley & McCloy LLP, By: Tyson M. Lomazow, Esq., New York, NY, for Appellant Wilmington Trust Company.

Jones Day, By: James O. Johnston, Esq., Los Angeles, CA, Foley & Lardner LLP, By: Mark L. Prager, New York, NY, for Appellant U.S. Bank National Association.

***472** Weil, Gotshal & Manges LLP, By: Stephen Karotkin, Esq., New York, NY, for Appellee.

*OPINION*

SWEET, District Judge.

Wilmington Trust Company, solely in its capacity as collateral trustee (the "Collateral Trustee") with respect to certain 7.5% Senior Secured Notes Due 2016 (the "Senior Secured Notes") issued by appellee American Airlines, Inc. ("American"), and guaranteed by appellee AMR Corporation ("AMR"), and U.S. Bank National Association, solely in its capacity as indenture trustee (the "Indenture Trustee" and, together with the Collateral Trustee, the "Trustees") with respect to the Senior Secured Notes, have appealed from an Order entered March 12, 2012 (the "Order") by the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court") denying their motion for adequate protection, or, in the alternative, for relief from the automatic stay (the "Motion"), in respect of their interest in the collateral securing the Senior Secured Notes (the "Collateral"). Upon the conclusions set forth below, the Order is affirmed, and the appeal is dismissed.

Skilled advocates have ably presented the issues raised by this appeal. The motion for adequate protection and its alternative for relief from the automatic stay present differing burdens of proof and factual considerations which were presented to the Bankruptcy Court in its non-evidentiary Omnibus Hearing. Appendix to Appellants' Opening Brief ("Apx.") 7 at 68. The nature of that hearing and the implications of the relief sought are largely responsible for the conclusions stated below.

***Prior Proceedings***

On March 15, 2011, less than nine months before the commencement of the bankruptcy cases that give rise to the instant appeal, American issued the $1,000,000,000 Senior Secured Notes pursuant to an Indenture among American, AMR, and the Trustees (the "Indenture"). *See* Apx. 3 ¶ 3.

The Senior Secured Notes are secured pursuant to (a) the Indenture, (b) the Collateral Trust Agreement, dated as of March 15, 2011, among American, the other grantors from time to time party thereto, the Trustees, and Citibank (South Dakota), N.A., as junior lien representative (the "Collateral Trust Agreement"), (c) the Priority Lien Security Agreement (Slots, Gate Leaseholds and Route Authorities), dated as of March 15, 2011, between American and the Collateral Trustee (the "Priority Lien Security Agreement"), and (d) the Collateral Account Control Agreement, dated as of March 15, 2011, among American and the Trustees (collectively with the Indenture, the Collateral Trust Agreement, and the Priority Lien Security Agreement, the "Note Documents"). Apx. 3.

As set forth in the Note Documents, the Senior Secured Notes are secured by a validly-granted and properly-perfected first priority security interest in and lien on the "Collateral," which consists generally of the following:

a. all of American's current and future right, title and interest in specified Route Authorities, Slots and Gate Leaseholds;

b. all of American's right, title and interest in certain collateral proceeds accounts and all cash, checks, money orders and other items American paid, deposited, credited or holds therein; and

***473** c. all of American's right, title and interest in all proceeds of any kind with respect to the foregoing.

Apx. 3 at ¶ 4. That Collateral enables American to provide international "Scheduled Services" to London, Japan and China and is utilized by American every day. Apx. 3; Apx. 5 ¶ 1.

In connection with American's issuance of the Senior Secured Notes, the accounting firm Morton, Beyer & Agnew ("MBA") prepared an appraisal of the Collateral dated as of February 16, 2011 (the "February Appraisal"). In that appraisal, MBA opined that the Collateral had value of at least $2.37 billion. *See* Apx. 3 ¶ 12.

On November 28, 2011, MBA prepared an updated appraisal of the Collateral at the request of American (the "November Appraisal"). The November Appraisal valued the Collateral as low as $1.53 billion. *See* Apx. 3.

The next day, on November 29, 2011 (the "Commencement Date"), AMR and its related debtors [1] (collectively, the "Debtors") each commenced a voluntary case under chapter 11 of the Bankruptcy Code. Debtors' Appendix 1.

On February 8, 2012, the Trustees filed the Motion, alleging that the value of their interest in the Collateral was at risk of diminution "if American fails to utilize the Collateral adequately or is not otherwise in compliance with the applicable regulations" or if there was "a downturn in the prospects of the airline industry—or, indeed, a downturn in general global macroeconomic conditions...." Apx. ¶ 11. In support of this contention, the Trustees noted that the value of the Collateral had declined in value by over $840 million —or more than 35% of its total value—in the nine months preceding the Commencement Date. *Id.* ¶ 12.

The Motion sought two forms of relief. The Trustees' primary request, made pursuant to 11 U.S.C. § 363(e) ("§ 363(e)"), was for the Bankruptcy Court to impose certain conditions [2] (the "Conditions") governing the Debtors' continued use of the Collateral, so as to provide adequate protection ***474** of the Trustees' interest in the Collateral. [3]

In the alternative, the Trustees sought an order pursuant to 11 U.S.C. § 362(d) ("§ 362(d)") granting relief from the automatic stay, so as to enable the Trustees to exercise their respective rights and remedies with respect to the Collateral.

On February 22, 2012, the Debtors filed an objection to the Motion (the "Objection"), Apx. 4, contending that (i) there was no evidence of a post-petition decline, or threat of a post-petition decline, in the value of the Trustees' interest in the Collateral; (ii) the November Appraisal did not take into account various cost saving measures implemented and to be implemented during the Debtors' chapter 11 cases; (iii) the Trustees' interest in the Collateral was already more than adequately protected by an ample equity cushion; and (iv) the Trustees were not entitled to adequate protection to preserve or enhance their equity cushion. *Id.* ¶¶ 2–4, 10, 14–17.

On February 24, 2012, the Trustees filed their reply to the Objection (the "Reply"). Apx. 5. The Trustees conceded the Collateral was worth more than the outstanding amount of the Notes, *id.* ¶ 7, but still claimed an entitlement to their requested adequate protection package because, *inter alia,* there "will be no harm whatsoever from the provision of adequate protection" and Bankruptcy Courts "routinely grant adequate protection to secured lenders." *Id.* ¶¶ 12, 15.

On February 29, 2012, the Motion was heard by the Bankruptcy Court as one of 34 matters under consideration at the omnibus hearing held on that date (the "Hearing"). *See* Apx. 7 at 1–7.

Following argument on the Motion, the Bankruptcy Court found that the Trustees bore a prima facie burden to "demonstrate[ ] that the value of the collateral was decreasing or likely to decrease during the pendency of these cases," and concluded that the Trustees failed to meet this burden. *Id.* at 75. In so deciding, the Bankruptcy Court noted that: (i) the ranges of values of the Collateral stated in the November Appraisal reflected a prepetition decline in the value of the Collateral that was less dramatic than what the Trustees alleged in the Motion; (ii) the Trustees failed to submit evidence of post-petition value of the Collateral; (iii) the Debtors submitted undisputed evidence that the Trustees held at least a 50% equity cushion in the Collateral; and (iv) the Trustees failed to submit persuasive evidence that the Debtors would fail to utilize the Collateral or comply with applicable federal government regulations. *Id.* at 75–76.

In addition, the Bankruptcy Court declined to accede to the request of counsel for one of the Trustees, who asked that if the Bankruptcy Court were inclined to deny the Motion, it premise such a denial upon an express finding that adequate protection existed as a result of the existence of an equity cushion to ensure that the Trustees would be entitled to a superpriority administrative claim under 11 U.S.C. § 507(b) should the adequate protection fail and the value of their interest in the Collateral be adversely affected. *See* Apx. 7 at 63; Appellants' Opening Brief at 19. In rejecting this request, the Bankruptcy Court noted the risk of affecting substantial interests of the parties in the future as a result of making such a preliminary ruling without engaging in a full evidentiary hearing. Apx. 7 at 63–65.

***475** On March 12, 2012, the Bankruptcy Court entered the Order, which denied the Motion without prejudice for the reasons set forth on the record at the Hearing. Apx. 9. On March 26, 2012, the Trustees filed a Notice of Appeal from the Order. Apx. 10.

The Trustees' appeal of the Bankruptcy Court's denial of the Motion (the "Appeal") was heard by this Court and marked fully submitted on October 24, 2012.

***Standard of Review***

**[1]** A district court reviews a bankruptcy court's findings of fact for clear error. *In re Adelphia Comms. Corp.,* 367 B.R. 84, 90–91 (S.D.N.Y.2007). A finding of fact is clearly erroneous if, after reviewing the entirety of the evidence, "the reviewing court is left with the definite and firm conviction that a mistake has been committed." *United States v. U.S. Gypsum Co.,* 333 U.S. 364, 395, 68 S.Ct. 525, 92 L.Ed. 746 (1948).

**[2]** **[3]** In contrast, a district court applies de novo review to a bankruptcy court's conclusions of law. *Adelphia,* 367 B.R. at 90–91. Accordingly, a bankruptcy court's interpretation of the Bankruptcy Code, the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"), and the local bankruptcy rules for the United States Bankruptcy Court for the Southern District of New York (the "Local Bankruptcy Rules") are subject to de novo review. *See In re Caldor Corp.,* 303 F.3d 161, 166 (2d Cir.2002).

**[4]** A district court reviews matters within a bankruptcy court's discretion under an abuse of discretion standard. *In re Crysen/Montenay Energy Co.,* 166 B.R. 546, 549–50 (S.D.N.Y.1994) (internal citations omitted). "The standard to be applied is thus, 'not what this Court would have done under the same circumstances, but whether, in light of the record as a whole, the bankruptcy court's decision was reasonable.' " *Id.* at 550 (*quoting In re United Merchants and Mfrs., Inc.,* 126 B.R. 149, 150 (S.D.N.Y.1991)).

***The Order Denying Adequate Protection and, in the Alternative, Relief from the Automatic Stay Was Final and Therefore Appealable***

Title 28 of the United States Code sets forth the requirements for the exercise of subject matter jurisdiction by a District Court over an appeal from a Bankruptcy Court order:

> (a) The district courts of the United States shall have jurisdiction to hear appeals
>
> (1) from final judgments, orders, and decrees;
>
> [ ... ] and
>
> (3) with leave of the court, from ... interlocutory orders and decrees.

28 U.S.C. § 158(a)(1), (3).

Accordingly, for this Court to consider the Appeal, the Order must either be considered "final" under section 158(a)(1) ("§ 158(a)(1)"), or else must be of the nature that renders it appropriate for interlocutory review pursuant to section 158(a)(3) ("§ 158(a)(3)"). *See In re Chateaugay Corp.,* 80 B.R. 279, 285 (S.D.N.Y.1987).

**[5]** **[6]** As for the Trustees' alternative motion for relief from the automatic stay pursuant to § 362(d), the Second Circuit has unequivocally held that a bankruptcy court's order denying such a motion is "a final, appealable order...." *In re Chateaugay Corp.,* 880 F.2d 1509, 1511–12 (2d Cir.1989). While there is no such binding precedent with respect to the Trustees' primary motion seeking adequate protection pursuant to § 363(e), district courts in this Circuit have consistently viewed orders denying such a request as final and ***476** therefore appealable pursuant to § 158(a)(1). *See Zink v. Vanmiddlesworth,* 300 B.R. 394, 396 (N.D.N.Y.2003) (noting that "[i]n this Circuit ... and order denying a motion for adequate protection" is "final and appealable"); *In re Waste Conversion Techs., Inc.,* 205 B.R. 1004, 1006–07 (D.Conn.1997); *In re Best Prods. Co.,* 149 B.R. 346, 347 (S.D.N.Y.1992); *In re Key Book Serv., Inc.,* Civ. Nos. B–89–424 (JAC) & B–89–425 (JAC), 1989 WL 221311, at *1 (D.Conn. Dec. 13, 1989). The same position has been adopted by courts in a number of other circuits. *See In re O'Connor,* 808 F.2d 1393, 1395 n. 1 (10th Cir.1987); *In re Sankey,* 307 B.R. 674, 677–78 (D.Alaska 2004); *Fed. Nat'l Mortgage Ass'n v. Dacon Bolingbrook Assocs. Ltd. P'ship,* 153 B.R. 204, 206–07 & 210–12 (N.D.Ill.1993), *In re Grant Broad. Of Phila., Inc.,* 75 B.R. 819, 821–22 (E.D.Pa.1987).

 

Although, as noted by the Debtors, there are instances where an order denying a motion for adequate protection has been held to be interlocutory rather than final for § 158 purposes, *see In re Alchar Hardware,* 730 F.2d 1386, 1388 (11th Cir.1984); *In re Kalian,* 191 B.R. 275, 278 (D.R.I.1996), the weight of the authority—both overall, and particularly within this Circuit—supports the contrary position. Accordingly, the portion of the Order denying the Trustees' motion for adequate protection pursuant to § 363(e) is considered a final order that is appealable pursuant to § 158(a)(1).

**[7]** The Debtors contend that, notwithstanding the above, the Bankruptcy Court's denial of the motion for adequate protection in this particular case is not final for § 158 purposes because the Bankruptcy Court expressly invited the Trustees to "come back when there is a change in circumstances." Apx. 7 at 76. However, that statement by the Bankruptcy Court was merely a recapitulation of the express language of § 363(e), which provides that a court shall "at any time, on request of an entity that has an interest in property used ... by the [debtor] ... as is necessary to provide adequate protection of such interest." party may move for adequate protection "at any time." *Id.* In other words, there was no special significance to the Bankruptcy Court's words in this case, as any denial of a motion for adequate protection is *by definition* without prejudice, because the statute itself provides that adequate protection is available whenever the circumstances dictate a need for it. If, *arguendo,* the Debtors' argument were to be accepted, it would effectively mean that no order denying a motion for adequate protection would *ever* be considered final for § 158 purposes. The cases cited above, both from this Circuit and from others, represent considerable authority rejecting such a proposition. Debtors' argument is therefore unavailing.

Since the Order is final with respect to its denial of the Trustees' primary request for adequate protection pursuant to § 363(e) as well as its denial of the Trustees' alternative request for relief from the automatic stay pursuant to § 362(d), this Court has jurisdiction over the appeal of the Order pursuant to 28 U.S.C. § 158(a)(1).

***The Bankruptcy Court's Misapplication of the Burden of Proof in the Motion for Adequate Protection was Harmless Error***

In analyzing the Motion, the Bankruptcy Court held that "the burden is on the movants first to make a prima facie case, and the prima facie case ... is that you have to prove a decline in value or a threat of a decline...." Apx. 7 at 62. While this was correct with respect to the Trustees' alternative motion pursuant to § 362(d), it ***477** was erroneous with respect to the Trustees' primary motion pursuant to § 363(e).

**[8]** A party seeking relief from an automatic stay pursuant to § 362(d) "has the burden of proof on the issue of the debtor's equity in property, [and] the party opposing such relief has the burden of proof on all other issues." 11 U.S.C. § 362(g). Thus, in order for secured creditors such as the Trustees to meet their initial burden on a § 362(d) motion, they must show that there has been a decline (or at least that there is a real threat of decline) in the value of the collateral at issue; only upon such a showing does the burden shift to the debtor to prove that the collateral at issue is not, in fact, declining in value. *See In re Balco Equities Ltd., Inc.,* 312 B.R. 734, 751 (Bankr.S.D.N.Y.2004) (*citing In re Elmira Litho, Inc.,* 174 B.R. 892, 902 (Bankr.S.D.N.Y.1994)); *In re Anthem Cmties./RBG, LLC,* 267 B.R. 867, 871 (Bankr.D.Colo.2001); *In re Oligbo,* 328 B.R. 619, 651 (Bankr.E.D.N.Y.2005); *In re WorldCom, Inc.,* No. 02–13533(AJG), 2003 WL 22025051, at *6 (Bankr.S.D.N.Y. Jan. 30, 2003); *In re Brutsche,* No. 11–11–13326(SA), 2012 WL 526047, at *3 (Bankr.D.N.M. Feb. 16, 2012). The Bankruptcy Court's analysis was therefore correct insofar as the Trustees' request for relief from the automatic stay.

**[9]** However, with respect to the Trustees' primary motion for adequate protection pursuant to § 363(e), the statute mandates that "the [debtor] has the burden of proof on the issue of adequate protection; and the entity asserting an interest in property has the burden of proof on the issue of validity, priority, or extent of such interest." 11 U.S.C. § 363(p). Thus, when a secured creditor moves for adequate protection pursuant to § 363(e), it need only establish the validity of its interest in the collateral, while "the Debtor bears the initial burden of proof as to the issue of 'adequate protection.' " *In re Village Green I, GP,* 435 B.R. 525, 530 (Bankr.W.D.Tenn.2010). The movant on a § 363(e) motion therefore bears a much lighter burden than the movant on a § 362(d) motion.

This disparity is noted in *Elmira Litho,* 174 B.R. 892, which is cited by both parties and is the only case within this Circuit to directly address the issue. *Elmira Litho* held that while the movant on a § 362(d) motion "must prove [a] decline in value—or the threat of decline—in order to establish a *prima facie* case," *id.* at 902, "[t]he burden of proof on motion under § 363(e) is governed by § 363 ( [p] )," which merely "requires the party asserting an interest in property to prove the 'validity, priority, or extent of such interest,' and imposes on the [debtor-in-possession] the 'burden of proof on the issue of adequate protection.' " *Id.* at 905 (*quoting* 11 U.S.C. § 363(p)(1) & (2)) (citations omitted). [4]

The Bankruptcy Court erred in its analysis of the Trustees § 363(e) motion for adequate protection because it effectively placed the burden upon the Trustees to make a prima facie showing that there was no adequate protection, *see* Apx. 7 at 62, when in fact the Trustees were merely required to establish the validity of their interest in the Collateral (which was unchallenged), while the Debtors had the ***478** burden of affirmatively demonstrating that the Trustees' interest in the Collateral was adequately protected without the conditions sought by the Trustees. *See* 11 U.S.C. § 363(p); *Elmira Litho,* 174 B.R. at 902–05.

**[10]** **[11]** The Bankruptcy Court's error, however, was harmless, as the Debtors established that that the Trustees were adequately protected under the existing conditions, and therefore that there was no need to implement the Conditions sought by the Trustees. As the Bankruptcy Court noted, the Debtors asserted the existence of an equity cushion that they claimed to be "at least fifty percent" of the Collateral, Apx. 7 at 75, and even the Trustees acknowledged as being "north of the twenty percent that is often relied upon by courts in making their determination." Apx. 7 at 76. It is well-settled that the existence of an equity cushion can be sufficient, in and of itself, to constitute adequate protection. *See In re Fortune Smooth (U.S.) Ltd.,* No. 93–40907(JLG), 1993 WL 261478, at *6 (Bankr.S.D.N.Y. July 6, 1993); *In re Mellor,* 734 F.2d 1396, 1400 (9th Cir.1984) ("In fact, it has been held that the existence of an equity cushion, standing alone, can provide adequate protection."); *Oligbo,* 328 B.R. at 651; *In re Elmira Litho, Inc.,* 174 B.R. 892, 904 (Bankr.S.D.N.Y.1994) ("An equity cushion, therefore, provides adequate protection if it is sufficiently large to ensure that the secured creditor will be able to recover its entire debt from the security at the completion of the case."); *In re Johnston,* 38 B.R. 34, 36 (Bankr.D.Vt.1983) ("It is well settled that an 'equity cushion' or 'value cushion' in and of itself may provide adequate protection for a secured creditor"). Accordingly, the equity cushion in the instant case—which all parties agreed was at least "north of twenty percent" of the Collateral, *see* Apx. 7 at 75–76—was a sufficient basis upon which to deny the Trustees' § 363(e) motion for implementation of the Conditions.

"[I]t is well-established that, where both parties have offered evidence, and where there is no evidentiary tie, any improper assignment of the burden of proof is harmless since the party supported by the weight of the evidence will prevail regardless of which party bore the burden of persuasion, proof, or preponderance." *TransCanada Pipelines Ltd. v. USGen New England, Inc.,* 458 B.R. 195, 215 (D.Md.2011) (*quoting Blodgett v. Comm'r,* 394 F.3d 1030, 1039 (8th Cir.2005)) (quotation marks omitted). Here, the Bankruptcy Court's erroneous assignment of the burden to the Trustees was harmless, since the Debtors asserted the existence of an equity cushion that was, by all accounts, "north of twenty percent" of the Collateral—to establish that the Trustees' interest in the Collateral was adequately protected. *See Fortune Smooth,* 1993 WL 261478, at *6; *Elmira Litho,* 174 B.R. at 904. Since the Bankruptcy Court reached the correct result in denying the Trustees' § 363(e) motion reversal of the decision is not required. [5]

***479** ***An Evidentiary Hearing on the Motion Was Unnecessary***

**[12]** The Trustees contend that the Bankruptcy Court erred in failing to hold an evidentiary hearing on the Motion. Appellants' Opening Brief at 20. In fact, no such hearing was requested, nor was one necessary.

**[13]** **[14]** The Trustees' Motion initiated a "contested matter" subject to Bankruptcy Rule 9014. *See* Fed. R. Bankr.P. 9014 & 4001. It is unnecessary to conduct an evidentiary hearing on a contested matter unless there are disputed issues of material fact that a Bankruptcy Court cannot decide based on the record. *See Powers v. Am. Honda Fin. Corp.,* 216 B.R. 95, 97 (N.D.N.Y.1997) (affirming Bankruptcy Court denial of a hearing on a motion to lift stay under section 362(d) because no material facts were in dispute); *In re Khachikyan,* 335 B.R. 121, 126–27 (9th Cir. BAP 2005) (noting Bankruptcy Rule 9014 only requires an evidentiary trial when there is a genuine factual dispute); see also Fed. R. Bankr.P. 9014(d) (requiring testimony of witnesses only for disputed material fact issues); Advisory Committee Note to 2002 Amendment (stating that an evidentiary hearing is not required unless there is a genuine factual dispute). Therefore, "[w]here the parties do not request an evidentiary hearing or the core facts are not disputed, the bankruptcy court is authorized to determine contested matters ... on the pleadings and arguments of the parties, drawing necessary inferences from the record." *In re Gonzalez–Ruiz,* 341 B.R. 371, 381 (1st Cir. BAP 2006).

As the Bankruptcy Court noted, the contentions of the Trustees did not establish a post-petition decline in the value of the Collateral, and only raised "inferences" of a threat of decline that were insufficiently cogent to establish the necessity of 362(d) relief. Apx. 7 at 74. Since the Trustees failed to submit viable evidence of a post-petition decline or threat of decline, there was no genuine factual dispute as to whether or not they met their prima facie burden pursuant to § 362(d), and it was proper for the Bankruptcy Court to rule on the § 362(d) motion without an evidentiary hearing. *See Powers,* 216 B.R. at 97. Similarly, with respect to the § 363(e) motion, there was no genuine factual dispute as to whether a significant equity cushion existed, as the existence of a cushion of more than twenty percent of the Collateral was uncontested, *see* Apx. 7 at 75–76, so it was proper for the Bankruptcy Court to rule on the § 363(e) motion without conducting an evidentiary hearing. *See Powers,* 216 B.R. at 97.

Moreover, since the Trustees did not affirmatively request an evidentiary hearing in the Motion or the Reply, the Bankruptcy Court was under no obligation to hold such a hearing. *See In re Blaise,* 219 B.R. 946, 949 (2d Cir. BAP 1998) (generally holding that a Court did not err in denying a motion without an evidentiary hearing because movant did not affirmatively request such a hearing). Trustees' counsel's general statement that "we're happy to put this over for an evidentiary hearing," Apx. 7 at 62, does not constitute the type of affirmative request necessary to trigger an obligation on the part of the bankruptcy court. *See Blaise,* 219 B.R. at 949; *Powers,* 216 B.R. at 97.

**[15]** Finally, the Bankruptcy Court did not violate the Trustees' due process rights. Due process requires that a person be given notice and an opportunity to be heard before being deprived of property. *See, e.g., Jones v. Flowers,* 547 U.S. 220, 223, 126 S.Ct. 1708, 164 L.Ed.2d 415 (2006). In this case, the Trustees were heard and made arguments in support of the Motion at the Hearing. The Bankruptcy Court considered the Trustees' arguments, ***480** but ultimately rejected them. Apx. 7 at 74–76. This constitutes sufficient process to vindicate the Trustees' constitutional rights. *See In re Bartle,* 560 F.3d 724, 729 (7th Cir.2009) ("The parties are entitled to an opportunity to be heard, not to a particular type of hearing."). The Trustees' reliance on *In re Rijos,* 263 B.R. 382 (1st Cir. BAP 2001), does not salvage their due process argument because, in that case, the First Circuit held that the bankruptcy court denied the debtors' due process rights by ruling on their summary judgment motion without scheduling or holding an hearing on the motion or otherwise affording the debtors an opportunity to present evidence in support of the motion. *Id.* at 387. In contrast, in the instant case, a hearing was held in which the Trustees were given a full and fair opportunity to be heard and to present evidence in support of their requests, so no due process violation occurred.

***Conclusion***

Based on the conclusions set forth above, the Order is affirmed and the appeal dismissed.

**All Citations**

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Footnotes

1 In addition to AMR, the other debtors are: American Airlines, Inc.; American Airlines Realty (N.Y.C.) Holdings, Inc.; AMR Eagle Holding Corporation; Americas Ground Services, Inc.; OPMA Investment Subsidiary, Inc.; SC Investment, Inc.; American Eagle Airlines, Inc.; Executive Airlines, Inc.; Executive Ground Services, Inc.; Eagle Aviation Services, Inc.; Admirals Club, Inc.; Business Express Airlines, Inc.; Reno Air, Inc.; AA Real Estate Holding GP LLC; AA Real Estate Holding LP.; American Airlines Marketing Services LLC; American Airlines Vacations LLC; American Aviation Supply LLC; and American Airlines IP Licensing Holding, LLC.

2 The Trustees sought an order requiring the Debtors to:

(i) comply with all laws, ordinances, orders, rules, regulations and requirements of aviation authorities that exercise jurisdiction over the issuance or authorization relating to the Collateral;

(ii) maintain and preserve the Collateral pursuant to the authority granted by the applicable aviation authorities;

(iii) use commercially reasonable efforts to defend the Collateral against claims and demands of parties claiming an interest in the Collateral that is adverse to the Trustees or any other secured party under the Notes Documents;

(iv) make regularly scheduled post-petition interest payments to the secured parties in accordance with the terms of the Indenture and the Notes;

 

(v) provide access to the Debtors' books and records or any other pertinent information relating to the Collateral for inspection by the Trustees;

(vi) pay the Trustees' fees and expenses (including the fees and expenses of their respective professionals); and

(vii) provide Wilmington Trust with replacement liens on all Collateral acquired by the Debtors after the Commencement Date.

3 As a procedural corollary, the Trustees also requested a modification of the automatic stay to the extent necessary in order to impose the requested conditions.

4 The cases cited by the Debtors in support of their position that, with respect to the § 363(e) motion for adequate protection, the Trustees bore the initial burden of proving an actual or threatened decline in Collateral value, *see* Answering Brief of AMR Corporation, et al., In Opposition to Appeal of Wilmington Trust Company and U.S. Bank National Association at 12–13, are inapposite, as they discuss the burden of proof applicable to a § 362(d) motion for relief from an automatic stay.

5 The Trustees also contend that the Bankruptcy Court's ruling was erroneous because it failed to “expressly hold that the alleged equity cushion constituted adequate protection.” Appellants' Opening Brief at 18. This argument is unavailing. During the Hearing, the Bankruptcy Court gave numerous bases for its decision, *see* Apx. 7 at 74–76, and in the Order the Bankruptcy Court expressly stated that the Motion was denied for the reasons set forth on the record at the Hearing, *see* Apx. 9. The Trustees have failed to present any authority supporting the position that the Bankruptcy Court acted improperly in this regard. Moreover, the Order was issued without prejudice, *see* Apx. 9, so to the extent that the Trustees believe that their rights were not properly preserved, they are free to file another motion to ameliorate the issue.

**End of Document**

# TAB 9

501 B.R. 549
United States Bankruptcy Court, S.D. New York.

IN RE: RESIDENTIAL CAPITAL, LLC, et al., Debtors.
Official Committee of Unsecured Creditors, on behalf of the estates of the Debtors, Plaintiff,
v.
UMB Bank, N.A., as successor indenture trustee under that certain Indenture, dated as of June 6, 2008; and Wells Fargo Bank, N.A., third priority collateral agent and collateral control agent under that certain Amended and Restated Third Priority Pledge and Security Agreement and Irrevocable Proxy, dated as of December 30, 2009, Defendants.
Residential Capital, LLC, et al, Plaintiffs,
v.
UMB BANK, N.A., as successor indenture trustee under that certain Indenture, dated as of June 6, 2008; and Wells Fargo Bank, N.A., third priority collateral agent and collateral control agent under that certain Amended and Restated Third Priority Pledge and Security Agreement and Irrevocable Proxy, dated as of December 30, 2009, Defendants.

Case No. 12–12020 (MG) Jointly Administered
|
Adversary Proceeding No. 13–01277(MG), Adversary Proceeding No. 13–01343 (MG)
|
Filed 11/15/2013

**Synopsis**
**Background:** Consolidated proceedings were brought for determination as to whether junior secured noteholders' collateral had value exceeding amount of their claims, such that noteholders were entitled to postpetition interest and fees, as well as for determination of noteholders' alleged right to unmatured original issue discount (OID) as addition to their secured claims and to payment on priority basis under debtors' proposed Chapter 11 plan based on alleged failure of adequate protection provided in cash collateral order. Debtors and creditors' committee also asserted claim for avoidance of transfers made to junior noteholders on preference theory.

**Holdings:** The Bankruptcy Court, Martin Glenn, J., held that:

[1] debtors' issuance of new notes to debenture holders as part of prepetition consensual workout, in connection with fair value debt-for-debt exchange, did not give rise to claim disallowable as one for unmatured interest;

[2] junior noteholders failed to satisfy their burden of showing that aggregate value of their collateral had diminished from date that debtors filed for Chapter 11 relief, and were not entitled to adequate protection claim payable on priority basis under plan;

[3] mortgage loans included in property of jointly administered Chapter 11 estates were properly valued, for purpose of determining the undersecured, secured, or oversecured nature of claims collateralized by these loans, using fair market valuation;

[4] paragraph in cash collateral order could not be interpreted as reviving junior secured noteholders' liens in collateral that had been released;

[5] refinancing opportunities associated with mortgage servicing rights that were expressly identified as "excluded" assets could not be separated from servicing rights themselves;

[6] no value could be assigned to goodwill of debtors' residential mortgage loan origination/servicing business as of date their Chapter 11 petitions were filed;

[7] junior secured noteholders did not have perfected liens that were protected from strong-arm avoidance in any deposit accounts

[8] plaintiffs asserting preference claims failed to satisfy burden of showing that challenged transfers enabled junior secured noteholders to receive more than they would have received in hypothetical Chapter 7 liquidation; and

[9] "carve out" provision in cash collateral order had to be interpreted as requiring junior secured noteholders to subordinate their secured claims to payment of carve out only if there were insufficient other unencumbered assets from which carve out could be paid.

So ordered.

West Headnotes (33)

[1] **Bankruptcy** Claims or proceedings against estate or debtor; relief from stay

**Bankruptcy** Bankruptcy judges

Bankruptcy court, even as non-Article-III court, had constitutional authority to enter final orders and judgment in proceeding brought for determination of junior secured noteholders' right to postpetition interest and fees as allegedly oversecured creditors, for determination of whether their claims based on original issue discount (OID) should be disallowed as claims for unmatured interest, and for whether they had adequate protection claims, as raising issues that would necessarily be resolved as part of claims-allowance process.

[2] **Bankruptcy** Evidence

Consolidated Financial Data Repository (CFDR) that Chapter 11 debtors maintained in ordinary course of their business as primary means for complying with their collateral tracking and reporting requirements under revolving loan agreement, as a Sarbanes–Oxley (SOX) compliant financial tool that was auditable, verifiable, and subject to heightened level of scrutiny, constituted a reliable and accurate business record which contained contemporaneous record of debtors' business transactions, and evidence of which was admissible under "business records" exception to hearsay rule as proof of what collateral had been released and what collateral was subject to junior secured noteholders' security interest in proceeding for determination of junior secured noteholders' allegedly oversecured status and purported entitlement to postpetition interest and fees. 11 U.S.C.A. § 506(b).

[3] **Bankruptcy** Post-petition interest

While Chapter 11 debtors' issuance of new notes to debenture holders as part of prepetition consensual workout, in connection with fair value debt-for-debt exchange, might result in an original issue discount (OID) for tax purposes, it did not give rise to claim for OID that was disallowable under the Bankruptcy Code as claim for unmatured interest; treating this transaction as giving rise to claim for OID that would be disallowable in bankruptcy would discourage parties from entering into consensual workouts to alleviate financial distress and would result in increased resort to bankruptcy process. 11 U.S.C.A. § 502(b)(2).

[4] **Bankruptcy** Presumptions and burden of proof

In establishing its claim, secured creditor generally bears burden of proving amount and extent of its lien. 11 U.S.C.A. § 506(a).

1 Cases that cite this headnote

[5] **Bankruptcy** Adequate protection in general

**Bankruptcy** Order of court and proceedings therefor in general

**Bankruptcy** Lease

Once amount and extent of creditor's secured claim has been established, burden shifts to debtor seeking to use, sell, lease, or otherwise encumber creditor's collateral to prove that secured creditor's interest will be adequately protected. 11 U.S.C.A. §§ 363, 364, 506(a).

2 Cases that cite this headnote

[6] **Bankruptcy** Determination of priority

Junior secured noteholders complaining of sufficiency of adequate protection granted to them in cash collateral order, and asserting priority claim based on this alleged insufficiency, bore burden of proof on issue. 11 U.S.C.A. § 507(b).

[7] **Bankruptcy** Determination of priority

To establish their entitlement to claim payable on priority basis under debtors' proposed Chapter 11 plan, based on alleged insufficiency of adequate protection granted to them in cash collateral order, junior secured noteholders had to show that aggregate value of their collateral diminished from the petition date to effective date of plan. 11 U.S.C.A. § 507(b).

1 Cases that cite this headnote

[8] **Bankruptcy** Superpriority; extension of credit or failure of adequate protection

**Bankruptcy** Valuation

In assessing value of junior secured noteholders' collateral on petition date, for purposes of deciding whether aggregate value of collateral had diminished from petition date to effective date of debtors' proposed Chapter 11 plan such that noteholders were entitled to priority claim based on insufficiency of adequate protection granted to them in cash collateral order, bankruptcy court would utilize fair market valuation, rather than valuing collateral based on its liquidation value, where junior secured noteholders had entered into cash collateral stipulation to allow sale of debtors' assets as going concern, and where going concern valuation was consistent with debtors' stated purpose in filing for Chapter 11 relief, which included "preserv[ation of] the debtors' [mortgage loan] servicing business on a going concern basis for sale." 11 U.S.C.A. § 507(b).

3 Cases that cite this headnote

[9] **Bankruptcy** Superpriority; extension of credit or failure of adequate protection

Junior secured noteholders failed to satisfy their burden of showing that aggregate value of their collateral had diminished from date that debtors filed for Chapter 11 relief to effective date of debtors' proposed plan, and were not entitled to claim payable on priority basis under plan based on alleged insufficiency of adequate protection granted to them in cash collateral order; while debtors had admittedly spent money that belonged to noteholders, they did so in manner that benefited noteholders, the value of whose collateral on petition date was very substantially impaired by reason of existing defaults that prevented debtors from disposing of collateral at that time, but which debtors, through settlements and consents achieved over many months at great effort and expense, were ultimately able to sell on very favorable terms. 11 U.S.C.A. § 507(b).

2 Cases that cite this headnote

[10] **Bankruptcy** Oversecurity

Determination as to whether junior secured noteholders were oversecured, as required for them to be entitled to postpetition interest and fees in debtors' jointly administered Chapter 11 cases, did not have to be made on debtor-by-debtor basis, but could be made by aggregating their claims against debtor entities, given that no debtor would be required to pay junior secured noteholders more than the value of their collateral; allowing aggregation of claims and collateral more accurately reflected realities of case and of business world at large, given that junior secured noteholders' indenture, like most indentures, allowed debtors to move assets among their subsidiaries, and to create new subsidiaries, as long as noteholders continued to maintain their liens in these assets. 11 U.S.C.A. § 506(b).

2 Cases that cite this headnote

[11] **Bankruptcy** In general; effect of substantive consolidation

Absent substantive consolidation, bankruptcy court will not pool assets of multiple debtors to satisfy their liabilities.

[12] **Bankruptcy** In general; effect of substantive consolidation

Substantive consolidation is to be used sparingly, in recognition of dangers of forcing creditors of one debtor to share on parity with creditors of less solvent debtor.

[13] **Bankruptcy** Adequacy of price; appraisal

When Chapter 11 debtor's assets are sold in arm's-length transaction, fair market value of assets is conclusively determined by the price paid.

[14] **Bankruptcy** Amount secured; partial security

**Bankruptcy** Oversecurity

Mortgage loans included in property of jointly administered Chapter 11 estates of debtors that were leading originators and servicers of residential mortgage loans were properly valued, for purpose of determining the undersecured, secured, or oversecured nature of claims collateralized by these loans, using fair market valuation, rather than a recovery analysis that discounted the figures on debtors' balance sheet based on assumed costs of collection, where debtors, in prior cash collateral order, had expressly waived right to surcharge collateral for costs of collection. 11 U.S.C.A. § 506(a-c).

[15] **Bankruptcy** Weight and sufficiency

While value of junior secured noteholders' security interests in equity that Chapter 11 debtors enjoyed in their non-debtor subsidiaries might perhaps be reduced based on contingent liabilities that subsidiaries faced in pending litigation, debtors, as parties seeking this reduction for purposes of establishing that junior noteholders were undersecured and not entitled to postpetition interest, had to present evidence of risk-adjusted equity value to account for litigation risk, and could not simply rely upon litigation risk to value equity interests at $0.00. 11 U.S.C.A. § 506(b).

[16] **Bankruptcy** Proceedings

Paragraph in cash collateral order could not be interpreted as reviving junior secured noteholders' liens in collateral that had been released to allow Chapter 11 debtors to use it to obtain postpetition financing from another lender, where no party had ever disclosed this purported effect of paragraph in question when cash collateral order was proposed or at any contemporaneous hearing, and where junior noteholders' interpretation of paragraph, as reviving their liens and according them priority even above lien interest of lender from which debtors obtained this postpetition financing, would not have been agreed to by lender, which relied on priority of its lien in making postpetition advances under cash collateral order.

[17] **Bankruptcy** Oversecurity

Refinancing opportunities associated with mortgage servicing rights that were expressly identified as "excluded" assets not subject to junior secured noteholders' liens, while not themselves excluded from general intangibles to which junior noteholders' liens attached, could not be separated from servicing rights themselves, and did not provide any additional security to junior secured noteholders, which bankruptcy court had to consider in assessing whether noteholders were oversecured and entitled to postpetition interest and fees. 11 U.S.C.A. § 506(b).

[18] **Bankruptcy** Oversecurity

No value could be assigned to goodwill of debtors' residential mortgage loan origination/servicing business as of date their Chapter 11 petitions were filed, and bankruptcy court did not have to consider this value in assessing whether noteholders were oversecured and entitled to postpetition interest and fees, where value subsequently allocated to goodwill in connection with postpetition sale of debtors' assets was result of settlements and consents that debtors ultimately achieved over many months, at great effort and expense, in order to make assets ready for sale; any goodwill reflected in postpetition sale of debtors' assets was not shown to exist on petition date, when value of debtors' assets was seriously impaired and subject to steep reductions in value to account for litigation risks, potential seizure of certain mortgage servicing rights, and termination of rights and setoff by trustees of residential mortgage-backed securities. 11 U.S.C.A. § 506(b).

[19] **Bankruptcy** Particular cases and problems

**Bankruptcy** Oversecurity

Any goodwill generated postpetition for Chapter 11 debtors' residential mortgage loan origination/servicing business was not product solely of debtors' use of cash collateral of junior secured noteholders but of settlements that debtors negotiated with government entities and trustees of residential mortgage-backed securities, such that junior secured noteholders' liens did not attach to this postpetition goodwill as product or offspring of their cash collateral, and bankruptcy court did not have to consider postpetition goodwill in assessing whether junior noteholders were oversecured and entitled to postpetition interest and fees. 11 U.S.C.A. §§ 506(b), 552(b).

[20] **Bankruptcy** Oversecurity

**Bankruptcy** Evidence

Bankruptcy court could rely on extrinsic evidence, including testimony of employees of debtors and of other parties to ambiguous prepetition security agreement, to find that excluded assets became part of junior secured noteholders' collateral, pursuant to all–asset granting clause in security agreement, once assets ceased to be excluded assets; accordingly, bankruptcy court had to consider such previously excluded assets in assessing whether junior noteholders were oversecured and entitled to postpetition interest and fees. 11 U.S.C.A. § 506(b).

[21] **Secured Transactions** After-acquired property

Under New York law, security interest arising by virtue of after-acquired property clause is no less valid than security interest in collateral in which debtor has rights at the time value is given. N.Y. Uniform Commercial Code § 9-204.

[22] **Bankruptcy** Particular cases and problems

**Bankruptcy** Debtor in possession

**Secured Transactions** Duration of filing; continuation statement

**Secured Transactions** Filing release

Under New York law, financing statements previously filed by junior secured noteholders continued in effect even after new financing statements were filed following release of portion of collateral securing junior noteholders' claims, and placed third parties on notice of need to investigate noteholders' interest in the released collateral after it was reacquired by Chapter 11 debtors, so as to prevent avoidance of security interest that noteholders possessed in this reacquired collateral pursuant to strong-arm statute. 11 U.S.C.A. § 544; N.Y. Uniform Commercial Code § 9-502.

1 Cases that cite this headnote

[23] **Bankruptcy** Particular cases and problems

**Bankruptcy** Debtor in possession

**Bankruptcy** Oversecurity

Junior secured noteholders did not have perfected liens that were protected from strong-arm avoidance in any deposit accounts of Chapter 11 debtors for which an executed control agreement could not be produced, and bankruptcy court did not have to consider any such accounts in assessing whether junior noteholders were oversecured and entitled to postpetition interest and fees. 11 U.S.C.A. §§ 506(b), 544; N.Y. Uniform Commercial Code § 9-312(b)(1).

[24] **Secured Transactions** Possession by secured party without filing

Under New York law, security interest in deposit account may be perfected only by control of account. N.Y. Uniform Commercial Code § 9-312(b)(1).

[25] **Mortgages and Deeds of Trust** Failure to record, effect on nonparties in general

Under New York law, in order to perfect lien on real property, secured party must duly record against the title of such property a properly executed mortgage or deed of trust.

[26] **Bankruptcy** Mortgages and pledges

**Bankruptcy** Debtor in possession

**Bankruptcy** Oversecurity

In absence of properly executed and duly recorded mortgage or deed of trust, any lien rights that junior secured noteholders possessed in real property of Chapter 11 debtors was avoidable by debtors in exercise of strong-arm powers as debtors-in-possession, and did not have to be considered by bankruptcy court in assessing whether junior noteholders were oversecured and entitled to postpetition interest and fees. 11 U.S.C.A. §§ 506(b), 544.

[27] **Bankruptcy** Elements and Exceptions

**Bankruptcy** Preferences

In preference-avoidance proceeding, trustee bears burden of proving each of statutory elements of preference claim, and unless trustee proves each and every one of these elements, transfer is not avoidable as preference. 11 U.S.C.A. § 547(b)(1-5).

[28] **Bankruptcy** Preferences

When creditor asserts that it was oversecured at time of its receipt of alleged preferential transfer, such that transfer did not enable it to receive more than it would have received in hypothetical Chapter 7 liquidation, it is plaintiff's burden to refute that assertion. 11 U.S.C.A. § 547(b)(5).

[29] **Bankruptcy** Preferences

Absent evidence regarding value of junior secured noteholders' collateral either at start of preference period or when they received allegedly preferential transfers, such as might permit bankruptcy court to determine that they were not oversecured, parties asserting preference claims failed to satisfy burden of showing that challenged transfers enabled junior secured noteholders to receive more than they would have received in hypothetical Chapter 7 liquidation. 11 U.S.C.A. § 547(b)(5).

[30] **Bankruptcy** Proceedings

"Carve out" is provision in cash collateral order that allows for some expenditure of administrative and/or professional fees to be paid before secured creditor gets paid on its collateral.

1 Cases that cite this headnote

[31] **Bankruptcy** Proceedings

Unless it conflicts with provisions of the Bankruptcy Code, "carve out" provision in cash collateral order is construed by applying normal contract interpretation principles.

2 Cases that cite this headnote

[32] **Bankruptcy** Proceedings

Usual purpose of "carve out" in cash collateral order is to ensure the payment of specified administrative expenses from secured creditor's collateral in event that bankruptcy case goes badly, use of cash collateral is terminated, and sufficient unencumbered funds are no longer available to administer case.

2 Cases that cite this headnote

[33] **Bankruptcy** Proceedings

Absent anything in cash collateral order to suggest contrary intent, "carve out" provision in order had to be interpreted in manner consistent with general purpose of "carve out" provisions, as requiring junior secured noteholders to subordinate their secured claims to payment of carve out only if there were insufficient other unencumbered assets from which carve out could be paid.

3 Cases that cite this headnote

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Chapter 11

**MEMORANDUM OPINION, AND FINDINGS OF FACT AND CONCLUSIONS OF LAW, AFTER PHASE I TRIAL**

MARTIN GLENN, UNITED STATES BANKRUPTCY JUDGE

ResCap and the Creditors' Committee (the "Plaintiffs") are co-proponents of a reorganization plan that treats the junior secured noteholders ("JSNs") as undersecured, but would pay them the face amount of all principal and prepetition interest ($2.222 billion, less $1.1 billion repaid ***556** postpetition). The JSNs voted against and oppose confirmation of the plan.

The JSNs contend they are oversecured and entitled to postpetition interest (at the default rate) and fees; they also contend they are entitled to recover an adequate protection claim of $515 million based on alleged diminution in value of their prepetition collateral used during the case under a series of consensual cash collateral orders. [1] They also contend that their collateral should be increased as the result of an "all assets" pledge, which purportedly attaches to the Debtors' assets that (1) were once excluded from the "all assets" pledge but no longer are, (2) were released from the JSNs' liens but were subsequently reacquired by the Debtors, or (3) were never properly released from the JSNs' liens at all.

The Plaintiffs contend that (1) the JSNs are undersecured and, therefore, not entitled to postpetition interest and fees; (2) the JSNs' collateral has not declined in value since the petition date and thus the JSNs cannot assert an adequate protection claim; (3) the JSNs' collateral should be reduced from lien challenges to deposit accounts and real estate owned ("REO") assets; (4) the Debtors' transfers of approximately $270 million of collateral to the undersecured JSNs in the 90 days before bankruptcy are avoidable preferences; and (5) and the principal amount of the JSNs' claim must be reduced by approximately $386 million for unmatured interest arising from original issue discount ("OID") created as part of the Debtors' "fair value" debt-exchange offer in 2008.

The swing between the JSNs' projected recoveries under the proposed plan and their "ask" is at least $350 million, or perhaps more. In other words, the parties are fighting about a lot of money.

The legal issues are framed in two adversary proceedings, one filed by the Debtors and the other by the Creditors' Committee (the "Committee") after it was given standing in an order granting an STN motion. The two adversary proceedings, asserting both claims and counterclaims, were consolidated. In two earlier written decisions, the Court granted in part (sometimes with prejudice and sometimes without prejudice) and denied in part motions to dismiss some of the claims and counterclaims. (*See In re Residential Capital, LLC,* 495 B.R. 250 (Bankr.S.D.N.Y.2013), ECF Doc. # 74, and *In re Residential Capital, LLC,* 497 B.R. 403

 

(Bankr.S.D.N.Y.2013), ECF Doc. # 100. [2]) Familiarity with those decisions is assumed.

The Court established an expedited schedule for discovery and trial. The trial was bifurcated into two phases because some issues involve only the Plaintiffs and Defendants (as defined below) while other issues potentially involve other creditor constituencies in the case. The Phase I trial, conducted between October 15–23 and on November 6, 2013, was limited to disputed issues between the Plaintiffs and Defendants, to simplify the trial and limit the number of parties that felt it necessary to actively participate; the Phase II trial, involving issues potentially affecting the Plaintiffs, Defendants and a broader group ***557** of parties in interest in the bankruptcy case, will be part of the contested plan confirmation hearing now scheduled to begin on November 19, 2013.

On August 23, 2013, the parties submitted an agreed list of issues for trial. (ECF Doc. # 84.) A Joint Pretrial Conference Order, approved by the Court on October 18, 2013, provides stipulations of fact, the parties' factual and legal contentions, and exhibit and witness lists. (ECF Doc. # 161.) All direct fact and expert sworn witness testimony was filed in advance, with the witnesses in court during the trial for cross and re-direct examination. Motions *in limine* to preclude some of the proposed expert testimony were granted in part and denied in part. (Oct. 16 Tr. 8:2–15. [3]) Deposition designations and counter-designations were introduced into evidence at trial mostly without objections. [4] Voluminous exhibits were admitted in evidence at trial, mostly without objections. The parties' filed post-trial submissions on November 1, 2013, and conducted closing arguments on November 6, 2013.

This Opinion resolves the legal and factual issues in the Phase I trial. The Court completed the Opinion quickly because the outcome of the Phase I trial impacts Phase II and the confirmation hearing. This Opinion contains the Court's findings of fact and conclusions of law pursuant to FED. R. CIV. P. 52, made applicable to these adversary proceedings by FED. R. BANKR. P. 7052. In making its findings of fact, the Court has resolved credibility issues and the weight appropriately given to conflicting evidence. Where contested or disputed facts or opinions were offered during trial, this Opinion reflects the Court's resolution of those disputes, whether or not the opinion specifically refers to the contrary evidence introduced by the opposing parties.

**[1]** All of the issues in the Phase I trial are "core," as provided in 28 U.S.C. § 157(b)(2). Because the JSNs (through UMB, the indenture trustee) submitted a proof of claim in this case, seeking to recover all principal, prepetition and postpetition interest and fees, and have asserted an adequate protection claim, all of the issues raised and resolved in these adversary proceedings necessarily must be resolved as part of the claims-allowance process. Therefore, the Court concludes that it has the constitutional authority to enter final orders and judgment in these adversary proceedings. Because issues in these adversary proceedings remain to be resolved following the Phase II trial and confirmation hearing, no final judgment can be entered now. This Opinion does include the Court's final resolution of the issues upon which it now rules.

The results of the Phase I trial can be viewed as a split decision —some issues have been resolved in favor of the Plaintiffs and some in favor of the Defendants. Subject to the outcome of the Phase II ***558** trial, the Court concludes that the JSNs' claim should not be reduced for unmatured OID; the JSNs have failed to establish that they are entitled to recover an adequate protection claim; the JSNs have liens on certain contested collateral, including certain intangible assets, but the JSNs do not have liens on the full extent of the collateral claimed; the Plaintiffs have failed to establish that the JSNs received avoidable preferences during the preference period (as defined below); and the JSNs are undersecured and not entitled to postpetition interest and fees. As explained below, the Court concludes that (subject to the results of the Phase II trial) the JSNs are undersecured by approximately $318 million.

## I. *BACKGROUND*

On May 14, 2012 (the "Petition Date"), the Debtors filed voluntary petitions for relief under chapter 11 of the Bankruptcy Code. Since the Petition Date, the Debtors have continued to operate their businesses and manage their properties as debtors in possession. Before filing for bankruptcy, the Debtors were a leading originator of residential mortgage loans and, together with their non-Debtor affiliates, the fifth largest servicer of residential mortgage loans in the United States, servicing approximately $374 billion of domestic residential mortgage loans and working with more than 2.4 million mortgage loans across the United States. (Marano Direct ¶ 23.)

Defendant UMB Bank, N.A. ("UMB") is the successor indenture trustee (in such capacity, the "Notes Trustee") for the 9.625% Junior Secured Guaranteed Notes due 2015 issued by ResCap (the "Junior Secured Notes" or the "Notes"). (PTO ¶ 3.) Wells Fargo Bank, N.A. ("Wells Fargo")—also a defendant—is the third priority collateral agent and collateral control agent for the Junior Secured Notes. (*Id.* ¶ 4.) Defendant Ad Hoc Group of holders of Junior Secured Notes (the "Ad Hoc Group" or the "JSNs" and, together with the Notes Trustee, the "Defendants" [5]) comprises entities that hold, or manage entities that hold, Junior Secured Notes. Membership in the Ad Hoc Group changes from time to time, as set forth in the Ad Hoc Group's statements periodically filed with the Court pursuant to Rule 2019 of the Federal Rules of Bankruptcy Procedure. (*Id.* ¶ 6.)

The Defendants' claims against the Debtors' estates arise from Junior Secured Notes that ResCap issued pursuant to an Indenture dated June 6, 2008. (PX 1.) Those notes and the collateral securing those notes are discussed in greater detail below. As of the Petition Date, the JSNs held secured claims against ResCap, and certain of its affiliates as guarantors and grantors, in the face amount of $2.222 billion, consisting of $2.120 billion in unpaid principal as of the Petition Date, and $101 million in unpaid prepetition interest. (DX ABF at 3.) The issue whether the face amount of the claim should be reduced by unamortized OID is discussed in section III.A below.

### A. The Adversary Proceedings

#### *1. Complaints and Counterclaims*

In or about July 2012, the Committee began investigating what it believed to be security interests improperly asserted by the Defendants. The Committee filed its complaint on February 28, 2013 (ECF Doc. # 1), seeking among other things (1) a declaratory judgment on claims that (a) certain of the Debtors' property is not ***559** subject to liens or security interests in favor of the JSNs, and that (b) certain liens or security interests on property of the Debtors are unperfected; (2) an order avoiding the JSNs' allegedly unperfected liens on or security interests in certain property; (3) an order avoiding as preferential certain liens or security interests allegedly granted for the Defendants' benefit within 90 days of the Petition Date; (4) an order characterizing postpetition payments to the Defendants' professionals as payments of principal; [6] (5) an order clarifying the priority of the JSNs' liens; and (6) an order disallowing the JSNs' claims pending final resolution of the Committee's complaint; and (7) an order disallowing a portion of the JSNs' claims as a result of unmatured interest allegedly arising from the 2008 debt-for-debt exchange. (*Id.*)

On May 3, 2013, the Debtors filed a Complaint (ECF 13–01343, Doc. # No. 1), and filed an Amended Complaint on June 19, 2013. (ECF 13–01343 Doc. # 8.) In their amended complaint, the Debtors seek declaratory judgments, including among other things that: (1) the JSNs' lien on general intangibles does not include any lien on the proceeds of, or value attributed to, the sale of assets pursuant to the Ocwen Asset Purchase Agreement dated November 2, 2012 ("Ocwen APA"); (2) the JSNs are not entitled to an adequate protection replacement lien; (3) the JSNs are not entitled to a lien on the assets that secure the Amended and Restated Loan Agreement, dated December 30, 2009 ("AFI LOC"), or any other collateral under the Notes Indenture (defined below) that was released by Wells Fargo; (4) the JSNs are not entitled to a lien on any recoveries of any future avoidance actions brought by or on behalf of the Debtors' estates; (5) the JSNs are undersecured and not entitled to postpetition interest; (6) if the JSNs are found to be entitled to postpetition interest, the interest should be awarded at the contractual nondefault rate of interest; and (7) the JSNs are undersecured because they are not oversecured at any individual Debtor entity.

On June 21, 2013, the Court entered an order consolidating the Committee's action with the Debtors' action. (ECF Doc. # 41.) On June 28, the Defendants filed an Answer, Affirmative Defenses and Counterclaims to the Debtors' Amended Complaint. (ECF 13–01343 Doc. # 14.) On July 29, 2013, the Defendants amended their answer and counterclaims. (ECF 13–01343 Doc. # 29.) Those amended counterclaims seek declaratory relief: (1) establishing the ownership and value of the stipulated and disputed collateral and the assets pledged in support of the JSNs; (2) establishing that the JSNs have a lien on claims against Ally Financial, Inc. ("AFI"); (3) determining the distributable value to be generated from all intercompany claims and causes of action; (4) allocating the purchase prices of Debtor assets sold in Court-approved sales; (5) establishing that the JSNs have a lien on the purportedly released assets; (6) determining that the use of cash collateral results in diminution in the collateral's value; (7) enforcing the Debtors' section 506(c) waiver; (8) defining the exact quantum of the direct costs of liquidating collateral; (9) determining the amount of the JSNs' adequate ***560** protection liens; (10) reallocating administrative expenses; (11) establishing that the JSNs are entitled to postpetition interest, default interest, fees, and expenses; (12) determining that the claims asserted by any residential mortgage backed security trust ("RMBS Trust"), monoline insurers, and RMBS certificate-holders must be subordinated; and (13) establishing that the claims against AFI identified by the Examiner [7] appointed in the chapter 11 proceedings and/or the property that is the subject of those claims, constitute the JSNs' collateral.

*2. Motions to Dismiss*

On April 30, 2013, UMB filed a motion to dismiss with prejudice Counts I, IV, V, VII, XI, XII, XIII and XIV of the Committee's complaint in their entirety, and Counts III and X in part. (ECF Doc. # 20.) UMB later withdrew its motion to dismiss certain of those counts, and on July 26, 2013, the Court heard oral argument on UMB's motion. (ECF. Doc. # 61.) The Court entered an opinion and order granting in part and denying in part UMB's motion. (ECF Doc. # 74.) In that opinion, the Court dismissed Count V and denied without prejudice UMB's motion to dismiss Counts I, IV, and XIII. (*Id.*) *See Residential Capital,* 495 B.R. at 250.

On July 16, 2013, the Defendants filed a Motion to Dismiss Counts 3 and 5 of the Debtors' Amended Complaint. (ECF Doc. # 52.) That same day, the Plaintiffs filed a motion to dismiss fourteen of the Defendants' counterclaims. (ECF Doc. # 53.) The Court heard oral argument on both of those motions to dismiss on August 28, 2013, and subsequently issued a memorandum opinion and order (1) denying the Defendants' motion without prejudice, and (2) granting in part and denying in part the Plaintiffs' motion. (ECF. Doc. # 100.) *See Residential Capital,* 497 B.R. at 403.

**B. The Trial**

On August 23, 2013, the parties entered into a Joint Statement of Issues, which the Court so-ordered. (ECF Doc. # 84.) That statement of issues contemplated a bifurcated adjudication whereby certain issues would be decided in a Phase I trial, and others would be decided in a Phase II trial (if necessary). The Phase I trial issues include (1) "[w]hether and to what extent any unamortized portion of the alleged original issue discount on the Junior Secured Note[holders]' claim should be disallowed as unmatured interest," (2) "valuation of each Debtor's collateral ... securing the JSN claims, on a debtor-by-debtor basis, and the appropriate methodologies for conducting such valuation," [8] (3) "[w]hether and to what extent the JSNs have liens on various items of disputed collateral ... including issues related to avoidance of preferential transfers, disputed lien releases, asserted equitable liens resulting therefrom, and potential avoidance of any such equitable liens," (4) adequate protection issues, including "[w]hether and to what extent the JSNs' collateral has diminished in value as a result of the Debtors' use of cash collateral; whether the JSNs are entitled to an adequate protection claim for some or all of that value diminution; and, if the Court deems it appropriate to decide during ***561** Phase I, whether as a matter of law the JSNs might be entitled to adequate protection for any diminution in value associated with the Debtors' entry into the Global Settlement," (5) "the appropriate allocation of proceeds to JSN collateral from the Debtors' asset sales to Ocwen and Walter" (described below), (6) "[w]hether the JSNs have a lien on all or any portion of the AFI Contribution, [9] and/or all or any of causes of action of the Debtors or avoidance claims that the Debtors may bring that are being settled in the Global Settlement," [10] and (7) "[w]hether under section 506 of the Bankruptcy Code, the [Noteholders] may recover postpetition interest and other fees, costs, or charges under the Indenture (a) only to the extent they are oversecured by assets at a single Debtor entity without reference to collateral at other Debtor entities; (b) to the extent they are oversecured with reference to all collateral held by any Debtor, collectively; and/or (c) to the extent that the Debtors collectively have sufficient assets to pay the [Noteholders'] claims in full and/or any particular Debtor is solvent." (*Id.*) [11]

The Court conducted a six-day hearing on Phase I from October 15–17 and October 21– 23, 2013. The parties submitted the written direct testimony of 13 witnesses: Teresa Rae Farley ("Ms. Farley"), John D. Finnerty ("Dr. Finnerty"), James Gadsden ("Gadsden"), Marc E. Landy ("Mr. Landy"), Thomas Marano ("Mr. Marano"), Marc D. Puntus ("Mr. Puntus"), and Mark Renzi ("Mr. Renzi"), for the Plaintiffs; and Michael Fazio ("Mr. Fazio"), Jeffrey M. Levine ("Mr. Levine"), Ronald J. Mann ("Mr. Mann"), P. Eric Siegert ("Mr. Siegert"), John A. Taylor ("Mr. Taylor"), and Scott Winn ("Mr. Winn"), for the Defendants. Each of these witnesses was subjected to cross-examination and redirect at trial. Neither party called any rebuttal witnesses. The Plaintiffs and the Defendants sent their final exhibit lists to the Court post trial. More than 700 exhibits were admitted in evidence, some for limited purposes. The Parties filed amended consolidated deposition designations on October 29, 2013 (ECF Doc. # 179).

## II. *FINDINGS OF FACT*

### A. The Notes, the Collateral, and the Loan Facilities

#### *1. The AFI Revolver and the Junior Secured Notes*

On or about June 4, 2008, Residential Funding Company, LLC ("RFC") and GMAC Mortgage LLC ("GMAC"), as borrowers, ResCap and certain other entities as guarantors, and certain entities as obligors, entered into a revolving loan facility (the "Revolver") as amended from time to time. The Revolver was provided under a Loan Agreement (the "Original Revolver Loan Agreement"), dated June 4, 2008 (and amended from time to time before December 30, 2009), with AFI as initial lender and lender agent. (PTO ¶ 10; PX ***562** 5.) To secure the obligations under the Revolver, ResCap and certain of its subsidiaries, as grantors, granted a security interest in favor of Wells Fargo, as First Priority Collateral Agent and Collateral Control Agent, pursuant to a First Priority Pledge and Security Agreement and Irrevocable Proxy (the "Original Revolver Security Agreement"), dated June 4, 2008 (and amended from time to time before December 30, 2009). (PTO ¶ 11; PX 7.) ResCap also issued $4.01 billion in face principal amount of Junior Secured Notes (the "Junior Secured Notes") pursuant to an indenture dated as of June 6, 2008 (the "Notes Indenture"). (PX 1 § 1.01.) Interest accrues on the Junior Secured Notes at an annual 9.625% rate. [12] (*Id.* at 8.) ResCap issued those Junior Secured Notes with certain other entities serving as guarantors and obligors, [13] and with U.S. Bank National Association, as the original indenture trustee. (*Id.*) To secure the obligations under the notes, ResCap and the guarantors under the Notes Indenture granted a security interest in favor of Wells Fargo —the Third Priority Collateral Agent—pursuant to the Third Priority Pledge and Security Agreement and Irrevocable Proxy (the "Original JSN Security Agreement"), dated June 6, 2008 (and amended from time to time before December 30, 2009). (PTO ¶ 13; PX 3.)

Pursuant to Original Revolver Security Agreement and the Original JSN Security Agreement, the collateral securing the Revolver was identical to the collateral securing the Junior Secured Notes. (*See* PX 7, PX 3.) [14] On December 30, 2009, the Original Revolver Security Agreement, the Original Revolver Loan Agreement, and Original JSN Security Agreement were amended and restated, giving rise to the "Revolver Loan Agreement," the "Revolver Security Agreement," and the "JSN Security Agreement." Following those amendments, the collateral securing the agreements remained identical. (*See* PX 8, PX 4.) The Plaintiffs contend that certain collateral was later pledged to the Revolver but not to the JSNs, which the Court will address below.

Since the collateral securing the Revolver and the Junior Secured Notes was identical, the creditors entered into an Intercreditor Agreement on June 6, 2008. (PX 2.) That agreement governs the Revolver Collateral Agent's ability to enforce rights associated with collateral. The governing documents expressly authorize the Collateral Agent, at the request of the Debtors, to release liens on the collateral previously securing the Revolver and the JSNs. Any lien releases executed by the Revolver Collateral Agent were binding on the Junior Secured Notes.

#### *2. Primary Collateral and Blanket Lien Collateral*

The Revolver and Junior Secured Notes were secured by two categories of collateral: ***563** Primary Collateral and Blanket Lien Collateral. (PTO ¶ 12.) Primary Collateral was specifically delineated on the schedules to the AFI Revolver and served as the borrowing base under the AFI Revolver. Primary Collateral was subject to various operational and reporting requirements. (Farley Direct ¶ 24; Farley Dep. 48:14–21.)

Blanket Lien Collateral encompassed the balance of the collateral pledged as security under the AFI Revolver and not falling within the definition of "Excluded Assets." [15] (Farley Direct ¶ 25.) The Blanket Lien Collateral included assets that were not Primary Collateral, "whether [such assets were] now or hereafter existing, owned or acquired and wherever located and howsoever created, arising or evidenced." (PX 3 at 11–12; *see also* PX 4 at 15.) All of the assets that came in to ResCap (except Excluded Assets) after the parties executed the Original JSN Security Agreement were subject to the JSNs' third priority lien due to the blanket lien. (*See* PX 3 at 11–13; PX 4 at 15–17.)

Between the Primary and Blanket Lien Collateral, the JSNs' collateral included (1) assets and property of ResCap, the Notes Guarantors, and the Additional Notes Grantors (other than Excluded Assets); [16] (2) certain equity interests, certain promissory notes and other debt instruments, certain deposit and security accounts, and certain related assets of the Notes Equity Pledgors; (3) all "Financial Assets" (as defined in Article 8 of the U.C.C.) and certain related assets of the FABS Grantors (as defined in the JSN Security Agreement); and (4) certain deposit accounts and certain related assets of the Additional Account Parties (collectively, the "JSN Collateral"). (PX 4.)

Primary Collateral could only be released if proceeds of that collateral were used to pay down the AFI Revolver or to buy replacement collateral. (*See* PX 1 at 56.) Blanket Lien Collateral, on the other hand, could be released without the same restrictive requirements. (Farley Direct ¶ 25; Oct. 16 Tr. 180:4–8.)

The Notes Indenture and the JSN Security Agreement combined to permit the Debtors to incur future indebtedness secured by liens, to conduct certain asset sales, and to release JSN Collateral so long that release was part of a transaction not prohibited by the Notes Indenture. (PX 1 §§ 1.01, 4.01, 8.04(a)(i); PX 4 § 7.) Additionally, the Intercreditor Agreement allowed the First Priority Collateral Agent to release liens on any collateral in connection with a sale or disposition of the collateral allowed under the Revolver Agreements and the Junior Secured Notes Agreement. (PX 2 § 3.1.) That collateral release would be binding on the JSNs. (*Id.*) The Debtors could only release JSN Collateral pursuant to the JSN Security Agreement, the Notes Indenture, and the Intercreditor Agreement. Additionally, the JSN Indenture allowed the Debtors to move assets among their subsidiaries, and to create new subsidiaries, as long as the JSNs continued to maintain liens on such ***564** assets. (PX 1 § 4.7 (requiring all "Significant Subsidiaries" to become "Guarantors" and thus also "Grantors" under the JSN Pledge Agreement).)

*3. The AFI LOC and Released Blanket Collateral*

In 2009, the Debtors determined that they needed additional financing to continue operating their businesses. To that end, on or about December 30, 2009, RFC and GMAC, as borrowers, entered into the AFI LOC, provided under an Amended and Restated Loan Agreement ("LOC Loan Agreement" with AFI as initial lender and lender agent). (PTO ¶ 18; PX 9.) To secure the obligations under the AFI LOC, ResCap and certain other Debtors granted a security interest to AFI pursuant to the Amended and Restated Pledge and Security Agreement and Irrevocable Proxy, dated December 30, 2009 (as amended from time to time, the "LOC Security Agreement") with GMAC Investment Management LLC, as secured party, and AFI, as omnibus agent, lender agent, lender and secured party. (PTO ¶ 19.) Granting that security interest to secure the AFI LOC required the First Priority Collateral Agent and Third Priority Collateral Agent to release their respective liens on certain collateral. (PX 134; Farley Direct ¶¶ 52–61.)

In 2010 and 2011, the Third Priority Collateral Agent released its lien on a variety of assets included in the JSN Collateral so the collateral could be pledged to secure the AFI LOC, including (1) certain mortgage loans, servicing rights and other assets (the "Released Loan Collateral"), and (2) certain Freddie Mac servicing advances (the "Released Advances," and collectively with the Released Loan Collateral, the "Released Blanket Collateral"). (PX 134.) To effectuate the releases, the Third Priority Collateral Agent executed (1) a Partial Release of Collateral, dated May 14, 2010, releasing the security interest in the Released Loan Collateral that previously secured the Junior Secured Notes, and (2) a Partial Release of Collateral, dated May 27, 2011, that released the security interest in the Released Advances that previously secured the Junior Secured Notes (together with the May 14, 2010 release, the "Blanket Releases"). (PX 130 at 1176–1305, PX 134.) The Third Priority Collateral Agent also filed U.C.C.–3 amendments that removed the Released Blanket Collateral from the collateral set forth in the original U.C.C.–1s (as amended) filed by the Third Priority Collateral Agent. (PX 131; PX 133.) Exhibits annexed to these U.C.C.–3s contained descriptions of the Released Blanket Collateral that were identical to those in the Blanket Releases themselves. (*Id.*)

The May 14, 2010 release described various categories of Released Loan Collateral, including any existing or future rights in "Subject Mortgage Loan[s]." The release defined those loans as:

> Any Mortgage Loan (a) which is identified in a Mortgage Schedule delivered under the LOC Loan Agreement, (b) the carrying value of which is included in the calculation of the borrowing base included in a borrowing base report or a monthly collateral report under the LOC Loan

> Agreement, or (c) which is indicated in a Relevant Party's [17] books and records as having been pledged to the Lender Agent. [18]

(PX 134 at 8.) Thus, a mortgage loan listed as AFI LOC collateral on the Debtors' books and records would qualify as a Subject ***565** Mortgage Loan that was released. The LOC Loan Agreement defines mortgage loans to mean residential mortgage loans and any right to receive payment from the Federal Housing Administration and Department of Veterans Affairs ("FHA/VA") for insurance or guarantees of residential mortgage loans. [19] (PX 9 at 87; PX 10 at 100.)

Other categories of collateral released under the Blanket Loan Release included (1) "Servicing Rights Collateral," defined as all of RFC's and GMAC's rights under existing or future agreements pursuant to which they were obligated to perform collection, enforcement or similar services to maintain and remit funds collected from mortgagees; and (2) all intangible assets and other general intangibles relating to Subject Mortgage Loans and Servicing Rights Collateral. (PX 134 at 6–8.)

The May 27, 2011 release described various categories of Released Advances that were being released from the JSNs' liens. These assets included any existing and future advances relating to mortgage loans and real estate owned property made pursuant to certain contracts with Freddie Mac. (*See* PX 130 at 1181–83.)

**B. The Debtors' Books and Records**

**[2]** To comply with the numerous collateral tracking and reporting requirements of the Revolver Loan Agreement, the Debtors developed and implemented technological systems and operational procedures. (Farley Direct ¶ 29.) Starting in 2008, the Consolidated Financial Data Repository, or "CFDR," became the Debtors' primary record for tracking their assets and was maintained in the ordinary course of the Debtors' business. (Farley Direct ¶¶ 29–30; *see also* PX 139.) The CFDR tracks various categories of assets, including without limitation, held for sale ("HFS") and held for investment ("HFI") mortgage loans, FHA/VA receivables, servicing advances, lending receivables, service fees and late charges, REO property, trading securities, and mortgage servicing rights. (Farley Direct ¶ 30 n.4.) Each asset is marked in the CFDR to reflect the facility to which it has been pledged. (Oct. 16 Tr. 194:3–10.) Because the collateral pools for the Revolver and the Junior Secured Notes were the same, the CFDR tracked the JSN Collateral by tracking the Revolver collateral. (Farley Direct ¶ 30.)

Assets comprising Primary Collateral under the Revolver Security Agreement are tracked and marked in the CFDR as pledged to the Revolver. (Oct. 16 Tr. 194:3–6.) Assets comprising Blanket Lien Collateral under the Revolver are also tracked, but before the Petition Date, those assets were marked as "Unpledged" in the CFDR because (1) the Debtors were not required, and the CFDR was not used, to report on Blanket Lien Collateral; and (2) Blanket Lien Collateral was not subject to the same constraints relating to use of proceeds as Primary Collateral. (Farley Direct ¶ 35.) Not all unpledged assets constituted Blanket Lien Collateral, though, because Excluded Assets under the Revolver Security Agreement and JSN Security Agreement would also be listed as unpledged. (Farley Direct ¶ 35; Oct. 16 Tr. 194:7–10.)

***566** Shortly before the Petition Date, the Debtors updated the CFDR to comply with stricter reporting and cash tracking requirements attendant to the bankruptcy process and recoded assets constituting Blanket Lien Collateral from "Unpledged" to "Blanket Lien Collateral." (Ruhlin Dep. 119:4–9, 155:16–156:2, 156:15–21; Farley Direct ¶ 36; Farley Dep. 115:4–14.) When the Debtors repurposed the CFDR in 2012 and began specifically tracking blanket lien collateral, "what [ResCap] viewed as blanket lien collateral was no longer included as unpledged. It was marked otherwise to be more specific that it related to pledged collateral in some way." (Ruhlin Dep. 119:4–9; *see also* Farley Dep. 138:4–11 ("Shortly before the filing date ... since [ResCap was] going to have to start reporting on all assets which had been subject to the blanket lien at the time of the filing date, there was an effort undertaken to label all of the assets which were in [ResCap's] view ... subject to the blanket lien.").)

During the trial, Ms. Farley testified that the CFDR is a Sarbanes–Oxley ("SOX") compliant financial tool that is auditable, verifiable, and subject to a heightened level of scrutiny and attention by the Debtors'/AFI's SOX teams and the Debtors' external auditors, Deloitte & Touche. (Farley Direct ¶ 43; Oct. 16 Tr. 233:1–6, 234:23–235:25.) Ms. Farley also testified that these controls were rigorous because the CFDR was a critical financial technology for the Debtors. (Oct. 16 Tr. 235:24–25.) Ms. Farley further detailed the strict controls on the collateral tracking process under the CFDR, including the processes for (1) designating an asset as being pledged to a particular facility; (2) changing an asset's designation; (3) reconciling any inconsistencies between the CFDR data, the general ledger, and source data submitted by various business units; and (4) submitting collateral reports under the Revolver and LOC Facility. (Farley Direct ¶¶ 30 n.4, 33–34, 38–42; Oct. 16 Tr. 194:1–10; *see also* PX 162.)

Following Ms. Farley's testimony, over the Defendants' objection, the Court admitted the CFDR in evidence as a business record maintained by the Debtors in the ordinary course of business. (Oct. 17 Tr. 32:17–33:17, 40:7–41:18.) The Court expressly finds that the CFDR is a reliable and accurate business record containing a contemporaneous record of the Debtors' business transactions concerning the assets tracked in the system. The Court also expressly finds that the Defendants' challenge to the CFDR is unpersuasive.

*1. The CFDR and the Released Blanket Collateral*

The CFDR constituted the Debtors' books and records by which the they tracked collateral pledged to various facilities. Thus, collateral listed as pledged to the AFI LOC in the CFDR would meet the definition of a Subject Mortgage Loan released by the Third Party Collateral Agent (discussed above) as part of the Blanket Releases.

The JSNs claim that they have a lien on $910 million of collateral that was identified in the CFDR as pledged to the AFI LOC on the Petition Date. That collateral is composed of categories of assets that were released under either of the Blanket Releases.[20] (Farley Direct ¶ 62.) The ***567** JSNs argue that other evidence of the release of this $910 million of JSN Collateral should exist, including schedules of mortgage loans, notices of collateral additions to the LOC Loan Agreement, and electronic templates used to update the CFDR. The Debtors, though, either did not maintain all these documents or did not locate them in their searches during discovery. (*See* ECF 13–01343 Doc. # 117; *see also* Oct. 16 Tr. 237:6–239:14.)

Regardless, there is no dispute that $910 million of collateral is listed in the CFDR as pledged to the AFI LOC; nor is there any dispute that the $910 million comprises categories of assets that were released under the Blanket Releases. In ruling on the motions to dismiss, the Court held that the description of the collateral covered by the releases satisfied the requirements of the Uniform Commercial Code ("U.C.C.") section 9–108(b). *Residential Capital,* 497 B.R. at 418. Therefore, the Court finds that the $910 million was effectively released, and no further evidence is necessary to support those releases. The absence of the additional records sought by the Defendants is not sufficient to overcome the evidence that was introduced at trial. The Court expressly finds that a preponderance of the evidence supports the finding that the $910 million of collateral was released from the JSNs' lien and pledged to the AFI LOC.

**C. Events Leading Up to the Debtors' Bankruptcy**

In August 2011, the Debtors began to contemplate out-of-court restructuring opportunities, a potential chapter 11 filing, financing alternatives and asset sales. To that end, in October 2011, ResCap retained Centerview Partners LLC ("Centerview") to assist in this process. (Puntus Direct ¶¶ 1, 16, 40, 41, 43; Marano Direct ¶ 28.) In December 2011 and January 2012, faced with significant debt maturities coming due in spring 2012, the Debtors and Centerview began evaluating, and launched a process to obtain, a stalking horse bid(s) for a chapter 11 sale of all or a substantial portion of the Debtors' assets. (Puntus Direct ¶¶ 3, 16, 44; Marano Direct ¶ 29.) Contemplating a potential bankruptcy filing, the Debtors wanted to obtain debtor-in-possession ("DIP") financing, secure a stalking horse bid, and continue to work with government-sponsored entities ("GSEs") and regulators to maintain the Debtors' GSE mortgage servicing rights ("MSRs"). (Marano Direct ¶ 3 1.) The Debtors also wanted to resolve potential claims against AFI to obtain AFI's support for the business and resolve litigation threats asserted by RMBS trustees. (*Id.*)

*1. Stalking Horse Bids*

On or about January 23, 2012, Centerview launched a marketing process for the Debtors' assets. (Puntus Direct ¶ 48.) After developing a list of potential bidders, Centerview contacted five potential bidders and negotiated nondisclosure agreements with each one. (*Id.*) Centerview made clear that the Debtors would consider bids for any and all asset combinations, including bids on individual assets. (*Id.*) ***568** Centerview also opened a data room to facilitate bidder due diligence, and the Debtors held multi-day management presentations with three of the five potential bidders. (*Id.*)

In February 2012, Centerview received three preliminary indications of interest from (a) Nationstar Mortgage LLC ("Nationstar") (PX 27), (b) Ocwen Loan Servicing LLC

("Ocwen") (PX 25), and (c) a certain undisclosed financial bidder (PX 17). The financial bidder's letter of intent ("LOI") included a bid of $1.5 billion for the Debtors' mortgage loan origination and servicing assets (the "Servicing and Origination Assets") and portions of the Debtors' whole loan portfolio (the "Whole Loan Portfolio"). Nationstar also submitted an LOI, which included a bid of $2.6 billion for a substantial portion of the Debtors' assets. (Puntus Direct ¶ 49.) Ocwen's initial LOI was a bid of $1.426 billion to acquire solely the Debtors' private label securitization ("PLS") MSRs and associated advances. (*Id.*) The Debtors and their advisors determined that proceeding with two of the three bidders—Nationstar and the financial bidder—was most prudent. (*Id.* ¶ 50.) Centerview then approached each of the two with a detailed request for supplemental information. (*Id.*) To that end, on February 22, 2012, Centerview sent a letter to Fortress Investment Group LLC ("Fortress") —Nationstar's primary shareholder—requesting additional clarification related to Nationstar's bid. (PX 366.) Centerview asked Nationstar to clarify how it would allocate its bid among the purchased assets, "including but not limited to a separate allocation for each of the financial assets (MSR, advances, whole loan portfolio) as well as the servicing and origination platforms, respectively." [21] (*Id.*) In its response to Centerview's questions about bid allocation, Fortress specified that it would allocate no value to either the consumer lending or servicing platforms. (PX 28 at 2.)

Nationstar submitted a revised LOI on February 28, 2012, increasing the purchase price on assets included in its initial bid by $100 million, and expanding the assets purchased to include GSE and PLS advances. (Puntus Direct ¶ 5 1.) It also increased its total bid for the Debtors' mortgage loan origination and servicing assets and Whole Loan Portfolio to $4.2 billion for the Debtors' mortgage loan origination and servicing assets and Whole Loan Portfolio. (*Id.*) Nationstar's bid on the Whole Loan Portfolio was contingent on AFI providing better-than-market debt financing for such portfolio. (*Id.*) After this bid, the Debtors decided to proceed with Nationstar as the exclusive bidder on the assets. (*Id.* ¶ 52.) In early March 2012, the Debtors and their advisers negotiated the terms of the asset purchase agreement with Nationstar (the "Nationstar APA"), and Nationstar completed its analysis of the Debtors' business. (*Id.* ¶ 55.)

During April and May of 2012, AFI decided not to provide Nationstar debt financing related to the Debtors' Whole Loan Portfolio, and offered its own bid of $1.4 to $1.6 billion to acquire those assets, depending on whether the sale was effectuated through a section 363 sale or chapter 11 plan. (*Id.* ¶ 56.) AFI's decision not to provide financing caused the value of Nationstar's overall bid to decrease. (*See* PX 52 at 6.) The Debtors' professionals determined that AFI's bid to acquire the Whole Loan Portfolio was superior to Nationstar's ***569** bid for those assets, particularly because AFI was not seeking any stalking horse protections in connection with the sale and had submitted a draft asset purchase agreement with very favorable terms for the Debtors. (Puntus Direct ¶ 56.) Thus, the Debtors and their advisors negotiated the terms of an asset purchase agreement with AFI (the "AFI APA").

The Debtors' Board of Directors approved both APAs. (*Id.* ¶ 57.) On May 13, 2012, both APAs were executed and delivered by the parties. (*Id.*) On the Petition Date, the Debtors filed two stalking horse bids with the Bankruptcy Court: Nationstar's $2.3 billion stalking horse bid for the Debtors' mortgage loan origination and servicing assets (encompassed in the Nationstar APA), and AFI's $1.4 to 1.6 billion bid for the Debtors' Whole Loan Portfolio (encompassed in the AFI APA). (Puntus Direct ¶ 57; Marano Direct ¶ 58.)

*2. Communications and Settlements with Various Parties*

During the prepetition auction process, the Debtors regularly communicated with the GSEs concerning the proposed agreement and plans for maintaining the Debtors' origination and servicing operations as a going concern until closing of the final sale to preserve the value of the MSRs and associated advances. (Marano Direct ¶ 50; Puntus Direct ¶ 45.) Through these regular contacts, the Debtors convinced the GSEs that the Debtors could sell the assets without damaging the MSRs and associated advances. (Puntus Direct ¶ 46.) The stakes were high: if the GSEs had concluded that ResCap could not operate or credibly pursue an orderly sale of the mortgage servicing assets, and that the GSE-related assets might therefore have been subject to liquidation, the GSEs would raise the cost of doing business and seize their assets. (Marano Direct ¶ 51.) By obtaining financing, use of cash, continuity of management through the end of sale, and a stalking horse bidder, the Debtors reassured the GSEs that during the chapter 11 sale process, the Debtors' business would continue to function as usual pending the sale. (*Id.*)

Before the Petition Date, the Debtors negotiated a settlement with the Department of Justice, the Department of Housing and Urban Development, and the attorneys general of

49 states (the "DOJ/AG Settlement") to resolve potential claims arising out of origination and servicing activities and foreclosure matters. (*Id.* ¶ 7.) The DOJ/AG Settlement required that the Debtors pay approximately $110 million in cash and provide various specified forms of borrower relief with a value of at least $200 million and that the Debtors—and any purchaser of the Debtors' assets—implement a remedial program of loan modification and enhanced servicing measures, both subject to ongoing regulatory monitoring and oversight, and imposed increased operational costs. (*Id.* ¶ 53.) Also before the bankruptcy filing, the Debtors entered into a consent order settling an investigation by the Federal Reserve Board (the "FRB Consent Order") arising out of the same general facts as the DOJ/AG Settlement. (*Id.* ¶ 54.) The terms of the FRB Consent Order required ResCap to pay a penalty of $207 million, as well as to enhance various aspects of their origination and servicing business, including their compliance and internal audit programs, internal audit, communications with borrowers, vendor management, employee training, and oversight by the Board of Directors. (*Id.*) The Consent Order required the Debtors—and any purchaser of the Debtors' assets—to maintain ***570** compliance with the terms of the order.[22] (*Id.*)

*3. Prepetition Settlements and Plan Support Agreements*

Before the Petition Date, the Debtors entered into plan support agreements with AFI and certain other parties in interest—including certain of the current Ad Hoc Group members—whereby the parties committed to support, subject to certain terms and conditions, the Debtors' effort to pursue a chapter 11 plan pursuant to the terms provided in the Plan Term Sheet, dated May 14, 2012 (the "Prepetition Plan Term Sheet"). (PX 432.) The Prepetition Plan Term Sheet contemplated, among other things, that AFI would make a cash contribution in exchange for estate and third party releases. (PTO ¶ 24.) The Debtors and AFI reached a prepetition settlement approved by the ResCap board on May 13, 2012 (the "Original AFI Settlement"). (Marano Direct ¶ 40.) That settlement was memorialized in a Plan Sponsor Agreement. (*Id.*) Under the terms of the Original AFI Settlement, AFI agreed to pay the Debtors $750 million, continue to support the Debtors' origination business in chapter 11, provide a stalking horse bid for the Whole Loan Portfolio, provide DIP financing, and continue to provide the Debtors the shared services it needed to run its business. (*Id.* ¶ 41.) The Original AFI Settlement and Plan Sponsor Agreement also provided for the automatic termination of the agreements if the Court did not approve a chapter 11 plan on or before October 31, 2012. AFI and the Debtors agreed to monthly waivers of this automatic termination through February 28, 2013. (*Id.* ¶ 41; Puntus Direct ¶ 35.)

Under the plan support agreement entered into with the JSNs (the "JSN PSA"), the JSNs would have waived all rights to postpetition interest through December 31, 2012, so long as no unsecured creditor received postpetition interest, the JSN PSA did not terminate, and the effective date of the plan occurred by December 31, 2012, or (1) the closing of contemplated asset sales occurred by December 31, 2012, and (2) the effective date of the plan occurred by March 31, 2013. (Puntus Direct ¶ 33.) The JSN PSA also would have provided that AFI would subordinate a portion of its liens and claims to the JSNs. (*Id.*)

At the same time that the Debtors were negotiating with AFI, they were also negotiating with the trustees of certain RMBS trusts (the "RMBS Trusts") for which the Debtors acted as sponsor, depositor, or in a similar capacity. (*Id.* ¶ 37.) These negotiations related to resolution of approximately $44 billion of potential liability for representation and warranty and servicing claims arising out of the Debtors' private-label residential mortgage backed securities. (Marano Direct ¶ 43.) The Debtors believed that resolving these private-label securities claims was crucial to enhancing the value of the Debtors' assets for a potential sale. (*Id.*) The overhang of this litigation exposure had impeded the Debtors' sale efforts in the years before the chapter 11 filing and would have diminished the value the Debtors' creditors could have obtained in a chapter 11 sale. (*Id.*) Further, the RMBS Trustees (the "RMBS Trustees") threatened to assert the right to withhold servicing advances owed to the Debtors as an offset against origination and servicing liabilities allegedly owed to them. (*Id.*)

In May 2012, the Debtors reached a proposed settlement with the institutional ***571** investors holding a substantial stake in the RMBS Trusts (the "RMBS Settlement"). (*Id.* ¶ 44.) ResCap's board of directors approved that agreement on May 13, 2012. (*Id.*)

With the stalking horse bids, proposed settlements, and plan support agreements in place, the Debtors filed their chapter 11 cases on May 14, 2012. Any notion that the Court was being presented with a pre-packaged bankruptcy was short-lived, however, and these cases rapidly descended into warfare threatening the Debtors' ability to continue operating as a going concern.

*4. Termination of the Initial Plan Support Agreements*

By late September 2012, two events occurred that altered the calculus of the JSNs who supported the prepetition PSA. (Siegert Direct ¶ 12.) First, with the auction still a month away, there was no longer any possibility of an expedited distribution upon a rapid sale closing. (*Id.*) Second, the Committee challenged certain of the JSNs' liens within the challenge period prescribed by the Cash Collateral Order. (*Id.*) The Ad Hoc Group then terminated the prepetition term sheet and inserted an express reservation of rights regarding adequate protection and allocation of expenses in each extension of the Cash Collateral Order. (*Id.*)

**D. The Cash Collateral Order**

To keep their business operating as debtors-in-possession, the Debtors sought to obtain postpetition financing and authorization to use the cash collateral encumbered by existing debt facilities. (Marano Direct ¶ 33; Puntus Direct ¶ 17.) The continued funding would allow the Debtors to (1) continue to issue loans and offer loan modifications to thousands of borrowers; (2) continue to service mortgages and make advances associated with such servicing obligations; (3) comply with the Federal Reserve and FDIC consent order; (4) comply with the DOJ/AG Settlement; (5) comply with the agreements that had been entered into with the GSEs mandating the care with which their loans should be serviced and refinanced, and repurchase loans from the GSEs; and (6) maintain hundreds of employees through retention payments so that delinquencies would not increase and thus diminish the value of, and jeopardize the sale of, the Debtors' MSRs and other assets. (Marano Direct ¶ 34.) For example, the Debtors needed to continue funding their servicing advance obligations for the RMBS and other PLS, as well as GSE loans. (*Id.* ¶ 35.) With respect to the GSE loans, the GSEs actually owned the Debtors' servicing rights, so if the Debtors failed to make the requisite advances, the GSEs could have revoked the Debtors' servicing rights, and re-assigned those rights to another company. (Marano Direct ¶ 35; Puntus Direct ¶ 19.)

The Debtors ultimately obtained DIP financing facilities from Barclays Bank PLC and AFI, as well as consensual use of cash collateral from their prepetition lenders, including the JSNs. (Marano Direct ¶ 37.) On May 14, 2012, the Debtors filed motions seeking authorization to (1) enter the Barclays postpetition financing facility (the "Barclays DIP Facility"); (2) make postpetition draws under the AFI LOC up to $200 million; and (3) use cash collateral securing each of the Revolver, the AFI LOC, and the Junior Secured Notes to fund the cash needs related to operations and assets of each of the respective collateral pools. (*Id.*; Puntus Direct ¶ 28.) The motions were approved on an interim basis on May 15, 2012, and were approved on a final basis, with the consent of the JSNs and AFI, pursuant to orders entered on ***572** June 25, 2012 (the "Cash Collateral Order"). (PX 76; Marano Direct ¶ 37.)

Under the Cash Collateral Order, the Debtors were authorized to use cash collateral in accordance with the Forecasts (as defined in the Cash Collateral Order), and the JSNs were protected to the extent of the aggregate diminution in value of the JSN Collateral. (PTO ¶ 29.) Among other things, the JSNs were granted adequate protection liens on all of the collateral securing the AFI Revolver, the AFI LOC, and all of the equity interests of the Barclays DIP Borrowers. (PX 76.)

The parties dispute whether, in determining an adequate protection claim based on diminution in value of collateral, the value of the collateral at the Petition Date should be determined by the foreclosure value of the collateral in the hands of the secured creditor (as argued by the Plaintiffs), or by the going concern value of the collateral in the hands of the Debtors (as argued by the Defendants). The legal issue is discussed below in section III.B.3. The Defendants' expert Mr. Siegert testified that when negotiating the Cash Collateral Order, the parties never discussed that adequate protection and diminution in value of JSN Collateral would be determined using foreclosure value. (Oct. 23 Tr. 195:9–13.) According to Mr. Siegert, that would have been contrary to the spirit of the negotiations, which were aimed at easing the Debtors' bankruptcy filing. (DX AIJ at 7.)

The Forecasts provided for the pro rata allocation of the cash disbursements during the relevant period to various silos of assets securing the Debtors' various secured credit facilities, as well as to unencumbered assets. (Puntus Direct ¶ 26.) The Debtors delivered updated Forecasts to the JSNs and AFI every four weeks as required by the Cash Collateral Order, and, although the JSNs did not have consent rights, at no point during the case did they object to any Forecast. (*Id.*) The Cash Collateral Order also obligated the Debtors to deliver to the JSNs a 20–week forecast of anticipated cash receipts and disbursements for the 20–week period. (PX 76 at 22.) The Debtors were only permitted to use cash collateral for the "purposes detailed within the Initial 20–Week Forecast and each subsequent Forecast." (*Id*. at 23–24.)

The Cash Collateral Order contained a waiver of the Debtors' right to surcharge against prepetition collateral pursuant to Bankruptcy Code section 506(c). (PX 76 at 42–43.) Specifically, the Cash Collateral Order states that: "[N]o expenses of administration of the Chapter 11 Cases or any future proceeding that may result therefrom, including liquidation in bankruptcy or other proceedings under the Bankruptcy Code, shall be charged against or recovered from the Prepetition Collateral and [Cash] Collateral pursuant to sections 105 or 506(c) of the Bankruptcy Code...." (*Id*.) The Cash Collateral Order also expressly waived the "equities of the case" exception contained in section 552(b) of the Code. (*Id*. at 35.)

The Debtors negotiated several extensions regarding the use of the cash collateral of AFI and the JSNs, including a stipulation entered on June 28, 2013. (ECF 12–12020 Doc. # 4115.) On July 10, 2013, the Court entered the Stipulation and Order in Respect of the Debtors' Motion for Entry of an Order to Permit the Debtors to Continue Using Cash Collateral (ECF 12–12020 Doc. # 3374) (the "Cash Collateral Stipulation") among the Debtors, AFI, and the JSNs, which terminated the use of cash collateral effective as of July 11, 2013, with certain limited exceptions. (PX 85 ¶ 2.)

The Debtors also negotiated a "Carve Out" in the Cash Collateral Order (PX 76 ***573** at 31– 32.) The Cash Collateral Stipulation served as the Carve Out Notice. No party disputes that a section 506(c) waiver was provided for the benefit of the JSNs. The parties dispute whether the JSNs are entitled to an adequate protection claim for amounts of cash collateral expended by the Debtors consistent with the agreed budget under the Cash Collateral Order. The issue also remains whether the Debtors may use an additional $143 million of the JSNs' cash collateral covered by the Carve Out in the Cash Collateral Order after the termination of the use of cash collateral where sufficient unencumbered cash is available to make the payments. The issue is addressed below in section III.D.8.

### E. Stipulation of Liens under the Cash Collateral Order

In the Cash Collateral Order, the Debtors stipulated that the JSNs' collateral included, but was not limited to, all categories of assets identified in the "Ally Revolver" and "Blanket" columns on Exhibit A to the Cash Collateral Order. (PTO ¶ 28.) The Debtors further stipulated, pursuant to paragraph 5(g) of the Cash Collateral Order, that security interests granted to the JSNs "are valid, binding, perfected and enforceable priority liens on and security interests in the personal and real property constituting 'Collateral' under and as defined in the Junior Secured Note Documents." (PX 76 at 11–12.) Under the Cash Collateral Order, the "Junior Note Documents" included the JSN Security Agreement, the Notes Indenture, "and all other documents executed in connection therewith." (*Id.* at 4) The Defendants contend that, under paragraph 5(g), the Debtors stipulated that the JSNs' liens extend to all collateral to which a security interest was initially granted, including the AFI LOC Collateral that was previously released by the Third Priority Collateral Agent under the Blanket Release. (PTO JSN Contentions ¶ 18.) The JSNs' witness, Mr. Siegert—the lead engagement partner for Houlihan Lokey Capital, Inc. ("Houlihan")—testified that as of the Petition Date, he had no belief that the Debtors' stipulations in paragraph 5(g) would revive the JSNs' previously released liens. (Oct. 23 Tr. 102:4–6, 102:19–24, 105:3–25, 115:4–8, 125:12–126:15, 126:23–127:21.) Mr. Siegert explained that if counsel for the JSNs had concluded that paragraph 5(g) would revive more than $1 billion of AFI LOC Collateral, that would have been material information for Houlihan and the Ad Hoc Group to know, as well as a material factor in estimating the value of the JSNs' liens. (Oct. 23 Tr. 127:25–128:16.) But Houlihan's May 14, 2012 public presentation (the "May 14 Presentation") that presented an estimation of the JSNs' recovery on their prepetition collateral did not incorporate or disclose the existence of the billion dollars of AFI LOC Collateral. (PX 169; Oct. 23 Tr. 128:17–21; 132:18–133:4.) Mr. Siegert testified that if Houlihan had known that paragraph 5(g) revived $1 billion worth of JSNs' liens, it would have incorporated that fact in the May 14 Presentation. (Oct. 23 Tr. 128:23–133:4.)

Further, in paragraph 5(g), the Debtors stipulated that the JSNs' liens are "subject and subordinate only" to those prepetition liens that were granted under the Revolver. (PX 76 at 11–12.) But this provision does not subordinate the JSNs' purported lien on the AFI LOC Collateral to AFI (i.e., the lender). So under the Defendants' proposed interpretation of paragraph 5(g), the JSNs' purported liens on the AFI LOC Collateral would be elevated ahead of the AFI's liens in that same collateral. Additionally, while granting the JSNs a postpetition adequate protection lien on the Revolver Collateral and the ***574** AFI LOC Collateral, the Cash

Collateral Order subordinated those liens to any existing liens on the same collateral. To that end, with respect to the JSNs' adequate protection lien on the Revolver Collateral the Order acknowledges that the lien is junior to the "existing liens granted to the Junior Secured Parties." (*Id.* at 28.) With respect to AFI LOC Collateral, though, the Cash Collateral Order does not mention the JSNs' purported existing lien on that collateral. (*Id*. at 28–29.)

Other documents also indicate that paragraph 5(g) was not intended to revive any previously released JSN liens. For example, in the JSN PSA, the JSNs expressly reserved the right to make a claim for an equitable lien on the AFI LOC Collateral. (PX 252 § 5.6.) That would have been superfluous if the JSNs believed that paragraph 5(g) already granted them a lien on that collateral. Moreover, when the Debtors sought approval of the Barclays DIP Facility, they argued that any asserted equitable JSN lien on the AFI LOC Collateral was invalid and not perfected. (PX 88 at 55.) That position would have been inconsistent with a stipulation granting the JSNs a lien on that collateral in paragraph 5(g). Neither the motion for approval of the use of cash collateral, nor any disclosures to the Court in connection with the interim or final cash collateral orders, disclose that the JSNs believed they were getting a perfected security interest in any previously released collateral.

**F. The Asset Sales**

On the Petition Date, the Debtors filed motions to approve stalking horse bids from AFI and Nationstar with respect to the Debtors' Whole Loan Portfolio and Servicing and Origination Assets, respectively. (*See* PX 61.) The Debtors entered into the initial stalking-horse bid with Nationstar to sell the servicing, origination, and capital markets platforms (which included people, software, and IT) of the Debtors. (PX 33.) The Debtors also agreed to sell Nationstar contracts, servicing agreements, MSRs owned by the Debtors, certain Ginnie Mae-guaranteed whole loans, and intellectual property, goodwill, and general intangibles "Related to the Business" for $2.3 billion. (*Id*. at 38–41.)

After the Petition Date, on June 15, 2012, Berkshire Hathaway, Inc. ("Berkshire") submitted competing bids to become the stalking horse bidder for both sets of assets. (Puntus Direct ¶ 59.) The bids, which were submitted without Berkshire having performed any due diligence, were in the form of executed asset purchase agreements virtually identical to the agreements executed by Nationstar (for the Servicing and Origination Assets) and AFI (for the Whole Loan Portfolio). (*Id.*) Due, at least in part, to Berkshire's bids, a "pre-auction" auction (the "Mini Auction") ensued in advance of and during the sale procedures hearing, with the Court ultimately directing that final proposed stalking horse bids be submitted to the Debtors on June 18, 2012. (*Id.*) In accordance with the Court's direction, both Nationstar and Berkshire submitted revised stalking horse bids. (*Id.*) With the support of the Committee, the Debtors sought and obtained Court approval of the Nationstar and Berkshire stalking horse bids and the bid and sales procedures at a hearing on June 19, 2012. [23] (*Id.* ¶ 60.)

In the lead-up to the Asset Sales, the Debtors maintained the servicing and origination ***575** platforms as going concerns. (Marano Direct ¶¶ 50–51.) The Debtors considered, but rejected, the possibility of liquidation, because, according to Mr. Marano, the Debtors did not believe that a liquidation was in the best interests of the creditors, and the Debtors did "everything [they] could" to prevent a foreclosure. (Oct. 15 Tr. 164:10–25.)

*1. The Servicing and Origination Assets Sale*

The Court approved the sale and bid procedures with respect to the Servicing and Origination Assets (PX 44), and Centerview approached those institutions that it believed would have an interest in purchasing, and the financial resources and expertise necessary to purchase, the Servicing and Origination Assets, to gauge their respective interest. (Puntus Direct ¶ 61.) Following these initial contacts and an introductory due diligence period for interested parties, the Debtors' management team and Centerview made formal presentations to five prospective purchasers, during which they described in detail the Servicing and Origination Assets being sold and afforded them an opportunity to visit the Debtors' locations and perform detailed on-site due diligence with the Debtors' business units. (*Id.*) The Debtors received responses from three potential purchasers: (1) Berkshire, (2) a consortium of two bidders, and (3) a consortium composed of Ocwen and Walter Investment Management Corporation ("Walter"). (*Id.* ¶ 63.) The Debtors focused their marketing efforts on these three potential purchasers. (*Id.*)

On October 19, 2012, the Debtors received two qualifying bids for the Servicing and Origination Assets: (1) the stalking horse bid previously submitted by Nationstar at a value of $2.357 billion; and (2) a bid from Ocwen and Walter at a value of $2.397 billion. (PX 48; PX 47.) The Debtors determined that the Ocwen bid was the highest and best bid for the Servicing and Origination Assets and decided that they would open the auction with the Ocwen bid. (Puntus Direct ¶ 64; PTO ¶ 34.) On October 23, 2012, the Debtors began the auction for the Servicing and Origination Assets with Ocwen's bid as the opening bid. Two bidders, Nationstar and Ocwen, submitted offers for these assets. Although Ocwen was a bidder of record for these assets, the Ocwen APA provided for the assignment of the Debtors' Fannie Mae assets to Walter. (PX 47; Puntus Direct ¶ 69.)

During the auction, the Debtors negotiated with Nationstar and Ocwen to obtain certain adjustments to their bids and asset purchase agreements. As required by Ginnie Mae, both bidders agreed to remove the Ginnie Mae liability bifurcation condition in the asset purchase agreements. (Puntus Direct ¶ 71.) Consequently, Ginnie Mae would be able to seek satisfaction of all liabilities relating to Ginnie Mae loans, either pre- or post-closing, related to servicing or origination, from the purchaser of the Servicing and Origination Assets. (*Id.*) Also, although both Ocwen's and Nationstar's bid did not contractually obligate them to acquire the servicing and origination platforms, both bidders agreed to include a commitment to acquire the platforms and associated liabilities as part of the bid. (Puntus Direct ¶ 72; Marano Direct ¶ 62.) To induce Ocwen and Nationstar to make this commitment, the Debtors offered the bidders a bid credit in the amount of $108.4 million, which represented the estimated liabilities associated with the platforms. (PX 56 at 37–41; Puntus Direct ¶ 72.) After 28 rounds of bidding, Ocwen made the highest and best offer to purchase the Debtors' Servicing and Origination Assets for itself and Walter, with a winning purchase price of approximately ***576** $3 billion. (PX 57 at 9–10.) The Court approved the Ocwen Sale on November 19, 2012, and entered an Order approving the asset sales on November 21, 2012. (PX 45; Puntus Direct ¶ 79; PTO ¶ 36.)

The parties effectuated the Ocwen Sale through the Ocwen APA, dated as of November 2, 2012 (and as later amended), among Ocwen, ResCap, and certain other Debtor signatories. (PX 19; PX 20; PX 21; PX 22; PX 23; PX 24; PTO ¶ 37.) The Ocwen APA provided that Ocwen was buying "goodwill and other intangible assets Related to the Business or related to the Purchased Assets." (DXPT at 41.) In total, over 2,000 ResCap employees, including those associated with call centers and management, were "migrat[ed]" to Ocwen as part of the purchase of ResCap's servicing and origination platform with no significant reduction in personnel. (Ziegenfuse Dep. 63:16–19:6, 65:7–21, 67:17–23.)

In the APA, Ocwen attributed zero value to goodwill and intangibles, but in a subsequent 10–Q filing, the company attributed approximately $210 million to those assets. (DX ZH at 30.) The APA contains a provision that any purchase price allocation in the APA would only bind the parties for tax purposes, and not for any other purpose. (PX 19 at 50.) The parties dispute whether a portion of the purchase price must be allocated to general intangibles and goodwill, as to which the JSNs claim to have a perfected lien.

*2. The Whole Loan Portfolio Sale*

Contemporaneously with the marketing process for the Servicing and Origination Assets, Centerview considered those institutions that it believed would be interested in and financially capable of purchasing the Whole Loan Portfolio. (Puntus Direct ¶ 65.) Centerview approached those potential purchasers to gauge their respective interest. (*Id.*) On October 19, 2012, the bid deadline approved by the Court, the Debtors received two qualifying bids for the Whole Loan Portfolio: (1) the stalking horse bid previously submitted by Berkshire at a value of $1.324 billion; and (2) a bid from a consortium of four financial bidders led by DLJ Mortgage Capital (the "DLJ Consortium") at a value of $1.339 billion. (*Id.* ¶ 66) The Debtors determined that the DLJ Consortium bid was the highest and best bid for the Whole Loan Portfolio and decided that they would open the auction with the DLJ Consortium bid. (*Id.*; PTO ¶ 35.)

On October 25, 2012, ResCap held an auction for its Whole Loan Portfolio. (Puntus Direct ¶ 79.) After 11 rounds of bidding, Berkshire won the auction with the highest and best offer of $1.5 billion, an amount $175 million higher than the original stalking horse bid. (*Id.*; PX 58 at 22–23.) Before the auction, Berkshire had agreed to continue compliance with certain aspects of the FRB Consent Order and the DOJ/AG Settlement. (Puntus Direct ¶ 79.) The Court approved the Berkshire sale on November 19, 2012, and entered an order approving the asset sales on November 21, 2012. (ECF 12–12020 Doc. # 2247; PX 46.)

**G. Facts related to Original Issue Discount**

The Junior Secured Notes were issued in connection with a 2008 debt-for-debt exchange offering (the "Exchange"). On May 5, 2008, ResCap issued an Offering Memorandum in which it offered to exchange $9.537 billion face value amount of its then-outstanding unsecured notes maturing from 2010 through 2015 (the "Old Notes") for the Junior Secured Notes. (PTO ¶ 7; PX 175.) Under the Exchange, ResCap offered to exchange $1,000 face principal amount of outstanding unsecured notes for $800 face value of Junior Secured ***577** Notes. (PTO ¶ 8.) Pursuant to a modified Dutch Auction, the clearing price was $650 per $1,000 principal amount of Junior Secured Notes, which was the lowest level at which tenders were accepted. (*Id.*) Through the Exchange, ResCap exchanged approximately $6 billion of Old Notes for approximately $4 billion in Junior Secured Notes and $500 million in cash. Approximately 63% of the Old Notes were exchanged in the Exchange. (*Id.* ¶ 9.) The issue price of the Junior Secured Notes was established as $613.75 based on trading activity from the first day of trading. Using this price, AFI calculated the amount of OID for tax purposes as of the Petition Date to be $377,262,728. (*Id.* ¶ 52; PX 189; Finnerty Direct ¶ 55.) As an economic matter the Exchange created OID. (Finnerty Direct ¶ 10.) AFI amortized the OID by compounding it on a semi-annual basis. Amortizing OID on a daily compounding basis results in a slightly larger amount of OID: $386 million. (*Id.* ¶ 60.)

The Plaintiffs argue that the OID should be disallowed in bankruptcy as unmatured interest. The Defendants, on the other hand, argue that the OID should be allowed as part of their claim based on Second Circuit precedent. The Plaintiffs and Defendants each offered expert testimony on issues relating to the bankruptcy treatment of the OID generated in the Exchange. John D. Finnerty, Ph.D., a Managing Director in the Financial Advisory Services Group at AlixPartners, LLP and Professor of Finance at Fordham University's Graduate School of Business Administration, testified on behalf of the Plaintiffs, and Mr. Siegert testified on behalf of the Defendants.

The parties do not dispute that the Exchange was a "fair value" exchange—*i.e.*, that old securities were exchanged for new securities with a reduced principal amount that in theory approximated the market value of the old securities. The Second Circuit's decision in *LTV Corp. v. Valley Fidelity Bank & Trust Co. (In re Chateaugay Corp.),* 961 F.2d 378 (2d Cir.1992), addressed the bankruptcy treatment of OID generated in connection with a "face value" exchange —*i.e.*, one in which the principal amount of the debt is not reduced. [24] (Finnerty Direct ¶ 102; Oct. 21 Tr. 151:11–14.) The experts also agreed that investors in the Notes were sophisticated investors who understood how to analyze risks associated with investing in OID bonds. (Finnerty Direct ¶ 92; Oct. 21 Tr. 184:8–11.)

In addition, Dr. Finnerty calculated that using semi-annual compounding, $377 million in OID remained unamortized as of the Petition Date. (Finnerty Direct, App'x 6A.) Dr. Finnerty, though, believed that daily compounding was the more appropriate method, which he calculated to yield $386 million of unamortized OID as of the Petition Date. (*Id.* at App'x 6B.) Mr. Siegert, on the other hand, testified that he believed that semi-annual compounding ***578** was the best method. (*See* Oct. 21 Tr. 163:21–25.)

Dr. Finnerty stressed the economic incentives built into the Exchange: yield, security, and seniority. (Finnerty Direct ¶ 62.) In addition, the Exchange allowed ResCap to reduce its overall debt obligations and extend its debt maturities, thereby enhancing the credit strength of the JSNs' obligor, allowing ResCap to avoid bankruptcy for four more years. (*Id.*) In fact, the JSNs will achieve a greater recovery than the noteholders who did not exchange and whose notes remained outstanding on the Petition Date. The Debtors Disclosure Statement (ECF 12–12020 Doc. # 4811) indicates that while the hold-outs have retained a $1,000 par amount unsecured claim, they are projected to recover only 36.3%, or $363.00. (Finnerty Direct ¶ 88.) In contrast, the holders of the JSNs, who received $800 of new secured notes in June 2008, are projected to recover $840. (*Id.*) The Exchange was attractive—and future exchanges could likewise be attractive regardless of the bankruptcy treatment of OID—because of the competitive effective yield of the Junior Secured Notes at issuance, the fact that the Junior Secured Notes, unlike the Old Notes, were secured, and the fact that the Junior Secured Notes were structurally senior to the Old Notes. (*Id.* ¶¶ 62–67, 93.)

Mr. Siegert, in contrast, testified, among other things, that: (1) the disclosures made by ResCap in the Exchange, along with general market evidence, are inconsistent with the conclusion that the Exchange generated disallowable OID for bankruptcy purposes; and (2) disallowing OID in fair value exchanges such as the Exchange would likely cause debt-holders to either reject such exchanges or demand more from distressed companies, thereby discouraging out-of-court workouts and leading to a greater number of bankruptcies. (Siegert Direct ¶ 30.) Mr. Siegert noted that the disclosures did not warn that the Exchange could create OID that would be disallowed in bankruptcy. (*Id.* ¶ 31.) Mr. Siegert also testified that the market did not place much value on the structural enhancements to the Notes that the Exchange created since

63% of noteholders participated in the Exchange, which was a lower participation rate than typical debt-for-debt exchanges. (*Id.* ¶ 32.) ResCap was expecting a significantly higher level of participation in the Exchange; the company and its advisors originally projected a base case participation level of 76%. (*See* Hall Dep. 53:10–21.)

If ResCap had not executed the Exchange, the Company would not have had an ability to meet its debt service obligations as they came due without some third party intervention. (Hall Dep. 43:10–16.) The successful completion of the Exchange enhanced shareholder value by reducing the amount of the Company's outstanding debt. (Hall Dep. 55:14–23; Oct. 21 Tr. 64:5–8; 64:25–65:2.) The successful completion of the Exchange also provided ResCap, its creditors, and other stakeholders with several other valuable benefits, including reducing ResCap's debt service and extending the maturities on ResCap's outstanding debt. (DX BB at 13; Oct. 21 Tr. 18:10–14; 63:6–15; 64:5–8.)

Both experts testified that there is little difference between a face value exchange and a fair value exchange, making disparate treatment for the two exchanges in bankruptcy economically illogical. (Siegert Direct ¶ 37; Oct. 21 Tr. 67:10–69:9.) Mr. Siegert explained that both fair and face value exchanges offer companies the opportunity to restructure out-of-court, avoiding the time and costs—both direct ***579** and indirect—of a bankruptcy proceeding. (DX AIJ at 7.)

The Second Circuit treats OID created by face value exchanges as allowable in bankruptcy, despite the Code's provision that unmatured interest is disallowed. *See Chateaugay,* 961 F.2d at 384. The *Chateaugay* decision left open the possibility that fair value exchanges could be treated differently, but it did not resolve the issue. Both Dr. Finnerty and Mr. Siegert acknowledged that under *Chateaugay,* there would be no disallowable OID here if the Junior Secured Notes were issued at 100% face value, and all other inducements for participation remained the same. (Oct. 21 Tr. 136:9–20; 214:2–4.) Dr. Finnerty and Mr. Siegert also both acknowledged that if creditors knew that OID created in fair value exchanges would be disallowed, distressed issuers would need to offer greater incentives to participate. (Siegert Direct ¶ 3 8; DX ABC; Oct. 21 Tr. 101:15–17.) According to Mr. Siegert, this would make distressed debt exchanges more difficult and would likely lead to more bankruptcy filings as opposed to out-of-court workouts. Additionally, bondholders could simply reject fair value exchanges altogether. (Siegert Direct ¶ 3 8.) The experts also both testified that they are unaware of any other creditors whose claim would be determined in bankruptcy based on the trading prices of bonds used to determine the issue price. (DX AIJ 10; Oct. 21 Tr. 23:20–24:2.) Thus, a holder of the Old Notes would not know the amount of OID that would be disallowed in bankruptcy before tendering. (Oct. 21 Tr. 50:24–51:21.) The legal analysis of OID is found in section III.A below.

**H. The Paydowns**

On or about June 13, 2013, the Debtors made a payment in the amount of $800 million on account of the outstanding principal of the Junior Secured Notes. (*See* ECF Doc. # 3967.) On or about July 30, 2013, the Debtors made an additional $300 million payment on account of the outstanding principal of the Junior Secured Notes. (*See* ECF Doc. # 4404.) Together these repayments reduced the outstanding principal balance by $1.1 billion.

**I. Expert Valuations of JSN Collateral on Petition Date**

The JSNs offered valuation testimony from four proposed experts affiliated with Houlihan: Messers. Fazio, Levine, Taylor, and Siegert. Mr. Fazio offered opinions on the Petition Date value of the Debtors' sold and unsold HFS assets and certain other unsold assets. (Fazio Direct ¶¶ 2–3; Oct. 22 Tr. 122:10–13.) He also offered an opinion on the Petition Date value of a hypothetical entity consisting solely of the Debtors' MSRs, servicing operations, and originations platform. (Fazio Direct ¶¶ 2, 7; Oct. 22 Tr. 122:14–16.) Mr. Levine offered opinions on the Petition Date value of the Debtors' MSRs, refinancing opportunities associated with the MSRs, and Servicing Advances. (Levine Direct ¶ 2.) Mr. Taylor offered an opinion on the allocation of value to certain assets associated with the Ocwen asset sale, including intangible assets, goodwill, and liabilities acquired by Ocwen and Walter. (Taylor Direct ¶¶ 2–3, 7.)

Mr. Siegert offered a single "Global Summary" of these Houlihan opinions suggesting the net fair market value of the JSN Collateral on the Petition Date totaled $2.79 billion. (Siegert Direct ¶¶ 4, 25; Oct. 23 Tr. 134:1–14, 141:14–142:6; DX ABF at 10.) He arrived at this value by first summing (1) the valuations of the Debtors' cash, HFS assets, unsold servicing advances, FHA/VA loans, equity interests, hedge contracts, and certain other contracts; (2) the valuation of the Debtors' ***580** sold servicing advances; and (3) his own valuation of the Debtors' intangible assets, derived from his own analysis of Messrs. Fazio, Taylor, and Levine's valuations. (DX ABF at 9–10.) This totaled $4.450 billion. (*Id*. at 10.) Mr. Siegert then subtracted $747 million owed to Ally on the Ally Revolver, and $912 million owed on two facilities, [25] to reach $2.791 billion. (Siegert Direct ¶ 25 & n. 6; DX ABF at 10.)

The Houlihan experts' valuation assumes that the assets could have been sold on the Petition Date by the Debtors. (Oct. 22 Tr. 139:18–142:4; Oct. 23 Tr. 147:23–149:3, 149:18–22.) But when valuing the assets, the Defendants' experts did not look to sales conducted by other distressed entities on the brink of insolvency; rather, the experts treated ResCap as a solvent seller able to capture fair value for its assets.

The Plaintiffs, on the other hand, offered the opinion of Mr. Puntus, Partner and Co–Head of the Restructuring Group at Centerview. Mr. Puntus has been the lead investment banker for the Debtors for over two years. (Puntus Direct ¶ 1, 16; Oct. 16 Tr. 98:9–16.) He was heavily involved in the Debtors' decision to market their assets, the prepetition marketing process and the postpetition sale process, serving as the lead business negotiator for the Debtors on the stalking horse agreements as well as the auction process. (Oct. 16 Tr. 97:23–98:16, 103:6–9.)

Mr. Puntus used the initial Nationstar and AFI stalking horse agreements to determine the benchmark value in his analysis ($1.736 billion), even though these agreements were never consummated. He also endeavored to estimate what the JSNs' Collateral would have been worth upon foreclosure, where the disposition of the assets would have been controlled, in the first instance, by the First Priority Collateral Agent (directed by AFI) or the lenders (*i.e.,* Barclays and AFI for GSAP and BMMZ, respectively).

Mr. Puntus's benchmark did not represent his opinion of the value of the JSNs' Collateral for purposes of adequate protection because the purchase prices reflected in the stalking horse deals were contingent upon the continued operation of the Debtors' business in chapter 11 (Oct. 16 Tr. 103:10–22.) To estimate the value of the JSNs' Collateral as of the Petition Date in the hands of the creditors' agents upon foreclosure, Mr. Puntus therefore made certain downward adjustments from his benchmark valuation. Mr. Puntus based these adjustments on two alternative scenarios, differing in how long he assumed the creditors would take to dispose of the collateral: "Alternative A" assumed the collateral would be monetized by the collateral agents over a three to four month time period ($1.474 billion), while "Alternative B" assumed a five to six-month period ($1.594 billion). (Puntus Direct, ¶¶ 86–88.) Mr. Puntus further made reductions to account for RMBS and government set off risks, which reduced the "Alternative A" valuation to $1.046 billion, and the "Alternative B" valuation to $1.13 5 billion. (Puntus Direct Ex. 1 at 9.)

Mr. Puntus's methodology was dependent upon his subjective valuations of risks associated with the collateral. At trial, Mr. Puntus conceded that he had never seen a valuation analysis relying on similar methodology before. (Oct. 16 Tr. 36:6–8.) Nor is it likely that Mr. Puntus's valuation methodology could be used in other contexts. ***581** While Mr. Puntus's methodology is unsupportable, the numbers he reached may well be closer to the actual value of the JSN Collateral on the Petition Date.

**J. Effective Date Value of JSN Collateral**

The parties agree to a value of $1.88 billion as the baseline valuation for the JSNs' collateral as of December 15, 2013 (the assumed "Effective Date"), but the Debtors contend that only $1.75 billion of that collateral is properly distributable to the JSNs. The Plaintiffs seek to reduce the JSNs' potential recovery by assessing $143 million of expenses under the Carve Out against the JSN Collateral. The Plaintiffs argue that the Cash Collateral Order expressly made the JSNs' liens subordinate to the Carve Out. The Defendants countered that the Plaintiffs should use unencumbered cash to pay the Carve Out rather than JSN cash collateral.

*1. Deposit Accounts*

Except for the Controlled Accounts (defined below), the Deposit Accounts listed on Schedule 5 to the Committee Action are not subject to an executed control agreement among the relevant Debtor, the Third Priority Collateral Agent, and the bank where such Deposit Accounts are maintained. (PX 126; Landy Direct ¶¶ 3(d), 24(a), 40.) The uncontroverted evidence at trial established that, as of the Petition Date, the Deposit Accounts held funds in the amount of $48,502,829. (Landy Direct ¶ 41.)

Executed control agreements were admitted into evidence for the following Deposit Accounts (collectively, the "Controlled Accounts"): Account Nos. xxxx7570, xxx6190, xxx8567, xxxx7618, xxxx2763, and xxxx0593. (*See* DX AIU; DX AIV;

DX AIW; DX AIX; DX AIY; DX AIZ.) As of the Petition Date, the Controlled Accounts held an aggregate amount of $16,885. (PX 126.) Deposit Account Nos. xxxx2607, xxxx7877, and xxxx1176 (collectively, the “WF Accounts”) are maintained at Wells Fargo, which is the Third Priority Collateral Agent. The WF Accounts contained $38,321 as of the Petition Date. (PX 126.)

Deposit Account Nos. xxxx3803 and xxxx6323 (together, the “Ally Accounts”) are maintained at Ally Bank, which is an indirect, wholly-owned subsidiary of the AFI, the Revolver Lender. (PTO JSN Contentions ¶ 103.) Ally Bank is not a party to the Junior Notes Documents, the Revolver Documents or the Intercreditor Agreement and is therefore not a “secured party” within the meaning of the U.C.C. for purposes of control and perfection. Further, the Third Priority Secured Parties are not perfected by virtue of the Revolver Lender and Ally Bank being affiliates. First, given that they are not the same entity, the Revolver Lender's lien is not perfected under the U.C.C. through automatic control. Second, even if AFI's lien were perfected through automatic control, that would be the case only with respect to its own security interest (under the Revolver).

Deposit Account No. xxxx2599, which is maintained at J.P. Morgan Chase Bank, N.A. and contained $8,091 as of the Petition Date, contains proceeds of the JSN Collateral (the “Proceeds Account”). (Oct. 17 Tr. 173:4–174:11; PX 6 at 18–19.) The Court finds that the Third Priority Secured Parties have a perfected interest in that account under the U.C.C. because it contains proceeds of JSN Collateral. The Defendants failed to proffer evidence at trial that any of the Deposit Accounts other than the Proceeds Account contain proceeds of the JSN Collateral.

*2. Real Property*

Various Debtors owned the real property and leasehold interests listed on Schedule ***582** 2 to the Committee Action, and that portion of Schedule 6 to the Committee Action that identifies REO properties (*i.e.*, mortgaged properties acquired through foreclosure or other exercise of remedies under mortgages or deeds of trust that secured the associated mortgage loan instruments) as of the Petition Date. The property and leasehold interests are not subject to either a mortgage or a deed of trust in favor of the Third Priority Collateral Agent (the “Unencumbered Real Property”). (PX 124; PX 127 at 44–47; Landy Direct ¶¶ 3(b), 24(b), 36; Oct. 17 Tr. 175:1–23.) The uncontroverted evidence at trial established that, as of the Petition Date, the fair market value of the Unencumbered Real Property was $21 million. (Landy Direct ¶ 38.)

The Third Priority Collateral Agent did not know whether it had received any mortgage or deed of trust with respect to the Unencumbered Real Property, nor did it know whether any property owner ever granted or signed a mortgage or deed of trust with respect to the Unencumbered Real Property. (Pinzon Dep. 24:7–11, 29:2–11.) No mortgage or deed of trust for the Unencumbered Real Property was proffered by any party or admitted into evidence during the trial. (Landy Direct ¶ 37.)

The JSNs, therefore, do not have a perfected security interest in or lien on any of the Unencumbered Real Property because that property was not subject to an executed and filed mortgage or deed of trust.

*3. Executive Trustee Services, LLC and Equity Investment I, LLC Assets*

The Plaintiffs argue that the JSNs do not have liens on assets of Executive Trustee Services, LLC (“ETS”) and Equity Investment I, LLC (“Equity I”). According to the Plaintiffs, ETS pledged all of its assets to the Revolver in February 2011, but did not pledge any assets to the JSNs. The Plaintiffs also claim that any security interest in Equity I was released on December 29, 2009.

On February 16, 2011, ETS executed a joinder to the Revolver Documents and pledged all of its assets to AFI under the Revolver as a guarantor. Neither the Debtors nor the JSNs have identified a similar joinder agreement whereby ETS became an obligor under any of the Notes Agreements or granted any security interest to the Noteholders. The JSNs have argued that Section 4.17 of the Notes Indenture and Section 2.3(c) of the Intercreditor Agreement dictate that ETS is a guarantor of the Junior Secured Notes. Section 4.17 of the Notes Indenture provides the process by which future guarantors execute supplemental indentures guaranteeing the Junior Secured Notes, and Section 2.3(c) of the Intercreditor Agreement provides that any party pledging assets to the Revolver must also pledge such assets to the JSNs. (PX 1 at 59–60; PX 2 at 17.) But these provisions are not self-effectuating, and ETS was not a party to the Intercreditor Agreement. Absent an indication that ETS actually did pledge assets to the JSNs, the JSNs cannot establish a lien on any ETS assets.

As for Equity I, that entity was an obligor under the Original Revolver Loan Agreement and the Original JSN Security Agreement, but it was removed as an obligor in the amended versions of those agreements. (PX 3; PX 4; PX 5; PX 6; PX 7; PX 8.) Further, On December 29, 2009, the Third Priority Collateral Agent executed a U.C.C.–3 termination statement terminating the security interest in all assets pledged by Equity I. (PX 131 at 841–45.) The next day, the parties executed the amended JSN Security Agreement that removed Equity I as an obligor. (PX 4.) Also on December 30, 2009, Equity I became a guarantor under the AFI LOC. ***583** (PX 9.) The JSNs therefore do not have a lien on any Equity I assets.

*4. Reacquired Mortgage Loans*

Count IV of the Committee' complaint alleges that the JSNs do not have perfected security interests in certain mortgage loans that were (1) released from the JSNs' liens and security interests in May 2010 to be sold to certain Citi and Goldman Repurchase Agreement Facilities ("Repo Facilities"), and (2) subsequently repurchased by the Debtors between September 2010 and the Petition Date (the "Reacquired Mortgage Loans"). As of the Petition Date, the Debtors owned the Reacquired Mortgage Loans, which were coded as "Blanket Lien Collateral" in the CFDR. The Debtors repurchased the majority of the Reacquired Mortgage Loans in January 2012. (*See* DX ABM, Schedule 1.) The Committee's complaint alleges that the Reacquired Mortgage Loans total approximately $14 million at book value and $10 million at fair value. (PX 125; PX 241 at 9.)

Wells Fargo, acting in its capacity as the Third Priority Collateral Agent, filed U.C.C.–3 financing statement amendments in May 2010 terminating the JSNs' security interests in, among other things, loans that later became the Reacquired Mortgage Loans. (*See, e.g.,* PX 133; PX 136.) Those U.C.C.–3 amendments made clear that the assets that were subject to the release were being sold to Repo Facilities by expressly referencing the Repo Facilities and identifying the assets subject to the U.C.C.–3 amendments as the Mortgage Loans listed on certain Schedules to the Repo Facilities. (*See, e.g.,* PX 133; PX 136.) The loans listed on the U.C.C.–3 amendment were within the scope of and were covered by preexisting U.C.C.–1 financing statements. The U.C.C.–3 amendments provided notice of a collateral change, not a termination of the effectiveness of the identified financing statement. (*See, e.g.,* PX 133; PX 136.)

The U.C.C.–1 financing statements, which remained in effect notwithstanding the filing of the U.C.C.–3 financing statements, continued in force and operated to perfect the JSNs' security interests in the Reacquired Mortgage Loans after the Debtors repurchased those loans. (*See, e.g.,* PX 132; PX 4 § 2.) The U.C.C.–1 financing statements and U.C.C.–3 amendments filed by Wells Fargo provided notice to any potential lender seeking to obtain a security interest in the Reacquired Mortgage Loans of the possibility that the JSNs held a perfected security interest therein. Any potential lender inquiring about the collateral (1) could learn that the Reacquired Mortgage Loans had been reacquired by the Debtors subsequent to the filing of the U.C.C.–3 amendments (by virtue of the fact that they were owned by the Debtors); and (2) would have access to the U.C.C.–1 financing statements providing that the JSNs held a perfected security interest in all assets that the Debtors subsequently acquired. (Oct. 23 Tr. 36:5–37:19.)

Had any actual or potential unsecured creditor inquired of ResCap into the status of the Reacquired Mortgage Loans prepetition, that creditor would have learned that the loans were once again subject to AFI's and the JSNs' Blanket Lien, which was reflected in the CFDR. (*See* Farley Dep. 95:3–14, 110:5–111:14, 115:4–14, 137:21–24, 138:4–11, 176:21–177:3, Oct. 16 Tr. 190:21–192:18; Hall Dep. 117:6–12; Ruhlin Dep. 65:19–22, 66:6–21, 106:8–12, 119:4–9, 155:16–156:2, 156:15–21.)

Therefore, the Court finds that the Reacquired Mortgage Loans are properly treated as collateral for the JSNs at the Petition Date.

***584** *5. Excluded Assets*

Count I of the Committee's complaint alleges that, pursuant to the JSN Security Agreement, the JSNs do not have perfected security interests in assets that were (1) pledged to a Bilateral Facility (as defined by the JSN Security Agreement) on the date that the Junior Secured Notes were issued by ResCap, (2) subsequently released from the applicable Bilateral Facility prior to May 14, 2012 (the "Petition Date"), and (3) owned by the Debtors on the Petition Date and coded as "Blanket Lien Collateral" (the "Former Bilateral Facilities Collateral"). [26]

The Plaintiffs' expert Mr. Landy valued the Former Bilateral Facilities Collateral at $24 million as of the Petition Date using fair market valuation. (*See* PX 241 at 9.)

On June 6, 2008, Wells Fargo, acting in its capacity as the Third Priority Collateral Agent, filed U.C.C.–1 financing statements indicating that the JSNs held a security interest in "[a]ll assets [of each grantor] now owned or hereafter acquired and wherever located." (PX 132.) Section 2 of the JSN Security Agreement (the "All–Assets Granting Clause") reaches all of the Debtors' assets that are legally and practicably available both at the time, and after, the JSN Security Agreement was executed. (PX 4 at 4–17, 18–19 (providing that the pledge includes assets "whether now or hereafter existing, owned or acquired and wherever located and howsoever created, arising or evidenced").)

The JSN Security Agreement carves out from the JSNs' Collateral certain assets (the "Excluded Assets") that could not be pledged to the JSNs for legal or business reasons. (PX 4 at 15–17 ("provided that, notwithstanding the foregoing, the 'Collateral' described in this Section 2 shall not include Excluded Assets.").) "Excluded Assets" are defined under the JSN Security Agreement as "(c) any asset ... to the extent that the grant of a security interest therein would ... provide any party thereto with a right of termination or default with respect ... to any Bilateral Facility to which such asset is subject as of the Issue Date [ (June 6, 2008) ]." (PX 4 at 4–15.) The Excluded Assets category included assets pledged to Bilateral Facilities as of the Issue Date, because the terms of the Bilateral Facilities precluded those assets from being pledged to the AFI Revolver or the JSNs. (Oct. 16 Tr. 184:24–185:3.)

The Court previously ruled that the JSN Security Agreement is ambiguous with respect to "whether an Excluded Asset becomes part of the Secured Parties' collateral pursuant to the All–Asset Granting Clause once it ceases to constitute an Excluded Asset." *Residential Capital,* 495 B.R. at 262. The Court therefore allowed the parties to present extrinsic evidence to determine the parties' intended meaning.

Ms. Farley, the Senior Director of Asset Disposition for ResCap, was involved in negotiating and implementing the Revolver. She testified that she understood that if the Bilateral Facilities had not precluded the Debtors' assets pledged thereunder from being pledged to AFI and the JSNs, and if those assets otherwise fell within the broad scope of the Blanket Lien, then the Debtors would have included those assets as Revolver and JSN Collateral. (Oct. 16 Tr. 184:24–185:12; Farley Dep. 26:7–18, 58:12–20, 65:13–66:2, 71:5–18.) She also testified that AFI and ResCap understood that the Excluded Assets would change over time. (Oct. 16 Tr. 182:13–21.)

Lara Hall of AFI testified at her deposition that:

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- "AFI's intent was as soon as the assets rolled off the bilateral facility, they would become subject to the blanket lien." (Hall Dep. 123:19–23; *see also id.* 119:7–15);
- at the time the original AFI Revolver and Revolver Security Agreement were negotiated, in exchange for funding the AFI Revolver, AFI was "trying to secure whatever remained unencumbered that we could, that was legally available to be pledged, not an excluded asset and was operationally feasible for the company, being ResCap." (Hall Dep. 106:2–20; 113:2–13); and
- "[t]he blanket lien basically suggested that anytime an asset became uncovered, it would be subject to the blanket lien." (Hall Dep. 116:6–14.)

Joseph Ruhlin, the Debtors' former Treasurer, testified that the Debtors understood that the Former Bilateral Facilities Collateral "would be covered by the blanket lien as long as they ... were owned [by the Debtors] and not pledged elsewhere to another bilateral facility," and that the Debtors' "understanding" was that "once an asset was released from a funding facility, depending on the asset, it would become part of the blanket lien." (Ruhlin Dep. 89:14–2, 93:8–14, 165:5–9.)

Ms. Farley, in her capacity as the Debtors' corporate representative, admitted at her deposition that if a loan was initially excluded from the collateral pool because it was pledged to a Bilateral Facility as of the Issue Date, the loan would be transferred into the pool of Blanket Lien Collateral if and when that Bilateral Facility subsequently terminated. (Farley Dep. 105:17–106:21.) At trial, Ms. Farley testified that, with respect to assets that were Excluded Assets as of June 2008 (because they were pledged under a Bilateral Facility), those assets would become part of the revolver and JSN Collateral pools if they fell within the scope of the security grant when the Bilateral Facility terminated. (Oct. 16 Tr. 186:23–187:9.) Ms. Farley further testified that, in negotiating the terms of the AFI revolver, Ally sought to secure the revolver with as much collateral as possible. (Farley Dep. 45:21–46:4; Farley Direct ¶ 13.)

Additionally, in December 2008, the Debtors' outside counsel sent an email explaining that "if at any point while owned by GMAC [ ] the assets are removed from a Bilateral Facility, the [AFI] Revolver and [JSN] Indenture liens may cover these assets and they will constitute Collateral (if and to the extent Sections 9–406/8 of the U.C.C. are applicable)." (DX ES at 1.)

Given the extrinsic evidence presented at trial about the parties' intent "whether an Excluded Asset becomes part of the Secured Parties' collateral pursuant to the All–Asset Granting Clause once it ceases to constitute an Excluded Asset," the Court is satisfied that the Former Bilateral Facilities Collateral is properly treated as JSN Collateral at the Petition Date.

## III. *CONCLUSIONS OF LAW*

### A. The JSNs Are Entitled to Recover All Original Issue Discount.

**[3]** The Plaintiffs ask the Court to disallow a portion of the JSNs' claim to the extent the claim seeks recovery of unamortized OID. OID is a form of "deferred interest" created when a bond is issued for less than the face value the borrower contracts to pay at maturity. (Finnerty Direct ¶ 10.) Unlike the more common periodic cash interest "coupon" payments made to noteholders, OID interest accretes over the life of the note but is payable only at maturity. (*Id.*) OID is amortized for tax and accounting purposes over the life of the bond. The Exchange Offer, which was a fair value exchange (*see supra* at ***586** II.F), created $1.549 billion of OID, which amortized over the life of the Junior Secured Notes. (*Id.* at ¶ 11.) As of the Petition Date, unamortized OID on the remaining outstanding Junior Secured Notes was $386 million.[27] (*Id.*)

The JSNs contend that their claim should be allowed in full and should not be reduced by any OID. For the following reasons, the Court agrees that the JSNs' claim should not be reduced by the amount of unamortized OID.

#### *1.* In re Chateaugay *Controls and Supports Allowing the JSNs' Claim in Full.*

Bankruptcy Code Section 502(b)(2) 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). The Second Circuit ruled in *Chateaugay* that unamortized OID is "unmatured interest" within the meaning of section 502(b)(2). 961 F.2d at 380. Nevertheless, the Second Circuit found that debt-for-debt "face value" exchanges offered as part of a consensual workout do not generate OID that is disallowable as unmatured interest for purposes of section 502(b)(2). *Id.* at 383.

The Second Circuit explained that "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. 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 [excluding OID recovery] 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.*

Applying that reasoning, the Second Circuit 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." *Id.* Rather than "chang[ing] the character of the underlying debt," a face value exchange "reaffirms and modifies" the debt. *Id.* But the court specifically left open whether the same rules should apply to a fair value exchange such as the one in this case. The court stated:

> [Disallowing OID recovery] might make sense in the context of a fair market value exchange, where the corporation's overall debt obligations are reduced. In a face value exchange such as LTV's, however, it is unsupportable.

*Id.*

Here, in ruling on the motions to dismiss, the Court concluded that it would benefit from a fuller evidentiary record before resolving whether as a matter of law the Exchange generated disallowable ***587** OID. *Residential Capital,* 495 B.R. at 266. Now having the benefit of a full record and argument, the Court concludes that despite the differences between face value and fair value debt-exchanges, the same rule on disallowance of OID should apply in both circumstances. Since *Chateaugay* is the law of the Circuit, and holds that unamortized OID should not be disallowed in the case of a face value exchange, the Court concludes that the unamortized OID generated by the fair value exchange here should not be disallowed from the JSNs' claim.

*2. The Legislative History of Section 502(b)(2)*

Section 502(b)(2) was enacted in 1978. The legislative history 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 as an example: "postpetition interest that is not yet due and payable, and any portion of prepaid interest that represents an original discounting of the claim, yet that would not have been earned on the date of the bankruptcy." 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), "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. *SeeChateaugay,* 961 F.2d at 383 ("The tax treatment of a transaction ... need not determine the bankruptcy treatment.... The tax treatment of debt-for-debt exchanges derives from the tax laws' focus on realization events, and suggests that an exchange offer may represent a sensible time to tax the parties. The same reasoning simply does not apply in the bankruptcy context."); *Texas Commerce Bank, N.A. v. Licht* (*In re Pengo Indus., Inc.*), 962 F.2d 543, 550 (5th Cir.1992) ("As bluntly stated by the Second Circuit, the reasoning underlying the tax treatment of debt-for-debt exchanges simply does not apply in the bankruptcy context.") (internal quotation marks omitted).

The parties do not dispute that disallowable OID is created for bankruptcy purposes when a company issues new debt in an original cash issuance for less than its face value. (Finnerty Direct ¶ 76; Oct. 21 Tr. 155:7–15.) Dr. Finnerty testified that "as an economic matter the bond exchange generated OID," but Dr. Finnerty never defines "economic matter" beyond references to taxable OID. (*Id.* at ¶ 10.) Under *Chateaugay,* however, creation of OID for tax purposes is irrelevant in the context of face value exchanges. Because the Court finds no basis for distinguishing OID generated by fair value exchanges from OID generated by face value exchanges, *Chateaugay* controls. Even though the Exchange may have generated OID under the Tax Code, that does not dicatate that it created disallowable unmatured interest.

*3. There is No Reason to Distinguish OID Generated by Fair Value Exchanges from OID Generated by Face Value Exchanges under the Second Circuit's Reasoning in Chateaugay.*

As the Second Circuit observed in *Chateaugay,* an exchange offer made by a ***588** financially impaired company "can be either a 'fair market value exchange' or a 'face value exchange.' " 961 F.2d at 381 (citations omitted).[28] Because the Second Circuit in *Chateaugay* was presented with a face value exchange, the court did not address whether its decision would extend to a fair value exchange. Instead, the Court explicitly limited its holding to face value exchanges, noting that it "might make sense" to disallow OID in a fair market value exchange. *Id.* The Court concludes, having the benefit of a full record and argument, that there is no meaningful basis upon which to distinguish between the two types of exchanges.

The Plaintiffs' expert Dr. Finnerty admitted at trial that distinguishing between face value and fair value exchanges is "somewhat arbitrary." (Oct. 21 Tr. 67:10–13.) In fact, Dr. Finnerty acknowledged that nearly all of the features that companies consider in connection with a debt-for-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 67:17–69:9.) Other than changing the face value of the bond (which is not possible in face value exchanges), an issuer "could adjust every other factor" available to it. (*Id.* at 69:4–9.) For example, an issuer could provide the exchanging noteholders with security. Both experts testified that there would be no disallowable OID if the Junior Secured Notes were issued at $1,000 face value, even though the new notes were secured while the Old Notes were unsecured, because that exchange would be expressly governed by *Chateaugay*. (*Id.* at 136:9–20; 214:2–4.) Thus, despite the Plaintiffs' contention that the consideration involved in the Exchange—trading the unsecured notes for secured and structurally senior obligations—justifies breaking from the Second Circuit's decision in *Chateaugay,* the evidence presented at trial indicated that the two types of exchanges are virtually identical, and it would be arbitrary for the Court to distinguish between them.

The Court thus concludes that there is no commercial or business reason, or valid theory of corporate finance, to justify treating claims generated by face value and fair value exchanges differently in bankruptcy. First, the market value of the old debt is likely depressed in both a fair value and face value exchange. 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. 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.

The Plaintiffs argue that the "plain language" of the statute must be enforced unless it leads to an absurd result. They contend that applying the language of section 502(b) to disallow OID will not lead to absurd results because even if OID is disallowed, the JSNs' recovery exceeds the recovery of the still-outstanding Original Noteholders. But the term "unmatured interest" in section 502(b)(2) is not defined, making application of the plain language rule debatable. And whatever rules are adopted by courts should provide predictability ***589** to parties in planning transactions. The outcome—whether a transaction results in disallowed OID for bankruptcy purposes—should not hinge on whether, with the benefit of hindsight, noteholders that exchanged their notes did better than those that did not exchange. Determining whether the transaction created disallowable OID should not depend on if the noteholders or the debtors got a "good deal" in bankruptcy. That rule would create confusion in the market and would likely complicate a financially distressed company's attempts to avoid bankruptcy with the cooperation of its creditors. The reasoning of *Chateaugay* supports this conclusion. 961 F.2d at 383.

For the foregoing reasons, the Court concludes that the JSNs' claim should not be reduced by the amount of unamortized OID.

### B. The JSNs Are Not Entitled to an Adequate Protection Claim.

*1. Generally*

The Bankruptcy Code requires a debtor to provide a secured lender with adequate protection against a diminution in value of the secured lender's collateral resulting from: (1) the imposition of the automatic stay under section 362; (2) the use, sale, or lease of the property under section 363; and (3) the granting of a lien under section 364. 11 U.S.C. § 361(1). The Bankruptcy Code does not articulate what constitutes "adequate protection" for purposes of the statute, but section 361 articulates three separate examples of what may constitute adequate protection: (1) periodic cash payments; (2) offering a replacement lien "to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property"; and (3) other relief that will assure the creditor that its position will not be adversely affected by the stay. *Id.*; *see also* 3 COLLIER ON BANKRUPTCY ¶¶ 3 62.07[3][b]–[d] (16th ed. 2011).

A secured creditor is entitled to adequate protection of its interest in the value of its collateral and can obtain adequate protection either after a contested cash collateral hearing, or, as is more often the case, by a consensual cash collateral order. At the commencement of this case, the parties negotiated, and the Court signed, a Cash Collateral Order that, among other things, established the JSNs' right to adequate protection for the use of their collateral and the means by which such adequate protection would be provided. Pursuant to paragraph 16 of the Cash Collateral Order, the JSNs are entitled to

> [A]dequate protection of their interests in Prepetition Collateral, including Cash Collateral, in an amount equal to the aggregate diminution in value of the Prepetition Collateral to the extent of their interests therein, including any such diminution resulting from the sale, lease or use by the Debtors (or other decline in value) of any Prepetition Collateral, including Cash Collateral, the priming of the AFI Lenders' liens on the AFI LOC Collateral by the Carve Out and AFI DIP Loan, and the automatic stay pursuant to section 362 of the Bankruptcy Code[.]

(PX 76 at 24.) As adequate protection, the JSNs were granted adequate protection liens on all of the collateral securing the AFI Revolver, the AFI LOC, and all of the equity interests of the Barclays DIP Borrowers, and, to the extent that such liens were insufficient to provide adequate protection, the right to assert a claim under section 507(b) of the Bankruptcy Code. (*Id.* at 29.) The JSNs now contend they are entitled to recover an adequate protection claim of $515 million based on alleged diminution in value of their prepetition collateral ***590** used during the case under a series of consensual cash collateral orders. The Plaintiffs disagree, asserting that the JSN Collateral has not declined in value since the Petition Date and that the JSNs therefore cannot assert an adequate protection claim.

The parties agree that the amount of any adequate protection claim is to be measured by the difference in value of the collateral on the Petition Date and the Effective Date. [29] The parties also largely agree about the Effective Date value of the JSN Collateral, subject to adjustments discussed elsewhere in this Opinion. Thus, much of the testimony offered at trial was aimed at establishing the Petition Date value of the JSNs' collateral.

*2. The JSNs Bear the Burden of Showing Diminution in Value.*

**[4]** **[5]** The burden of proving valuation falls on different parties at different times. In establishing its claim, a secured creditor generally bears the burden under section 506(a) of proving the amount and extent of its lien. *In re Sneijder,* 407 B.R. 46, 55 (Bankr.S.D.N.Y. 2009); *see also In re Heritage Highgate, Inc.,* 679 F.3d 132, 140 (3d Cir.2012) (holding that "the ultimate burden of persuasion is upon the creditor to demonstrate by a preponderance of the evidence both the extent of its lien and the value of the collateral securing its claim") (quoting *In re Robertson,* 135 B.R. 350, 352 (Bankr.E.D.Ark.1992)). Once the amount and extent of the secured claim has been set, the burden shifts to a debtor seeking to use, sell, lease, or otherwise encumber the lender's collateral under sections 363 or 364 of the Code to prove that the secured creditor's interest will be adequately protected. *See Wilmington Trust Co. v. AMR Corp. (In re AMR Corp.),* 490 B.R. 470, 477–78 (S.D.N.Y.2013) (holding that 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") (internal quotation marks and citation omitted); *see also Resolution Trust Corp. v. Swedeland Dev. Grp., Inc. (In re Swedeland Dev. Grp., Inc.),* 16 F.3d 552, 564 (3d Cir.1994) (holding, in the context of granting a priming lien under section 364(d)(1), that the "debtor has the burden to establish that the holder of the lien to be subordinated has adequate protection") (citation omitted). In contrast, a secured creditor seeking to lift the automatic stay under section 362(d)(1) "for cause, including lack of adequate protection," bears the burden of showing that the debtor lacks equity in the property. 11 U.S.C. §§ 362(d)(1), 362(g)(1); *see also In re Elmira Litho, Inc.,* 174 B.R. 892, 900–03 (Bankr.S.D.N.Y.1994). But in all cases, the creditor bears the burden in the first instance of establishing the amount and extent of its lien under section 506(a).

The JSNs recognize that they must establish their section 507(b) adequate protection claim within the rubric of section 506(a). Further, they concede that the burden of proving the extent of a claim is typically born by the creditor seeking to establish the claim. Nonetheless, the JSNs argue that because their claim seeks adequate protection, the Debtors should have the burden of proving that the JSNs' ***591** interests were adequately protected. The Court disagrees.

**[6]** The parties established at the outset of this case that the JSNs' interest in their collateral was adequately protected, when they negotiated, and the Court signed, the Cash Collateral Order.[30] As the Court explained in its ruling on the motions to dismiss:

> If the value of the JSNs' collateral actually diminishes, then the JSNs may assert an adequate protection claim.... The Defendants caution against establishing new rules on adequate protection and valuation, but the Court's decision is premised on the terms of the Cash Collateral Order, which the JSNs helped negotiate. That Order provided the JSNs with bargained-for adequate protection.

*Residential Capital*, 497 B.R. at 420. The bargained-for adequate protection included several liens and the right to assert a claim under section 507(b) for any diminution in value not otherwise protected. (PX 76 at 29.) That the JSNs now seek to assert this adequate protection claim based on diminution in value does not shift the initial burden of proving the extent and validity of the claim under section 506(a) to the Debtors. Rather, this burden remains squarely with the secured creditor—the JSNs.[31] *See, e.g., Qmect, Inc. v. Burlingame Capital Partners II, L.P.*, 373 B.R. 682, 690 (N.D.Cal.2007) (affirming bankruptcy court's requirement that secured lenders prove diminution in value of collateral prior to foreclosing on replacement liens, because "the purpose of adequate protection is to protect lenders from diminution in the value of their collateral").

*3. Fair Market Value in the Hands of the Debtors is the Proper Petition Date Valuation Methodology.*

The Plaintiffs argue that for adequate protection purposes, the collateral should be valued at the Petition Date based on the foreclosure ***592** value of the collateral in the hands of the secured creditor. The Defendants argue that the collateral should be valued based on the fair market value of the collateral in the hands of the Debtors. The Court agrees with the Defendants that fair market value rather than foreclosure value applies, but as explained below, this holding provides little benefit to the Defendants because the Defendants' fair market valuation evidence introduced by their expert witnesses is unreliable, vastly overstates the value of the collateral on the Petition Date, and is rejected by the Court as a basis to establish an adequate protection claim.

**[7]** **[8]** To establish their entitlement to an adequate protection claim, the JSNs must show that the aggregate value of their collateral diminished from the Petition Date to the Effective Date. The JSNs will only be entitled to adequate protection, if at all, to the extent of the value of their interest in the collateral as of the Petition Date. 11 U.S.C. § 361. The Supreme Court has explained that the phrase "value of such entity's interest" in section 361 means the same as the phrase "value of such creditor's interest" in section 506(a): the value of the collateral. *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd.,* 484 U.S. 365, 372, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988). Thus, the question becomes how to value the JSN Collateral as of the Petition Date. To answer this question, the Court looks to valuation principles under section 506(a). *See In re Winthrop Old Farm Nurseries, Inc.,* 50 F.3d 72, 74 (1st Cir.1995) (stating that "a valuation for § 361 [i.e. adequate protection] purposes necessarily looks to § 506(a) for a determination of the amount of a secured claim").

Section 506(a) provides:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest ... is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property ... and is an unsecured claim to the extent that the value of such creditor's interest ... is less than the amount of such allowed claim. *Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property....*"

11 U.S.C. § 506(a)(1) (emphasis added).

In *Associates Commercial Corp. v. Rash,* the Supreme Court interpreted section 506(a) in the context of a chapter 13 plan, where the chapter 13 debtor sought to cram down a plan over the objection of a secured creditor, keeping the secured lender's collateral. 520 U.S. 953, 955, 117 S.Ct. 1879, 138 L.Ed.2d 148 (1997). In calculating the value of the lender's secured claim, the Court looked at the first sentence of section 506(a) and observed that the phrase "value of such creditor's interest" did not explain *how* to value the interest. *Id*. at 960–61, 117 S.Ct. 1879. Therefore, the Court looked to the second sentence of 506(a) and held that "the 'proposed disposition or use' of the collateral is of paramount importance to the valuation question." *Id.* at 962, 117 S.Ct. 1879. Based on the proposed disposition of the property in that case, the Court held that foreclosure value could not be the proper methodology for valuing the secured creditor's claim. *Id.* at 963, 117 S.Ct. 1879. Rather, the Court applied replacement value; the amount a willing buyer would have paid a willing seller for the collateral. *Id.*

Although this case involves the consensual use of collateral in the context of a sale under chapter 11, the reasoning of *Rash* is equally applicable here. *See In re Motors Liquidation Co.,* 482 B.R. 485, 492 (Bankr.S.D.N.Y.2012) (holding that "*Rash* 's underlying thought process is still instructive" in calculating value in a 363 sale and further noting that "[p]ost–*Rash* case law suggests that *Rash* can be applied to the provisions of all three reorganization ***593** chapters—11, 12, and 13—because these chapters all treat secured claims similarly"); *see also Heritage Highgate,* 679 F.3d at 141 (applying *Rash* in chapter 11 to value secured claim under 506(a)).

The Defendants cite only one case that deals with the exact scenario of this case—diminution of collateral in the context of a consensual use of cash collateral that funded a going concern sale—in which the district court affirmed application of the *Rash* reasoning in the adequate protection context. *See Salyer v. SK Foods, L.P. (In re SK Foods, L.P.),* 487 B.R. 257, 262 n. 11 (E.D.Cal.2013). In *SK Foods,* secured creditors and the chapter 11 trustee had negotiated a settlement on the amount of the creditors' adequate protection claim, conducting their valuation based on the proposed disposition of the collateral on the petition date—a going concern sale. *Id.* at 259–60. The bankruptcy court approved the settlement. *Id.* The appellants objected, asserting that the proper valuation could only be liquidation value, setting the value of the secured creditors' adequate protection claim at "0." *Id.* at 260. The district court rejected that argument, holding that "the Bankruptcy Court properly relied upon the 'liquidation' value for those assets which were to be liquidated, and as required by *Rash,* properly relied upon the 'going-concern' value for those assets which were to be sold as part of the business as a going concern." *Id.* at 263.

None of the other cases that the Defendants cite involve the calculation of an adequate protection claim based on diminution in value due to consensual use of collateral. Instead, the cases cited by the Defendants involve valuations performed for forward-looking determinations of whether secured creditors' interests would be adequately protected. [32] Nonetheless, ***594** the Court views the current valuation exercise as similar in nature. That is, the Court is being asked to apply a Petition Date valuation of the JSN Collateral to determine whether the JSNs' interests as of that date were adequately protected. In doing so, the Court agrees with the holdings of *SK Foods* and the other cases cited by the Defendants that the proper valuation methodology must account for the proposed disposition of the collateral.

The Debtors would like this Court to apply a foreclosure standard based on the JSNs' interest in the collateral as of the Petition Date, which, the Debtors contend, was simply to be able to foreclose on the property. Thus, because "the purpose of providing adequate protection is to insure that the secured creditor receives the value for which the creditor bargained for prior to the debtor's bankruptcy," *In re WorldCom, Inc.,* 304 B.R. 611, 618–19 (Bankr.S.D.N.Y.2004), the JSNs should be entitled to foreclosure value of the collateral as of the Petition Date—and no more. In support, the Debtors cite to a line of cases holding that under a section 506(a) analysis, a secured lender's interest is limited to the right to foreclose upon the property. [33]

The Court disagrees, and in light of the Supreme Court's rulings in *Rash* and *Timbers,* the Court finds the cases cited by the Plaintiffs unpersuasive. *See Winthrop,* 50 F.3d at 75–76 (disapproving of cases that "render[ ] the second sentence of § 506(a) virtually meaningless" and holding that "a court remains faithful to the dictates of § 506(a) by valuing the creditor's interest in the collateral in light of the proposed post-bankruptcy reality: no foreclosure sale and economic benefit for the debtor derived from the collateral equal to or greater than its fair market value"). In this case, the parties were not contemplating on the Petition Date that the creditors might conduct a foreclosure sale. The Debtors never had any intention of turning over the JSN Collateral to the collateral ***595** agent. (Oct. 15 Tr. 164:21–165:2, 249:6–16.) Nor did the JSNs foreclose or attempt to foreclose on the assets. Rather, the JSNs entered into a cash collateral stipulation to allow the sale of assets as a going concern. (DX AIJ at 5.) A going concern valuation is consistent with the Debtors' stated purpose in this case as of the Petition Date, which, among other things was "preserv[ing] the Debtors' servicing business on a going concern basis for sale." (PX 137 at 7.) The testimony at trial confirmed that the parties always intended to market and sell the properties as a going concern. This is also evident by looking at the stalking horse APAs that were in place on the Petition Date. [34] Thus, in determining the value of the JSN Collateral on the Petition Date, the Court must apply that value based on the proposed disposition of the collateral—fair market value in the hands of the Debtors.

*4. The JSNs Did Not Calculate the Fair Market Value of the Impaired Collateral in the Hands of an Insolvent Company and Have Therefore Failed to Carry Their Burden of Proving a Diminution in Value.*

**[9]** While the Court agrees with the Defendants that the correct methodology for Petition Date valuation is fair market value in the hands of the Debtors, the Court finds that the Defendants have not provided a credible valuation of their collateral as of that date. Therefore, the Defendants have failed to carry their burden of proving a diminution in the value of their collateral, and their adequate protection claim fails. [35]

As detailed above, the JSNs offered valuation testimony from four experts affiliated with Houlihan. The Houlihan opinions of the fair market value of each asset comprising the JSN Collateral was informed, where applicable, by the prices obtained in the auction process, adjusted for cash flows and loan balances back to the Petition Date. (Siegert Direct ¶ 18.) In addition, Houlihan performed a "bottoms-up" fair market valuation as of the Petition Date. Mr. Siegert offered a single "Global Summary" of the Houlihan opinions suggesting the net fair market value of the JSN Collateral on the Petition Date totaled $2.79 billion—nearly $1 billion more than the stipulated Effective Date value of the same collateral. (Siegert Direct ¶¶ 4, 25; Oct. 23 Tr. 134:1–14, 141:14–142:6; DX ABF at 10.) While the Court recognizes that the Houlihan experts used accepted valuation methodologies, the assumptions and inputs they used were seriously flawed. As a result, Houlihan's conclusions regarding value are not credible.

First, the Houlihan experts' valuation assumes that the JSN Collateral could have been sold on the Petition Date by the Debtors. (Oct. 22 Tr. 139:18–142:4; Oct. ***596** 23 Tr. 147:23–149:3, 149:18–22.) This assumption ignores reality. For example, Mr. Levine's opinion assumes a sale with appropriate representations, warranties, and market indemnifications from the seller; he valued the assets assuming that they could be sold free and clear of certain obstacles to sale. (Oct. 22 Tr. 62:17–21.) But at trial, Mr. Levine conceded that a sale of MSRs would have required the consent of the RMBS Trustees and of the GSEs. (*Id.* at 64:8–65:9.) Mr. Levine did not take into account the costs associated with obtaining the requisite consents, and simply assumed that the transaction would have closed upon the receipt of all required consents. (*Id.* at 63:15–25.) Those costs were considerable, including hundreds of millions of dollars in payments to GSEs to cure alleged liabilities to those entities and obtain their consent to the sale. (*Id.* at 67:1–22; PX 388 ¶ 1.) There was no assurance that the consents could be obtained. In addition, the Debtors agreed to settle billions of dollars of potential RMBS liability to obtain consent of the RMBS Trustees and be able sell the assets free and clear. (Marano Direct ¶ 43.) Mr. Levine's valuation did not account for the potential reduction in funds available to the lender or seller in a sale of those assets nor did his valuation take into account the time and difficulty in obtaining those consents. (*Id.* at 72:7–73:10, 69:10–69:20.)

Second, even assuming that the Debtors could have sold their assets on the Petition Date—an assumption the Court views with considerable skepticism—the Houlihan valuation suffers from another, fatal flaw. When valuing the assets, the Defendants' experts did not look to sales conducted by other distressed entities on the brink of insolvency. The experts instead only considered a solvent company, able to capture fair value for its assets. Thus, even if the Court accepts that the assets were saleable on the Petition Date—before all of the of work conducted during the bankruptcy necessary to make them saleable—the Houlihan experts' valuation cannot be relied upon because it provides a fair market value of the assets in the hands of a solvent company. Most of the assets could not simply be turned over to a buyer who could instantly reap full value as if the assets were commodity products. MSRs require that accurate mortgage security records are provided. The Houlihan valuation ignores the reality of the period leading up to this bankruptcy: ResCap was an insolvent company, over-burdened with debt, owning assets that had to be "fixed" before they could be sold, and facing a real possibility of being shut down. As Mr. Levine testified, the

GSEs had the right to terminate ResCap's servicing rights and transfer the rights to another party upon any breach of their servicing agreement. (*Id.* at 96:22–97:7.) Therefore, the Court finds the Houlihan analysis flawed in its premise, and unreliable.

The Court is mindful that the Debtors have spent money that belonged to the JSNs. But while the JSNs' cash collateral has been consumed during the case consistent with the Cash Collateral Forecasts, this does not mean that the JSNs have suffered a diminution in the aggregate value of their collateral.[36] As already held by the Court, the JSNs are not entitled to an adequate protection claim on a dollar-for-dollar ***597** basis for cash collateral used during the case. *Residential Capital*, 497 B.R. at 420. Where cash collateral use is permitted according to an approved budget, and the cash collateral order includes a section 506(c) waiver, the two provisions work in tandem. Unless the remaining value of the cash and non-cash collateral at the effective date falls below the value of the collateral on the petition date, the creditor is not entitled to compensation for the amount of cash collateral spent under the approved budget. But the debtor does not get to charge the secured creditor again for any costs of preserving or enhancing the collateral.

Rather, the Defendants have the burden of showing that there has been a diminution in the aggregate value of JSN Collateral. Case law and the Cash Collateral Order both impose this requirement. The Defendants failed to make this required showing. Simply put, the Court cannot accept that the value of the JSN Collateral on the Effective Date does not exceed the value of their collateral on the Petition Date, even after the expenditure of the JSNs' cash collateral. This result was achieved because the value of the collateral at the Petition Date (even valued in the hands of the Debtors on a going concern basis) was very substantially impaired by reason of existing defaults that prevented Debtors from disposing of most of their collateral at that time. Through the settlements and consents achieved over many months, with great effort and expense, the Debtors successfully closed the sales of most of their assets on very favorable terms. The JSNs and all estate creditors will benefit from this accomplishment.

### C. The JSNs Can Establish Whether They Are Oversecured by Aggregating Their Claims against Debtor Entities.

**[10]** Under section 506(b) of the Bankruptcy Code, a secured creditor is ***598** entitled to postpetition interest, fees, costs and charges to the extent the value of the property securing the creditor's claim is greater than the amount of the creditor's claim. 11 U.S.C. § 506(b). The Debtors contend that under applicable law, the JSNs must be oversecured at a single Debtor entity—without reference to JSN Collateral held by other Debtor entities—to be entitled to postpetition interest. In contrast, the JSNs argue that a determination of their oversecured status must be made based on the aggregate value of their collateral, across Debtor entities. There is a surprising dearth of case law explicitly addressing the issue of valuing the extent of a creditor's security in multi-debtor cases. The statute likewise does not provide much guidance. The Court agrees with the JSNs that they are entitled to aggregate their collateral across debtor entities. Any other reading of the statute would lead to inequitable and illogical results.

Section 506(b) permits a secured creditor to collect postpetition interest to the extent that its "allowed secured claim is secured by property the value of which ... is greater than the amount of such claim." 11 U.S.C. § 506(b). Section 506(a), in turn, establishes the rule governing the calculation of secured claims. That section provides that a creditor's claim is secured "to the extent of the value of such creditor's interest in the estate's interest in [the securing] property." 11 U.S.C. § 506(a)(1).

**[11]** **[12]** Based on the language of the statute, the Plaintiffs argue that even where a creditor's claim is secured by collateral pledged by other debtors, it is necessary to examine the value of a specific "estate's interest" under section 506(a) to determine whether the secured creditor is entitled to postpetition interest with respect to its claim against that particular debtor under section 506(b).[37] This view seems to follow from the general principle that, absent substantive consolidation, a court will not pool the assets of multiple debtors to satisfy their liabilities. *See Union Sav. Bank v. Augie/Restivo Baking Co. (In re Augie/Restivo Baking Co.),* 860 F.2d 515, 518 (2d Cir.1988). "Because of the dangers in forcing creditors of one debtor to share on a parity with creditors of a less solvent debtor, ... substantive consolidation ... [is] to 'be used sparingly.' " *Id.* (quoting *Chemical Bank New York Trust Co. v. Kheel,* 369 F.2d 845, 847 (2d Cir.1966)) (citation omitted). But aggregating collateral for purposes of determining whether a secured creditor is oversecured and entitled to postpetition interest and fees does not run afoul of this rule. No debtor in a multi-debtor case will be required to pay a secured creditor more than the value of the secured creditor's collateral. The secured creditor by definition has a superior right to the value of the collateral;

junior creditors have no right to share on a parity with the secured creditor.

In support of their interpretation of section 506(a), the Plaintiffs cite to *DeNofa v. Nat'l Loan Investors L.P. (In re DeNofa),* 124 Fed.Appx. 729 (3d Cir.2005). In *DeNofa,* the Third Circuit addressed whether a secured creditor, secured by both debtor and non-debtor assets, was entitled to aggregate its collateral to become oversecured. *Id.* at 730–31. The court held that it was not, stating that "the allowed secured claim of [a secured lender to] examine for purposes of postpetition interest under § 506(b) is limited to the extent of the value of the property of the [debtor's] bankruptcy estate which secures it [under § 506(a) ]." *Id.* at 731. But *DeNofa* dealt with debtor and non-debtor entities; it did not address the situation presented here—multiple debtor obligors may own collateral sufficient, in the aggregate, to render a secured creditor oversecured. While the Plaintiffs contend this is a distinction without a difference, the Court disagrees. There is no scenario where a debtor will ever have to pay on a secured claim more than the value of the collateral securing the debt. However, when all of the secured lender's obligors are in bankruptcy, to the extent that the aggregate value of the collateral exceeds the lender's claim, the estates' unencumbered assets are unaffected by the payment of postpetition interest, and there is nothing inequitable about permitting the secured lender to apply its collateral towards postpetition interest once its prepetition claim has been paid in full. Therefore, *DeNofa* 's analysis is not dispositive of the questions presented ***599** here.[38]

In another ill-fated attempt to shed light on the issue, the Plaintiffs cite to a Second Circuit case holding that the filing of a joint petition by spouses under section 302 of the Bankruptcy Code "does not automatically consolidate their estates," nor does it "allow the property of one spouse to be used to satisfy the debts of the other spouse." *Wornick v. Gaffney,* 544 F.3d 486, 491 (2d Cir.2008). In *Wornick,* the Second Circuit held that "the trustee may not reach assets in a joint filing that he could not have reached had the spouses filed separately." *Id.* The Plaintiffs assert that the same principle should prevail in the context of section 506(a).

But comparison to *Wornick* ignores the important fact that only collateral securing the debt is at stake here; *Wornick* is easily distinguishable and of little utility to the Court. The interests at question in *Wornick* were the cash surrender values of several life insurance policies. *Id.* at 488. The Second Circuit found that under the applicable state insurance law, had the spouses filed separately, neither spouse's creditors could have claimed an interest in the policies' surrender values. *Id.* at 489–91 (finding that "the beneficiary has no legal or equitable interest in the policy that could be made part of the property of the beneficiary's bankruptcy estate" and that "the trustee would have been powerless to administer the cash surrender value as part of the estate of the owner/insured because [insurance law] provides an express exemption in favor of the beneficiary"). Under those facts, the court held that "[a] joint filing does not vest the trustee with the power to reach a spouse's assets that would have otherwise been insulated...." *Id.* at 491. The facts in front of this Court are completely different. The JSNs do have a right to assert claims against property held at each of the individual Debtors. Thus, the question presented here does not involve property that does not form part of the secured creditor's collateral; only collateral pledged to the secured creditor will be used to pay postpetition interest. Rather, the question is whether property subject to the JSNs' liens, held across multiple debtors, can be aggregated for the purposes of making the JSNs oversecured.

The Defendants cite two cases explicitly rejecting arguments that a secured creditor had to be oversecured at a single debtor in order to be entitled to postpetition interest.[39] *See* ***600** *In re SW Hotel Venture, LLC,* 460 B.R. 4, 26 (Bankr.D.Mass.2011),*aff'd in part and rev'd on other grounds sub nom. Prudential Ins. Co. of Am. v. City of Boston (In re SW Boston Hotel Venture, LLC),* 479 B.R. 210 (1st Cir. BAP 2012); *In re Revolution Dairy, LLC*, Case No. 13–20770 (Bankr.D.Utah Apr. 29, 2013) Hr'g Tr. [Docket No. 206] (the "Rev. Dairy Tr."). In *SW Hotel Venture*, the debtors, like the Plaintiffs here, argued that a secured creditor "cannot aggregate the value of all of the Debtors' assets to establish an entitlement to postpetition interest." 460 B.R. at 22. The court "unequivocally reject[ed]" this argument, ruling instead that "the determination of [a secured creditor's] status as an oversecured (or undersecured) creditor must be made aggregating the collateral of all the Debtors...." *Id.* at 33.[40] In Revolution Dairy, the court reached the same conclusion. There, affiliated debtors argued that the collateral held by each debtor should be considered separately for purposes of determining the secured creditors' entitlement to postpetition interest and fees under section 506(b). In rejecting the debtors' position, the court noted that the debtors' failure to "cite ... case authority in support of their argument" was "not surprising," as "[t]he argument is clearly inconsistent with the code and cannot stand modest scrutiny." *Revolution Dairy*, No. 13–20770, Rev. Dairy Tr. at 12:19–13:3.

In this case, given the facts that lead to the creation of the JSNs' liens, the Court believes that the Defendants' interpretation of section 506 best reflects reality and comports with the purpose underlying the Bankruptcy Code. The Plaintiffs argue that adopting the Defendants' suggestion that courts can "cavalierly pool collateral from multiple debtors" runs contrary to the plain text of the statute and the principle of law "deeply ingrained" in American corporate and bankruptcy jurisprudence that corporate separateness must be respected absent extraordinary circumstances. *See, e.g.,United States v. Bestfoods,* 524 U.S. 51, 61, 118 S.Ct. 1876, 141 L.Ed.2d 43 (1998) (refusing to disturb corporate separateness to penalize shareholders of polluting company). According to the Plaintiffs, "arbitrarily merging the assets and liabilities of multiple distinct entities would upset creditors' expectation that the assets of their debtor will be available to satisfy their claim." (Plaintiffs' Post Trial Brief, ECF Doc. # 186 at 66.) *See, e.g.,Augie/Restivo,* 860 F.2d at 518–19 ("[C]reditors who make loans on the basis of the financial status of a separate entity expect to be able to look to the assets of their particular borrower for satisfaction of that loan."); *In re Tribune Co*., 464 B.R. 126, 182 (Bankr.D.Del.2011) ("In the absence of substantive consolidation, entity separateness is fundamental.").

The Plaintiffs woefully mischaracterize the present situation. Only the value of the JSN Collateral would be used to satisfy their claims. They would have this Court ignore the reality of their business arrangement with the JSNs, in favor of a formulaic adherence to fictional corporate separateness. Far from "arbitrarily merging" assets of distinct entities, the Court is giving the JSNs the benefit of their bargain. The JSN Indenture explicitly provides that the JSNs are entitled to collect ***601** interest until the principal was paid in full. (DX CN at 7; PX 1 at 51.) In the Offering Memorandum, the Debtors represented that the JSNs would be secured by ResCap and its subsidiaries, together, jointly and severally. (PX 175 at 1 ("The new notes will be issued by ResCap and will be secured by substantially all of our existing and after-acquired unencumbered assets remaining available to be pledged as collateral as described below. The notes will also be unconditionally guaranteed by subsidiaries of ResCap."); PX 1. at 79–80.) "Guarantor" is defined in the JSN Indenture as "(i) each of the Subsidiaries of the Company that is a party to this Indenture, and (ii) any other Subsidiary that executes a supplemental indenture in accordance with the provisions of this Indenture." (PX 1 at 14.) The Guarantors provided unconditional guarantees to the JSNs *jointly and severally*. (*Id.* at 79–80.) Additionally, the JSN Indenture required that if the Debtors moved assets to a Significant Subsidiary or created a Significant Subsidiary, [41] such Significant Subsidiary would become a Guarantor, subject to certain exceptions. (*See, e.g.,id.* at 59–60 (Section 4.17 requiring all "Significant Subsidiaries" to become "Guarantors" and thus also "Grantors" under the JSN Pledge Agreement).)

Outside of bankruptcy court the JSNs would have been entitled to levy against the assets of any and all of the Obligors and Guarantors to secure their rights to collect interest until principal was paid in full. (*Id.* at 79–80.) The JSN Indenture explicitly states that the JSNs are entitled to collect postpetition interest in the event of a bankruptcy proceeding, to the extent allowed by law. (*Id*. at 51.) The JSN Indenture contains no provision conditioning those interest payments on the JSNs being oversecured at any single Debtor entity.

Additionally, the Debtors routinely reported their financial status in consolidated financial statements. (*See, e.g.,* DX GU; DX HQ; DX IT; DX JT.) The Debtors continued to report collateral value in the aggregate after the Petition Date. (*See, e.g.,* Monthly Operating Report for the Period from September 1, 2012 through September 30, 2012, ECF 12–12020 Doc. # 1914; Monthly Operating Report for the Period from August 1, 2013 through August 31, 2013, ECF 12–12020 Doc. # 5209.)

The Defendants' view more accurately reflects the reality of this case. It also reflects the workings of the business world at large. For example, like the JSN Indenture at issue here, most indentures allow debtors to move assets among their subsidiaries, and to create new subsidiaries, as long as the creditors continue to maintain liens in such assets. (See PX 1 § 4.7 (requiring all "Significant Subsidiaries" to become "Guarantors" and thus also "Grantors" under the JSN Pledge Agreement).) This flexibility is beneficial to borrowers, as it enables them to employ varying ***602** corporate structures in order to avail themselves of tax benefits, limit their liability, and comply with a multiplicity of regulatory requirements (for example, state laws requiring that construction or other permits be obtained by a domestic entity). *See, e.g.,In re Owens Corning,* 419 F.3d 195, 200 (3d Cir.2005) ("[Parent] and its subsidiaries (which include corporations and limited liability companies) comprise a multinational corporate group. Different entities within the group have different purposes. Some, for example, exist to limit liability concerns (such as those related to asbestos), others to gain tax benefits, and others have regulatory reasons for their formation."). For these Debtors, the use of special purpose subsidiaries was particularly necessary in order to allow the Debtors to obtain financing secured by mortgage loans. (*See* ECF 12–12020 Doc. # 1546 ¶ 49 ("Presumably to avoid the burden and expense of preparing and recording separate mortgages on each parcel of property, the Debtors are permitted to transfer real property to SPVs whose equity were pledged under the Security Agreements.").)

If, to be oversecured, and thus entitled to payment in full of all amounts owing, including postpetition interest, fees, costs, and charges in a bankruptcy case, secured lenders were required to be oversecured at a single entity, credit agreements and indentures might begin to prohibit corporate families from employing the type of complex subsidiary and affiliate structures that are currently commonplace and borrowers will be required to hold all collateral at a single entity. Lenders might also require their approval before collateral could be moved among entities. Absent these precautions, lenders would be less willing to extend credit (especially to borrowers in precarious economic situations, who may be most in need of financing), or would charge higher interest rates to compensate for the possibility that their contractual rights to postpetition interest, fees, costs, and charges will not be honored in bankruptcy.

Moreover, if the Plaintiffs' view is accepted, section 506(b) will effectively be nullified in multi-debtor cases where a secured creditor is not oversecured at any single debtor, even in instances where the creditor is vastly oversecured by the property held by the debtors in the aggregate. An interpretation of section 506(b) that allows for this scenario defies common sense. For all of these reasons, the Court holds that the JSNs must be allowed to aggregate collateral held at each of the Debtors in order to calculate the extent of their security.

### D. Since the Debtors Can Aggregate Collateral, the Court Must Determine What Constitutes JSN Collateral.

The parties agree to a $1.88 billion baseline valuation of the JSN Collateral on the Effective Date, but the Defendants want to add to that figure, and the Plaintiffs want to subtract from it. The analysis below addresses both the Defendants' attempts to add to their collateral along with the Plaintiffs' challenges to certain JSN liens on collateral.

#### *1. The JSNs Are Not Entitled to Additional Sale Proceeds for the HFS Collateral.*

The Defendants claim that the JSNs' liens attach to an additional $66 million of cash proceeds from the Berkshire sale, based on their expert's allocation of the sale price to the HFS loans. Mr. Fazio conducted an analysis of the value of the HFS loans sold to Berkshire, reaching a value that was $66 million higher than that provided by the Plaintiffs. Mr. Fazio testified that he did not rely on the pricing ***603** formula in the Berkshire APA, which broke the HFS loan portfolio into categories based on only one criterion, but instead looked at all the credit quality and credit statistics associated with each of the portfolios to determine value. (Oct. 22 Tr. 167:16–24.) In general, those statistics—including borrower credit rating, interest rate, and delinquency—were better for the JSN loan collateral than for the non-JSN Collateral. (*See* DX ABI at 5–7.)

The Court does not find Mr. Fazio's calculation the best indicator of the value of the HFS loans. In applying his own methodology to allocate the value of the HFS Portfolio between JSN and non-JSN Collateral, Mr. Fazio disregarded the actual purchase prices that Berkshire Hathaway agreed to pay for the collateral pursuant to § 3.1(a) of the Berkshire APA, which was an arm's-length agreement.[42] (PX 31 at 27.) The Berkshire APA classified the loans within the HFS Portfolio into six buckets based on certain characteristics: (1) Performing First Lien; (2) Non–Performing First Lien; (3) Performing Second Lien; (4) Non–Performing Second Lien; (5) Other; and (6) Securitized Advances. (Oct. 22 Tr. 161:20–162:11, 163:7–17; PX 31 at 19.) The Berkshire APA established different purchase prices calculated as percentages to be multiplied by the unpaid principal balance of the loans, for each category (plus any adjustments for the document deficiency multiplier). (Oct. 22 Tr. 162:12–19; 164:8–166:13; 167:25–168:18; PX 31 at 20.) Rejecting these contractual purchase prices, Mr. Fazio reclassified the loans based on characteristics such as origination vintage, product type, or adjustable or fixed rate mortgage, and valued the loans within his classifications based on metrics such as borrower credit scores and interest rates, to derive his bottoms-up valuation. (Oct. 22 Tr. 154:24–158:11, 159:3–9, 164:1–7, 169:2–10; DX ABI at 5, 19–22.)

**[13]** Where, as here, an asset is sold in an arm's-length transaction, the fair market value of such asset is conclusively determined by the price paid. *See Romley v. Sun Nat'l Bank*

*(In re Two "S" Corp.),* 875 F.2d 240, 244 (9th Cir.1989); *see also* *Covey v. Davlin (In re Hobbick)*, No. 97–83543, 2001 WL 34076375, at *14 (Bankr.C.D.Ill. Sept. 10, 2001). The Berkshire APA was the result of a highly competitive auction process approved by the Court, and the price paid for the whole loans was the result of arm's-length negotiations that established the fair market value of each category of loans. The Court will not rely on Mr. Fazio's reallocation of Berkshire's price calculation. The Court finds that the JSNs are not entitled to a lien on additional sale proceeds for the HFS loans.

*2. The JSNs Are Entitled to a $17 Million Increase in FHA/VA Loan Value.*

**[14]** The Defendants seek to add an additional $17 million to the baseline collateral, to reflect a net increase to the value of the FHA/VA loans. The difference between the Plaintiffs' and Defendants' valuations of the FHA/VA loans is attributable to their methodologies. The Plaintiffs' expert Mr. Renzi employed a recovery analysis, discounting the figures in the Debtors' April 30, 2013 balance sheet for assumed costs of collection. (Oct. 16 Tr. 139:5–11.) Mr. Renzi assumed a recovery rate of 91.1% of book value, deducting the costs, ***604** expenses and risks associated with disposing of the assets. (Renzi Direct ¶ 13; Oct. 16 Tr. 144:20–145:2.) The Defendants' expert Mr. Fazio employed a fair market value analysis. Mr. Fazio assumed that the loans would monetize over a 30–36 month period. (DX ABI at 59.) Mr. Fazio discounted the estimated cash flow at 5% over the three year period, taking into consideration the risk of loss and government insurance. (*Id.*) Ultimately, Mr. Fazio valued the FHA/VA loans at 95% of book value. (*Id.*) The Plaintiffs challenge Mr. Fazio's assumption that the loans would be runoff in three years, claiming that the Debtor documents on which he relied actually project a seven-year timetable. (Oct. 22 Tr. 169:15–175:8; DX ABI at 58; *see also* Puntus Direct ¶ 162.) Mr. Fazio stated at trial that while his calculations were based on a 100% monetization by the end of the third year, it is possible that some small "insignificant amount" of the loans would not be monetized until years later. (Oct. 22 Tr. 174:22–175:8.)

The Court believes that fair market value, and not recovery value, was the correct methodology for valuing the FHA/VA loans. Even if there are costs in monetizing the 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). 11 U.S.C. §§ 506(b)–(c). Here, there are no such costs under section 506(c) because the Debtors waived their section 506(c) rights in the Cash Collateral Order. (PX 76.) Thus, the premise of the Plaintiffs' recovery analysis—that the assets will continue to generate expenses and cost money to monetize—runs counter to section 506(b). The Court finds that the JSNs are entitled to a lien on an additional $17 million for the FHA/VA loans.

*3. The JSNs Are Entitled to Another $40 Million in Liens on Non–Debtor Equity.*

**[15]** The JSNs claim they have a lien on an additional $40 million of equity interests in non-Debtor subsidiaries. Their argument is based on a report filed by the Debtors, titled *Periodic Report Regarding Value, Operations and Profitability of Entities in Which the Debtors' Estates Hold a Substantial or Controlling Interest* (the "Periodic Report"), which included a summary balance sheet for each of the non-Debtor subsidiaries. (*See* DX ABI at 68–69.) Using the Periodic Report as a guide, Mr. Fazio concluded that the value of the equity pledges in non-Debtor Subsidiaries was approximately $40 million. (*Id.*) Specifically, Mr. Fazio calculated that the value of the equity pledges in the Non–Debtor subsidiaries were $26 million in CAP RE of Vermont, LLC; $3 million in CMH Holdings LLC; $1 million in GMAC–RFC Europe Limited; and $10 million in GMAC–RFC Holdings Limited. (*Id.*)

The Plaintiffs have not offered any evidence regarding these equity interests. At trial, Mr. Renzi testified that Plaintiffs' counsel told him that the non-Debtor subsidiaries had very limited equity value due to contingent liabilities, namely litigation liability. (Oct. 16 Tr. 153:16–154:3.) Plaintiffs' counsel further informed Mr. Renzi that the probability was high that the Debtors would not prevail in the litigation. (*Id.* at 154:4–9.) Instead of presenting a risk-adjusted equity value to account for the litigation risk at the Non–Debtor subsidiaries, based upon his conversations with counsel, Mr. Renzi presented the equity value in those entities as zero. (*Id.* at 153:12–154:15.)

Moreover, the Plaintiffs have not refuted that the JSNs have a lien on equity pledges. The Defendants have carried ***605** their initial burden of putting forth evidence to show they have an interest in the equity of these non-Debtor subsidiaries, in an amount totaling $40 million. The Plaintiffs' expert did not produce a value for the equity; Mr. Renzi simply valued the equity at “0.” The Plaintiffs have therefore failed to put forth sufficient evidence to rebut the Defendants' claim. *See Heritage Highgate,* 679 F.3d at 140 (“It is only fair ... that the party seeking to negate the presumptively valid amount of a secured claim—and thereby affect the rights of a creditor—bear the initial burden.... If the movant establishes with sufficient evidence that the proof of claim overvalues a creditor's secured claim because the collateral is of insufficient value, the burden shifts.”). The Court finds that the JSNs have a lien on $40 million of equity at non-Debtor entities.

*4. The JSNs Do Not Have a Lien on Any Collateral Pledged to the AFI LOC.*

The Defendants offer two arguments for why the JSNs have liens on approximately $910 million in collateral pledged to the AFI LOC. First, the Defendants claim that the collateral was previously pledged to the JSNs and was never properly released from the JSNs' liens, so their liens still attach to the collateral. Second, the Defendants assert that even if their liens on the collateral were released, paragraph 5(g) of the Cash Collateral Order revived those liens. Both arguments fail.

a. All JSN Collateral Subsequently Pledged to the AFI LOC Was Properly Released Before Being Pledged to the AFI LOC.

In 2010 and 2011, Wells Fargo, acting as Third Priority Collateral Agent (i.e., the collateral agent for the Junior Secured Notes) consented in writing to the release of a variety of assets from the Notes Collateral that were then pledged to AFI under the LOC Facility. Wells Fargo did this by executing the Blanket Loan Release, which released the JSNs' security interest in the Released Loan Collateral, and the Servicing Advance Release, which released the JSNs' security interest in the Released Advances. Wells Fargo then filed U.C.C.–3 amendments that deleted the Blanket Released Collateral from the collateral provided in the original U.C.C.–1 financing statements (as amended) filed by the Third Priority Collateral Agent.

The Defendants previously contested the effectiveness of those releases. The Court rejected the Defendants' arguments, holding that the releases were effective and entitled to enforcement. *See Residential Capital,* 497 B.R. at 416–17. Specifically reviewing the Blanket Loan Release—which accounts for approximately 97% of the $910 million in dispute—the Court found that the descriptions of the collateral covered by that release satisfied U.C.C. 9–108(b)'s requirement for reasonably identifying the released collateral, and the U.C.C.–3s “are therefore valid.” *Id*. at 418.

At trial, the Defendants tried to attack the releases of the collateral pledged to the AFI LOC by arguing that there was an insufficient paper trail documenting the releases. This is not so. The Blanket Loan Release released, among other things, “Servicing Rights Collateral” and “Subject Mortgage Loans.” The releases provided three means for determining whether an asset was a Subject Mortgage Loan that had been released from the Revolver and Junior Secured Notes:

- a “Mortgage Schedule delivered under the LOC Loan Agreement”;
- in the backup to the monthly borrowing base reports or monthly collateral reports under the LOC Loan Agreement, which reflected the carrying value ***606** of the assets pledged to the LOC Facility; or
- most broadly, any of the Debtors' “books and records” reflecting that a loan had been pledged to the LOC Facility. This category would include, among other things, the CFDR, which tracked various details concerning the Debtors' loans, including the facility (if any) to which such loans were pledged.

(PX 134.)

Under these terms, if a loan was listed on the CFDR as pledged to the AFI LOC, it was covered by the Blanket Loan Release. There is no dispute that the collateral in question was listed in the CFDR as pledged to the AFI LOC. The Court has already admitted the CFDR as a reliable record that was subject to rigorous audits and controls. Therefore, the releases were effective since the loans appeared in the CFDR as pledged to the AFI LOC. Moreover, a written description of the released collateral was attached as an exhibit to the U.C.C.–3 amendments, which the Third Priority Collateral Agent also filed to delete the Blanket Released Collateral from the collateral set forth in the original U.C.C.–1 financing statements. These written descriptions put all potential creditors on notice that the collateral they covered includes certain servicing rights and mortgage loans (among other assets), and that further diligence may be required to determine to whom they are pledged. As the Court has explained, the U.C.C.–3s are sufficient to satisfy the lenient description standards outlined in U.C.C. § 9–108(b)(6) because the descriptions of the collateral released "reasonably identif[ied]" the collateral released, satisfying the U.C.C. permissive standard. *See Residential Capital,* 497 B.R. at 418.

The Court's conclusion applies with equal force to the Servicing Advance Release. Like the Blanket Loan Release, the Servicing Advance Release contained a description of various categories of Released Advances that were being released from the JSNs' liens, which included, among others, any existing and future advances relating to mortgage loans and REO property, made pursuant to certain contracts with Freddie Mac. Moreover, the Servicing Advance Release described all servicing advances pledged to the AFI LOC.

The Defendants contend that other back-up documentation should exist regarding the release of this $910 million of assets, including schedules of mortgage loans, collateral addition notices to the LOC Facility, and electronic templates used to update the CFDR. But there is no need for this type of additional back-up. The CFDR suffices for the Blanket Loan Release, and the Servicing Advance Release effectively released all advances pledged to the AFI LOC.

b. Paragraph 5(g) Did Not Revive Any Liens on Collateral Pledged to the AFI LOC or to Any Other Previously Released Collateral.

**[16]** The Defendants ask the Court to interpret paragraph 5(g) of the Cash Collateral Order to mean that the Debtors agreed that assets released from the JSNs' liens years earlier were revived by the Order. If so, the Defendants would have a lien on the collateral pledged to the AFI LOC, totaling an additional $1.1 billion in value. In ruling on the motions to dismiss, the Court determined that it would benefit from a greater factual record on this issue, and extrinsic evidence could be submitted to establish the meaning of paragraph 5(g). *Residential Capital,* 497 B.R. at 403. Based on the evidence submitted by both sides, the Court concludes that the Defendants' interpretation of paragraph 5(g) fails on multiple grounds.

*First*, the Court notes that no party ever disclosed this purported effect of paragraph ***607** 5(g) to the Court when the Cash Collateral Order was proposed or at any contemporaneous hearing, despite Local Rule 4001–2(a)(6). That rule requires disclosure of provisions in a cash collateral motion that would secure prepetition debt with liens on assets that the creditor would not otherwise have by virtue of the prepetition security agreement or applicable law. The Court will not countenance the Defendants' attempt to slide a $1.2 billion windfall past the Court and past the Plaintiffs.

*Second*, other portions of the Cash Collateral Order reveal the parties' intent at the time the order was submitted. For instance, the very next stipulation in the Cash Collateral Order provides an overview of the collateral securing the Junior Secured Notes:

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

(PX 76 at 12.) If, at the time the Cash Collateral Order was negotiated, the JSNs actually believed that they were being granted new liens on the AFI LOC collateral, paragraph 5(h) should have included "AFI LOC" in the categories of assets securing the Junior Secured Notes on Exhibit A to the Cash Collateral Order.

Moreover, the Defendants reading of Paragraph 5(g) is also not supported by the language of the Cash Collateral Order. For example, in Paragraph 5(g), the Debtors acknowledge that the JSNs' liens are "subject and subordinate *only* " to the liens granted under the Revolver. (*Id.* at 11–12 (emphasis added).) This provision does not also subordinate JSNs' purported lien to the LOC Lenders' lien under the LOC Facility. Under the Defendants' proposed interpretation of Paragraph 5(g), the JSNs' purportedly revived lien on the AFI LOC collateral is elevated ahead of the LOC Lenders' (uncontrovertibly senior) lien in that collateral. AFI would not have agreed to such a provision, especially since it relied on the AFI LOC collateral to make the postpetition advances under the Cash Collateral Order.

In addition, in granting the JSNs a postpetition adequate protection lien on the Revolver Collateral and the AFI LOC collateral, the Cash Collateral Order subordinated adequate protection liens to any *existing* liens on the same collateral.

To that end, with respect to the JSNs' adequate protection lien on the Revolver Collateral, the order acknowledges that the adequate protection lien is junior to (among other things) the "*existing liens granted to the Junior Secured Parties.*" (*Id.* at 28 (emphasis added).) But the order does not contain similar language with respect to the adequate protection lien in the AFI LOC collateral, indicating that the JSNs did not have an existing lien on that collateral. (*Id.* at 28–29.)

Aside from the terms of the Cash Collateral Order, other documents filed simultaneously in the bankruptcy court reflect that the stipulations in paragraph 5(g) were not intended to revive previously released liens. For example, the Debtors indicated in their motion seeking approval of the Barclays DIP Facility that any purported equitable lien asserted by the JSNs on the assets securing the AFI LOC was not a valid, perfected, and nonavoidable lien or security interest as of the Petition Date. (PX 88 at 55.) Offering that argument is squarely at odds with a purported stipulation to the validity of a lien on that collateral.

*Third*, the testimony of Mr. Siegert indicates that when the parties were negotiating the Cash Collateral Order, the JSNs did not believe that the Order would revive liens on more than $1 billion in released ***608** collateral. The JSNs did not include the value of the assets securing the AFI LOC in their own contemporaneous analysis of the collateral securing the Junior Secured Notes. On cross-examination, Mr. Siegert was shown a Houlihan presentation dated May 14, 2012, which was prepared immediately before the Petition Date. (PX 169; Oct. 23 Tr. 110:8–23.) That presentation valued the JSNs' collateral. Mr. Siegert acknowledged that if the counsel for the JSNs had concluded that the Debtors had stipulated to JSN liens on the AFI LOC collateral, that would have been a material fact for Houlihan to consider when presenting estimates of the value of the JSN Collateral. (Oct. 23 Tr. 127:25–128:21.) And further, that would have been a material fact for Houlihan to convey to the JSNs. (*Id.*) But the May 14 Houlihan presentation did not reflect any liens on the AFI LOC collateral. (*Id.*)

It defies the parties' conduct and the terms of the Cash Collateral Order to argue that paragraph 5(g) revived previously leased liens. The JSNs do not have a lien on any AFI LOC collateral by virtue of paragraph 5(g).

### *5. General Intangibles*

The Defendants argue that the value of the JSN Collateral on the Effective Date should increase beyond the $1.88 baseline valuation because the baseline valuation does not account for certain JSN liens on intangible assets. Specifically, the Defendants argue that the Debtors sold intangible assets subject to JSN liens during the Ocwen asset sale, but the Debtors did not allocate any portion of the proceeds to intangibles subject to JSN liens. These intangibles include software, certain refinancing opportunities, trademarks, and goodwill. According to the Plaintiffs, Ocwen and Walter did not place any value on these intangibles, so it is not proper to allocate any proceeds to intangible value. Further, the Plaintiffs argue that to the extent the JSNs had any lien on goodwill, that goodwill was created postpetition and is not subject to any JSN lien. The Defendants respond that they had a lien on assets sold to Ocwen, but have received no benefit of the sale simply because the Ocwen APA assigned no value to the intangibles, even though the Ocwen APA provided that Ocwen and Walter were buying "goodwill and other intangible assets." (PX 19.) According to the Defendants, the Court may still assign value to the intangible assets based on the work of the Defendants' expert Mr. Taylor, who used general accounting principles to value the intangible assets.

#### a. The JSNs Had Liens on Software Sold to Ocwen.

In the JSN Security Agreement, the JSNs were specifically granted a lien on computer software as well as general intangibles. (*See* PX 4.) The Debtors used software in connection with the PLS MSRs and the GSE MSRs. (Oct. 15 Tr. 171:10–12.) The Plaintiffs argue the JSNs' lien on software associated with the PLS MSRs was released under the May 14, 2010 Blanket Release. That release specifically stated that all general intangibles were released "if and to the extent related to the Servicing Rights Collateral" (i.e., the PLS MSRs). (PX 134 at 6.) The Defendants counter, though, that "Servicing Rights Collateral" was defined to specifically exclude computer programs. (*Id.* at 8.) The Court therefore finds that the JSNs' lien on software associated with the PLS MSRs was not released by virtue of the Blanket Release. Any value associated with software sold to Ocwen and Walter would be allocable to the JSNs as JSN Collateral.

The next question is how to value the collateral. The Defendants' expert Mr. Taylor endeavored to value the Debtors' ***609** software and associated know-how by using an accounting method that considers what a typical market participant would have paid for the asset, regardless of any particular incentives (e.g., synergies) or disincentives that may have existed in the market at the time. The Plaintiffs challenged Mr. Taylor's analysis on several grounds, including that (1) Mr. Taylor's analysis ignores the allocations of assets in the Ocwen APA; (2) the Debtors gave Ocwen and Walter a substantial bid credit (exceeding $100 million) so Ocwen and Walter would buy the Debtors' servicing platform, including the software; (3) Ocwen and Walter later attributed lower values to software, ostensibly using the same accounting principles that Mr. Taylor applied; (4) Mr. Taylor's "avoided cost" analysis assumed that Ocwen and Walter planned to use the Debtors' software for three years, contrary to Ocwen's and Walter's actual plans; and (5) Mr. Taylor put inordinate weight on certain precedent transactions when applying his "relief from royalty method."

*First*, the Court finds that the allocations in the Ocwen APA do not control here. Section 3.3(b) of that APA provided that the Debtors and Ocwen were bound by the allocations for tax purposes, "*but not for any other purpose.*" (PX 19 at 50 (emphasis in original).) *Second*, the Debtors' bid credit awarded to Ocwen did not render the Debtors' software valueless. Rather, Ocwen and Walter intended to use and did use the Debtors' software associated with the platforms they were buying. Their public filings attributed value to software, whether as a standalone asset or built into the premises and equipment asset category.[43] (*See* DX ZH at 9; DX ST at 3; DX WK at 13.) Therefore, the software had and provided value.

Turning to Mr. Taylor's analysis, the Court is not satisfied with his valuation of the software and associated know-how. The Plaintiffs are correct that Mr. Taylor's avoided cost analysis unreasonably assumes a duration of software use that is contrary to the actual intended use in the Ocwen and Walter sale. As for his "relief from royalty" analysis, the Plaintiffs sufficiently demonstrated flaws in Mr. Taylor's methodology. For example, Mr. Taylor gave no weight to certain transactions between seemingly related parties because those may not have been arm's-length deals. (DX ABH at 135.) But Mr. Taylor then attributed 33.34% of his outcome to a transaction that appears to be between related parties. (*Id.*) Not only is this transaction given greater weight than any other transaction, but it is also a significant outlier in terms of its "point estimate." (*Id.*) Simply removing Mr. Taylor's weight assigned to this transaction would yield a $100 million lower software value. Thus, the Court finds that Mr. Taylor's "relief from royalty" analysis is unreliable.

Rather than relying on Mr. Taylor's analysis, the Court turns to how Ocwen and Walter actually reported the value of the software using a fair value accounting method. Walter's public filings indicate a $17.1 million value for software (DX WK at 13), and Ocwen's filing and its third-party valuation reflect a $1.295 value for software (DX ZH at 9; DX ST at 3.) The Court therefore finds that $18.395 million of the Ocwen sale proceeds should be attributed to JSN liens on software.

### ***610** b. The JSNs Have a Lien on the Tradename, Iconography, and Logotype Associated With the Assets Sold to Ocwen and Walter.

The Defendants submitted expert evidence that $10 million of proceeds from the Ocwen and Walter sale was allocable to "tradename/marks, iconography and logotype." (DX ABH at 42–45.) The Plaintiffs did not rebut this analysis at trial. Mr. Taylor notes that the Ocwen APA required the purchasers to rebrand assets within 120 days, but a 10–Q filed by Walter shows that it attributed value to tradename with an estimated eight-year life. (DX ABH at 43.) Thus, there may have been some intangible tradename or logotype value that would not cease to exist after 120 days. The Plaintiffs did not rebut this contention. Nor did the Plaintiffs demonstrate that any tradename value was associated only with the Servicing Rights Collateral or Subject Mortgage Loans and would therefore have been released in the Blanket Release. The Court is satisfied with Mr. Taylor's valuation of the intangible tradename assets associated with the Ocwen sale and finds that a $10 million allocation to the JSNs' liens is appropriate.

### c. The Defendants Do Not Have a Lien on Refinancing Opportunities Associated With GSE MSRs.

**[17]** At trial, the Defendants' expert Mr. Levine testified to the value of refinancing opportunities associated with certain GSE MSRs. The JSNs do not have liens on GSE MSRs since those are Excluded Assets, but the Defendants argue that the JSNs have a lien on intangible assets associated with GSE MSRs. Although the Defendants may be correct that the JSNs could have a lien on intangible assets absent a lien on an underlying asset, the value created by refinancing opportunities is inherent to the value of the GSE MSRs. In other words, the opportunities are not a separate intangible asset.

  

Mr. Levine testified that he regularly values refinancing opportunities separately from servicing rights. (Oct. 22 Tr. 100:9–16.) Even so, the value of the refinancing opportunities are inextricably linked to the MSRs themselves: Mr. Levine conceded that "to the buyer of the servicing, there would not be value to the HARP [refinancing opportunities] without the servicing rights." (*Id.* at 91:11–23.) In fact, Mr. Levine had never seen an instance where refinancing opportunities were sold separately from servicing rights. (*Id.* at 101:9–11.) Therefore, the value is properly attributable to the GSE MSRs themselves. As such, the JSNs do not have a lien on any refinancing opportunities.

d. The JSNs Did Not Establish the Value of Their Lien on Goodwill as of the Petition Date.

**[18]** The JSNs argue that they have a lien on goodwill associated with the Debtors' assets sold to Ocwen. Goodwill is "an intangible asset that represents the ability of a company to generate earnings over and above the operating value of the company's other tangible and intangible assets." *In re Prince,* 85 F.3d 314, 322 (7th Cir.1996). Goodwill may include "name recognition, consumer brand loyalty, or special relationships with suppliers or customers." *Id.* To calculate the value of goodwill, generally accepted accounting principles ("GAAP") look to "any excess of [a] purchase price over the fair value of the assets acquired and the liabilities assumed." *Fait v. Regions Fin. Corp.,* 655 F.3d 105, 110 (2d Cir.2011). Although GAAP does not require a company to record internally developed goodwill absent an asset sale, *see Sanders v. Jackson,* 209 F.3d 998, 1001–02 (7th Cir.2000), the existence of goodwill does not depend on an asset sale. *See Prince,* 85 F.3d at 323–24 ***611** (describing valuation of goodwill in context of assigning value to company stock); *see also Ackerman v. Schultz (In re Schultz),* 250 B.R. 22, 29 (Bankr.E.D.N.Y.2000) (valuing goodwill outside context of asset sale). So the question becomes whether any goodwill existed on the Petition Date subject to JSN liens.

The Defendants use two methods to calculate goodwill on the Petition Date. First, they look to the Ocwen and Walter asset sale and calculate a present value of the goodwill in that sale as of the Petition Date. Second, the Defendants perform a "top down" analysis of the intangibles associated with the MSRs and servicing and originating platforms, including goodwill. While Houlihan's methodologies may have been textbook, the assumptions and inputs they used were seriously flawed. As a result, Houlihan's conclusions regarding the values of intangibles and goodwill are not credible.

Regarding the first method, the Court cannot conclude that any goodwill derived from the Ocwen and Walter sale existed on the Petition Date. The value of the Debtors' assets on that date was seriously impaired, subject to steep reductions in value by litigation risks, potential seizure of certain MSRs, and termination of rights and setoff by the RMBS Trustees. Ocwen and Walter, the eventual buyers, were not committed to paying the Debtors anything for their assets on the Petition Date, let alone a price above the fair value of the Debtors' assets and liabilities. The Debtors facilitated the asset sale to Ocwen and Walter by maintaining the value of the assets throughout the bankruptcy, along with decreasing the liabilities associated with those assets. The Debtors worked very hard at substantial expense to achieve settlements and consents that allowed the sales to close. If the Debtors had not taken those actions, Ocwen and Walter may not have bought any assets at all, and likely would not have paid any price above the fair value of the assets and liabilities. To be sure, there may have been name recognition or special market relationships associated with the Debtors' assets on the Petition Date, but that name recognition or those relationships could have been valueless in the eyes of a buyer on the Petition Date. The Court cannot indulge the speculation that the Ocwen and Walter purchase price provides an adequate starting point for the goodwill that would have been generated by an asset sale on the Petition Date. After all, "goodwill often fluctuates widely for innumerable reasons." *Sanders,* 209 F.3d at 1002.

As for the "top down" valuation, the Plaintiffs raised serious problems with the Defendants' market multiple analysis that provided the starting point for the "top down" valuation. *First,* the Defendants' expert Mr. Fazio acknowledged that his market multiple analysis only weighed comparable companies in terms of their equity, rather than their total enterprise value. (Oct. 22 Tr. 198:20–199:6; 199:19–22.) *Second,* Mr. Fazio's analysis failed to account for any value that would be attributable to the Debtors' servicing advances. (Oct. 22 Tr. 200:1–22; DX ABG at 35, 38, 41.) Since those assets were not properly accounted for, and were not properly deduced from Mr. Fazio's valuation, it is possible that what the Defendants concluded was goodwill actually represented value attributable to servicing advances. Thus, the Defendants' second method for determining goodwill is unpersuasive.

Having failed to provide an adequate basis for valuing goodwill on the Petition Date, the JSNs have not met their burden in demonstrating the extent of their lien on goodwill as of the Petition Date.

***612** e. The JSNs Do Not Have a Lien on Goodwill Generated after the Petition Date.

**[19]** Although the JSNs have a lien on the proceeds of their prepetition collateral, any goodwill generated in connection with the assets sold to Ocwen and Walter was not the proceeds of that collateral and is not subject to JSN liens. Bankruptcy Code Section 552(b) provides that if a prepetition security agreement extends to proceeds of collateral, then postpetition proceeds would also be subject to that security agreement, unless the court orders otherwise after a hearing based on the equities of the case. 11 U.S.C. § 552(b). The JSN Security Agreement granted the JSNs a lien on "all Proceeds, products, offspring, rents, issues, profits and returns of and from, and all distributions on and rights arising out of any of the [collateral described in the JSN Security Agreement]." (PX 4 at 17.) Additionally, the Cash Collateral Order provided that the proceeds of prepetition JSN Collateral are "deemed to be cash collateral of the [JSNs]." (PX 76 at 22.) To establish a lien on the goodwill created by the Ocwen sale, the JSNs would need to demonstrate that the goodwill was the product of their prepetition collateral. They did not meet this burden.

"Section 552(b) is intended to cover after-acquired property that is directly attributable to prepetition collateral, *without addition of estate resources*." 5 COLLIER ON BANKRUPTCY ¶ 552.02[2][a] (emphasis added). Here, even if JSN Collateral was used to generate goodwill (either by maintaining or improving the value of assets or by diminishing liabilities), Debtor resources were used as well. The Debtors improved the value of the assets sold to Ocwen by negotiating settlements with government entities and RMBS Trustees. That involved time, effort, and expense by the Debtors' estates. The Debtors did not merely take some JSN Collateral and convert it into goodwill without any other resources. That means that the goodwill is not the proceeds of JSN Collateral. *See In re Delco Oil, Inc.,* 365 B.R. 246, 250 (Bankr.M.D.Fla.2007) ("The concept of proceeds is only implicated when one asset is disposed of and another is acquired as its substitute.") (internal quotation marks omitted). Even if a portion of the goodwill was directly attributable to JSN Collateral, without any other additional resources, the JSNs have failed to separate the value of that goodwill. Thus, the JSNs have not met their burden of establishing a lien on goodwill generated postpetition.

*6. Miscellaneous Collateral Categories*

a. The JSNs Have Liens on the "Contested Assets."

**[20]** The JSNs claim to have liens on "Contested Assets," which consist of (1) the Former Bilateral Facilities Collateral and (2) the Reacquired Mortgage Loans. The Court has previously ruled that the JSN Security Agreement is ambiguous with respect to "whether an Excluded Asset becomes part of the Secured Parties' collateral pursuant to the All–Asset Granting Clause once it ceases to constitute an Excluded Asset." *Residential Capital,* 495 B.R. at 262. Where a contract is ambiguous, courts may consider extrinsic evidence in order to determine the parties' intended meaning. *See Bank of New York Trust Co., N.A. v. Franklin Advisers, Inc.,* 726 F.3d 269, 276 (2d Cir.2013) (stating that a principle of New York contract law is that, "if contract terms are ambiguous, the court may accept any available extrinsic evidence to ascertain the meaning intended by the parties during the formation of the contract") (citations omitted). Extrinsic evidence can include testimony of the parties' intent. *See* ***613** *Webb v. GAF Corp.,* 936 F.Supp. 1109, 1124 (N.D.N.Y.1996) ("The court is of the opinion that testimony regarding the understandings of the parties ... was both competent and helpful to the triers of fact....").

Having the benefit of a full evidentiary record, including an examination of both the contractual language and the extrinsic evidence provided by witness testimony, the Court concludes that the JSN Security Agreement grants the JSNs liens on the Contested Assets.

i. The JSNs Have Liens on the Collateral Released from the Bilateral Facilities.

The Plaintiffs argue that the JSNs do not have a lien on the Former Bilateral Facilities Collateral, which has an alleged fair market value of approximately $24 million. [44] The Plaintiffs argue that the JSNs were never granted liens in the Former Bilateral Facilities Collateral because the underlying loans were originally Excluded Assets. Additionally, the Plaintiffs assert that no "springing lien" exists with respect to the Former Bilateral Facilities Collateral and, even if it did, the JSN Security Agreement is ambiguous whether the Former Bilateral Facilities Collateral automatically reverted to JSN Collateral before the Petition Date when the reason for the exclusion of the Former Bilateral Facilities Collateral no longer existed. The Plaintiffs contend that the testimony presented at trial did not sufficiently establish a course of dealing among the parties. The Defendants argue that even though the Former Bilateral Facilities Collateral consists of assets that were carved out of the JSN Collateral as "Excluded Assets" at the time the JSN Security Agreement was executed, the collateral was subsequently released from Bilateral Facilities before the Petition Date and treated as AFI and JSN Collateral. The Court finds that the JSNs have liens on the Former Bilateral Facilities Collateral.

The JSN Security Agreement provides that "the 'Collateral' ... shall not include Excluded Assets." (PX 4 § 2.) "Excluded Assets" in turn means, in relevant part:

> (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....

(*Id.* at 4–15).

The testimony presented at trial revealed that employees for both the Debtors and AFI understood the JSN Security Agreement and the All–Asset Granting Clause to convert the Former Bilateral Facilities Collateral to Notes Collateral when the Bilateral Facilities terminated or when collateral was released from those facilities. The witnesses also testified that once an asset that otherwise fell within the scope Blanket Lien was released from a Bilateral Facility, that asset would become part of the JSN Collateral. Lara Hall testified at her deposition that "AFI's intent was as soon as the assets rolled off the bilateral facility, they would become subject to the blanket lien." (Hall Dep. 123:19–23.) She also said that "[t]he blanket lien basically suggested that anytime an asset became uncovered, it would be subject to the blanket lien." (*Id.* at 116:6–14.) Joseph Ruhlin, the Debtors' former Treasurer, testified in his deposition that the Debtors understood the Former Bilateral Facilities Collateral "would be covered by the blanket lien as long as they ... were owned [by the Debtors] and not ***614** pledged elsewhere to another bilateral facility," and that the Debtors' "understanding" was that "once an asset was released from a funding facility, depending on the asset, it would become part of the blanket lien." (Ruhlin Dep. 89:14–25; 93:8–14, 165:5–9.) Ms. Farley, the Debtors' appointed 30(b)(6) witness on the assets constituting JSN Collateral, testified that Former Bilateral Facilities Collateral would "absolutely" become JSN Collateral when the Bilateral Facilities terminated, "[t]o the extent they fell within the security grant." (Oct. 16 Tr. 186:24–187:9.)

Finally, the Debtors were told by their outside counsel via email in December 2008 that "if at any point while owned by GMAC [ ] the assets are removed from a Bilateral Facility, the [AFI] Revolver and [JSN] Indenture liens may cover these assets and they will constitute Collateral (if and to the extent Sections 9–406/8 of the U.C.C. are applicable)." (DX ES at 1.) The extrinsic evidence presented at trial indicates that the parties to the JSN Security Agreement understood and intended that the JSN Collateral would include Former Bilateral Facilities Collateral. The Court therefore finds that the JSNs have liens on the Former Bilateral Facilities Collateral. [45]

ii. The JSNs Have Liens on the Released and Reacquired Collateral.

The Plaintiffs seek a declaration that the Defendants have not perfected any interest in the Reacquired Mortgage Loans. According to the Plaintiffs, even if the JSNs retained a continuing security interest in the Released Mortgage Loans when those assets were re-acquired by the Debtors, which the Plaintiffs contest, the JSNs never perfected their security interest, and it is avoidable. The Defendants contend that (1) the Reacquired Mortgage Loans 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 between September 2010 and the Petition Date, thereby falling within the scope of the Blanket Lien, and (2) the JSNs' lien on the Reacquired Mortgage Loans is perfected because the original U.C.C. filings perfecting those liens provided adequate notice to potential creditors. The book value of the Reacquired

Mortgage Loans is approximately $14.1 million and has an alleged fair market value of approximately $10 million. [46]

The Court finds that the Defendants have perfected liens on the Reacquired Mortgage Loans.

(a) The Reacquired Mortgage Loans Fall within the Blanket Lien's Grasp.

**[21]** The Defendants argue that the loans that were released from the JSNs' liens in May 2010 to be sold to the Citi and Goldman Repo Facilities and subsequently repurchased by the Debtors between September 2010 and the Petition Date are JSN Collateral due to the Blanket Lien. The Blanket Lien arises from the All–Assets Granting Clause expressly covering all of the Debtors' assets, "whether not or hereafter existing, owned or acquired and wherever located and howsoever created...." (JSN Security Agreement at 13.) "[U]nder the Uniform Commercial Code, ***615** 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." *In re Minor,* 443 B.R. 282, 288 n.3 (Bankr.W.D.N.Y.2011) (citing N.Y. U.C.C. § 9–204 (2001)). A security interest "arising by virtue of an after-acquired property clause is no less valid than a security interest in collateral in which the debtor has rights at the time value is given ... 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 (2013).

No language in the JSN Security Agreement suggests that the Blanket Lien does not apply to ***616** the Reacquired Mortgage Loans. Instead, the Debtors' and AFI's employees testified that they understood that assets sold and repurchased by the Debtors would become JSN Collateral upon their reacquisition. (*See* Oct. 16 Tr. 190:21–191:24 (when an asset that had been released from the JSN Collateral package to be sold to a third party was repurchased by the Debtors, "the blanket lien would pick it up"); Ruhlin Dep. 65:19–22, 66:6–14 ("[A]ssets such as loans that were acquired in the future would be subject to the lien," and those assets could have been "[r]epurchases ... previously owned by ResCap," or "[t]hey ... could be repurchased outside from a third party.").) Thus, under the Blanket Lien, the Reacquired Mortgage Loans became JSN Collateral when the Debtors repurchased them.

(b) The JSNs' Interest in the Reacquired Mortgage Loans Is Perfected.

**[22]** The Plaintiffs argue that the U.C.C.–3 statements filed in May 2010 terminated the U.C.C.–1 financing statements as to these assets, rendering any security interests the JSNs had in the Reacquired Mortgage Loans unperfected. However, because the Court finds that the U.C.C.–1 financing statements continued in effect notwithstanding the filing of the U.C.C.–3 financing statements, the U.C.C.–1 statements operated to perfect the JSNs' security interests.

The U.C.C. employs a notice filing system requiring that a financing statement provide "a simple record providing a limited amount of information" that puts parties on notice to inquire further to ascertain "the complete state of affairs." N.Y. U.C.C. § 9–502 cmt. 2. "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). In cases where courts have addressed inconsistent financing statements, courts have found that the inconsistency in the statements itself was sufficient to put the creditor on notice. *See In re A.F. Evans Co.,* No. 09–41727(EDJ), 2009 WL 2821510, at *5 (Bankr.N.D.Cal. July 14, 2009) ("Here, CNB's financing statements, as amended by the U.C.C.–3 Amendment statements, each with two conflicting boxes checked [ (a termination box plus a release of collateral box) ], 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.").

In this case, because the U.C.C.–1s were on file, potential lenders were on notice to investigate the extent of the JSNs' security interest in the Reacquired Mortgage Loans notwithstanding the U.C.C.–3s relating to those assets. After further inquiry, they would have been informed that the Reacquired Mortgage Loans were automatically pledged once again to AFI and the JSNs under the Blanket Lien, and were coded first as unpledged and later as Blanket Lien Collateral in the CFDR. (*See* Farley Dep. 95:3–14, 110:5–111:14, 115:4–14, 137:21–24, 138:4–11, 176:21–177:3; Oct. 16 Tr. 190:21–192:18; Hall Dep. 117:6–12; Ruhlin Dep. 65:19–22, 66:6–21, 106:8–12, 119:4–9, 155:16–156:2, 156:15–21.)

 

For the foregoing reasons, the Court finds that the JSNs' interest in the Reacquired Mortgage Loans was perfected, and the JSNs are entitled to their lien on the released and reacquired collateral.

b. The JSNs Have Liens on a Portion of the Deposit Accounts.

**[23]** The Plaintiffs also challenge JSN liens on certain deposit accounts, which the Plaintiffs refer to as "Avoidable Deposit Accounts."[47] The Avoidable Deposit Accounts hold approximately $48.4 million. The Plaintiffs allege that the JSNs have not perfected their security interests in the Avoidable Deposit Accounts.

**[24]** The Court finds that, except for the Controlled Accounts and the WF Accounts, the JSNs do not have perfected liens on the Avoidable Deposit Accounts. Under the U.C.C., "a security interest in a deposit account may be perfected only by control" of the account. N.Y. U.C.C. § 9–312(b)(1). A secured party has control of a deposit account if: "(1) the secured party is the bank with which the deposit account is maintained; (2) the debtor, secured party, and bank have agreed in an authenticated record that the bank will comply with instructions originated by the secured party directing disposition of the funds in the deposit account without further consent by the debtor; or (3) the secured party becomes the bank's customer with respect to the deposit account." *Id.* at § 9–104(a)(1)–(3).

The parties requested executed control agreements in discovery. (Landy Direct ¶ 40.) The Defendants offered evidence of control agreements for certain accounts (the "Controlled Accounts"). (*See* DX AIU; DX AIV; DX AIW; DX AIX; DX AIY; DX AIZ.) Given the control agreements, the JSNs have established control over those accounts. Additionally, the Plaintiffs concede that certain accounts the Committee initially challenged are controlled by Wells Fargo, which is the Third Priority Collateral Agent. Since Wells Fargo controls those accounts and is the secured party for the Junior Secured Notes, the JSNs have sufficiently established control over the WF Accounts. The Court finds that the Controlled Accounts and the WF Accounts are the only Deposit Accounts over which the JSNs have established control.

The JSNs claim to have liens on certain Ally Bank accounts by virtue of Ally's corporate relationship with AFI, the Revolver Lender. But Ally and AFI are not the same entity. The JSNs cannot establish control over Ally Bank accounts due to the corporate relationship between Ally and AFI. And even if AFI had control over those accounts by virtue of its relationship with Ally Bank, that would not benefit the JSNs.

Under the U.C.C., the Notes Trustee has the burden of tracing funds to "identifiable cash proceeds" of collateral that would be automatically perfected under U.C.C. § 9–514(c). U.C.C. § 9–315. *See also* *In re Milton Abeles, LLC,* No. 812–70158–reg, 2013 WL 530414 at *2 (Bankr.E.D.N.Y. Sept. 20, 2013) ("[S]ection 9–315 ***617** provides that 'proceeds' of a secured creditor's collateral must be 'identifiable proceeds.' Proceeds that are commingled with other property are 'identifiable' only if 'the secured party identifies the proceeds by a method of tracing.' "); *Matter of Guaranteed Muffler Supply Co., Inc.,* 1 B.R. 324, 330 (Bankr.N.D.Ga.1979) ("secured parties bear the burden of identifying, or tracing, the proceeds obtained upon the sale of property in which they have an interest ..."). But for a single account that the Plaintiffs concede contains proceeds of JSN Collateral, the Defendants have failed to provide sufficient evidence that any deposit accounts contain proceeds of JSN Collateral.

After excluding the Controlled Assets, the WF Accounts, and the proceeds account, the amount of funds in the remaining deposit accounts (i.e., the Avoidable Deposit Accounts) as of the Petition Date was $48,439,532. Accordingly, the JSNs do not have a lien on the Avoidable Deposit Accounts pursuant to sections 544(a)(1)–(2) of the Bankruptcy Code. The property or the value of the property represented by the Avoidable Deposit Accounts should be recovered and/or preserved for the benefit of the Debtors' estates pursuant to sections 550(a) and 551 of the Bankruptcy Code.

For the foregoing reasons, the Court finds that the value of the JSNs' collateral should be reduced by $48,439,532, the amount of cash in the Avoidable Deposit Accounts as of the Petition Date.

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

**[25]** **[26]** To perfect a lien on real property, a secured party must execute a mortgage or a deed of trust and duly record it against the title of such real property. *See* *In re Churchill Mortg. Inv. Corp.,* 233 B.R. 61, 70 (Bankr.S.D.N.Y.1999) ("Under the New York Real Property Law § 291, a security interest in real property can be perfected only by filing written notice with the Clerk of the County where the property is located so that the lien may be publicly recorded, giving notice of the encumbrance to potential purchasers or future creditors."). The Court finds that the JSNs do not have a perfected security interest in or lien on any of the Unencumbered Real Property because that property was not subject to an executed and filed mortgage or deed of trust. Accordingly, any JSN lien with respect to the Unencumbered Real Property is avoidable pursuant to sections 544(a)(1) and (2) of the Bankruptcy Code, and the property or the value of the property represented by the Unencumbered Real Property should be recovered and/or preserved for the benefit of the Debtors' estates pursuant to sections 550(a) and 551 of the Bankruptcy Code.

For the foregoing reasons, the Court finds that the value of the JSNs' collateral should be reduced by $21 million, the fair market value of the Unencumbered Real Property as of the Petition Date.

*7. The Plaintiffs Failed to Establish Preferential Transfers to the JSNs.*

The Plaintiffs seek to avoid $270 million of the JSNs' claim as preferential transfers (the "Alleged Preferential Transfers"). The Alleged Preferential Transfers, listed on Schedule 6 to the Committee's complaint (PX 127), consist of (1) mortgage loan instruments, including HFS Loans and FHA/VA loans, (2) REO property, and (3) government insurance claims arising as a result of expenditures incurred by the Debtors in connection with FHA/VA ***618** Loans.[48] The Plaintiffs contend that these assets first became JSN Collateral on or after February 29, 2012, during the Modified Preference Period.[49] To prove this contention, the Plaintiffs point to how the collateral was recorded in the CFDR as of February 29, 2012, and as of the Petition Date. As such, the Plaintiffs claim to have met their prima facie burden of proof for a preference claim under Bankruptcy Code sections 547(b)(1)-(5).

The Defendants offer two reasons why the Plaintiffs are not entitled to avoid the Alleged Preferential Transfers: (1) the Plaintiffs failed to make a prima facie case for avoidance, and (2) even if the Plaintiffs could make such a showing, their Preference Claim is barred by the "improvement in position test." Because the Court concludes that the Plaintiffs have failed to make a prima facie case for avoidance of the Alleged Preferential Transfers the Court need not consider the "improvement in position test."

**[27]** Section 547(b) of the Bankruptcy Code "permits a trustee to avoid certain prepetition transfers as 'preferences.' "[50] 5 COLLIER ON BANKRUPTCY ¶ 547.01. Section 547(b) lays out the elements of an avoidable preference as a transfer of an interest in debtor property:

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made—

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to received more than such creditor would receive if—

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 547(b). Unless the trustee proves each and every one of these elements, a transfer is not avoidable as a preference under section 547(b). *See*11 U.S.C. § 547(g) ("For the purposes of this section, the trustee has the burden of proving the avoidability of a transfer under subsection (b) of this section ...."); *see also Waldschmidt v. Ranier (In re Fulghum Constr. Corp.),* 706 F.2d 171, 172 (6th Cir.1983) ("As is facially evident from this provision, all five enumerated criteria must ***619** be satisfied before a trustee may avoid any transfer of property as a preference.").

a. The Plaintiffs Failed to Show that the JSNs Were Undersecured as of February 29, 2012.

**[28]** The Defendants argue that the Plaintiffs failed to make a showing that the JSNs were undersecured at the start of the Modified Preference Period, immunizing them "from [a] preference attack because [they] would have been paid in full in a hypothetical Chapter 7 liquidation by virtue of [their] realization on [their] collateral." *Official Comm. v. AAF–McQuay (In re 360networks(USA), Inc.),* 327 B.R. 187, 190 (Bankr.S.D.N.Y.2005); *see also 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). 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* "). A defendant's assertion that it was fully secured is not a defense pursuant to section 547(c), but "rather a negation of one of the elements of a preference action, pursuant to section 547(b)." *Teligent III,* 2009 WL 2152320, at *6.

**[29]** Throughout this case, the Defendants have maintained that they were oversecured as of the start of the Modified Preference Period, placing the burden squarely on the Plaintiffs to prove that the Defendants were not oversecured. While the Plaintiffs' expert Mr. Puntus provided a proposed valuation of the JSNs' collateral as of the Petition Date, [51] he did not calculate the value as of the start of the Modified Preference Period. In fact, none of the Plaintiffs' experts provided a valuation of the JSN Collateral at the beginning of the Modified Preference Period, or at any time during that period. As a result, the Plaintiffs have failed to satisfy section 547(b)(5) and are not entitled to avoid the portion of the Defendants' liens related to the so-called "Preferential Transfers."

b. The Plaintiffs Failed to Prove the Identity or Scope of Transfers of Collateral to Defendants During the Modified Preference Period.

Even assuming that the Plaintiffs had shown that the Defendants were undersecured at the beginning of the Modified Preference Period, the Plaintiffs have failed to show the identity or scope of these Alleged Preferential Transfers. The Plaintiffs' only evidence in support of their preference claim, the CFDR, is reliable as a business record to establish when AFI LOC Collateral was properly released, but it is not sufficient to establish the identity or scope of the Alleged Preferential Transfers. The Plaintiffs' expert Mr. Landy identified the Alleged Preferential Transfers by performing a comparison of CFDR extracts as of February 29, 2012, and the Petition Date. (Oct. 17 Tr. 152:16–153:13, 162:12–15.) He concluded that any asset appearing in the CFDR for the first time as JSN Collateral during the Modified ***620** Preference Period was a preferential transfer, though he "did not attempt to understand the circumstances for why each loan may have appeared on 5/13...." (Oct. 17 Tr. 153:10–22; 155:5–7.) Indeed, the CFDR contains little information explaining why an asset would appear for the first time or reappear after an absence in the database. (*See* PX 139.) At trial, the Defendants raised a variety of explanations why these assets may have appeared in the CFDR during the Modified Preference Period, tending to negate their status as preferential transfers. For example, the loans may have been modified, repaid in full and then subsequently drawn upon, or they may represent refinancings of old loans that formerly constituted JSN Collateral. (Oct. 22 Tr. 26:23–27:9, 28:3–10, 31:18–32:15, 33:18–34:4, 35:18–21, 42:14–43:3, 56:25.) Under any example, they would not be preferential transfers.

The Defendants' expert Mr. Winn specifically identified a variety of alleged "Preferential Transfers" that should not have been included in Schedule 6. (DX ABN 12 ("[T]he CFDR shows that approximately $18 million of the alleged Preference Assets were owned by the Debtors and served as JSN Collateral as of or prior to 2/29/12 and thus should not be listed as Preference Assets.").) Mr. Landy, who prepared Schedule 6, conceded that certain of these assets were inaccurately included on Schedule 6. (*See* Landy Direct ¶ 56 ("I have determined that I concur with Mr. Winn's observations regarding (a) 18 loans identified as 'FHA/VA Reclassified as Loans HFS' ... with a net book value of approximately $1.95 million, and (b) 2 loans identified as 'REO Reclassified as Loans' ..., with a net book value of $50,478.") ("Mr. Winn identifies approximately $12 million of 'REO' assets that were pre-existing components of the JSN Collateral pool as of February 29, 2012, and were therefore never transferred to or for the benefit of the JSNs during the preference period.").) Specifically, Mr. Landy concurred with Mr. Winn's conclusions that the following do not constitute preferential transfers:

- 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 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 before the Modified 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 Modified Preference Period;

- The HFS loans appearing for the first time in the CFDR during the Modified Preference Period with Loan Funding Dates before the Modified 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 before the Modified Preference Period, disappeared from the CFDR and reappeared within the CFDR during the Modified Preference Period.

Given these errors, appearance in the CFDR alone cannot be enough to identify ***621** a preferential transfer. Too many questions and inconsistencies remain to conclude that the JSNs first acquired an interest in these assets during the Modified Preference Period. Thus, the Plaintiffs have failed to prove the identity and scope of the Alleged Preferential Transfers and are not entitled to avoid this portion of the JSNs' claim.

*8. The Plaintiffs Are Not Entitled to Charge the JSNs with a $143 Million Carve Out Payment If the Plaintiffs Can Pay Professional Fees and Administrative Expenses with Unencumbered Cash.*

The Plaintiffs seek a declaration permitting them to charge up to an additional $143 million in Carve Out expenses, thereby further reducing the JSNs' secured claim on the Effective Date. The Court holds that the Plaintiffs are not entitled to this declaration if they can pay fees and expenses with unencumbered cash. While this case is not over, it appears that the Debtors have substantial unencumbered cash available to pay administrative expenses.

**[30]** A carve out is a provision of a cash collateral order that allows for some expenditure of administrative and/ or professional fees to be paid before a secured creditor gets paid on its collateral. *See In re Blackwood Associates, L.P.,* 153 F.3d 61, 68 (2d Cir.1998) (stating that "absent an agreement to the contrary, a secured creditor's collateral may only be charged for administrative expenses, including attorney's fees, to the extent these expenses directly benefited that secured creditor," but "if a secured party consents to allowing such administrative expenses, that party may be liable for such expenses even in the absence of conferred benefit"); 3 COLLIER ON BANKRUPTCY ¶ 364.04[2][d] ("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, 445 (2002) ("As generally used, a carve out is an agreement between a secured lender, on the one hand, and the trustee or debtor in possession ... on the other, providing that a portion of the secured creditor's collateral may be used to pay administrative expenses.").

**[31]** The Bankruptcy Code does not deal with carve out provisions typically included in cash collateral orders. *See In re White Glove, Inc.,* No. 98–12493 DWS, 1998 WL 731611 at *6 (Bankr.E.D.Pa. Oct. 14, 1998) ("The term 'carve out' is one of those uniquely bankruptcy phrases, much like 'cram down,' that appears nowhere in the bankruptcy statute but connotes definite meaning to the parties."); *see also* Levin at 445 ("Unlike 'cram down,' ... which has a relatively well-defined meaning derived from ¶ 1129(b) of the Bankruptcy Code, 'carve out' does not derive its substance from any particular section of the Bankruptcy Code."). Unless it conflicts with provisions of the Bankruptcy Code, a carve out is construed applying normal contract interpretation provisions. *See Blackwood,* 153 F.3d at 67 (applying "the statutory context underlying cash collateral stipulations[ ] and the text of the Stipulation itself" to conclude that a disputed carve out provision did not grant the chapter 11 debtor's counsel payment from cash collateral when the debtor failed to meet the terms of the cash collateral stipulation).

**[32]** The usual purpose of a carve out is to assure the payment of specified administrative expenses from a secured creditor's

 

***622** collateral in the event that the case goes badly, use of cash collateral is terminated, and sufficient unencumbered funds are no longer available to administer the case, usually after conversion to chapter 7. *See* Levin at 451 ("The carve out becomes important to the protected administrative claimants *only* when the unencumbered assets in the bankruptcy estate that remain after application of the collateral proceeds to the secured claim are not adequate to pay all administrative claims, so that the administrative claimants will need to look to the carve out as an alternative source for payment.") (emphasis added).

**[33]** Here, the Cash Collateral Order controls the priority of the JSN liens with respect to the Carve Out. 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:

> the [JSN Liens] 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 ... and (iii) are subject and subordinate only to (A) the liens and security interests granted to the AFI Lender under the AFI Revolver, all subject to the terms and conditions of the Intercreditor Agreement, dated as of June 6, 2008 ..., (B) the Carve Out, and (C) the liens and security interests granted to secure the Adequate Protection Obligations....

(PX 76 at 11–12.) The Carve Out, in turn, is defined as the sum of: (1) court and United States Trustee fees, (2) accrued and unpaid professional fees following a termination event in an aggregate amount not exceeding $25 million (plus all unpaid professional fees allowed by the Court at any time that were incurred on or before the business day following the Carve Out Notice), and (3) 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.

(*Id.* at 31–32.)

The Cash Collateral Order clearly requires the JSNs to subordinate their secured claim to the payment of the Carve Out, but is silent whether the Debtors may use those funds, further reducing the JSNs' secured claim, when other unencumbered funds are available. Absent contractual language requiring that result, the Court concludes that the Cash Collateral Order does not go beyond the ordinary purpose of assuring funds to pay the specified expenses if unencumbered funds are no longer available to do so.

The JSNs' liens remain subordinated to the Carve Out. If during the remainder of the case, unencumbered funds are no longer available to pay the expenses, the JSN Collateral can be used for that purpose. At this stage, however, there is no reason to believe that will occur. The Court holds that the JSNs' Collateral should not be reduced at this time.

***623 E. Given the Court's Findings on What Constitutes JSN Collateral, the JSNs are Undersecured.**

Notwithstanding the JSNs' ability to aggregate their collateral across debtors, the Court finds that, as of the conclusion of Phase I, the JSNs are undersecured and not entitled to postpetition interest and fees. [52] As of the Petition Date, the

JSNs held secured claims against ResCap, and certain of its affiliates as guarantors and grantors, in the face amount of $2.222 billion, consisting of $2.120 billion in unpaid principal as of the Petition Date, and $101 million in unpaid prepetition interest. (DX ABF at 3.) As the Court discussed in section III.A above, the JSNs' claim will not be reduced by unamortized OID. Assuming an effective date of December 15, 2013, the JSNs will assert a claim for postpetition interest at the default rate, in the amount of $342 million. (JSN Corrected Proposed Findings of Fact, ECF Doc. # 190 § II ¶ 15.) The JSNs are only entitled to receive postpetition interest up to the value of their collateral. 11 U.S.C. § 506(b). Thus, to receive their full claim for postpetition interest, the JSNs have to establish an effective date value of their collateral of at least $2.564 billion. At this point in the case, they fall well shy of the mark.

The parties have largely agreed on $1.888 billion as a baseline estimation of the Effective Date value of the JSN Collateral. (DX AIR at 5.) The Plaintiffs seek to subtract from the baseline; the Defendants seek to add to it. Based on the Court's rulings, the following amounts will be added to the baseline:

- $40 million in equity held at certain non-Debtors;
- $17 million for a net increase in the value of the FHA/VA Loans;
- $18.395 million for software; and
- $10 million for tradename, iconography, and logotype.

The following amounts will be subtracted from the baseline:

- $48,439,532 in Deposit Accounts (the JSNs retain an interest in $63,297); and
- $20.8 million of unencumbered real property.

Based on the Court's ruling, the following factors will not affect the baseline valuation:

- The Plaintiffs may not charge an additional $143 million of expenses to the JSNs' collateral under the cash collateral carve out at this time.
- The Plaintiffs have not carried their burden in proving any preferential transfers.
- The JSNs do not have a lien on the $1.1 billion of AFI LOC Collateral.
- The JSNs have a lien on $24 million of Former Bilateral Facilities Collateral.
- The JSNs have a lien on $10 million of Reacquired Mortgage Loans.
- The JSNs are not entitled to a $66 million allocation from sale proceeds for net increases in HFS Collateral.
- The JSNs do not have a lien on any other intangibles or goodwill.

Based on the above findings, the JSNs have established that the Effective Date value of their collateral is $1,904,155,468. Because their claim is for the face amount of $2.222 billion, the JSNs are undersecured at the end of Phase I. A final determination of the extent of their security will ***624** be deferred until after Phase II of the trial.

## IV. *CONCLUSION*

The Phase I trial presented a large number of complex factual and legal issues requiring extraordinary time and expense for the parties and considerable effort for the Court to reach a result leaving the JSNs substantially undersecured. The JSNs have achieved that result in a case in which the proposed plan would pay the JSNs *all* prepetition principal and interest. The JSNs have pursued from the start a strategy where they contest everything and concede nothing (even when the Court has questioned whether they are acting in good faith). The JSNs have made clear that they will continue to follow the same strategy in the Phase II trial and contested confirmation hearing beginning on November 19, 2013.

The Court will continue to decide all issues fairly (the JSNs did prevail on some of the important issues in the Phase I trial), but it should not be lost on anyone that the JSNs stand virtually alone in this case in failing to reach a consensual agreement to resolve their issues. The result has been protracted proceedings that have burdened the estate and reduced funds available to satisfy creditor claims. That is unfortunate!

**All Citations**

501 B.R. 549

Footnotes

1 The value of the JSNs' purported adequate protection claim will increase or decrease based on the value of the JSNs' Collateral on the Petition Date and on the Effective Date. This Opinion will resolve some issues relating to both values.

2 All docket numbers listed refer to the Adversary Proceeding Docket 13–01277, unless otherwise noted.

3 [Date] Tr. [Citation] refers to transcripts of the Phase I trial. References to [Name] Direct [Citation] refer to direct testimony submitted in writing before the trial began and available on the public docket. Plaintiffs' exhibits are referenced by number (e.g., PX 1), and Defendants' exhibits are referenced by letter (e.g., DX A). All references to page numbers in the Plaintiffs' exhibits refer to the PX page numbers at the bottom of each page (e.g., PX 1 at 51 refers to PX 1 at page 51 of 120.) All references to page numbers in the Defendants' exhibits refer to the DX page numbers at the bottom of the each page. References to [Name] Dep. [Citation] refer to the deposition testimony designated for the Phase I trial. Citations to "PTO ¶ __" are to the stipulated facts contained in the Revised Joint Pretrial Order entered in the consolidated adversary proceedings. (ECF Doc. # 161.)

4 Any remaining objections to deposition designations are overruled.

5 Although Wells Fargo is also a defendant, this opinion refers to UMB and the Ad Hoc Group as the "Defendants" to simplify referring to those parties.

6 Paragraph 16(c)(v) of the Final CashCollateral Order provides that the JSNs are entitled to, as part of adequate protection, prompt payment of reasonable fees and expenses, whether accrued prepetition or postpetition, for certain identified professionals. (PX 76 at 30.) The provision also provides that "nothing shall prejudice the rights of any party to seek to recharacterize any such payments ... as payments of principal under the Junior Secured Notes." (*Id*.) The issue was not addressed by the parties during the Phase I trial.

7 On June 20, 2012, the Court directed that an examiner be appointed (ECF 12–12020 Doc. # 454). On July 30, 2012, the Court approved Arthur J. Gonzalez as the examiner ("Examiner") (ECF 12–12020, Doc. # 674), and on June 26, 2013, the *Report of Arthur J. Gonzalez, as Examiner* was made publicly available (ECF Doc. # 3698).

8 The parties did not present evidence at trial of the value of the JSNs' collateral on a debtor-by-debtor basis, but instead focused on the aggregate value of the JSNs' collateral.

9 The "AFI Contribution" is a $2.1 billion cash contribution AFI agreed to make to the Debtors' estates pursuant to the terms of the settlement among the Debtors, the Committee, AFI, and the Consenting Claimants set forth in Article IV of the Debtors' Joint Chapter 11 Plan.

10 During the trial, the Court determined that issues relating to liens on the AFI Contribution would be tried in Phase II.

11 The issues reserved for Phase II include (1) the value of intercompany balances, (2) the treatment of various claimant classes, (3) allocation of the AFI Contribution, (4) the value of collateral, oversecurity, and interest and fees if not determined in Phase I, and (5) a final calculation of the Defendants' adequate protection claim, if applicable. (*Id.* )

12 The Notes Indenture also provided that "[t]he [Borrower] will pay interest (including postpetition interest in any proceeding under any Bankruptcy Law) on overdue principal at the rate equal to 1% per annum in excess of the then applicable interest rate on the Notes to the extent lawful; it will pay interest (including postpetition interest in any proceeding under any Bankruptcy Law) on overdue installments of interest and Additional Interest (without regard to any applicable grace period) at the same rate to the extent lawful." (PX 1 § 4.01.)

13 The guarantor entities that are Debtors in these chapter 11 proceedings (the "Guarantor Debtors") guaranteed ResCap's obligations under the Notes Indenture, including the obligation to pay in full all principal, interest, fees, and premiums, if any, with respect to the Junior Secured Notes. (PX 1 § 10.01.)

14 ResCap also issued senior secured notes that were secured by the same collateral, but those notes were satisfied in full before the petition date and are not central to the present dispute.

15 *See infra* II.H.5 for discussion of Excluded Assets.

16 Pursuant to the JSN Security Agreement, the assets included "accounts, chattel paper, commercial tort claims, deposit accounts, financial assets, investment property, intellectual property, and general intangibles" of ResCap and the Notes Guarantors and Additional Grantors. (PX 4.) Although the JSN Security Agreement listed "Commercial Tort Claim described on Schedule V" as collateral, no commercial tort claims were identified or listed on Schedule V. Schedule V was never amended or modified. As a result, the Court previously found that the Defendants do not have a properly perfected lien on any Commercial Tort Claims. (*See* ECF Doc. # 100.)

17 A "Relevant Party" is an obligor under the Revolver Security Agreement or the JSN Security Agreement.

18 AFI was the Lender Agent.

 

19 FHA/VA loans are repurchased whole loans from Ginnie Mae trusts. (DX ABI at 58.) Since these assets are partially insured, the amounts paid by the Debtors to repurchase these loans are substantially reimbursable. (*Id.*) The Debtors also have the choice of modifying or selling these Ginnie Mae repurchased loans to a Ginnie Mae trust or third party. (*Id.*) The Debtors always intended to sell the FHA/VA loans but ultimately pulled the FHA loans from the auction because they felt the bids received were not high enough. (Puntus Direct ¶ 117.)

20 The $910 million questioned by the Ad Hoc Group is composed of four categories of assets (domestic mortgage loans, FHA/VA receivables, REO properties, and servicing advances) and three of these categories (comprising approximately 97% of the assets at issue) are covered by the Blanket Loan Release. Mortgage loans ($550.4 million) and FHA/VA receivables ($324.7 million) fall within the express definition of "Subject Mortgage Loans." REO properties ($5.9 million) are merely proceeds obtained upon foreclosure of mortgage loans and are therefore covered as well. (*See* DX AHD at 24 (setting forth the values of the various asset classes purportedly lacking evidence of release).) The last category of assets questioned by the Ad Hoc Group—servicing advances ($29.4 million)—is covered by the Servicing Advance Release. The Servicing Advance Release covers Freddie Mac servicing advances (PX 130 at 1181–83), which were the only types of servicing advances pledged as collateral to the AFI LOC on the Petition Date. Farley Direct ¶ 62 & n.7. Therefore, the Servicing Advance Release covered all servicing advances that were pledged as collateral to secure the LOC Facility.

21 The servicing platform related to the MSRs includes, *inter alia,* software servicing contracts, employee contracts and certain other operating expenses relating to the MSRs (Oct. 15 Tr. 171: 8–17), and the origination platform related to the MSRs includes the call center. (Oct. 15 Tr. 172: 1–6.)

22 A significant modification of the FRB Consent Order—effectively reducing the Debtors' costs of compliance—was negotiated during this case and approved by the Court.

23 The Mini Auction resulted in increases in the sales prices by a total of $150 million, as well as a reduction in the proposed break-up fees for the origination and servicing platform.

24 The Second Circuit explained the distinction between the two types of exchanges, writing:

> An exchange offer made by a financially troubled company can be either a "fair market value exchange" or a "face value exchange." In a fair market value exchange, an existing debt instrument is exchanged for a new one with a reduced principal amount, determined by the market value at which the existing instrument is trading. By offering a fair market value exchange, an issuer seeks to reduce its overall debt obligations.... A face value exchange, by contrast, involves the substitution of new indebtedness for an existing debenture, modifying terms or conditions but not reducing the principal amount of the debt.

*Chateaugay,*961 F.2d at 381–82 (citations omitted).

25 The GMAC Mortgage Services Advance Funding Company Ltd. ("GSAP") Facility and the BMMZ Holding LLC Facility.

26 The "Former Bilateral Facilities Collateral" is referred to as "Released Bilateral Facilities Collateral" in the Committee's complaint and briefings by the Plaintiffs.

27 The parties dispute whether the amount of OID at the Petition Date is $386 million (according to the Plaintiffs) or $377 million (according to the Defendants). Since the Court concludes that the amount of the JSNs' claim should not be reduced by OID, the Court need not resolve this dispute.

28 *See supra* note 24 for the differences between fair market value and face value exchanges.

29 Here, the cash collateral motion was filed as a first day motion, so there is no issue of whether a later date should apply for purposes of an adequate protection claim. *See* 4 COLLIER ON BANKRUPTCY ¶ 506.03[7][a][iv] ("In general, courts typically hold that, for purposes of adequate protection, the value of the collateral is to be determined either as of the petition date or as of the date on which the request for adequate protection was first made.").

30 There is no question here that the JSNs received adequate protection by a very substantial postpetition lien on collateral (far beyond the property covered by the JSNs' liens on the petition date). Had there been a contested cash collateral hearing the Debtors would have had the burden of establishing adequate protection; that was unnecessary because of the agreement of the parties. The issue now is different: Are the JSNs entitled to recover a claim based on a diminution in the aggregate value of their collateral at the petition date? As explained in the text, on that issue the JSNs have the burden of proof.

31 None of the cases cited by the Defendants support the proposition that in a post-hoc analysis of the sufficiency of adequate protection, the debtor continues to bear the burden of proving adequate protection. Rather, they all involve the well-established rule that, before a debtor may use, sell, lease, or otherwise encumber the lender's collateral, the debtor must show that the creditor's interest will be adequately protected. *See Swedeland,* 16 F.3d at 564 (discussing whether adequate protection existed sufficient to grant a priming lien); *Wilmington Trust Co. v. AMR Corp. (In re AMR Corp.),* 490 B.R. 470, 477–78 (S.D.N.Y.2013) (discussing whether a secured lender was entitled to adequate protection

  

during the pendency of the case); *In re Erewhon, Inc.,* 21 B.R. 79, 84 (Bankr.D.Mass.1982) (stating that a secured creditor worried about diminution in value need only object to use of collateral "since the burden of proving 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) (denying use of cash collateral because debtor failed to carry burden of showing that secured lender's interest "would be adequately protected"). As the Court already explained, the parties already agreed that the JSNs' interest in their collateral would be adequately protected when they signed the Cash Collateral Order.

32 *See In re Walck,* No. 11–37706(MER), 2012 WL 2918492, at *2 (Bankr.D.Colo. Jul. 17, 2012) (in the context of a motion for relief from stay, construing section 506(a) in light of *Rash,* finding that secured creditor was adequately protected based on the fair market value of collateral projected to be earned by sale); *Bank R.I. v. Pawtuxet Valley Prescription & Surgical Ctr.,* 386 B.R. 1, 4 (D.R.I.2008) (holding that going concern/fair market value could be used where secured lender objected to finding that it was adequately protected); *In re Eskim LLC,* No. 08–509, 2008 WL 4093574, at *2–4 (Bankr.N.D.W.Va. Aug. 28, 2008) (in the context of motion for relief from stay, temporarily permitting debtor to use collateral to bridge to a going concern sale, and finding secured creditor might be 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 Pelham Enters., Inc.,* 376 B.R. 684, 690–93 (Bankr.N.D.Ill.2007) (in the context of a motion for relief from stay, construing section 506(a) in light of *Rash* and rejecting estimated liquidation value of collateral in the hands of creditor given undisputed evidence that the collateral was actually being used as part of debtor's going concern); *In re Deep River Warehouse, Inc.,* No. 04–52749, 2005 WL 1287987, at *7–8 (Bankr.M.D.N.C. Mar. 14, 2005) (construing section 506(a) in the context of a motion for relief from stay, 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 in chapter 13 case 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); *In re Savannah Gardens–Oaktree,* 146 B.R. 306, 308–10 (Bankr.S.D.Ga.1992) (adopting going concern valuation where collateral was to be retained and used under chapter 11 plan, in order to determine amount of secured claim under 506(a) and evaluate whether claim would be adequately protected by value of collateral); *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 was entitled to continue receiving adequate protection payments because the collateral as of petition date was worth the amount actually realized from asset sales during the case); *Bank Hapoalim B.M. v. E.L.I., Ltd.,* 42 B.R. 376, 379 (N.D.Ill.1984) (in context of motion for relief from stay, 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); *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 on motion for relief from stay, rejecting evidence of liquidation value and holding that going concern methodology is appropriate when collateral is to be retained and used).

33 *See In re Scotia Dev., LLC,* No. 07–20027, slip op. at 23–24 (Bankr.S.D.Tex. July 7, 2008) ("With non-cash property, the interest that secured creditor has a right to is the right to foreclose. Therefore, the case law suggests that the appropriate value to protect is the foreclosure value of the property and not the fair market value of the property."), *aff'd in part, In re SCOPAC,* 624 F.3d 274, 285–86 (5th Cir.2010); *In re Ralar Distribs., Inc.,* 166 B.R. 3, 7 (Bankr.D.Mass.1994) ("The value relevant for adequate protection purposes, however, is not book value. It is liquidation value realizable by the creditor."),*aff'd,*182 B.R. 81 (D.Mass.1995),*aff'd,*69 F.3d 1200 (1st Cir.1995); *Sharon Steel Corp. v. Citibank, N.A. (In re Sharon Steel Corp.),* 159 B.R. 165, 169 (Bankr.W.D.Pa.1993) (using liquidation value for adequate protection purposes); *United States v. Case (In re Case),* 115 B.R. 666, 670 (9th Cir. BAP 1990) ("If we were attempting to value FmHA's interest in the property for adequate protection purposes, the possibility of forced liquidation would be assumed and a deduction for selling costs would be logical."); *La Jolla Mortg. Fund v. Rancho El Cajon Assocs.,* 18 B.R. 283, 289 (Bankr.S.D.Cal.1982) ("In this regard, we must evaluate the collateral, being the adequate protection, in the hands of the claim holder. It is the creditors' expected costs to liquidate the property that is relevant, not those of the debtor.").

34 The Nationstar APA states clearly that the purchased assets are "Related to the Business." (PX 33 at 38.) Related to the Business is defined in the Nationstar APA as "required for, held for, or used in the conduct of the Business." (*Id.* at 30.) The Business described in the Nationstar APA is, broadly, the Debtors' servicing and origination business. (*Id.* at 13, definition of "Business.") In addition, the Nationstar APA specifically enumerates goodwill as a purchased asset. (*Id.* at 40.) Finally, in a provision requiring the Debtors to effect "Separation Services," the Nationstar APA states that a stand-alone business was part of the bargain, and that "Sellers acknowledge and agree that Separation Services are

intended to permit Sellers to deliver at Closing to the Purchaser the Business and Purchased Assets as a stand-alone business....” (*Id.* at 84.)

35 The Court notes that it was equally unimpressed with the testimony presented by Mr. Puntus on behalf of the Plaintiffs. But since the burden of proof lies with the Defendants, the shortcomings of Mr. Puntus's methodology do not alter the result.

36 As Collier explains:

> However, often a secured party will consent to limited use of cash collateral to preserve the value of his interest in other collateral. Payment of expenses of preserving non-cash collateral, payroll expenses to keep the business operating and other immediate cash needs may be as important to a secured party early in the case as it is to the debtor in possession.

3 COLLIER ON BANKRUPTCY ¶ 363.03[4], at 363–34.

37 As a matter of statutory construction, the Defendants argue that while section 506 of the Bankruptcy Code—and indeed, the entire Bankruptcy Code—is written for a single debtor, section 102(7) of the Bankruptcy Code (the “Rules of Construction” section) explicitly provides that “the singular includes the plural.” 11 U.S.C. § 102(7). Thus, in multi-debtor cases, courts will treat Bankruptcy Code provisions that refer to a single debtor as referring to all debtors. *See, e.g., In re Vagi,* 351 B.R. 881, 885 (Bankr.N.D.Ohio 2006) (holding that, in a case involving co-debtors, under subsection 102(7), the phrase “acquired for the personal use of the debtor” in subsection 1325(a) “may also be read, ‘acquired for the personal use of the debtors’ ”). The Defendants contend therefore that section 506(a)(1) is properly read as follows: “an allowed claim of a creditor secured by lien[s] on property in which the estate[s] have an interest ... is a secured claim to the extent of the value of such creditor's interest in the estate[s'] interest in such property....” (Defendants' Motion to Dismiss, ECF No. 13–01343 Doc. # 21–1 at 9.) The Court is unconvinced by either party's statutory interpretation argument. Indeed, the statute seems silent on the issue at hand.

38 Another case cited by the Plaintiffs is equally unhelpful because it also deals with non-debtor entities. *SeeOfficial Comm. of Unsecured Creditors of Toy King Distribs., Inc. v. Liberty Sav. Bank (In re Toy King Distribs., Inc.)*, 256 B.R. 1, 187 (Bankr.M.D.Fla.2000) (“Although the collateral subject to [creditor's] loan includes the property of the individual guarantors and property of the debtor, only the debtor's property is relevant to the court's determination of the secured status of [creditor's] claim against the debtor under Section 506.”). The Defendants also argue out that even if *DeNofa's* interpretation of subsection 506(b) is correct, it would not change the outcome here, because pursuant to section 102(7), “the singular includes the plural,” and the term “estate” must be interpreted as including all debtor “estates” holding collateral. Therefore, *DeNofa* could still be read to include all debtor estates in the section 506(b) calculation.

39 Other cases cited by the Defendants either involved substantively consolidated debtors or merely assumed, without discussing, that collateral could be aggregated across debtors. *See, e.g., In re Gen. Growth Props., Inc.,* No. 09–11977(ALG), 2011 WL 2974305, *1 n.3 (Bankr.S.D.N.Y. July 20, 2011); *In re Capmark Fin. Grp., Inc.,* 438 B.R. 471, 490, 501 (Bankr.D.Del.2010); *In re Dana Corp.,* 367 B.R. 409, 412 (Bankr.S.D.N.Y.2007); *In re Urban Communicators PCS Ltd. P'ship,* 379 B.R. 232, 244 (Bankr.S.D.N.Y.2007), *aff'd in part and rev'd in part on other grounds,*394 B.R. 325 (S.D.N.Y.2008); *In re Fiberglass Indus., Inc.,* 74 B.R. 738, 740 (Bankr.N.D.N.Y.1987).

40 While the court reached this conclusion in the context of a plan that provided for limited substantive consolidation under section 1123(a)(5)(C), the court seemingly reached its conclusion independently, rejecting the debtor's argument “particularly in view of the provisions of [the] Plan.” *SW Hotel Venture,* 460 B.R. at 33.

41 “Subsidiary” is defined in the JSN Indenture as “any corporation, partnership, limited liability company, association or other entity of which at least majority of the outstanding stock or other interest having by its terms ordinary voting power to elect majority of the board of directors, managers or trustees of such corporation, partnership, limited liability company, association or other entity (irrespective of whether or not at the time stock or other interest of any other class or classes of such Person shall have or might have voting power by reason of the happening of any contingency) is at the time owned by the Company, or owned by one or more Subsidiaries, or owned by the Company and one or more Subsidiaries (it being understood that GMAC Bank is not Subsidiary).” (PX 1 at 24.) “Significant Subsidiary” is defined in the JSN Indenture as any Subsidiary that met certain threshold conditions respecting the income or proportionate share of the total assets of the Company and Subsidiaries on a consolidated basis. (*Id.*)

42 Here, the Court distinguishes between allocation and calculation. As the Court already held in connection with the Ocwen APA, any purchase price allocation in the Berkshire APA was for tax purposes only. (PX 31 at 30.) This is distinct from the calculations relied upon here, which set out actual formulas for determining the amount Berkshire would eventually pay for different categories of loans.

43 As explained in Mr. Taylor's report, Ocwen engaged a third-party valuation expert (Applied Economics) to appraise the fair value of certain assets. (DX ABH; DX ST.) Applied Economics considered the ResCap software to be worth $1.295

million (DX ST at 3), and that figure served as a portion of the "premises and equipment" allocation in Ocwen's 10–Q reporting on the ResCap sale.

44 This total does not include the $25 million of BMMZ assets that JSNs claim a lien on and that were subject to an earlier motion to dismiss.

45 The Court already dismissed the Committee's attempt to recharacterize the BMMZ assets as Debtor assets. *Residential Capital,* 495 B.R. at 261. In its opinion, the Court rejected the Committee's contention that the BMMZ collateral was pledged to a bilateral facility as of the Petition Date. In fact, the Debtors did not own the BMMZ collateral on the Petition Date.

46 The Reacquired Mortgage Loans are distinct from the $910 million of loans in the AFI LOC.

47 Account Nos. xxxx7286, xxxx3803, xxxx6323, xxxx9917, xxxx9454, xxxx4806, xxxx2482, xxxx2540, xxxx2565, xxxx2573, xxxx1781, xxxx1799, and xxxx1718. (Plaintiffs' Proposed Findings of Fact ECF Doc. # 187 at ¶ 293.)

48 The "Adjusted Preference Assets" asserted by the Plaintiffs do NOT include the following assets identified on Schedule 6 of the Committee Action: (1) 18 loans identified as "HFS Revolver" or "HFS Blanket," with a net book value of $1,950,188.00, (2) two REO properties identified as "HFS Blanket," with a net book value of $50,478.00, (3) three mortgage loans that were refinanced (the "Refinanced Mortgages"), with a net book value of $1,021,096.00, and (4) certain REO properties that Mr. Landy acknowledges were "never transferred to or for the benefit of the [Noteholders] during the preference period," with a net book value of $12,106,073.00. (Landy ¶ 57; DX ABN at 12; DX AIS at 4; PX 127.)

49 The Committee used a reduced preference period from February 29, 2012 through the Petition Date (75 days instead of 90) (the "Modified Preference Period"). (ECF Doc. # 97.)

50 A preconfirmation debtor-in-possession has the power to initiate and prosecute preference actions. *See*11 U.S.C. § 1107.

51 The Court reiterates comments made during closing arguments that it has serious problems with the methodology employed by Mr. Puntus in his valuation.

52 This finding is not a final decision whether the JSNs are oversecured or undersecured. Issues relating to certain other alleged JSN collateral were reserved for Phase II of the trial.

**End of Document**

# TAB 10

2012 WL 5427531 (Bkrtcy.S.D.N.Y.) (Trial Order)
United States Bankruptcy Court, S.D. New York.

In re: JOURNAL REGISTER COMPANY, et al.,[1] Debtors.

No. 12-13774 (SMB).
September 7, 2012.

**Final Order (A) Authorizing Debtors to Obtain Post-Petition Financing, Use Cash Collateral, and Grant Security Interests and Superpriority Administrative Expense Status Pursuant to 11 U.S.C. §§ 105 and 364(C); (B) Modifying the Automatic Stay Pursuant to 11 U.S.C. § 362; (C) Authorizing Debtors to Enter into Agreements with Wells Fargo Bank, N.A.**

Stuart M. Bernstein, United States Bankruptcy Judge.

Chapter 11

Jointly Administered

Upon the motion (the *"Motion"*), dated September 5, 2012, of Journal Register Company (*"Journal Register"*), 21[st] Century Newspapers, Inc. (*"21[st] Century"*), Acme Newspapers, Inc. (*"Acme"*), All Home Distribution, Inc. (*"All Home"*), Chanry Communications, Ltd. (*"Chanry"*), The Goodson Holding Company (*"Goodson"*), Great Lakes Media, Inc. (*"Great Lakes"*), Great Northern Publishing, Inc. (*"Great Northern"*), Greater Detroit Newspaper Network, Inc. (*"Greater Detroit"*), Heritage Network Incorporated (*"Heritage Network"*), Hometown Newspapers, Inc. (*"Hometown Newspapers"*), Independent Newspapers, Inc. (*"Independent Newspapers"*), JIUS, Inc. (*"Jius"*), Journal Company, Inc. (*"Journal Company"*), Journal Register East, Inc. (*"Journal Register East"*), Journal Register Supply, Inc. (*"Journal Register Supply"*), JRC Media, Inc. (*"JRC Media"*), Middletown Acquisition Corp. (*"Middletown"*), Morning Star Publishing Company (*"Morning Star"*), Northeast Publishing Company, Inc. (*"Northeast"*), Orange Coast Publishing Company (*"Orange Coast"*), Pennysaver Home Distribution Corp. (*"Pennysaver"*), Register Company, Inc. (*"Register Company"*), Saginaw Area Newspapers, Inc. (*"Saginaw"*), St. Louis Sun Publishing Company (*"St. Louis"*), Up North Publications, Inc. (*"Up North"*), Voice Communications Corp. (*"Voice"*), JR East Holdings, LLC (*"JR East"*) and Digital First Media Inc. (*"Digital First"* and together with Journal Register, 21[st] Century, Acme, All Home, Chanry, Goodson, Great Lakes, Great Northern, Greater Detroit, Heritage Network, Hometown Newspapers, Independent Newspapers, Jius, Journal Company, Journal Register East, Journal Register Supply, JRC Media, Middletown, Morning Start, Northeast, Orange Coast, Pennysaver, Register Company, Saginaw, St. Louis, Up North, Voice and JR East, each individually, a *"Borrower"* or a *"Debtor"* and collectively, the *"Borrowers"* or the *"Debtors"*), each as a Debtor and Debtor-in-Possession in the above-captioned Chapter 11 cases (collectively, the *"Cases"*), pursuant to Sections 105, 361, 362, 363 364(c)(1), 364(c)(2), 364(c)(3) and 507 of Title 11 of the United States Code, 11 U.S.C. §§ 101, et seq. (the *"Bankruptcy Code"*) and Rules 2002, 4001(c), and 9014 of the Federal Rules of Bankruptcy Procedure (the *"Bankruptcy Rules"*), and S.D.N.Y. LBR 4001-2, seeking, among other things:

(a) authorization for Debtors to obtain post-petition loans, advances and other financial accommodations on a final basis from Wells Fargo Bank, N.A. (*"Lender"*) in accordance with all of the lending formulae, sublimits, terms and conditions set forth in the Existing Loan Agreement (as defined below), as amended and ratified by the Ratification Agreement (as defined below), and in accordance with this Final Order, secured by security interests in and liens upon all of the Collateral (as defined below) pursuant to Sections 364(c)(2) and 364(c)(3) of the Bankruptcy Code;

 

(b) authorization for Debtors to enter into the Ratification and Amendment Agreement, dated of even date herewith, by and among Debtors and Lender (the *"Ratification Agreement",* a copy of which is annexed to the Interim Order (as defined below) as Exhibit "A" thereto and is incorporated herein), which ratifies, extends, adopts and amends the Existing Loan Agreement and the other Pre-Petition Financing Agreements (as defined below);

(c) modification of the automatic stay to the extent hereinafter set forth;

(d) authorization for the Debtors to use cash collateral pursuant to Sections 361 and 363 of the Bankruptcy Code in accordance with the terms of the Interim Order and this Order;

(e) the grant to Lender of superpriority administrative claim status pursuant to Section 364(c)(1) of the Bankruptcy Code in respect of all Post-Petition Obligations (as defined in the Ratification Agreement); and

(f) the grant to Wells Fargo Bank, N.A., in its capacity as agent (in such capacity, the *"Term Loan A Agent"*) for the Term Loan A Lenders (as hereinafter defined), of adequate protection on account of the prepetition liens in favor of the Term Loan A Lenders on the Pre-Petition Collateral (as defined in the Ratification Agreement);

(g) the grant to Wells Fargo Bank, N.A., in its capacity as agent (in such capacity, the *"Term Loan B Agent"*) for the Term Loan B Lenders (as hereinafter defined), of adequate protection on account of the prepetition liens in favor of the Term Loan B Lenders on the Pre-Petition Collateral; and

The initial hearing on the Motion having been held by this Court on September 7, 2012 (the *"Interim Hearing"*) and the final hearing on the Motion having been held by this Court on October 4, 2012 (the *"Final Hearing"*).

It appearing that due and appropriate notice of the Motion, the relief requested therein, the Interim Hearing and the Final Hearing (the *"Notice"*) having been served by the Debtors in accordance with Rule 4001(c) on (i) Lender, (ii) the United States Trustee for the District of Delaware (the *"U.S. Trustee"*), (iii) the holders of the thirty (30) largest unsecured claims against the Debtors' estates, (iv); Morgan, Lewis & Bockius LLP, counsel for the Debtors, (v) Akin Gump Strauss Hauer & Feld LLP, counsel for the Term Loan A Lenders and the Term Loan B Lenders, (vi) Emmet, Marvin & Martin LLP, counsel to the Term Loan A Agent and the Terms Loan B Agent, (vii) the Internal Revenue Service, (viii) all appropriate state taxing authorities, (ix) all landlords, owners, and/or operators of premises at which any of the Debtors' inventory and/or equipment is located, and (x) certain other parties identified in the certificate of service filed with the Court, including, without limitation, all creditors who have filed or recorded pre-petition liens or security interests against any of the Debtors' assets (collectively, the *"Noticed Parties"*).

Upon the record made by the Debtors at the Interim Hearing, the Final Hearing, including the Motion, and the filings and pleadings in the Cases, and good and sufficient cause appearing therefor;

THE COURT HEREBY MAKES THE FOLLOWING FINDINGS OF FACT AND CONCLUSIONS OF LAW:

A. *Petition.* On September 5, 2012 (the *"Petition Date"*), each Debtor filed a voluntary petition under Chapter 11 of the Bankruptcy Code. The Debtors continue to operate their businesses and manage their properties as debtors-in-possession pursuant to Sections 1107(a) and 1108 of the Bankruptcy Code.

B. *Jurisdiction and Venue.* The Court has jurisdiction of this proceeding and the parties and property affected hereby pursuant to 28 U.S.C. §§ 157(b) and 1334. The Motion is a "core" proceeding as defined in 28 U.S.C. §§ 157(b)(2)(A), (D) and (M). Venue of the Cases and the Motion in this Court is proper pursuant to 28 U.S.C. §§ 1408 and 1409.

 

C. *Notice.* Under the circumstances, the Notice given by the Debtors of the Motion, the Interim Hearing, the Final Hearing and the relief granted under this Order constitutes due and sufficient notice thereof and complies with Bankruptcy Rule 4001(c).

D. *Debtors' Acknowledgments and Agreements.* The acknowledgments and agreements of the Debtors set forth below shall be binding on the Debtors; *provided, that,* notwithstanding such acknowledgments and agreements, the Official Committee of Unsecured Creditors (the *"Committee"*) shall have the right to file an Objection (as defined below) in accordance with Section 4.1 of this Order. Subject to the foregoing, the Debtors admit, stipulate, acknowledge and agree that:

(i) *Pre-Petition Financing Agreements.* Prior to the commencement of the Cases, Lender made loans, advances and provided other financial accommodations to Borrowers pursuant to the terms and conditions set forth in: (1) the Loan and Security Agreement, dated August 7, 2009, by and among Debtors and Lender, together with the Consent and First Amendment to Loan and Security agreement, dated as of September 15, 2010, the Consent and Second Amendment to Loan and Security Agreement, dated as of November 19, 2010, the Consent, Waiver and Third Amendment to Loan and Security Agreement, dated as of July 14, 2011, and the Fourth Amendment to Loan and Security Agreement, dated as of March 19, 2012 (as the same has heretofore been amended, supplemented, modified, extended, renewed, restated and/or replaced at any time prior to the Petition Date, the *"Existing Loan Agreement,"* a copy of which is included with the Exhibit Supplement defined below) and (2) all other agreements, documents and instruments executed and/or delivered with, to, or in favor of Lender, as defined in section 1.55 of the Existing Loan Agreement, including, without limitation, all security agreements, notes, guarantees, mortgages, Uniform Commercial Code financing statements and all other related agreements, documents and instruments executed and/or delivered in connection therewith or related thereto (all of the foregoing, together with the Existing Loan Agreement and the Intercreditor Agreement referred to below, as all of the same have heretofore been amended, supplemented, modified, extended, renewed, restated and/or replaced at any time prior to the Petition Date (collectively, the *"Pre-Petition Financing Agreements"*). Copies of the operative Pre-Petition Financing Agreements are contained in the Exhibit Supplement to the Motion (the *"Exhibit Supplement"*).

(ii) *Pre-Petition Obligations Amount.* As of the opening of business on September 4, 2012, the aggregate amount of all Loans, [2] Letters of Credit and other Pre-Petition Obligations owing by Borrowers to Lender under and in connection with the Pre-Petition Financing Agreements was not less than $13,232,921.04, plus interest accrued and accruing thereon, together with all costs, fees, expenses (including attorneys' fees and legal expenses) and other charges accrued, accruing or chargeable with respect thereto (collectively, and as such term is more fully defined in the Ratification Agreement, the *"Pre-Petition Obligations"*). The Pre-Petition Obligations constitute allowed, legal, valid, binding, enforceable and non-avoidable obligations of Debtors, and are not subject to any offset, defense, counterclaim, avoidance, recharacterization or subordination pursuant to the Bankruptcy Code or any other applicable law, and Debtors do not possess and shall not assert any claim, counterclaim, setoff or defense of any kind, nature or description which would in any way affect the validity, enforceability and non-avoidability of any of the Pre-Petition Obligations.

(iii) *Pre-Petition Collateral.* As of the Petition Date, the Pre-Petition Obligations were fully secured pursuant to the Pre-Petition Financing Agreements by valid, perfected, enforceable and non-avoidable first priority security interests and liens granted by Debtors to Lender upon all of the Pre-Petition Collateral (as defined in the Ratification Agreement and 1.28 and 5.1 of the Existing Loan Agreement) subject only to (a) the terms of the Intercreditor Agreement (as defined below) and (b) the liens specifically permitted under the Existing Loan Agreement to the extent that such security interests, liens or encumbrances are (1) valid, perfected and non-avoidable security interests, liens or encumbrances existing as of the Petition Date, and (2) senior to and have not been or are subject to being subordinated to Lender's liens on and security interests in the Pre-Petition Collateral or otherwise avoided, and, in each instance, only for so long as and to the extent that such encumbrances are and remain senior and outstanding (hereinafter referred to as the *"Permitted Encumbrances"*). The Debtors do not possess and will not assert any claim, counterclaim, setoff or defense of any kind, nature or description which would in any way affect the validity, enforceability and non-avoidability of any of Lender's liens, claims or security interests in the Pre-Petition Collateral.

  

(iv) *Proof of Claim.* Any order entered by the Court in relation to the establishment of a bar date for any claims (including without limitation administrative expense claims) in any of the Cases or any successor cases shall not apply to Lender unless an order is entered specifically addressing Lender. The liens, rights, priorities and protections granted to or in favor of Lender as set forth in this Order and in the Pre-Petition Financing Agreements shall be deemed a timely filed proof of claim on behalf of Lender in these Cases.

(v) *Term Loan A Loan Documents.* Prior to the commencement of the Cases, Term Loan A Agent and the financial institutions from time to time party to the Existing Term Loan A Credit Agreement (as defined below) as lenders (collectively, the *"Term Loan A Lenders"*) made a term loan to Journal Register pursuant to the terms and conditions set forth in: (1) the Term Loan Agreement (Tranche A Term Loans), dated as of August 7, 2009, by and among Journal Register, Term Loan A Agent and Term Loan A Lenders (as the same has heretofore been amended, supplemented, modified, extended, renewed, restated and/or replaced at any time prior to the Petition Date, the *"Existing Term Loan A Credit Agreement,"*) and (2) all other agreements, documents and instruments executed and/or delivered with, to, or in favor of Term Loan A Agent or any Term Loan A Lender, including, without limitation, all security agreements, notes, guarantees, mortgages, Uniform Commercial Code financing statements and all other related agreements, documents and instruments executed and/or delivered in connection therewith or related thereto (all of the foregoing, together with the Existing Term Loan A Credit Agreement, as all of the same have heretofore been amended, supplemented, modified, extended, renewed, restated and/or replaced at any time prior to the Petition Date, collectively, the *"Pre-Petition Term Loan A Loan Documents"*). Pursuant to the Pre-Petition Term Loan A Documents, each Debtor (other than Journal Register) guaranteed the payment in full of all Obligations (as defined in the Existing Term Loan A Credit Agreement) of Journal Register owing to the Term Loan A Agent and the Term Loan A Lenders.

(vi) *Pre-Petition Term Loan A Obligations Amount.* As of the Petition Date, the aggregate amount of all Obligations (as defined in the Existing Term Loan A Credit Agreement) owing by Debtors to Term Loan A Agent and Term Loan A Lenders under and in connection with the Pre-Petition Term Loan A Loan Documents was not less than $112,251,850.42, plus interest accrued and accruing thereon, together with all costs, fees, expenses (including attorneys' fees and legal expenses) and other charges accrued, accruing or chargeable with respect thereto (collectively, the *"Pre-Petition Term Loan A Obligations"*). The Pre-Petition Term Loan A Obligations constitute allowed, legal, valid, binding, enforceable and non-avoidable obligations of Debtors, and are not subject to any offset, defense, counterclaim, avoidance, recharacterization or subordination pursuant to the Bankruptcy Code or any other applicable law, and Debtors do not possess and shall not assert any claim, counterclaim, setoff or defense of any kind, nature or description which would in any way affect the validity, enforceability and non-avoidability of any of the Pre-Petition Term Loan A Obligations.

(vii) *Pre-Petition Term Loan A Collateral.* As of the Petition Date, the Pre-Petition Term Loan A Obligations were secured, pursuant to the Pre-Petition Term Loan A Loan Documents, by valid, perfected, enforceable and non-avoidable security interests and liens granted by Debtors to Term Loan A Agent, for the benefit of itself and the other Term Loan A Lenders, upon all of the Pre-Petition Collateral, subject only to (a) the terms of the Intercreditor Agreement, and (b) the liens specifically permitted under the Existing Term Loan A Credit Agreement to the extent that such security interests, liens or encumbrances are (1) valid, perfected and non-avoidable security interests, liens or encumbrances existing as of the Petition Date, and (2) senior to and have not been or are subject to being subordinated to Term Loan A Agent's and Term Loan A Lenders' liens on and security interests in the Pre-Petition Collateral or otherwise avoided, and, in each instance, only for so long as and to the extent that such encumbrances are and remain senior and outstanding (hereinafter referred to as the *"Permitted Term Loan A Encumbrances"*). The Debtors do not possess and will not assert any claim, counterclaim, setoff or defense of any kind, nature or description which would in any way affect the validity, enforceability and non-avoidability of any of Term Loan A Agent's and Term Loan A Lenders' liens, claims or security interests in the Pre-Petition Collateral.

(vii) *Term Loan B Loan Documents.* Prior to the commencement of the Cases, Term Loan B Agent and the financial institutions from time to time party to the Existing Term Loan B Credit Agreement (as defined below) as lenders (collectively with Term Loan B Agent, the *"Term Loan B Lenders"*) made loans, advances and provided other financial accommodations to Journal Register pursuant to the terms and conditions set forth in: (1) the Term Loan Agreement (Tranche B Term Loans), dated as of

  

August 7, 2009, by and among Journal Register, Term Loan B Agent and Term Loan B Lenders (as the same has heretofore been amended, supplemented, modified, extended, renewed, restated and/or replaced at any time prior to the Petition Date, the *"Existing Term Loan B Credit Agreement,"*) and (2) all other agreements, documents and instruments executed and/or delivered with, to, or in favor of Term Loan B Agent or any Term Loan B Lender, including, without limitation, all security agreements, notes, guarantees, mortgages, Uniform Commercial Code financing statements and all other related agreements, documents and instruments executed and/or delivered in connection therewith or related thereto (all of the foregoing, together with the Existing Term Loan B Credit Agreement, as all of the same have heretofore been amended, supplemented, modified, extended, renewed, restated and/or replaced at any time prior to the Petition Date, collectively, the *"Pre-Petition Term Loan B Loan Documents"*). Pursuant to the Pre-Petition Term Loan B Loan Documents, each Debtor other than Journal Register guaranteed the payment in full of all Obligations (as defined in the Existing Term Loan B Credit Agreement) of Journal Register owing to the Term Loan B Agent and the Term Loan B Lenders.

(viii) *Pre-Petition Term Loan B Obligations Amount.* As of the Petition Date, the aggregate amount of all Obligations (as defined in the Existing Term Loan B Credit Agreement) owing by Debtors to Term Loan B Agent and Term Loan B Lenders under and in connection with the Pre-Petition Term Loan B Loan Documents was not less than $40,032,109.03, plus interest accrued and accruing thereon, together with all costs, fees, expenses (including attorneys' fees and legal expenses) and other charges accrued, accruing or chargeable with respect thereto (collectively, the *"Pre-Petition Term Loan B Obligations"*). The Pre-Petition Term Loan B Obligations constitute allowed, legal, valid, binding, enforceable and non-avoidable obligations of Debtors, and are not subject to any offset, defense, counterclaim, avoidance, recharacterization or subordination pursuant to the Bankruptcy Code or any other applicable law, and Debtors do not possess and shall not assert any claim, counterclaim, setoff or defense of any kind, nature or description which would in any way affect the validity, enforceability and non-avoidability of any of the Pre-Petition Term Loan B Obligations.

(ix) *Pre-Petition Term Loan B Collateral.* As of the Petition Date, the Pre-Petition Term Loan B Obligations were secured, pursuant to the Pre-Petition Term Loan B Loan Documents, by valid, perfected, enforceable and non-avoidable security interests and liens granted by Debtors to Term Loan B Agent, for the benefit of itself and the other Term Loan B Lenders, upon all of the Pre-Petition Collateral, subject only to (a) the terms of the Intercreditor Agreement, and (b) the liens specifically permitted under the Existing Term Loan B Credit Agreement to the extent that such security interests, liens or encumbrances are (1) valid, perfected and non-avoidable security interests, liens or encumbrances existing as of the Petition Date, and (2) senior to and have not been or are subject to being subordinated to Term Loan B Agent's and Term Loan B Lenders' liens on and security interests in the Pre-Petition Collateral or otherwise avoided, and, in each instance, only for so long as and to the extent that such encumbrances are and remain senior and outstanding (hereinafter referred to as the *"Permitted Term Loan B Encumbrances"* and together with the Permitted Revolving Loan Encumbrances and Permitted Term Loan A Encumbrances, the *"Permitted Encumbrances"*). The Debtors do not possess and will not assert any claim, counterclaim, setoff or defense of any kind, nature or description which would in any way affect the validity, enforceability and non-avoidability of any of Term Loan B Agent's and Term Loan B Lenders' liens, claims or security interests in the Pre-Petition Collateral.

(x) *Intercreditor Agreement.* Prior to the Petition Date, Journal Register Company, Lender, Term Loan A Agent and Term Loan B Agent entered into the Intercreditor Agreement, dated as of August 7, 2009 (as amended, the *"Intercreditor Agreement"*), which sets forth the respective rights, obligations and priorities of the liens and security interests of Lender, Term Loan A Agent and Term Loan A Lenders, and Term Loan B Agent and Term Loan B Lenders, with respect to the Pre-Petition Collateral and the obligations of the Debtors due to Lender, Term Loan A Agent and Term Loan A Lenders, and Term Loan B Agent and Term Loan B Lenders. Nothing in this Order shall modify the terms of the Intercreditor Agreement, and the rights, priorities and obligations set forth thereunder; *provided, that,* to the extent the last sentence of Section 5.3 of this Order is inconsistent with the terms of the Intercreditor Agreement, each Secured Lender has agreed that, as among Secured Lenders, the last sentence of Section 5.3 of this Order shall control and shall be deemed to amend the Intercreditor Agreement solely to the extent set forth in such last sentence

E. *Limitation on Debtors' Acknowledgements.* Notwithstanding anything to the contrary in this Order, the Financing Agreements or otherwise, any and all acknowledgements and agreements by the Debtors in this Final Order, and findings by the Court contained in this Final Order with respect thereto, are expressly subject to the right of the Committee in Section 4.1 of this Order to investigate and raise an Objection in accordance with Section 4.1 and, if an Objection is timely filed by the Committee in accordance with the provisions of this Order, the Debtors' acknowledgements contained herein shall have no res judicata, collateral estoppel or other issue preclusive effect upon the Committee, including in connection with any Objection timely filed by the Committee and shall not be asserted as a defense to any such Objection timely filed by the Committee.

(i) *Limitation On Intercreditor Agreement.* Notwithstanding anything to the contrary contained in this Order, (a) nothing in this Order shall give or shall be deemed in any way as giving any greater or additional rights, powers, liens or priorities to the Term Loan A Agent, the Term Loan A Lenders, the Term Loan B Agent or the Term Loan B Lenders in the Debtors' cases or under the Intercreditor Agreement than existed as of the Petition Date (other than the limited replacement liens and limited superpriority claims expressly provided for herein) and (b) nothing in this Order shall be construed or deemed to amend, modify or change in any way, the relative pre-petition priorities, as among the Secured Lenders, of any liens or claims of Secured Lenders against the Debtors and the Collateral as set forth in the Intercreditor Agreement.

F. *Findings Regarding the Postpetition Financing.*

(i) *Postpetition Financing.* The Debtors have requested from Lender, and Lender is willing to extend, certain loans, advances and other financial accommodations on the terms and conditions set forth, in this Order and the Financing Agreements (as defined below).

(ii) *Need for Post-Petition Financing.* The Debtors do not have sufficient available sources of working capital, including cash collateral, to operate their businesses in the ordinary course of their business without the financing requested under the Motion. The Debtors' ability to maintain business relationships with their vendors, suppliers and customers, to pay their employees, and to otherwise fund their operations is essential to the Debtors' continued viability as the Debtors seek to maximize the value of the assets of the Estates (as defined below) for the benefit of all creditors of the Debtors. The ability of the Debtors to obtain sufficient working capital and liquidity through the proposed post-petition financing arrangements with Lender as set forth in this Order and the Financing Agreements is vital to the preservation and maintenance of the going concern values of the Debtors. Accordingly, the Debtors have an immediate need to obtain the post-petition financing in order to, among other things, permit the orderly continuation of the operation of their businesses, minimize the disruption of their business operations, and preserve and maximize the value of the assets of the Debtors' bankruptcy estates (as defined under Section 541 of the Bankruptcy Code, the *"Estates"*) in order to maximize the recovery to all creditors of the Estates.

(iii) *No Credit Available on More Favorable Terms.* The Debtors are unable to procure financing in the form of unsecured credit allowable under Section 503(b)(1) of the Bankruptcy Code, as an administrative expense under Section 364(a) or (b) of the Bankruptcy Code, or in exchange for the grant of an administrative expense priority pursuant to Section 364(c)(1) of the Bankruptcy Code, without the grant of liens on assets. The Debtors have been unable to procure the necessary financing on terms more favorable than the financing offered by Lender pursuant to the Financing Agreements; and

(iv) *Budget.* The Debtors have prepared and delivered to Lender an initial Budget (as defined in the Ratification Agreement). Such Budget has been thoroughly reviewed by the Debtors and their management and sets forth, among other things, projections for the periods covered thereby. The Debtors represent that the Budget is achievable in accordance with the terms of the Financing Agreements and this Order and will allow the Debtors to operate at all times during these Cases without the accrual of unpaid administrative expenses. Lender is relying upon the Debtors' compliance with the Budget in accordance with Section 5.3 of the Ratification Agreement, the other Financing Agreements and this Order in determining to enter into the post-petition financing arrangements provided for herein.

(v) *Financial Reporting.* The Debtors shall provide the Committee with financial and other reporting provided to Lender.

(vi) *Business Judgment and Good Faith Pursuant to Section 364(e).* The terms of the Financing Agreements and this Order are fair, just and reasonable under the circumstances, are ordinary and appropriate for secured financing to debtors-in-possession, reflect the Debtors' exercise of their prudent business judgment consistent with their fiduciary duties, and are supported by reasonably equivalent value and fair consideration. The terms and conditions of the Ratification Agreement and this Order have been negotiated in good faith and at arms' length by and among the Debtors and Lender, with all parties being represented by counsel. Any credit extended under the terms of this Order shall be deemed to have been extended in good faith by Lender as that term is used in Section 364(e) of the Bankruptcy Code.

(vii) *Good Cause.* The relief requested in the Motion is necessary, essential and appropriate, and is in the best interest of and will benefit the Debtors, their creditors and their Estates, as its implementation will, among other things, provide the Debtors with the necessary liquidity to (a) minimize disruption to the Debtors' businesses and on-going operations, (b) preserve and maximize the value of the Debtors' Estates for the benefit of all the Debtors' creditors, and (c) avoid immediate and irreparable harm to the Debtors, their creditors, their businesses, their employees, and their assets.

(viii) *Immediate Entry.* Sufficient cause exists for immediate entry of this Order pursuant to Bankruptcy Rules 4001(c)(2). No party appearing in the Cases has filed or made an objection to the relief sought in the Motion or entry of this Order, or any objections that were made (to the extent such objections have not been withdrawn) are hereby overruled.

(ix) *Interim Financing Order.* On September 11, 2012, this Court entered the *Order (A) Authorizing Debtors to Obtain Interim Post-Petition Financing, Use Cash Collateral, and Grant Security Interests and Superpriority Administrative Expense Status Pursuant to 11 U.S.C. §§ 105 and 364(C); (B) Modifying the Automatic Stay Pursuant to 11 U.S.C. § 362; (C) Authorizing Debtors to Enter Into Agreements With Wells Fargo Bank, N.A.; and (D) Scheduling a Final Hearing Pursuant to Bankruptcy Rule 4001* (Doc No. 41, the *"Interim Order"*).

Based upon the foregoing, and after due consideration and good cause appearing therefor;

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, that:

**Section 1. *Authorization and Conditions to Financing.***

1.1 *Motion Granted.* The Motion is granted in accordance with Bankruptcy Rule 4001(c)(2) to the extent provided in this Order. This Order shall hereinafter be referred to as the *"Final Order."*

1.2 *Authorization to Borrow and Use Loan Proceeds.* Borrowers are hereby authorized and empowered to immediately borrow and obtain Loans and Letters of Credit and to incur indebtedness and obligations owing to Lender pursuant to the terms and conditions of this Final Order and the Existing Loan Agreement, as ratified and amended by the Ratification Agreement (the *"Loan Agreement"*) and the other Financing Agreements, as ratified and amended by the Ratification Agreement (the *"Financing Agreements"*),i in such amounts not to exceed the Budget plus any variances permitted under the Ratification Agreement, and in accordance with all of the lending formulae, sublimits, terms and conditions set forth in the Loan Agreement, the other Financing Agreements and this Final Order. Notwithstanding anything to the contrary contained herein, the term Financing Agreements as used herein shall not include any of the Pre-Petition Term Loan A Loan Documents, the Pre-Petition Term Loan B Loan Documents or the Intercreditor Agreement. Subject to the terms and conditions contained in this Final Order and the Financing Agreements, Borrowers shall use the proceeds of the Loans and any other credit accommodations provided to Borrowers pursuant to this Final Order, the Loan Agreement or the other Financing Agreements for, *inter alia,* the payment of employee salaries, payroll, taxes, and all other expenses specified in the Budget and for other operating and working capital purposes in the ordinary course of Borrowers' business in accordance with and to the extent permitted under the Financing Agreements, including the fees of the U.S. Trustee, the Clerk of this Court and, subject to Section 2.3 of this Final Order and the Budget, Allowed Professional Fees (as defined below) and for the payment of adequate protection to Lender, the Term Loan A

Agent and the Term Loan B Agent solely to the extent provided in this Order. Without in any way limiting the last sentence of Section 2.5.3 of this Order, the amounts set forth in the Budget for professional fees shall not be a maximum cap on the amounts of any such fees and expenses which the Court may allow and the professionals may seek allowance of fees and expenses in excess of any amounts provided in the Budget.

1.3 *Financing Agreements*

1.3.1 *Authorization.* Debtors are hereby authorized and directed to enter into, execute, deliver, perform, and comply with all of the terms, conditions and covenants of the Loan Agreement, and all other agreements, documents and instruments executed or delivered in connection with or related to the ratified Loan Agreement, the other Financing Agreements and all other agreements, documents and instruments executed or delivered in connection with or related to the ratified Loan Agreement, the other Financing Agreements or this Final Order, including, without limitation, the Ratification Agreement, pursuant to which, inter alia, each Debtor ratifies, reaffirms, extends, assumes, adopts, amends, and restates the Existing Loan Agreement and the other Pre-Petition Financing Agreements to which it is a party.

1.3.2 *Approval.* The Financing Agreements (including, without limitation, the Loan Agreement) and each term set forth therein are approved to the extent necessary to implement the terms and provisions of this Final Order. All of such terms, conditions and covenants shall be sufficient and conclusive evidence of the borrowing arrangements by and among Debtors and Lender, and of each Debtor's assumption and adoption of all of the terms, conditions, and covenants of the Loan Agreement and the other Financing Agreements for all purposes, including, without limitation, to the extent applicable, the payment of all Obligations arising thereunder, including, without limitation, all principal, interest, letter of credit fees, servicing fees, unused line fees, the DIP facility fee and other fees and expenses, including, without limitation, all of Lender's reasonable consultant fees, professional fees, attorney fees and legal expenses, as more fully set forth in the Financing Agreements; *provided, that,* copies of the invoices issued by Lender's attorneys and consultants in connection with these Cases shall made available to the Office of the United States Trustee, and to counsel to the Committee for purposes of providing twenty (20) days to review such invoices with a right to object (if necessary) to the reasonableness of such fee statements within such twenty (20) day period. This Court shall have jurisdiction to hear and determine all disputes regarding such fee statements. Without limiting the generality of the foregoing, but subject to the right to review set forth above, the Debtors are authorized and directed, without further order of this Court, to pay or reimburse Lender for all present and future reasonable costs and expenses, including, without limitation, all reasonable professional fees, consultant fees and legal fees and expenses paid or incurred by Lender in connection with the financing transactions as provided in this Final Order and the Financing Agreements, all of which shall be and are included as part of the principal amount of the Obligations and secured by the Collateral.

1.3.3 *Amendment.* Subject to the terms and conditions of the Loan Agreement and the other Financing Agreements, Debtors and Lender may amend, modify, supplement or waive any provision of the Financing Agreements (an *"Amendment"*) without further approval or order of the Court so long as (a) such Amendment is not material (for purposes hereof, a "material" Amendment shall mean, any Amendment that operates to increase the interest rate other than as currently provided in the Financing Agreements, increase the Maximum Credit (as defined in the Loan Agreement), add specific new events of default or enlarge the nature and extent of default remedies available to the Lender following an event of default, or otherwise modify any terms and conditions in any Financing Agreement in a manner materially less favorable to Debtors) and is undertaken in good faith by Lender and Debtors; (b) the Debtors provide prior written notice of the Amendment (the *"Amendment Notice"*) to (i) the U.S. Trustee, (ii) counsel to the Committee, (iii) counsel to the Term Loan A Lenders and the Term Loan B Lenders, and (iv) counsel to the Term Loan A Agent and the Term Loan B Agent; (c) the Debtors file the Amendment Notice with the Court; and (d) no objection to the Amendment is filed with the Court within five (5) business days from the later of the date the Amendment Notice is served or the date the Amendment Notice is filed with the Court in accordance with this Section. Any material Amendment to the Financing Agreements, and any amendment fee payable by the Debtors in connection with any Amendment, must be approved by the Court to be effective.

1.4 *Payment of Prepetition Debt.* The Debtors are authorized to pay Lender in respect of all Pre-Petition Obligations in accordance with the Financing Agreements and Sections 1.5 and 1.6 of this Final Order. Subject to the right of the Committee to raise an Objection in accordance with Section 4.1 of this Order, all proceeds of the Collateral (as defined below) received by Lender, and any other amounts or payment received by Lender in respect of the Obligations, shall be applied or deemed to be applied by Lender in accordance with the Loan Agreement, the other Financing Agreements and this Final Order first to the Pre-Petition Obligations, until such Pre-Petition Obligations are indefeasibly paid in full and completely satisfied and then to the Post-Petition Obligations; *provided, that,* no payments or deemed payments of any prepetition debt of the Term A Lenders and Term B Lenders on account of the Pre-Petition Term Loan A Obligations and the Pre-Petition Term Loan B Obligations shall be made to the Term A Lenders and Term B Lenders.

1.5 *Payments and Application of Payments.* The Debtors are authorized and directed to make all payments and transfers of Estate property to Lender as provided, permitted and/or required under the Loan Agreement and the other Financing Agreements, which payments and transfers, subject to Section 4.1 herein, shall not be avoidable or recoverable from Lender under Section 547, 548, 550, 553 or any other Section of the Bankruptcy Code, or any other claim, charge, assessment, or other liability, whether by application of the Bankruptcy Code, other law or otherwise. All proceeds of the Collateral received by Lender, and any other amounts or payments received by Lender in respect of the Obligations, shall be applied or deemed to be applied by Lender in accordance with the Loan Agreement, the other Financing Agreements and this Final Order (including the last sentence of Section 5.3 of this Final Order) first to the Pre-Petition Obligations, until such Pre-Petition Obligations are indefeasibly paid in full and completely satisfied, and then to the Post-Petition Obligations (but subject to the right of the Committee to raise an Objection in accordance with Section 4.1 of this Order).

1.6 *Continuation of Prepetition Procedures.* All pre-petition practices and procedures for the payment and collection of proceeds of the Collateral, the turnover of cash, the delivery of property to Lender and the funding pursuant to the Financing Agreements, including any lockbox or blocked depository bank account arrangements, are hereby approved and shall continue without interruption after the commencement of the Cases.

**Section 2. *Postpetition Lien; Superpriority Administrative Claim Status.***

2.1 *Post-Petition Lien.*

2.1.1 *Post-Petition Lien Granting.* To secure the prompt payment and performance of any and all Post-Petition Obligations of Debtors to Lender of whatever kind, nature or description, absolute or contingent, now existing or hereafter arising, Lender shall have and is hereby granted, effective as of the Petition Date, valid and perfected first priority security interests and liens, superior to all other liens, claims and/or security interests that any creditor of the Debtors' Estates may have (but subject to certain claims entitled to priority, including the Permitted Liens and Claims (as defined below), as and to the extent expressly provided in Section 2.1.2 below), in and upon all of the Pre-Petition Collateral and the Post-Petition Collateral (as defined in the Ratification Agreement). The Pre-Petition Collateral and the Post-Petition Collateral are collectively referred to herein as the *"Collateral."* Notwithstanding the foregoing or anything to the contrary contained in the Loan Agreement, the Collateral shall not include, and Lender's liens and security interests shall not attach to, avoidance actions brought under Sections 542, 545, 547, 548, 549 or 550 of Bankruptcy Code or the identifiable proceeds thereof (collectively, the *"Avoidance Actions"*). For the avoidance of doubt, none of the Term Loan A Agent, Term Loan A Lenders, Term Loan B Agent or Term Loan B Lenders shall have any lien on or security interest in the Avoidance Actions (including the proceeds thereof). In accordance with Sections 552(b) and 361 of the Bankruptcy Code, the value, if any, in any of the Collateral, in excess of the amount of Obligations secured by such Collateral after satisfaction of the Post-Petition Obligations of Debtors to Lender, shall constitute additional security for the repayment of the Pre-Petition Obligations and adequate protection for the use by Debtors, and the diminution in the value, of the Collateral existing on the Petition Date. Notwithstanding anything contained in this order, the Post-Petition Collateral shall not secure any Pre-Petition Debt.

2.1.2 *Lien Priority.* The pre-petition and post-petition liens and security interests of Lender granted under the Financing Agreements and this Final Order in the Collateral shall be and shall continue to be first and senior in priority to all other interests and liens of every kind, nature and description, whether created consensually, by an order of the Court or otherwise, including, without limitation, liens or interests granted in favor of third parties in conjunction with Section 363, 364 or any other Section of the Bankruptcy Code or other applicable law; *provided, however,* that Lender's liens on and security interests in the Collateral shall be subject only to Permitted Liens and Claims and the Intercreditor Agreement. For purposes hereof, the term *"Permitted Liens and Claims"* shall mean, as to each Secured Lender (as defined below), (a) the Permitted Encumbrances applicable to such Secured Lender, (b) the Carve Out Expenses (as defined below) solely to the extent provided for in Sections 2.3, 2.4 and 2.5 of this Final Order and (c) any non-consensual lien entitled to priority under applicable non-bankruptcy law. For purposes hereof, the term *"Secured Lenders"* shall mean, collectively, (x) Lender, (y) Term Loan A Agent and Term Loan A Lenders and (z) Term Loan B Agent and Term Loan B Lenders, each individually referred to from time to time herein as a *"Secured Lender".*

2.1.3 *Post-Petition Lien Perfection.* This Final Order shall be sufficient and conclusive evidence of the priority, perfection and validity of the post-petition liens and security interests granted herein, effective as of the Petition Date, without any further act and without regard to any other federal, state or local requirements or law requiring notice, filing, registration, recording or possession of the Collateral, or other act to validate or perfect such security interest or lien, including without limitation, control agreements with any depository or other financial institution(s) holding a Blocked Account or other depository account consisting of Collateral (a *"Perfection Act"*). Notwithstanding the foregoing, if Lender shall, in its sole discretion, elect for any reason to file, record or otherwise effectuate any Perfection Act, Lender is authorized to perform such act, and the Debtors are authorized and directed to perform such act to the extent necessary or required by Lender, which act or acts shall be deemed to have been accomplished as of the date and time of entry of this Final Order (as applicable) notwithstanding the date and time actually accomplished, and in such event, the subject filing or recording office is authorized to accept, file and/or record any document in regard to such act in accordance with applicable law. Lender may choose to file, record or present a certified copy of this Final Order in the same manner as a Perfection Act, which shall be tantamount to a Perfection Act, and, in such event, the subject filing or recording office is authorized to accept, file or record such certified copy of this Final Order (as applicable) in accordance with applicable law. Should Lender so choose and attempt to file, record or perform a Perfection Act, no defect or failure in connection with such attempt shall in any way limit, waive or alter the validity, enforceability, attachment, or perfection of the post-petition liens and security interests granted herein by virtue of the entry of this Final Order.

2.2 *Superpriority Administrative Expense.* For all Post-Petition Obligations now existing or hereafter arising pursuant to this Final Order, the Financing Agreements or otherwise, Lender is granted an allowed superpriority administrative claim pursuant to Section 364(c)(1) of the Bankruptcy Code, having priority in right of payment over any and all other obligations, liabilities and indebtedness of Debtors, whether now in existence or hereafter incurred by Debtors, and over any and all administrative expenses or priority claims of the kind specified in, or ordered pursuant to, inter alia Sections 105, 326, 328, 330, 331, 503(b), 506(c) (to the extent provided herein), 507(a), 507(b), 364(c)(1), 546(c), 726 or 1114 of the Bankruptcy Code (the *"Superpriority Claim"*), *provided, that* the Superpriority Claim shall be subject only to the Permitted Liens and Claims and the Carve-Out as and to the extent expressly set forth in this Final Order, *provided, further, that* the Superpriority Claim shall not be satisfied from Avoidance Actions or identifiable proceeds thereof.

2.3 *Carve Out Expenses.*

2.3.1 *Carve Out Expenses.* Upon the delivery by Lender to Debtors, counsel to Debtors, counsel to the Committee, counsel to Term Loan A Lenders and Term Loan B Lenders, and counsel to Term Loan A Agent and Term Loan B Agent, of notice of the occurrence of an Event of Default (the *"Trigger Date"*), (a) Lender's liens, claims and security interests in the Collateral and its Superpriority Claim shall be subject to the right of payment of the Carve Out Expenses (as defined below), (b) Term Loan A Agent's and Term Loan A Lenders' liens, claims and security interests in the Collateral shall be subject to the right of payment of the Carve Out Expenses and (c) Term Loan B Agent's and Term Loan B Lenders' liens, claims and security interests in the Collateral shall be subject to the right of payment of the Carve Out Expenses. For purposes hereof, the term *"Carve Out Expenses"* means, collectively, the following:

a. statutory fees payable to the U.S. Trustee pursuant to 28 U.S.C. § 1930(a)(6), plus interest accrued thereon;

b. fees payable to the Clerk of this Court;

c. the allowed reasonable fees and expenses of any Chapter 7 trustee appointed for any Debtor's Chapter 7 case, in a cumulative aggregate sum not to exceed $50,000 (the *"Chapter 7 Trustee Carve Out"*); and

d. subject to the terms and conditions of this Final Order, the unpaid and outstanding reasonable fees and expenses actually incurred on or after the Petition Date, and approved by a final order of the Court pursuant to Sections 326, 328, 330, or 331 of the Bankruptcy Code (collectively, the *"Allowed Professional Fees"*), by attorneys, accountants and other professionals retained by the Debtors and any Committee(s) under Section 327 or 1103(a) of the Bankruptcy Code (collectively, the *"Professionals"*), in a cumulative, aggregate sum not to exceed $750,000 (the *"Professional Fee Carve Out"*). Sixty percent (60%) of the Professional Fee Carve Out is dedicated, in the first instance, to the payment of Allowed Professional Fees of the Committee's Professionals, while forty percent (40%) of the Professional Fee Carve Out (plus any remainder of the Professional Fee Carve Out after payment of Allowed Professional Fees of the Committee's Professionals) is dedicated to the Allowed Professional Fees of the Debtors' Professionals.

2.3.2 *Excluded Professional Fees.* Notwithstanding anything to the contrary in this Final Order, neither the Professional Fee Carve Out nor the proceeds of any Loans, Letters of Credit or Collateral shall be used to pay any Allowed Professional Fees or any other fees or expenses incurred by any Professional in connection with any of the following: (a) an assertion or joinder in (but excluding any review and investigation into) any claim, counterclaim, action, proceeding, application, motion, objection, defense or other contested matter seeking any order, judgment, determination or similar relief: (i) challenging the legality, validity, priority, perfection, or enforceability of the Obligations or Lender's liens on and security interests in the Collateral, (ii) invalidating, setting aside, avoiding or subordinating, in whole or in part, the Obligations or Lender's liens on and security interests in the Collateral or (iii) preventing, hindering or delaying any Secured Lender's assertion or enforcement of any lien, claim, right or security interest or realization upon any Collateral in accordance with the terms and conditions of this Final Order, (b) a request to use the Cash Collateral (as such term is defined in Section 363 of the Bankruptcy Code) without the prior written consent Lender in accordance with the terms and conditions of this Final Order, (c) a request for authorization to obtain Debtor-in-Possession financing or other financial accommodations pursuant to Section 364(c) or Section 364(d) of the Bankruptcy Code, other than from Lender, without the prior written consent of Lender (*provided, that,* subject to this Final Order, (1) following the delivery by Lender to Debtors, counsel to Debtors, counsel to the Committee, counsel to Term Loan A Lenders and Term Loan B Lenders, and counsel to Term Loan A Agent and Term Loan B Agent, of notice of an Event of Default, Debtors shall be authorized to continue to use Cash Collateral, up to an aggregate amount not exceed $50,000 and for a period not to exceed seven (7) days from the date of such notice, solely for the purpose of contesting the validity of such Event of Default) and (2) the Committee, without further order of the Court, shall have automatic standing to review and challenge the validity of the notice of an Event of Default and shall be authorized to use Cash Collateral, up to an aggregate amount not to exceed $50,000 and for a period not to exceed seven (7) days from the date of such notice, solely for the purpose of contesting the validity of such Event of Default, (d) the commencement or prosecution of any action or proceeding of any claims, causes of action or defenses against Lender or any of its officers, directors, employees, agents, attorneys, affiliates, successors or assigns, including, without limitation, any attempt to recover or avoid any claim or interest from such person under Chapter 5 of the Bankruptcy Code, or (e) any act which has or could have the effect of materially and adversely modifying or compromising the rights and remedies of Lender, or which is contrary, in a manner that is material and adverse to Lender, to any term or condition set forth in or acknowledged by the Financing Agreements and this Final Order and which results in the occurrence of an Event of Default under the Financing Agreements and/or this Final Order.

2.3.3 *Professional Fee Reserve.* The Debtors are authorized to establish a separate account at a financial institution other than Wells Fargo Bank, N.A. (the *"Professional Fee Reserve"*) and, prior to the Trigger Date and subject to availability under the Financing Agreements, to fund such account each month on the first day of each month in an amount equal to the projected monthly professional fees of Morgan, Lewis & Bockius LLP, Young, Conaway, Stargatt & Taylor LLP, Lowenstein Sandler PC, SSG Capital Advisors, LLC and FTI Consulting, Inc. as set forth in the Budget. No payments to any Professionals shall be made from such Professional Fee Reserve except upon further order of this Court (and only in such amounts allowed by this Court) in accordance with the compensation procedures applicable to this case. Any monies remaining in the Professional Fee Reserve after the payment of all Allowed Professional Fees to the foregoing Professionals at the conclusion of these Cases shall be returned to the Debtors' estates. For the avoidance of doubt, the amounts set forth in the Budget that are projected for Professional fees and expenses are intended to consist of the projected fees and expenses of the Professionals for the period between September 13, 2012 and December 13, 2012 (i.e. 13 weeks). The parties reserve all rights with regard to the amounts to be included in any subsequent Budget or Professional Fee Reserve (in each case, if any) for the payment of Professionals for any subsequent period, which amount, for the avoidance of doubt, shall be subject to negotiation among the Committee, the Lender, the Term Loan A Lenders, Term Loan A Agent, Term Loan B Lenders, Term Loan B Agent, and the Debtors.

2.4 *Carve Out Reserve.* At Lender's sole discretion, Lender may, at any time and in any increment in accordance with the Loan Agreement, establish a Reserve against the amount of Loans or other credit accommodations that would otherwise be made available to Debtors pursuant to the lending formulae contained in the Loan Agreement in respect of the Professional Fee Carve Out and the other Carve Out Expenses.

2.5 *Payment of Carve Out Expenses.*

2.5.1 Prior to the Trigger Date, and subject to the terms of the Financing Agreements (including the Budget), Debtors shall be permitted to pay Allowed Professional Fees of the Professionals, and any such amounts paid prior to the Trigger Date shall not reduce the Professional Fee Carve-Out.

2.5.2 Within five (5) days of the Trigger Date, Lender shall remit to an account designated by the Debtors at a financial institution other than Wells Fargo Bank, N.A. (the *"Carve Out Account"*) an equal to (a) the Professional Fee Carve Out, plus (b) the Chapter 7 Trustee Carve Out plus (c) without duplication of the foregoing clauses (a) and (b), all other accrued and unpaid Carve Out Expenses through the Trigger Date. Upon remittance by Lender of the Professional Fee Carve Out and other Carve Out Expenses to the Carve Out Account in accordance with this Section 2.5.2, Lender shall be released and discharged from all obligation and liability with respect to the Professional Fee Carve Out and the other Carve Out Expenses, and from all claims of any Professionals or other persons with respect thereto. Subject to the foregoing, the deposit or availability of funds in the Professional Fee Escrow or Carve Out Account shall not by itself constitute payment of Allowed Professional Fees. Upon payment in full of all Carve Out Expenses, any remaining funds on deposit in the Carve Out Account shall be remitted to Lender for application to the Obligations in accordance with and subject to this Final Order. Any failure of Lender to remit the Carve Out Expenses to the Carve Out Account following the Trigger Date in accordance with this Section 2.5.2 shall, to the extent Lender has not already paid such Carve Out Expenses, constitute a default by Lender under this Final Order.

2.5.3 Any payment or reimbursement made either directly by Lender at any time, or by or on behalf of the Debtors on or after the Trigger Date, in respect of any Allowed Professional Fees or any other Carve Out Expenses (exclusive of the application of any retainers by any of the Professionals), including pursuant to Section 2.5.2 above, shall, in either case, permanently reduce the Professional Fee Carve Out and the other Carve Out Expenses, as applicable, on a dollar-for-dollar basis. Lender's obligation to fund or otherwise pay the Professional Fee Carve Out and the other Carve Out Expenses shall be added to and made a part of the Obligations, secured by the Collateral, and entitle Lender to all of the rights, claims, liens, priorities and protections under this Final Order, the Financing Agreements, the Bankruptcy Code or applicable law. Payment of any Carve Out Expenses, whether by or on behalf of Lender, shall not and shall not be deemed to reduce the Obligations, and shall not and shall not be deemed to subordinate any of Lender's liens and security interests in the Collateral or its Superpriority Claim to any junior pre- or post-petition lien, interest or claim in favor of any other party. Except as otherwise provided herein with respect to the Professional Fee Carve and the other Carve Out Expenses, Lender shall not, under any circumstance, be responsible for the direct payment or reimbursement of any fees or disbursements of any Professionals incurred in connection with the Case under any chapter of the Bankruptcy Code, and nothing in this Final Order shall be construed to obligate Lender in any way, to pay compensation to or to reimburse expenses of any Professional, or to ensure that the Debtors have sufficient funds to pay such compensation or reimbursement.

2.6 *Use of Cash Collateral; Adequate Protection.*

2.6.1 *Authorization to Use Cash Collateral Subject to Financing Agreements.* Subject to the terms and conditions of this Final Order, the Loan Agreement and the other Financing Agreements, and in accordance with the Budget, Debtors shall be and are hereby authorized to use, and are granted consent to use, until the expiration of Lender's commitment to lend under the Loan Agreement and the other Financing Agreements, the Cash Collateral (as defined in Section 363 of the Bankruptcy Code) subject to the pre-petition liens and security interests granted to (a) Lender, (b) Term Loan A Agent and Term Loan A Lenders, and (c) Term Loan B Agent and Term Loan B Lenders, and to the replacement liens granted hereunder. Nothing in this Final Order shall authorize the disposition of any assets of the Debtors or their Estates outside the ordinary course of business, or any Debtor's use of Cash Collateral or other proceeds resulting therefrom, except as permitted in this Final Order, the Loan Agreement and the other Financing Agreements.

2.6.2 *Replacement Liens.*

(a) As adequate protection for any diminution in value of its interests in the Pre-Petition Collateral (including Cash Collateral) on account of the Debtors' use of such Pre-Petition Collateral (including Cash Collateral), the imposition of the automatic stay and the subordination to the Carve Out-Expenses, Lender is hereby granted pursuant to Sections 361 and 363 of the Bankruptcy Code, valid, binding, enforceable and perfected replacement liens upon and security interests in all Collateral (the *"Lender Replacement Lien"*). The Lender Replacement Lien (i) shall be junior and subordinate to the Carve-Out Expenses, the other Permitted Liens and Claims and to the liens and security interests granted to Lender in the Collateral securing the Post-Petition Obligations and (ii) subject to the foregoing clause (i) and to the terms of the Intercreditor Agreement, shall otherwise be senior to all other security interests in, liens on, or claims against any of the Collateral.

(b) As adequate protection for any diminution in value of its interests in the Pre-Petition Collateral (including Cash Collateral) on account of the Debtors' use of such Pre-Petition Collateral (including Cash Collateral), the imposition of the automatic stay and the subordination to the Carve Out-Expenses, Term Loan A Agent, for the benefit of itself and the Term Loan A Lenders, is hereby granted pursuant to Sections 361 and 363 of the Bankruptcy Code, valid, binding, enforceable and perfected replacement liens upon and security interests in all Collateral (the *"Term Loan A Replacement Lien"*). The Term Loan A Replacement Lien (i) shall be junior and subordinate to the Carve-Out Expenses, the other Permitted Liens and Claims and, subject to the terms of the Intercreditor Agreement, to the liens and security interests of Lender in the Collateral (including the Lender Replacement Lien) and (ii) subject to the foregoing clause (i), shall otherwise be senior to all other security interests in, liens on, or claims against any of the Collateral. Notwithstanding anything to the contrary set forth herein, the Term Loan A Replacement Lien shall only replace the existing liens and security interests of the Term Loan A Agent in and upon the Collateral in which the Term Loan A Agent, for the benefit of itself and the Term Loan A Lenders, held duly perfected liens and security interests as of the Petition Date in these Cases. For the avoidance of doubt, neither the Term Loan A Agent nor the Term Loan A Lenders shall have (x) any lien upon or security interest in the Avoidance Actions or any proceeds thereof or (y) any rights under Section 4.3 of this Final Order, including any right to assert or raise the waiver granted to Lender pursuant to Section 4.3 of this Final Order as a defense to any claim or cause of action under Section 506(c) of the Bankruptcy Code; *provided, that,* the foregoing shall not in any way limit or modify the rights and benefits granted to Lender under Section 4.3 of this Final Order.

(c) As adequate protection for the diminution in value of its interests in the Pre-Petition Collateral (including Cash Collateral) on account of the Debtors' use of such Pre-Petition Collateral (including Cash Collateral), the imposition of the automatic stay and the subordination to the Carve Out-Expenses, Term Loan B Agent, for the benefit of itself and the Term Loan B Lenders, is hereby granted pursuant to Sections 361 and 363 of the Bankruptcy Code, valid, binding, enforceable and perfected replacement liens upon and security interests in all Collateral (the *"Term Loan B Replacement Lien"*). The Term Loan B Replacement Lien (i) shall be junior and subordinate to the Carve-Out Expenses, the other Permitted Liens and Claims and, subject to the terms of the Intercreditor Agreement, to the liens and security interests of Lender in the Collateral (including the Lender Replacement Lien) and (ii) subject to the foregoing clause (i), shall otherwise be senior to all other security interests in, liens on, or claims against any of the Collateral. Notwithstanding anything to the contrary set forth herein, the Term Loan B Replacement Lien shall only replace the existing liens and security interests of the Term Loan B Agent in and upon the Collateral in which the Term Loan B Agent, for the benefit of itself and the Term Loan B Lenders, held duly perfected liens and security interests as of the Petition Date in these Cases. For the avoidance of doubt, neither the Term Loan B Agent nor the Term Loan B Lenders shall have any lien upon or security interest in the Avoidance Actions or any proceeds thereof.

2.6.3 *Section 507(b) Priority Claims.*

(a) As adequate protection for the diminution in value of its interests in the Pre-Petition Collateral (including Cash Collateral) on account of the Debtors' use of such Pre-Petition Collateral (including Cash Collateral), the imposition of the automatic stay and the subordination to the Carve-Out-Expenses, Lender is hereby granted as and to the extent provided by Section 507(b) of the Bankruptcy Code an allowed superpriority administrative expense claim in each of the Cases and any successor Cases (the *"Lender Adequate Protection Superpriority Claim"*). The Lender Adequate Protection Superpriority Claim (i) shall be junior and subordinate to the Carve-Out Expenses and (ii) subject to the foregoing clause (i), shall otherwise have priority over all administrative expense claims and unsecured claims against Debtors and their Estates now existing or hereafter arising, of any kind or nature whatsoever, *provided that,* the Lender Adequate Protection Superpriority Claim shall not be satisfied from Avoidance Actions or any identifiable proceeds thereof.

(b) As adequate protection solely for the diminution in value of its interests in the Pre-Petition Collateral (including Cash Collateral) on account of the Debtors' use of such Pre-Petition Collateral (including Cash Collateral), the imposition of the automatic stay and the subordination to the Carve-Out-Expenses, Term Loan A Agent, for the benefit of itself and the Term Loan A Lenders, is hereby granted as and to the extent provided by Section 507(b) of the Bankruptcy Code an allowed superpriority administrative expense claim in each of the Cases and any successor Cases (the *"Term Loan A Adequate Protection Superpriority Claim"*). The Term Loan A Adequate Protection Superpriority Claim (i) shall be junior and subordinate to the Carve-Out Expenses and to the pre-and post-petition claims of Lender against Debtors and (ii) subject to the foregoing clause (i), shall otherwise have priority over all administrative expense claims and unsecured claims against Debtors and their Estates now existing or hereafter arising, of any kind or nature whatsoever; *provided, that,* (i) the Term Loan A Adequate Protection Superpriority Claim shall exclude any claim upon or interest in the Avoidance Actions or proceeds thereof and (ii) the Committee's rights to challenge the Term Loan A Adequate Protection Superpriority Claim or any diminution in value of the Pre-Petition Collateral protected thereby shall not be subject to the Objection Period (as defined herein) and are hereby preserved.

(c) As adequate protection solely for the diminution in value of its interests in the Pre-Petition Collateral (including Cash Collateral) on account of the Debtors' use of such Pre-Petition Collateral (including Cash Collateral), the imposition of the automatic stay and the subordination to the Carve-Out-Expenses, Term Loan B Agent, for the benefit of itself and the Term Loan B Lenders, is hereby granted as and to the extent provided by Section 507(b) of the Bankruptcy Code an allowed superpriority administrative expense claim in each of the Cases and any successor Cases (the *"Term Loan B Adequate Protection Superpriority Claim"*). The Term Loan B Adequate Protection Superpriority Claim (i) shall be junior and subordinate to the Carve-Out Expenses and, subject to the terms of the Intercreditor Agreement, to the pre- and post-petition claims of Lender against the Debtors, and to the pre- and post-petition claims of the Term Loan A Agent and Term Loan A Lenders against Debtors, and (ii) subject to the foregoing clause (i) and to the terms of the Intercreditor Agreement, shall otherwise have priority over all administrative expense claims and unsecured claims against Debtors and their Estates now existing or hereafter arising, of any kind or nature whatsoever. For the avoidance of doubt, (i) the Term Loan B Adequate Protection Superpriority Claim shall exclude any claim upon or interest in the Avoidance Actions or proceeds thereof and (ii) the Committee's rights to challenge the Term Loan B Adequate Protection Superpriority Claim or any diminution in value of the Pre-Petition Collateral protected thereby shall not be subject to the Objection Period and are hereby preserved.

  

2.6.4 *Other Adequate Protection. Lender.* As further adequate protection, Debtors are hereby authorized to provide adequate protection to Lender in the form of: (a)payment of interest, fees (including reasonable legal fees and expenses) and other amounts due under the Pre-Petition Financing Agreements, at the times specified therein, to the Lender, and (b) ongoing payment of the reasonable fees, costs and expenses, including, without limitation, reasonable legal and other professionals' fees and expenses, of the Lender as required under the Pre-Petition Financing Agreements. The Committee shall have the right to contest or object, under Section 506(b) of the Bankruptcy Code, to the payment of interest, fees, costs or expenses to Lender on the basis that the then outstanding Obligations exceed the post-petition value of the Collateral.

*Term Loan A Agent and Term Loan B Agent.* As further adequate protection, Debtors are hereby authorized to provide adequate protection to Term Loan A Agent and the Term Loan B Agent in the form of (i) the ongoing payment of the reasonable fees, costs and expenses of the Term Loan A Agent and the Term Loan B Agent, up to a maximum aggregate monthly payment of $5,000.00, and (ii) reasonable legal and other professionals' fees and expenses of the Term Loan A Agent and Term Loan B Agent, up to a maximum aggregate monthly payment of $30,000.00. Additionally, the Debtors shall continue to provide (a) the Term Loan A Agent and the Term Loan A Lenders with the financial reporting required in 5.01 of the Existing Term Loan A Credit Agreement during the Cases and (b) the Term Loan B Agent and the Term Loan B Lenders with the financial reporting required in 5.01 of the Existing Term Loan B Credit Agreement during the Cases. Notwithstanding the foregoing or anything to the contrary herein, the adequate protection granted herein to Term Loan A Agent, Term Loan A Lenders, Term Loan B Agent and Term Loan B Lenders shall not include any interest or principal in respect of the Term Loan A or Term Loan B or professional fees or expenses other than those described above. Nothing in this Final Order shall be construed to prejudice the right of any party in interest (other than the Debtors), in the event that the liens securing the Pre-Petition Term A Loan Obligations or the Pre-Petition Term B Loan Obligations, as applicable, are invalidated, subordinated or otherwise avoided or the Pre-Petition Term A Loan Obligations or the Pre-Petition Term B Loan Obligations are invalidated, subordinated, avoided or determined to be undersecured, to seek to disgorge such payments or to recharacterize such payments as payments of principal.

**Section 3. *Default; Rights and Remedies; Relief from Stay.***

3.1 *Events of Default.* The occurrence of any of the following events shall constitute an *"Event of Default"* under this Final Order:

a. Any Debtor's failure to perform, in any respect, any of the terms, conditions or covenants or their obligations under this Final Order; or

b. An "Event of Default" under the Loan Agreement or any of the other Financing Agreements (other than, subject to Section 10 of the Ratification Agreement, the Specified Defaults as defined in the Ratification Agreement).

3.2 *Rights and Remedies Upon Event of Default.* Upon the occurrence of and during the continuance of an Event of Default, (a) the Debtors shall be bound by all restrictions, prohibitions and other terms as provided in this Final Order, the Loan Agreement and the other Financing Agreements, and (b) Lender shall be entitled to take any act or exercise any right or remedy (subject to Section 3.4 below (including the notice provisions set forth therein) and the Intercreditor Agreement) as provided in this Final Order or any Financing Agreement, including, without limitation, declaring all Obligations immediately due and payable, accelerating the Obligations, ceasing to extend Loans or provide or arrange for Letter of Credit Accommodations on behalf of Debtors, setting off any Obligations with Collateral or proceeds in Lender's possession, and enforcing any and all rights with respect to the Collateral. Lender shall have no obligation to lend or advance any additional funds to or on behalf of Debtors, or provide any other financial accommodations to Debtors, immediately upon or after the occurrence of an Event of Default or upon the occurrence of any act, event, or condition that, with the giving of notice or the passage of time, or both, would constitute an Event of Default.

3.3 *Expiration of Commitment.* Upon the expiration of the Debtors' or Borrowers' authority to borrow and obtain other credit accommodations from Lender pursuant to the terms of this Final Order and the Financing Agreements (except if such authority shall be extended with the prior written consent of Lender, which consent shall not be implied or construed from any action, inaction or acquiescence by Lender) and after providing notice to the parties set forth in Section 3.4 of this Final Order, unless an Event of Default set forth in Section 3.1 above occurs sooner and the automatic stay has been lifted or modified pursuant to Section 3.4 of this Final Order, all of the Obligations shall immediately become due and payable and Lender shall be automatically and completely relieved from the effect of any stay under Section 362 of the Bankruptcy Code, any other restriction on the enforcement of its liens upon and security interests in the Collateral or any other rights granted to Lender pursuant to the terms and conditions of the Financing Agreements or this Final Order, and Lender shall be and is hereby authorized, in its sole discretion, to take any and all actions and remedies provided to it in this Final Order, the Financing Agreements or applicable law, but subject to the terms of the Intercreditor Agreement, which Lender may deem appropriate and to proceed against and realize upon the Collateral or any other property of the Debtors' Estates.

3.4 *Relief from Automatic Stay.* The automatic stay provisions of Section 362 of the Bankruptcy Code and any other restriction imposed by an order of the Court or applicable law are hereby modified and vacated without further notice, application or order of the Court to the extent necessary to permit Lender to perform any act authorized or permitted under or by virtue of this Final Order or the Financing Agreements, including, without limitation, (a) to implement the post-petition financing arrangements authorized by this Final Order and pursuant to the terms of the Financing Agreements, (b) to take any act to create, validate, evidence, attach or perfect any lien, security interest, right or claim in the Collateral, and (c) to assess, charge, collect, advance, deduct and receive payments with respect to the Obligations, including, without limitation, all interests, fees, costs and expenses permitted under the Financing Agreements, and apply such payments to the Obligations pursuant to the Financing Agreements and this Final Order. In addition to and without limiting the foregoing, upon the occurrence of an Event of Default and after providing ten (10) business days prior written notice (the *"Enforcement Notice"*) to counsel for the Debtors, counsel for the Committee, counsel for the Term Loan A Agent and Term Loan B Agent, and counsel for the Term Loan A Lenders and the Term Loan B Lenders, and the U.S. Trustee, Lender shall be entitled to take any action and exercise all rights and remedies provided to it by this Final Order, the Financing Agreements or applicable law, but subject to the terms of the Intercreditor Agreement, as Lender may deem appropriate in its sole discretion to, among other things, proceed against and realize upon the Collateral or any other assets or properties of Debtors' Estates upon which Lender has been or may hereafter be granted liens and/or security interests to obtain the full repayment and satisfaction of all Obligations (including letters of credit and contingent Obligations); provided, that, (a) in the event relief from an Enforcement Notice is timely sought, in accordance with this Section 3.4, by the Debtors or the Committee (which is granted standing and the authority, without further order of the Court to challenge any such Enforcement Notice on behalf of the Debtors and in the name of the Debtors), Lender shall be stayed from exercising such rights and remedies pending resolution of such objection by Order of this Court and (b) the only permissible basis for contesting, challenging or objecting to an Enforcement Notice shall be to contest the validity of the Event of Default(s) giving rise to such Enforcement Notice. In the event that the automatic stay is modified with respect to the Lender as provided for hereunder, the automatic stay shall also be modified with respect to the Term Loan A Agent, the Term Loan A Lenders, the Term Loan B Agent, and the Term B Lenders to the extent necessary to permit them to participate in any action or litigation initiated by the Lender with respect to the Collateral.

**Section 4. *Representations; Covenants; and Waivers.***

4.1 *Objections to Pre-Petition Obligations.*

(a) For purposes of this Order, the term *"Objection"* shall mean any action (including any adversary proceeding), claim or defense (i) against any Secured Lender arising out of or related to the Pre-Petition Obligations, the Pre-Petition Term Loan A Obligations or the Pre-Petition Term Loan B Obligations of such Secured Lenders, or the pre-petition actions or inactions of any Secured Lender with respect to such pre-petition obligations or claim of any kind or (ii) that seeks to object to, challenge, contest or otherwise invalidate or reduce, whether by setoff, recoupment, counterclaim, deduction, disallowance, disgorgement, recharacterization or otherwise: (A) the existence, validity, allowability, priority, status or amount of the Pre-Petition Obligations, the Pre-Petition Term Loan A Obligations or the Pre-Petition Term Loan B Obligations, (B) the extent, legality, validity, perfection, priority or enforceability of any Secured Lender's pre-petition liens and security interests in the

Pre-Petition Collateral, or (C) Lender's right to apply proceeds of Post-Petition Collateral against Pre-Petition Obligations in satisfaction of Lender's pre-petition liens as provided for in this Final Order.

(b) Any such Objection shall be filed by the Committee, and no other party, within seventy-five (75) calendar days of the date of entry of this Final Order (the *"Objection Period"*). The Objection Period, as to any or all Secured Lenders, may be extended by the Court for cause shown prior to the expiration thereof or with the written consent of the applicable Secured Lender(s); *provided, that,* with respect to the Term A Loan Agent, the Term A Loan Lenders, the Term B Loan Agent and the Term B Loan Lenders, such time limit shall apply solely to Objections related to the items set forth in the foregoing paragraph 4.1 (a), and no such time limit shall apply to any claims relating to the status or conduct of the Term A Loan Lenders and the Term B Loan Lenders in their capacities as shareholders of the Debtors or in any other capacity.

(c) The releases, waivers and acknowledgments made by the Debtors in this Final Order shall not prejudice the rights of the Committee to raise or pursue an Objection in accordance with this Section 4.1. The Committee is granted standing and the authority, without further order of the Court, to file, (i) prior to the expiration of the Objection Period an Objection and (ii) at any time, with respect to the Term A Loan Agent, the Term A Loan Lenders, the Term B Loan Agent and the Term B Loan Lenders, any other claim or cause of action relating to the status or conduct of the Term A Loan Lenders and the Term B Loan Lenders in their capacities as shareholders of the Debtors or in any other capacity. Nothing contained herein is intended to, and nothing contained herein shall, limit the rights of the Committee, or of any other party in interest with requisite standing, to contest or object, under Section 506(b) of the Bankruptcy Code, to the payment of interest, fees, costs or expenses to Lender on the basis that the then outstanding Obligations exceed the post-petition value of the Collateral.

(d) If any such Objection is timely filed and successfully pursued, nothing in this Final Order shall prevent the Court from granting appropriate relief with respect to (i) the Pre-Petition Obligations, the Pre-Petition Term Loan A Obligations and/or the Pre-Petition Term Loan B Obligations with respect to which such Objection was timely filed and successfully pursued and/or (ii) the liens and security interest on the Pre-Petition Collateral of the Secured Lender(s) against whom such Objection was timely filed and successfully pursued.

(e) If no Objection is timely filed, or if an Objection is timely filed but denied, (i) the Pre-Petition Obligations, the Pre-Petition Term Loan A Obligations and/or Pre-Petition Term Loan B Obligations with respect to which an Objection was not timely filed or was timely filed but denied, shall be deemed allowed in full, shall not be subject to any setoff, recoupment, counterclaim, deduction or claim of any kind, and shall not be subject to any further objection or challenge by any party at any time, (ii) the pre-petition liens on and security interests in the Pre-Petition Collateral of the Secured Lender(s) with respect to which an Objection was not timely filed or was timely filed but denied, shall be deemed legal, valid, perfected, enforceable, and non-avoidable for all purposes, and with respect to such Secured Lender, of first and senior priority, subject to only the Permitted Liens and Claims, and (iii) the Secured Lender(s) with respect to which an Objection was not timely filed or was timely filed but denied, in each instance together with its participants and each of their respective agents, officers, directors, employees, attorneys, professionals, successors, and assigns shall be deemed released and discharged from any and all claims and causes of action related to or arising out of the Pre-Petition Financing Agreements, the Pre-Petition Term Loan A Loan Documents, and the Pre-Petition Term Loan B Documents, as applicable, and shall not be subject to any further objection or challenge by any party at any time.

(f) Nothing contained in this Section 4.1 or otherwise shall or shall be deemed or construed to impair, prejudice or waive any rights, claims and protections afforded to Lender in connection with all Loans, Letter of Credit Accommodations and other financial and credit accommodations advanced by Lender to Debtors on or after the Petition Date in reliance on Section 364(e) of the Bankruptcy Code and in accordance with the terms and provisions of this Final Order and the Financing Agreements; *provided, that* all Loans, Letter of Credit Accommodations and other financial and credit accommodations advanced by Lender to Debtors prior to the Petition Date shall remain subject to this Section 4.1.

4.2 *Intentionally omitted.*

~~4.3~~ *Section 506(c) Claims.* No costs or expenses of administration which have or may be incurred in the Cases at any time shall be charged against the Collateral against which Lender holds a first priority lien and security interest pursuant to Section 506(c) of the Bankruptcy Code (or against Lender itself) without the prior written consent of Lender, and no such consent shall be implied from any other action, inaction or acquiescence by Lender; *provided, that,* if the Obligations are repaid and satisfied in full (including cash collateral for all letters of credit and contingent Obligations in accordance with the Financing Agreements), any Collateral existing or arising after the date of such repayment (but not any Collateral or proceeds of Collateral remitted to Lender prior to or in connection with such repayment) shall be subject to Section 506(c). For the avoidance of doubt, neither Term Loan A Lenders nor the Term Loan B Lenders shall have any rights under this Section 4.3, including the right to raise or assert the waiver granted to Lender pursuant to this Section 4.3 as a defense to any claim or cause of action under Section 506(c) of the Bankruptcy Code.

~~4.4~~ *Collateral Rights.* Until all of the Obligations shall have been indefeasibly paid and satisfied in full, upon and after the occurrence of an Event of Default, and subject to Lender obtaining relief from the automatic stay as provided for herein and to the terms of the Intercreditor Agreement, in connection with a liquidation of any of the Collateral, Lender (or any of its employees, agents, consultants, contractors or other professionals) shall have the right, at the sole cost and expense of Debtors, except as may be limited under non-bankruptcy law to: (a) enter upon, occupy and use any real or personal property, fixtures, equipment, leasehold interests or warehouse arrangements owned or leased by Debtors and (b) use any and all trademarks, tradenames, copyrights, licenses, patents or any other similar assets of Debtors, which are owned by or subject to a lien of any third party and which are used by Debtors in their businesses. Lender will be responsible for the payment of any applicable fees, rentals, royalties or other amounts due such lessor, licensor or owner of such property for the period of time that Lender actually uses the equipment or the intellectual property (but in no event for any accrued and unpaid fees, rentals or other amounts due for any period prior to the date that Lender actually occupies or uses such assets or properties).

4.5 *Release.* Subject to the Committee's right to assert an Objection, upon the repayment in full of all Obligations owed Lender by Debtors and termination of the rights and obligations arising under the Financing Agreements or this Final Order (which payment and termination shall be on terms and conditions acceptable to Lender), Lender shall be released from any and all obligations, liabilities, actions, duties, responsibilities and causes of action arising or occurring in connection with or related to the Financing Agreements or this Final Order (including without limitation any obligation or responsibility (whether direct or indirect, absolute or contingent, due or not due, primary or secondary, liquidated or unliquidated) to pay or otherwise fund the Carve-Out Expenses), on terms and conditions acceptable to Lender.

**Section 5. *Other Rights and Obligations.***

5.1 *No Modification or Stay of This Final Order.* Notwithstanding the occurrence of a Subject Event (as defined below), (a) the acts taken by Lender in accordance with this Final Order, and the Post-Petition Obligations incurred or arising prior to Lender's actual receipt of written notice from Debtors expressly describing the occurrence of such Subject Event, shall, in each instance, be governed in all respects by this Final Order, and (b) the acts taken by Lender in accordance with this Final Order, and the liens granted to Lender in the Collateral, and all other rights, remedies, privileges, and benefits in favor of Lender pursuant to this Final Order and the Financing Agreements shall remain valid and in full force and effect to the extent provided for pursuant to Section 364(e) of the Bankruptcy Code. For purposes of this Final Order, the term *"Subject Event"* shall mean the occurrence of any of the following: (i) any stay, modification, amendment, supplement, vacating, revocation or reversal of this Final Order, the Financing Agreements or any term hereunder or thereunder or (ii) the dismissal or conversion of one or more of the Cases. For purposes of this Final Order, the term "appeal", as used in Section 364(e) of the Bankruptcy Code, shall be construed to mean any proceeding for reconsideration, amending, rehearing, or re-evaluating this Final Order by this Court or any other tribunal.

5.2 *Power to Waive Rights; Duties to Third Parties.* Lender shall have the right to waive any of the terms, rights and remedies provided or acknowledged in this Final Order in respect of Lender (the *"Lender Rights"*), and shall have no obligation or duty to any other party with respect to the exercise or enforcement, or failure to exercise or enforce, any Lender Right(s). Any waiver by Lender of any Lender Rights shall not be or constitute a continuing waiver. Any delay in or failure to exercise or enforce any Lender Right shall neither constitute a waiver of such Lender Right, subject Lender to any liability to any other party, nor cause or enable any other party to rely upon or in any way seek to assert as a defense to any obligation owed by the Debtors to Lender.

5.3 *Disposition of Collateral.* Debtors shall not sell, transfer, lease, encumber or otherwise dispose of any portion of the Collateral without, subject to the terms of the Intercreditor Agreement, the prior written consent of each Secured Lender (and no such consent shall be implied, from any other action, inaction or acquiescence by each Secured Lender) and an order of this Court, except for sales of Debtors' Inventory in the ordinary course of their business; *provided, that,* this Section 5.3 shall not be deemed to require the consent of any Secured Lender whose consent is provided in the Intercreditor Agreement. Debtors shall remit to Lender, or cause to be remitted to Lender, all proceeds of the Collateral for application by Lender to the Obligations, in such order and manner as Lender may determine in its discretion, in accordance with the terms of this Final Order, the Loan Agreement and the other Financing Agreements; *provided, that,* in the event Lender receives proceeds of Collateral which, pursuant to the Intercreditor Agreement, Lender is required to turnover or remit to Term Loan A Agent, Term Loan A Lenders, Term Loan B Agent or Term Loan B Lenders (any such proceeds, *"Term Loan Collateral Proceeds"*), (i) Lender shall not remit or turnover such Term Loan Collateral Proceeds to such other Secured Lenders, (ii) Lender shall instead remit and turnover such Term Loan Proceeds to the Debtors or, at Lender's option, to the Court, (iii) any such Term Loan Proceeds turned over or remitted to the Debtors shall be held by the Debtors in a segregated account pending the entry of an Order of this Court authorizing the disposition of such Term Loan Proceeds, (iv) such other Secured Lenders shall have the right to file with this Court a motion seeking such relief with respect to such Term Loan Proceeds as such Secured Lender may determine, including the right to seek the entry of an Order directing the release of any such Term Loan Proceeds to such Secured Lenders for application to the Term Loan A Obligations or Term Loan B Obligations and (v) the Debtors and the Committee reserve the right to contest any such relief or motion sought by such other Secured Lenders pursuant to the foregoing clause (iv)

5.4 *Inventory.* Debtors shall not, without the consent of Lender, (a) enter into any agreement to return any Inventory to any of their creditors for application against any pre-petition indebtedness under any applicable provision of Section 546 of the Bankruptcy Code, or (b) consent to any creditor taking any setoff against any of its pre-petition indebtedness based upon any such return pursuant to Section 553(b)(1) of the Bankruptcy Code or otherwise.

5.5 *Reservation of Rights.* The terms, conditions and provisions of this Final Order are in addition to and without prejudice to the rights of Secured Lenders (and each of them) to pursue any and all rights and remedies under the Bankruptcy Code, the Financing Agreements, the Intercreditor Agreement, the Pre-Petition Loan A Loan Documents, the Pre-Petition Loan B Loan Documents, and or any other applicable agreement or law, including, without limitation, rights to seek adequate protection and/or additional or different adequate protection, to seek relief from the automatic stay, to seek an injunction, to oppose any request for use of cash collateral or granting of any interest in the Collateral or priority in favor of any other party, to object to any sale of assets, and to object to applications for allowance and/or payment of compensation of Professionals or other parties seeking compensation or reimbursement from the Estate.

5.6 *Binding Effect.*

5.6.1 The provisions of this Final Order and the Financing Agreements, the Post-Petition Obligations, Superpriority Claim and any and all rights, remedies, privileges and benefits in favor of Lender, Term Loan A Agent, Term Loan A Lenders, Term Loan B Agent or Term Loan B Lenders provided or acknowledged in this Final Order and any actions taken pursuant thereto, shall be effective immediately upon entry of this Final Order pursuant to Bankruptcy Rules 6004(g) and 7062, shall continue in full force and effect, and shall survive entry of any such other order, including without limitation any order which may be entered confirming any plan of reorganization, converting one or more of the Cases to any other chapter under the Bankruptcy Code, or dismissing one or more of the Cases.

5.6.2 Any order dismissing one or more of the Cases under Section 1112 or otherwise shall be deemed to provide (in accordance with Sections 105 and 349 of the Bankruptcy Code) that (a) the Superpriority Claim and Lender's liens on and security interests in the Collateral shall continue in full force and effect notwithstanding such dismissal until the Obligations are indefeasibly paid and satisfied in full, and (b) this Court shall retain jurisdiction, notwithstanding such dismissal, for the purposes of enforcing the Superpriority Claim and liens in the Collateral.

5.6.3 This Final Order shall be binding upon Debtors, all parties in interest in the Cases and their respective successors and assigns, including any trustee or other fiduciary appointed in the Cases or any subsequently converted bankruptcy case(s) of any Debtor. The Final Order shall also inure to the benefit of each Secured Lender, Debtors, and their respective successors and assigns.

5.7 *Intentionally omitted.*

5.8 *Marshalling.* In no event shall Lender be subject to the equitable doctrine of “marshalling” or any similar doctrine with respect to the Collateral.

5.9 [*Intentionally omitted.*]

5.10 *Term; Termination.* Notwithstanding any provision of this Final Order to the contrary, the term of the financing arrangements among Debtors and Lender authorized by this Final Order may be terminated pursuant to the terms of the Loan Agreement.

5.11 *Limited Effect.* Unless as specifically provided otherwise, in the event of a conflict between the terms and provisions of any of the Financing Agreements and this Final Order, the terms and provisions of this Final Order shall govern, interpreted as most consistent with the terms and provisions of the Financing Agreements.

5.12 *Objections Overruled.* All objections to the entry of this Final Order are, to the extent not withdrawn, hereby overruled.

5.13 *Jurisdiction.* The Bankruptcy Court has and will retain jurisdiction to enforce this Order.

5.14 *Avoidance Actions.* Notwithstanding anything to the contrary herein, no Secured Lender in any capacity as a creditor shall be entitled to any interest in or recovery with respect to Avoidance Actions.

Dated: October 4 th , 2012

/s/ STUART M. BERNSTEIN

UNITED STATES BANKRUPTCY JUDGE

Footnotes

1 The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are: Journal Register Company (8615), Register Company, Inc. (6548), Chanry Communications Ltd. (3704), Pennysaver Home Distributions Corp. (9476), All Home Distribution Inc. (0624), JR East Holdings, LLC (N/A), Journal Register East, Inc. (8039), Journal Company, Inc. (8220), JRC Media, Inc. (4264), Orange Coast Publishing Co. (7866), St. Louis Sun Publishing Co. (1989), Middletown Acquisition Corp. (3035), JiUS, Inc. (3535), Journal Register Supply, Inc. (6546), Northeast Publishing Company, Inc. (6544), Hometown Newspapers, Inc. (8550), The Goodson Holding Company (2437), Acme Newspapers, Inc. (6478), 21st Century Newspapers, Inc. (6233), Morning Star Publishing Company (2543), Heritage Network Incorporated (6777), Independent Newspapers, Inc. (2264), Voice Communications Corp. (0455), Digital First Media Inc. (0431), Great Lakes Media, Inc. (5920), Up North Publications, Inc. (2784), Greater Detroit Newspaper Network, Inc. (4228), Great Northern Publishing, Inc. (0800), and

Saginaw Area Newspapers, Inc. (8444). The mailing address for each of the Debtors is Lower Makefield Corporate Center, 790 Township Road, 3rd Floor, Yardley, PA 19067.

2 Capitalized terms used but not otherwise defined in this Order shall have the respective meanings ascribed thereto in the Existing Loan Agreement, as amended and ratified by the Ratification Agreement.

End of Document

# TAB 11

2010 WL 6826284 (Bkrtcy.S.D.N.Y.) (Trial Order)
United States Bankruptcy Court, S.D. New York.

In re: UNO RESTAURANT HOLDINGS CORPORATION, et al., Debtors.

No. 10-10209 (MG).
February 18, 2010.

Jointly Administered

**Final Order Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364 and 507 (1) Approving Postpetition Financing, (2) Authorizing Use of Cash Collateral, (3) Granting Liens and Providing Superpriority Administrative Expense Status, (4) Granting Adequate Protection, and (5) Modifying Automatic Stay**

Honorable Martin Glenn, United States Bankruptcy Judge.

Chapter 11

THIS MATTER having come before the Court upon the motion (the *"DIP Motion"*) of Uno Restaurant Holdings Corp. ("Uno"), and its direct and indirect subsidiaries (collectively, the "Borrowers"), [1] each as a debtor and debtor in possession (collectively the "Debtors") in the above-captioned chapter 11 cases (collectively, with any successor cases, the "Cases"), pursuant to sections 105, 361, 362, 363, 364(c)(1), 364(c)(2), 364(c)(3), 364(d) and 507 of title 11 of the United States Code, 11 U.S.C. §§ 101 *et seq.* (the *"Bankruptcy Code"),* Rules 2002, 4001 and 9014 of the Federal Rules of Bankruptcy Procedure (the *"Bankruptcy Rules"),* and Rule 4001-2 of the Local Bankruptcy Rules for the Southern District of New York, seeking entry of a final order (this *"Final Order") inter alia:*

(i) authorizing the Debtors to obtain secured, superpriority postpetition financing (the *"DIP Facility"*) pursuant to the terms and conditions of that certain Debtor in Possession Credit Agreement (as may be amended, supplemented, restated, or otherwise modified from time to time, the *"DIP Agreement"*) by and among the Borrowers, Wells Fargo Capital Finance, Inc. as Arranger and Administrative Agent (in such capacity, together with it successors in such capacity, the *"DIP Agent"),* for and on behalf of itself and the other lenders party thereto from time to time (collectively, including the DIP Agent, the *"DIP Lenders"),* substantially in the form of Exhibit A attached to the DIP Motion;

(ii) authorizing the Debtors on a final basis to perform under the DIP Agreement and other related loan documents (collectively with all documents comprising the DIP Facility, the *"DIP Documents"*) and to perform such other acts as may be necessary or desirable in connection with the DIP Documents;

(iii) granting to the DIP Agent and the DIP Lenders allowed superpriority administrative expense claims in each of the Cases and any Successor Cases (as defined herein) for the DIP Facility and all obligations owing thereunder and under the DIP Documents (collectively, and including all "Obligations" as described in the DIP Agreement, the *"DIP* Obligations"), subject to the priorities set forth in paragraph 8 below;

(iv) granting to the DIP Agent, for the benefit of itself and the DIP Lenders automatically perfected security interests in and liens on all of the DIP Collateral (as defined herein), including, without limitation, all property constituting "cash collateral" (as defined in section 363(a) of the Bankruptcy Code, *"Cash Collateral"),* which liens shall be subject to the priorities set forth in paragraph 7 below;

 

(v) authorizing and directing the Debtors to pay the principal, interest, fees, expenses and other amounts payable under each of the DIP Documents as they become due, including, without limitation, letter of credit fees (including issuance and other related charges), closing fees, extension fees, servicing fees, unused line fees, appraisal fees, administrative agent's fees, continuing commitment fees, the fees and disbursements of each DIP Agent's attorneys, advisers, accountants, and other consultants, and the legal expenses of the DIP Lenders, all to the extent provided by and in accordance with the terms of the respective DIP Documents;

(vi) authorizing the Debtors' use of the Cash Collateral of the Prepetition Agent, Prepetition Lenders, Indenture Trustee and Noteholders (each as defined herein);

(vii) providing adequate protection to the Prepetition Agent and Prepetition Lenders (to the extent any Prepetition Obligations remain outstanding), and the Indenture Trustee and Noteholders for any Diminution in Value (as defined herein) of their respective interests in the Prepetition Collateral (as defined herein), including the Cash Collateral; and

(viii) vacating and modifying the automatic stay imposed by section 362 of the Bankruptcy Code to the extent necessary to implement and effectuate the terms and provisions of the DIP Documents and this Final Order.

The Court having considered the DIP Motion, the Affidavit of Louie Psallidas Pursuant to Local Bankruptcy Rule 1007-2 in Support of First Day Motions and Applications (the *"Psallidas Affidavit"),* the exhibits attached thereto, the DIP Documents, and the evidence submitted or adduced and the arguments of counsel made at the interim hearing held on January 20, 2010 (the *"Interim Hearing"),* and the final hearing held on February 10, 2010 (the *"Final Hearing");* and the Court having entered on January 20, 2010 an interim order authorizing funding on an interim basis and granting adequate protection on account of the interests of certain holders of liens on the property of the estates on which liens are to be granted; and adequate notice of the Final Hearing having been provided accordance with Bankruptcy Rules 2002, 4001(b), (c) and (d), and 9014; and the Final Hearing to consider the relief requested in the DIP Motion having been held and concluded; and all objections, if any, to the entry of this Final Order approving the DIP Motion and the DIP Documents having been withdrawn, resolved or overruled by the Court; and after due deliberation and consideration, and for good and sufficient cause appearing therefor;

BASED UPON THE RECORD ESTABLISHED AT THE INTERIM AND FINAL HEARINGS BY THE DEBTORS, THE COURT HEREBY MAKES THE FOLLOWING FINDINGS OF FACT AND CONCLUSIONS OF LAW:

A. *Petition Date:* On January 20, 2010 (the *"Petition Date"),* each of the Debtors filed a separate voluntary petition under chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York commencing these Cases (the "Court").

B. *Debtors in Possession.* The Debtors are continuing in the management and operation of their businesses and properties as debtors in possession pursuant to sections 1107 and 1108 of the Bankruptcy Code. No trustee or examiner has been appointed in these Cases.

C. *Jurisdiction and Venue.* This Court has jurisdiction, pursuant to 28 U.S.C. §§ 157(b) and 1334, over these proceedings, and over the persons and property affected hereby. Consideration of the DIP Motion constitutes a core proceeding under 28 U.S.C. § 157(b)(2). Venue for the Cases and proceedings on the DIP Motion is proper in this district pursuant to 28 U.S.C. §§ 1408 and 1409.

D. *Statutory Committee.* On January 27, 2010, the United States Trustee (the *"U.S.* Trustee") appointed an official committee of unsecured creditors in these Cases pursuant to section 1102 of the Bankruptcy Code (the *"Statutory Committee").* The Statutory Committee consists of the following members: (i) Circle Associates, (ii) Angelo Luppino, Jr. and Nancy Luppino, (iii) Amelia Island Plantation, (iv) NSTAR Electric Company and NSTAR Gas Company, and (v) Stone Ridge Construction Services.

  

E. *Interim Order.* Based upon the DIP Motion, the Psallidas Affidavit, the DIP Documents and the evidence submitted by the Debtors at the Interim Hearing, the Court approved the Debtors' entry into and performance under the DIP Documents and DIP Facility, and on January 20, 2010, entered that certain Interim Order Pursuant to 11 U.S. C. §§ 105, 361, 362, 363, 364 and 507 (1) Approving Postpetition Financing, (2) Authorizing Use of Cash Collateral, (3) Granting Liens and Providing Superpriority Administrative Expense Status, (4) Granting Adequate Protection, (5) Modifying Automatic Stay, and (6) Scheduling a Final Hearing (the "Interim *Order").* Pursuant to the Interim Order and Bankruptcy Rule 4001, the Debtors were authorized, among other things, to incur secured borrowings from the DIP Lenders pursuant to the terms of the DIP Documents and the Interim Order pending the Final Hearing on the DIP Motion. Pursuant to the Interim Order, the Final Hearing was scheduled for February 10, 2010.

F. *Debtors' Stipulations.* After consultation with their attorneys and financial advisors, and without prejudice to the rights of parties in interest as set forth in paragraph 31 herein, the Debtors (on behalf of and for themselves and their estates) admit, stipulate, acknowledge and agree that (collectively, paragraphs F(i) through F(viii) below are referred to herein as the *"Debtors' Stipulations"):*

(i) *Prepetition Facility:* Pursuant to that certain Credit Agreement dated as of February 22, 2005 (as amended, supplemented, restated or otherwise modified prior to the Petition Date, the *"Prepetition Credit Agreement,"* and together with all other loan and security documents executed in connection therewith, the *"Prepetition Credit Documents"),* among the Borrowers, Wells Fargo Foothill, Inc. as Arranger and Administrative Agent (the *"Prepetition* Agent"), and the lenders that are parties thereto from time to time (collectively, together with the Prepetition Agent, the *"Prepetition Lenders"),* the Prepetition Lenders provided credit and letter of credit facilities to the Borrowers and provided other financial accommodations to or for the benefit of the Borrowers (collectively, the *"Prepetition Facility").*

(ii) *Prepetition Obligations:* The Prepetition Facility provided the Borrowers with (a) up to $32,000,000 in aggregate maximum principal amount of revolving commitments, including letter of credit and swingline loan commitments, with a sublimit for letters of credit of $20,000,000, and (b) up to $14,250,000 in aggregate principal amount of term loan commitments. As of the Petition Date, the outstanding principal amount of all loans under the Prepetition Credit Agreement was $33,900,000, and the face amount of issued and outstanding letters of credit was $9,775,000 (collectively, together with any amounts paid, incurred or accrued prior to the Petition Date in accordance with the Prepetition Credit Documents, principal, accrued and unpaid interest, any fees, expenses, and disbursements (including, without limitation, attorneys' fees, related expenses and disbursements), indemnification obligations and other charges of whatever nature, whether or not contingent, whenever arising, due or owing in respect thereof, the *"Prepetition Obligations").* The Prepetition Obligations are guaranteed by Uno Holdings II, LLC and other affiliates of the Borrowers party to that certain General Continuing Guaranty dated February 22, 2005 (as amended, supplemented, restated, or otherwise modified prior to the Petition Date).

(iii) *Prepetition Indenture Obligations:* Pursuant to that certain Indenture dated as of February 22, 2005 (as amended, supplemented, restated or otherwise modified prior to the Petition Date, the "Indenture," and together with all other loan and security documents executed in connection therewith, the *"Indenture Documents"),* among Uno, as issuer, certain of Uno's domestic subsidiaries and Uno Holdings II, LLC as guarantors, and U.S. Bank National Association as collateral agent and trustee (in such capacities, the *"Indenture Trustee"),* Uno incurred indebtedness to certain holders (collectively, the *"Noteholders"*) for certain notes issued pursuant to the Indenture in an initial aggregate principal amount at maturity of $142,000,000 (the "Notes," and together with accrued and unpaid interest, any fees, expenses, and disbursements (including, without limitation, attorneys' fees, related expenses and disbursements), indemnification obligations and other charges of whatever nature, whether or not contingent, whenever rising, due or owing in connection with the Indenture, the *"Indenture* Obligations").

(iv) *Prepetition Liens and Prepetition Collateral.* As more fully set forth in the Prepetition Credit Documents and Indenture Documents, prior to the Petition Date, the Borrowers granted security interests in and liens on, among other things, substantially all assets of the Borrowers (collectively, the *"Prepetition Collateral"*) to: (a) the Prepetition Agent, for itself and the Prepetition

Lenders (the *"Prepetition Facility Liens");* and (b) the Indenture Trustee, for the benefit of the Noteholders (the *"Indenture Liens",* and together with the Prepetition Facility Liens, the *"Prepetition* Liens"). The Indenture Liens on the Prepetition Collateral are subordinate to the Prepetition Facility Liens on the Prepetition Collateral in accordance with the Intercreditor Agreement (as defined herein).

(v) *Priority of the Prepetition Liens; Intercreditor Agreement.* The Debtors, Prepetition Agent, Indenture Trustee and the informal group of holders of the Debtors' 10% senior secured notes (the *"Noteholder Group"*) stipulate, acknowledge and agree that the Prepetition Agent and Indenture Trustee entered into that certain Intercreditor and Lien Subordination Agreement dated February 22, 2005 (as amended, supplemented or modified prior to the Petition Date, the *"Intercreditor Agreement"*) to govern the respective rights, interests, obligations, priority, and the positions of the Prepetition Agent, on behalf of itself and the Prepetition Lenders, and Indenture Trustee, on behalf of itself and the Noteholders, with respect to the assets and properties of the Borrowers and other obligors, which Intercreditor Agreement remains in full force and effect and binding on the parties thereto.

(vi) *Validity, Perfection and Priority of Prepetition Liens, Prepetition Obligations and Indenture Obligations.* Subject to the provisions of paragraph 31 of this Final Order, the Debtors (for themselves and their estates), the Prepetition Agent, for itself and the Prepetition Lenders, and the Indenture Trustee, for itself and the Noteholders, acknowledge and agree that: (a) as of the Petition Date, the Prepetition Liens on the Prepetition Collateral were valid, binding, enforceable, non-avoidable and properly perfected; (b) as of the Petition Date, the Prepetition Facility Liens were senior in priority over any and all other liens on the Prepetition Collateral, subject only to certain liens otherwise permitted by the Prepetition Credit Documents (to the extent any such permitted liens were valid, properly perfected, non-avoidable and senior in priority to the Prepetition Facility Liens as of the Petition Date, the *"Permitted Prior Liens*"); [2] (c) as of the Petition Date, the Indenture Liens were junior and subordinate to the Prepetition Facility Liens and Permitted Prior Liens, and otherwise had priority over any and all other liens on the Prepetition Collateral; (d) the Prepetition Obligations and Indenture Obligations constitute legal, valid, binding, and non-avoidable obligations of the Debtors; (e) no offsets, challenges, objections, defenses, claims or counterclaims of any kind or nature to any of the Prepetition Facility Liens, Prepetition Obligations, Indenture Liens or Indenture Obligations exist, and no portion of the Prepetition Facility Liens, Prepetition Obligations, Indenture Liens or Indenture Obligations is subject to any challenge or defense including, without limitation, avoidance, disallowance, disgorgement, recharacterization, or subordination (whether equitable or otherwise, provided that as set forth in the Intercreditor Agreement, the Indenture Liens are subordinated to the Prepetition Liens) pursuant to the Bankruptcy Code or applicable non-bankruptcy law; (f) the Debtors and their estates have no claims, objections, challenges, causes of actions, and/or choses in action, including without limitation, avoidance claims under chapter 5 of the Bankruptcy Code, against any of the Prepetition Agent, Prepetition Lenders, Indenture Trustee, Noteholders or any of their respective affiliates, agents, attorneys, advisors, professionals, officers, directors and employees; (g) as of the Petition Date, the value of the Prepetition Collateral securing the Prepetition Obligations exceeded the amount of those obligations, and accordingly the Prepetition Obligations are allowed secured claims within the meaning of section 506 of the Bankruptcy Code, in a principal amount (and including the face amount of issued and outstanding letters of credit) of not less than $43,675,000, together with accrued and unpaid interest, fees (including, without limitation, attorneys' fees and related expenses), and any and all other charges of whatever nature owing in respect of such Prepetition Obligations; and (h) any payments made on account of the Prepetition Obligations to or for the benefit of the Prepetition Agent or the Prepetition Lenders prior to the Petition Date were on account of amounts in respect of which the Prepetition Agent and the Prepetition Lenders were oversecured, were payments out of the Prepetition Collateral, and such payments did not diminish any property otherwise available for distribution to unsecured creditors.

(vii) *Cash Collateral.* The Debtors represent that all of the Debtors' cash, including the cash in their deposit accounts, wherever located, whether as original collateral or proceeds of other Prepetition Collateral, constitute the Cash Collateral of the Prepetition Agent, Prepetition Lenders, Indenture Trustee and Noteholders.

(viii) *Default by the Debtors.* The Debtors acknowledge and stipulate that the Debtors are in default of their debts and obligations under the Prepetition Credit Documents and the Indenture Documents.

  

***G. Findings Regarding the Postpetition Financing.***

(i) *Need for Postpetition Financing and Use of Cash Collateral.* Since the Petition Date, the Debtors' need to obtain credit pursuant to the DIP Facility and to use Cash Collateral has been and continues to be immediate and critical in order to enable the Debtors to continue operations and to administer and preserve the value of their estates. The ability of the Debtors to finance their operations, maintain business relationships with their vendors, suppliers and customers, to pay their employees, and to otherwise finance their operations has required and continues to require the availability of working capital from the DIP Facility and the use of Cash Collateral, the absence of either of which would immediately and irreparably harm the Debtors, their estates, their creditors and equity holders, and the possibility for a successful reorganization. The Debtors have not had and do not have sufficient available sources of working capital and financing to operate their businesses or maintain their properties in the ordinary course of business without the DIP Facility and authorized use of Cash Collateral.

(ii) *No Credit Available on More Favorable Terms.* Given their current financial condition, financing arrangements, and capital structure, the Debtors have been unable to obtain financing from sources other than the DIP Lenders on terms more favorable than the DIP Facility. The Debtors have been unable to obtain unsecured credit allowable under Bankruptcy Code section 503(b)(1) as an administrative expense. The Debtors have also been unable to obtain credit: (a) having priority over that of administrative expenses of the kind specified in sections 503(b), 507(a) and 507(b) of the Bankruptcy Code; (b) secured by a lien on property of the Debtors and their estates that is not otherwise subject to a lien; or (c) secured solely by a junior lien on property of the Debtors and their estates that is subject to a lien. Financing on a postpetition basis is not otherwise available without granting the DIP Agent, for the benefit of itself and the DIP Lenders, (1) perfected security interests in and liens on (each as provided herein) all of the Debtors' existing and after-acquired assets with the priorities set forth in paragraph 7 hereof, (2) superpriority claims with the priorities set forth in paragraph 8, and (3) the other protections set forth in this Final Order.

(iii) *Priming of the Prepetition Facility Liens and Indenture Liens.* The priming of the Prepetition Facility Liens and Indenture Liens on the Prepetition Collateral pursuant to section 364(d) of the Bankruptcy Code, as further described below, enabled the Debtors to obtain the DIP Facility and to continue to operate their businesses for the benefit of their estates and creditors. The Prepetition Agent and Prepetition Lenders consent, and the Indenture Trustee and Noteholders consent or are deemed to consent to such priming liens and are entitled to receive adequate protection as set forth in this Final Order, pursuant to sections 361, 363 and 364 of the Bankruptcy Code, for any diminution in the value of their interests in the Prepetition Collateral (including Cash Collateral) resulting from, among other things, the subordination to the Carve Out (as defined herein) and to the DIP Liens, the Debtors' use, sale or lease of such Prepetition Collateral, and the imposition of the automatic stay (collectively, and solely to the extent of any such diminution in value, the *"Diminution in* Value").

(iv) *Use of Proceeds of the DIP Facilities; Payment of Prepetition Obligations.* As a condition to the entry into the DIP Agreement, the extension of credit under the DIP Facility and the agreement for the use of Cash Collateral, the DIP Agent and DIP Lenders required, and the Debtors agreed that proceeds of the DIP Facility shall be used, in each case in a manner consistent with the terms and conditions of the DIP Documents, including any covenant (the *"Budget Compliance Covenant"*) contained therein pertaining to compliance with the Budget (as defined in the DIP Documents and as the same may be modified from time to time in accordance with the consents required under the DIP Documents), solely for (a) payment in full of the Prepetition Obligations, (b) working capital, letters of credit, and other general corporate purposes, (c) permitted payment of costs of administration of the Cases (subject to the limitations of the Carve Out (as defined herein)), (d) payment of fees and expenses due under the DIP Facility, (e) payment of any authorized Adequate Protection Payments, and (f) payment of such prepetition expenses, in addition to the Prepetition Obligations permitted to be so paid in accordance with the consents required under the DIP Documents, and as approved by the Court. Payment of the Prepetition Obligations in accordance with the Interim Order, and the ratification and confirmation of such payment pursuant to this Final Order, was and is necessary as the DIP Agent and DIP Lenders will not otherwise consent to providing the DIP Facility and extending credit to the Debtors thereunder, and the Prepetition Agent, Prepetition Lenders, Indenture Trustee and Noteholders will not otherwise consent to the use of their Cash Collateral and other Prepetition Collateral or the subordination of their liens to the DIP Liens and Carve Out. Such payment will not prejudice the Debtors or their estates, because payment of such amounts is on account of the Prepetition Agent and the Prepetition Lenders being oversecured and remains subject to the rights of parties in interest under paragraph 31 herein.

(v) *Committee Objection Resolved.* On February 4, 2010, the Committee filed an objection to the DIP Motion and entry of this Final Order (the *"Committee Objection").* On February 8, 2010, each of the Debtors, the Noteholder Group, the Prepetition Agent and the DIP Agent filed a reply to the Committee Objection, and the Indenture Trustee filed a joinder to the reply of the Noteholder Group. The Committee Objection has been resolved by agreement of the parties, as read into the record at the Final Hearing, and has been withdrawn.

H. *Application of Proceeds of Collateral.* As a condition to the entry into the DIP Documents, the extension of credit under the DIP Facility and the authorization to use Cash Collateral and other Prepetition Collateral, the Debtors agreed that the Debtors shall apply the proceeds of DIP Collateral as set forth in the DIP Documents.

*I. Adequate Protection.* The Prepetition Agent, for the benefit of itself and the Prepetition Lenders (to the extent any Prepetition Obligations remain outstanding), and the Indenture Trustee, for the benefit of itself and the Noteholders, are each entitled to receive adequate protection on account of their respective interests in the Prepetition Collateral pursuant to sections 361, 362, 363 and 364 of the Bankruptcy Code to the extent of any Diminution in Value of their respective interests in the Prepetition Collateral (including the Cash Collateral). Pursuant to sections 361, 363, 364 and 507(b), as adequate protection: (i) the Prepetition Agent, for the benefit of itself and the Prepetition Lenders, will receive (a) adequate protection liens and superpriority claims, as more fully set forth in paragraphs 12 and 13 herein, (b) current payments of interest, fees and other amounts due under the Prepetition Credit Documents as more fully set forth in paragraph 14 herein and subject to footnote 5 hereof, and (c) ongoing payment of the reasonable fees, costs and expenses, including, without limitation, legal fees and expenses, of the Prepetition Agent and Prepetition Lenders as more fully set forth in paragraph 14 herein; and (ii) the Indenture Trustee, for the benefit of itself and the Noteholders, will receive (a) adequate protection liens and superpriority claims, as more fully set forth in paragraphs 12 and 13 herein, (b) reimbursement of the reasonable fees and expenses of Akin Gump Strauss Hauer & Feld LLP ("Akin Gump"), counsel to the Noteholder Group, as more fully set forth in paragraph 14, and (c) reimbursement of the all costs and expenses of the Indenture Trustee (including attorneys' and consultant's fees), as more fully set forth in paragraph 14 herein.

J. *Interim Borrowing.* After the Interim Hearing, and pursuant to the Interim Order, the Court authorized, among other things (i) $27 million under the Term Loan (as defined in the DIP Documents) and (ii) up to an aggregate principal amount of $11.9 million at any one time outstanding, including a sublimit for letters of credit up to $20 million under the Revolver Commitment (as defined in the DIP Documents) (together, the *"Interim Financing").* Based upon the record of the Interim Hearing, the Court authorized and empowered the Debtors to execute and deliver the DIP Documents and authorized, empowered and directed the Debtors after execution to perform all of the DIP Obligations in accordance with the terms of the Interim Order and DIP Documents, including, without limitation the payment of fees, expenses and other amounts described in the DIP Documents as such became due. On January 21, 2010, the DIP Documents were executed, and the Borrowers were authorized to borrow on the terms and conditions set forth in the DIP Documents and the Interim Order.

K. *Sections 506(c) and 552(b).* In light of (i) the DIP Agent's and DIP Lenders' agreement to subordinate their liens and superpriority claims to the Carve Out and to the current payment of administrative expenses of the Debtors' estates in accordance with the Budget and Budget Compliance Covenant; (ii) the Prepetition Agent's and Prepetition Lenders' agreement to subordinate their liens and superpriority claims to the Carve Out, DIP Liens and DIP Superpriority Claims; (iii) the Indenture Trustee's and Noteholders' agreement to subordinate their liens and superpriority claims to the Carve Out, DIP Liens, DIP Superpriority Claims, Credit Facility Adequate Protection Liens and Credit Facility Superpriority Claims (each capitalized term as defined herein), each of the DIP Agent, DIP Lenders, Prepetition Agent, Prepetition Lenders, Indenture Trustee and Noteholders are entitled to a waiver of the provisions of section 506(c) of the Bankruptcy Code. The Debtors, Committee, DIP Agent, DIP Lenders, Prepetition Agent, Prepetition Lenders, Indenture Trustee and Noteholders agree that they shall not assert the "equities of the case" exception under section 552(b) of the Bankruptcy Code with respect to proceeds, product, offspring or profits of any of the Prepetition Collateral.

  

**L. *Good Faith of the DIP Agent and the DIP Lenders.***

(i) *Willingness to Provide Financing.* The DIP Lenders each have indicated a willingness to provide financing to the Debtors subject to: (a) the entry of the Interim Order and this Final Order; (b) approval of the terms and conditions of the DIP Facility and the DIP Documents; and (c) entry of findings by this Court that such financing is essential to the Debtors' estates, that the DIP Agent and DIP Lenders are extending credit to the Debtors pursuant to the DIP Documents in good faith, and that the DIP Agent's and DIP Lenders' claims, superpriority claims, security interests, liens, rights, and other protections granted pursuant to the Interim Order, this Final Order and the DIP Documents will have the protections provided in section 364(e) of the Bankruptcy Code and will not be affected by any subsequent reversal, modification, vacatur, amendment, reargument or reconsideration of the Interim Order, this Final Order, or any other order.

(ii) *Business Judgment and Good Faith Pursuant to Section 364(e).* The terms and conditions of the DIP Facility and the DIP Documents, and the fees paid and to be paid thereunder, are fair, reasonable, and the best available to the Debtors under the circumstances, reflect the Debtors' exercise of prudent business judgment consistent with their fiduciary duties, and are supported by reasonably equivalent value and consideration. The DIP Facility and the use of Cash Collateral were negotiated in good faith and at arms' length among the Debtors, DIP Agent, DIP Lenders, Prepetition Agent, Prepetition Lenders, Indenture Trustee and Noteholder Group. Use of Cash Collateral and all extensions of credit under the DIP Facility, whether made prior or subsequent to entry of this Final Order, shall be deemed to have been so allowed, advanced, made, used or extended in good faith, and for valid business purposes and uses within the meaning of section 364(e) of the Bankruptcy Code. Accordingly, the DIP Agent and DIP Lenders are entitled to the protection and benefits of section 364(e) of the Bankruptcy Code and this Final Order and will not be affected by any subsequent reversal, modification, vacatur, amendment, reargument or reconsideration of the Interim Order, this Final Order, or any other order.

M. *Notice.* Notice of the Final Hearing and the relief requested in the DIP Motion has been provided by the Debtors in accordance with the Interim Order, whether by facsimile, email, overnight courier or hand delivery, to certain parties in interest, including: (i) the U.S. Trustee; (ii) the Securities and Exchange Commission; (iii) the Internal Revenue Service; (iv) the parties included on the Debtors' list of the thirty (30) largest unsecured creditors; (v) counsel to the Prepetition Agent for itself and for the Prepetition Lenders; (vi) the Indenture Trustee for itself and for the Noteholders; and (vii) counsel for the Noteholder Group. Such notice is good and sufficient to permit the relief set forth in this Final Order, and no other or further notice is or shall be required.

Based upon the foregoing findings and conclusions, the DIP Motion and the record before the Court with respect to the DIP Motion, and good and sufficient cause appearing therefor,

IT IS HEREBY ORDERED that:

1. *Financing Approved.* The DIP Motion is granted on a final basis as set forth herein, the DIP Facility is authorized and approved, and the use of Cash Collateral is authorized, subject to the terms and conditions set forth in this Final Order.

2. *Objections Resolved or Overruled.* All objections to the DIP Motion and entry of this Final Order, to the extent not withdrawn or resolved, are hereby overruled.

***DIP Facility Authorization***

3. *Ratification of the Interim Order and Authorization of the DIP Financing and DIP* Documents. The terms of the Interim Order are hereby ratified and confirmed, except to the extent amended or modified by this Final Order, and all borrowings and payments made under the Interim Order are ratified and confirmed on a final basis and shall be deemed made in accordance with and pursuant to this Final Order. The DIP Documents are hereby approved on a final basis. The Debtors are expressly

  

and immediately authorized and empowered, on a final basis, to incur and to perform the DIP Obligations in accordance with, and subject to, the terms of this Final Order and the DIP Documents and, to the extent applicable, execute and deliver any and all additional instruments and documents which may be required or necessary for the performance by the Debtors under the DIP Facility and the creation and perfection of the DIP Liens (as defined herein) described in and provided for by this Final Order and the DIP Documents. The Debtors are authorized and directed on a final basis to pay the principal, interest, reasonable fees, out-of-pocket expenses and other amounts described in the DIP Documents as such become due and without need to obtain further Court approval, all to the extent provided in the DIP Documents, including, without limitation, closing fees, letter of credit fees (including issuance, fronting, and other related charges), unused revolver fee, servicing fees, appraisal fees, administrative agent's fees, the fees and disbursements of the DIP Agent's and DIP Lenders' attorneys, advisers, accountants, and other consultants.[3] All collections and proceeds, whether from ordinary course collections, asset sales, debt or equity issuances, insurance recoveries, condemnations or otherwise, will be deposited and applied as required by this Final Order and the DIP Documents. The DIP Documents evidence the valid and binding obligations of the Debtors, which obligations shall be enforceable against each of the Debtors and their estates in accordance with the terms of the DIP Documents.

4. *Authorization to Borrow.* Until the earlier of (a) the Maturity Date (as defined in the DIP Agreement) and (b) the termination of obligations under the DIP Documents by the DIP Agent upon the occurrence and during the continuation of an Event of Default (as defined herein) (such earlier date, the *"Commitment Termination Date"),* and subject to the terms, conditions, limitations on availability and reserves set forth in the DIP Documents, DIP Facility, and this Final Order, the Debtors are authorized on a final basis to request extensions of credit under the DIP Facility (in the form of loans and letters of credit) of (i) $27 million under the Term Loan (as defined in the DIP Documents, and inclusive of amounts previously extended and outstanding) and (ii) up to an aggregate principal amount of $25 million at any one time outstanding, including a sublimit for letters of credit up to $20 million, under the Revolver Commitment (as defined in the DIP Documents, and inclusive of amounts previously extended and outstanding). All letters of credit outstanding under the Prepetition Facility and Prepetition Facility Documents shall be deemed issued and outstanding under the DIP Facility and DIP Documents as of the Petition Date.

5. *DIP Obligations.* The DIP Documents and this Final Order shall constitute and evidence the validity and binding effect of the Debtors' DIP Obligations, which DIP Obligations shall be enforceable against the Debtors, their estates and any successors thereto, including without limitation, any trustee or other estate representative appointed in the Cases, or any case under chapter 7 of the Bankruptcy Code upon the conversion of any of the Cases, or in any other proceedings superseding or related to any of the foregoing (collectively, *"Successor* Cases"). Upon entry of this Final Order, the DIP Obligations will include all loans, letter of credit reimbursement obligations, and any other indebtedness or obligations, contingent or absolute, which may now or from time to time be owing by any of the Debtors to the DIP Agent or DIP Lenders under the DIP Documents and whether borrowed under the terms of the Interim Order or this Final Order, including, without limitation, all principal, accrued interest, costs, fees, expenses and other amounts owed pursuant to the DIP Documents. The DIP Obligations shall be due and payable, without notice or demand, and the use of Cash Collateral shall automatically cease on the Commitment Termination Date, except as provided in paragraph 11 herein.

6. *DIP Liens and DIP Collateral.* Effective immediately upon the execution of the Interim Order, pursuant to sections 361, 362, 364(c)(2), 364(c)(3), and 364(d) of the Bankruptcy Code, the DIP Agent was granted, for the benefit of itself and the DIP Lenders (and such grant is hereby ratified, confirmed and approved on a final basis), continuing, valid, binding, enforceable, non-avoidable and automatically and properly perfected postpetition security interests in and liens on (the *"DIP Liens"*) any and all presently owned and hereafter acquired personal property, real property and other assets of the Debtors, whether owned or consigned by or to, or leased from or to the Debtors, including, without limitation, the following (collectively, the "DIP *Collateral*")[4]: all (i) Prepetition Collateral; (ii) Accounts; (ii) Books; (iii) Chattel Paper; (iv) Deposit Accounts, (v) Equipment and fixtures, (vi) General Intangibles, (vii) Inventory, (viii) Investment Related Property, (ix) Negotiable Collateral, (x) Supporting Obligations, (xi) Commercial Tort Claims, (xii) money, cash and Cash Equivalents, (xiii) proceeds of all leases and leasehold interests (*provided, however,* that the DIP Collateral shall not include any liens directly on any leases or leasehold interests), (xiv) owned Real Property, (xv) unencumbered assets, including proceeds of any and all lawsuits or causes of action,

 

(xvi) all bankruptcy avoidance actions or claims arising under chapter 5 of the Bankruptcy Code and the proceeds thereof; (xvii) Patent Collateral; (xviii) Trademark Collateral; (xix) Copyright Collateral; and (xx) Proceeds.

7. *DIP Lien Priority.* The DIP Liens securing the DIP Obligations shall be junior to the (a) Carve Out, and (b) Permitted Prior Liens, and shall otherwise be senior in priority and superior to any security, mortgage, collateral interest, lien or claim on or to any of the DIP Collateral. Other than as set forth herein, the DIP Liens shall not be made subject to *or pari passu* with any lien or security interest heretofore or hereinafter granted in the Cases or any Successor Cases. The DIP Liens shall be valid and enforceable against any trustee or other estate representative appointed in the Cases or any Successor Cases, upon the conversion of any of the Cases to a case under chapter 7 of the Bankruptcy Code (or in any other Successor Case), and/or upon the dismissal of any of the Cases or Successor Cases. The DIP Liens shall not be subject to sections 506(c), 510, 549, or 550 of the Bankruptcy Code. No lien or interest avoided and preserved for the benefit of any estate pursuant to section 551 of the Bankruptcy Code shall be *made pari passu* with or senior to the DIP Liens.

8. *DIP Superpriority Claims.* Effective immediately upon execution of the Interim Order, the DIP Agent and DIP Lenders were granted (and such grant is hereby ratified, confirmed and approved on a final basis), pursuant to section 364(c)(1) of the Bankruptcy Code, an allowed superpriority administrative expense claim in each of the Cases and any Successor Cases (collectively, the *"DIP Superpriority Claims"*) for all DIP Obligations. The DIP Superpriority Claims shall be subordinate only to the Carve Out, and shall (a) otherwise have priority over any and all administrative expenses and unsecured claims against the Debtors or their estates in any of the Cases and any Successor Cases, at any time existing or arising, of any kind or nature whatsoever, including, without limitation, administrative expenses of the kinds specified in or ordered pursuant to Bankruptcy Code sections 105, 326, 328, 330, 331, 365, 503(a), 503(b), 506(c), 507(a), 507(b) (except as set forth herein), 546(c), 546(d), 726 (to the extent permitted by law), 1113 and 1114, and any other provision of the Bankruptcy Code, except as set forth herein, and (b) at all times be senior to the rights of the Debtors and their estates, and any successor trustee or other estate representative to the extent permitted by law. The DIP Superpriority Claim shall extend to avoidance actions or claims arising under chapter 5 of the Bankruptcy Code and the proceeds thereof.

9. *No Obligation to Extend Credit.* None of the DIP Agent or DIP Lenders shall have any obligation to make any loan or advance under the DIP Documents, or to issue, amend, extend or renew any letters of credit issued under or deemed issued under the DIP Documents, unless all of the conditions precedent to the making of such extension of credit or the issuance of such letter of credit under the applicable DIP Documents and this Final Order have been satisfied in full or waived by the DIP Agent and the DIP Lenders, each in its sole discretion.

10. *Use of DIP Facility Proceeds; Payment of Prepetition Obligations.* From and after the Petition Date, the Debtors shall use advances of credit under the DIP Facility only for the purposes specifically set forth in this Final Order, the DIP Documents and in compliance with the Budget Compliance Covenant. Notwithstanding any first-day orders entered authorizing the Debtors to pay any prepetition or other expenses, all such payments shall be made in accordance with the Budget and Budget Compliance Covenant. A copy of the Budget is attached to this Final Order as Exhibit 1. Immediately upon the Closing Date (as defined in the DIP Documents), the Debtors were authorized and directed to draw Interim Financing under the DIP Facility to repay in full all outstanding Prepetition Obligations, which payment is hereby ratified, confirmed and approved on a final basis. The payment of the Prepetition Obligations shall be subject to the rights of parties in interest set forth in paragraph 31 of this Final Order, *provided* that upon expiration of the Challenge Period (as defined herein), the Debtors' payment of the Prepetition Obligations shall be deemed to be indefeasible, final and not subject to challenge.

***Authorization to Use Cash Collateral and Adequate Protection***

11. *Authorization to Use Cash Collateral.* Subject to the terms and conditions of this Final Order and the DIP Documents, and in accordance with the Budget, the Debtors are authorized to use Cash Collateral until the Termination Declaration Date (as defined herein); *provided, however,* that during the five (5) days after the Termination Declaration Date, the Debtors may use Cash Collateral in accordance with the terms and provisions of the Budget solely to meet payroll and to pay expenses critical

to the preservation of the Debtors and their estates with the prior written consents required under the DIP Documents. Nothing in this Final Order shall authorize the disposition of any assets of the Debtors or their estates outside the ordinary course of business, or any Debtor's use of any Cash Collateral or other proceeds resulting therefrom, except as permitted in this Final Order, the DIP Facility and/or the DIP Documents, and in accordance with the Budget.

12. *Adequate Protection Liens.*

(a) *Credit Facility Adequate Protection Liens.* Effective immediately upon execution of the Interim Order, and pursuant to sections 361, 363(e) and 364(d) of the Bankruptcy Code, as adequate protection of the interests of the Prepetition Agent and Prepetition Lenders in the Prepetition Collateral (to the extent any Prepetition Obligations remain outstanding) against any Diminution in Value of such interests in the Prepetition Collateral, the Debtors were authorized to grant and have granted to the Prepetition Agent, for the benefit of itself and the Prepetition Lenders (and such grant is hereby ratified, confirmed and approved on a final basis), continuing valid, binding, enforceable, non-avoidable and automatically perfected postpetition security interests in and liens on the DIP Collateral (the *"Credit Facility Adequate* Protection Liens").

(b) *Indenture Adequate Protection Liens.* Effective immediately upon execution of the Interim Order, and pursuant to sections 361, 363(e) and 364(d) of the Bankruptcy Code, as adequate protection of the interest of the Indenture Trustee, on behalf of the Noteholders, in the Prepetition Collateral against any Diminution in Value of such interests in the Prepetition Collateral, the Debtors were authorized to grant and have granted to the Indenture Trustee, for the benefit of itself and the Noteholders (and such grant is hereby ratified, confirmed and approved on a final basis), continuing valid, binding, enforceable, non-avoidable and automatically perfected postpetition security interests in and liens on the DIP Collateral (the *"Indenture Adequate Protection Liens",* and together with the Credit Facility Adequate Protection Liens, the *"Adequate Protection Liens").*

(c) *Priority of Adequate Protection Liens*

(i) The Credit Facility Adequate Protection Liens shall be junior only to the : (A) Carve Out; (B) DIP Liens; (C) Prepetition Facility Liens; and (D) Permitted Prior Liens. The Credit Facility Adequate Protection Liens shall otherwise be senior to all other security interests in, liens on, or claims against any of the DIP Collateral.

(ii) The Indenture Adequate Protection Liens shall be junior only to the: (A) Carve Out; (B) DIP Liens; (C) Prepetition Facility Liens; (D) Credit Facility Adequate Protection Liens; (E) Indenture Liens; and (F) Permitted Prior Liens. The Indenture Adequate Protection Liens shall be senior to all other security interests in, liens on, or claims against any of the DIP Collateral.

(iii) Except as provided herein, the Adequate Protection Liens shall not be made subject to *or pari passu* with any lien or security interest by any court order heretofore or hereafter entered in the Cases or any Successor Cases, and shall be valid and enforceable against any trustee appointed in any of the Cases or any Successor Cases, or upon the dismissal of any of the Cases or Successor Cases. The Adequate Protection Liens shall not be subject to sections 506(c), 510, 549, or 550 of the Bankruptcy Code. No lien or interest avoided and preserved for the benefit of any estate pursuant to section 551 of the Bankruptcy Code shall be *made pari passu* with or senior to the Adequate Protection Liens.

13. *Adequate Protection Superpriority Claims.*

(a) *Credit Facility Superpriority Claim.* Effective immediately upon execution of the Interim Order, as further adequate protection of the interests of the Prepetition Agent and Prepetition Lenders in the Prepetition Collateral (to the extent any Prepetition Obligations remain outstanding) against any Diminution in Value of such interests in the Prepetition Collateral, the Prepetition Agent and Prepetition Lenders were each granted (and such grant is hereby ratified, confirmed and approved on a final basis) as and to the extent provided by sections 503(b) and 507(b) of the Bankruptcy Code an allowed superpriority administrative expense claim in each of the Cases and any Successor Cases (the *"Credit Facility* Superpriority Claims"). The

 

Credit Facility Superpriority Claim shall extend to avoidance actions or claims arising under chapter 5 of the Bankruptcy Code and the proceeds thereof.

(b) *Indenture Superpriority Claim.* Effective immediately upon execution of the Interim Order, as further adequate protection of the interests of the Indenture Trustee, on behalf of the Noteholders, in the Prepetition Collateral against any Diminution in Value of such interests in the Prepetition Collateral, the Indenture Trustee, on behalf of itself and the Noteholders, were granted (and such grant is hereby ratified, confirmed and approved on a final basis) as and to the extent provided by sections 503(b) and 507(b) of the Bankruptcy Code an allowed superpriority administrative expense claim in each of the Cases and any Successor Cases (the *"Indenture Superpriority Claims",* and together with the Credit Facility Superpriority Claim, the *"Adequate Protection Superpriority Claims").* The Indenture Superpriority Claim shall extend to avoidance actions or claims arising under chapter 5 of the Bankruptcy Code and the proceeds thereof.

(c) *Priority of Adequate Protection Superpriority Claims.* The Credit Facility Superpriority Claims shall be junior only to the Carve Out and DIP Superpriority Claims. The Indenture Superpriority Claims shall be junior only to the Carve Out, the DIP Superpriority Claims, and the Credit Facility Superpriority Claims. Except as set forth herein, the Adequate Protection Superpriority Claims shall have priority over all administrative expense claims and unsecured claims against the Debtors or their estates, now existing or hereafter arising, of any kind or nature whatsoever, including, without limitation, administrative expenses of the kinds specified in or ordered pursuant to sections 105, 326, 328, 330, 331, 365, 503(a), 503(b), 506(c), 507(a), 507(b), 546(c), 546(d), 726 (to the extent permitted by law), 1113 and 1114 of the Bankruptcy Code.

**14.** ***Adequate Protection Payments and Protections.***

(a) *Credit Facility Adequate Protection Payments and Protections.* As further adequate protection, to the extent any Prepetition Obligations remain outstanding, the Debtors were authorized and directed to provide adequate protection to the Prepetition Agent and Prepetition Lenders (and such adequate protection is hereby ratified, confirmed and approved on a final basis), in the form of: (i) monthly payments of interest, fees and other amounts due under the Prepetition Credit Documents; and (ii) ongoing payment of the Prepetition Agent's and Prepetition Lenders' reasonable fees, costs and expenses, including, without limitation, legal fees and expenses (together, the *"Credit Facility Adequate Protection Payments").*

(b) *Indenture Adequate Protection Payments and Protections.* As further adequate protection, and subject to the Intercreditor Agreement, the Debtors were authorized and directed to provide adequate protection to the Indenture Trustee, for and on behalf of itself and the Noteholders (and such adequate protection is hereby ratified, confirmed and approved on a final basis), in the form of: (i) ongoing payment of the reasonable fees and expenses of Akin Gump, counsel to the Noteholder Group; (ii) ongoing payment of the costs and expenses of the Indenture Trustee, including attorneys' and consultant's fees (together, the *"Indenture Adequate* Protection Payments," and together with the Credit Facility Adequate Protection Payments, the *"Adequate Protection Payments*"). [5] However, following a Triggering Event (as defined in paragraph 29), the Indenture Adequate Protection Payments incurred in connection with the Cases or any Successor Cases shall not exceed the aggregate amount of $200,000.

15. *Section 507(b) Reservation.* Nothing herein shall impair or modify the application of section 507(b) of the Bankruptcy Code in the event that the adequate protection provided to any of the Prepetition Agent, Prepetition Lenders, Indenture Trustee and/or Noteholders hereunder is insufficient to compensate for any Diminution in Value of their respective interests in the Prepetition Collateral during the Cases or any Successor Cases.

***Provisions Common to DIP Financing and Use of Cash Collateral Authorizations***

16. *Amendment of the DIP Documents.* The DIP Documents may from time to time be amended, modified or supplemented by the parties thereto without notice or a hearing if: (i) the amendment, modification, or supplement is (A) in accordance with the DIP Documents, (B) beneficial to the Debtors, and (C) not prejudicial in any material respect to the rights of third parties; (ii) a

 

copy (which may be provided through electronic mail or facsimile) of the amendment, modification or supplement is provided to counsel for the Statutory Committee and the U.S. Trustee upon three (3) business days notice; and (iii) the amendment, modification or supplement is filed with the Court; *provided, however,* that consent of the Statutory Committee or the U.S. Trustee, and approval of the Court is not necessary to effectuate any such amendment, modification or supplement. Except as otherwise provided in this paragraph 16, no waiver, modification, or amendment of any of the provisions of any DIP Document shall be effective unless set forth in writing, signed on behalf of the Debtors and with the necessary consents required under and executed in accordance with the DIP Documents, and approved by the Court on notice.

17. *Budget Maintenance.* The Budget and any modification to, or amendment or update of, the Budget shall be in form and substance acceptable to and approved by the DIP Agent and DIP Lenders, each in its sole discretion. The Budget may be amended or modified in writing from time to time only with the written consents required under the DIP Documents. The Debtors shall update the Budget from time to time (provided that any update shall be in form and substance acceptable to the DIP Agent and DIP Lenders, each in its sole discretion), but in any event not less than every four fiscal weeks, commencing February 21, 2010 (with delivery to the DIP Agent, DIP Lenders, Indenture Trustee, Noteholder Group and Statutory Committee thereafter within five (5) business days after the end of each such fourth fiscal week).

18. *Modification of Automatic Stay.* The automatic stay imposed under Bankruptcy Code section 362(a) is hereby modified as necessary to effectuate all of the terms and provisions of this Final Order, including, without limitation, to: (a) permit the Debtors to grant the DIP Liens, Adequate Protection Liens, DIP Superpriority Claims, and Adequate Protection Superpriority Claims; (b) permit the Debtors to perform such acts as the DIP Agent, DIP Lenders, Prepetition Agent, Prepetition Lenders, Indenture Trustee, or Noteholder Group each may request in its sole discretion to assure the perfection and priority of the liens granted herein; (c) permit the Debtors to incur all liabilities and obligations to the DIP Agent, DIP Lenders, Prepetition Agent, Prepetition Lenders, Indenture Trustee and Noteholders under the DIP Documents, the DIP Facility and this Final Order; (d) authorize the Debtors to pay, and the DIP Agent, DIP Lenders, Prepetition Agent, Prepetition Lenders, Indenture Trustee and Noteholders to retain and apply, payments made in accordance with the terms of the Interim Order and this Final Order; and (e) permit the Debtors to pay the Prepetition Obligations, to the extent any amounts remain outstanding, consistent with the terms of the Interim Order and this Final Order.

19. *Perfection of DIP Liens and Adequate Protection Liens.* This Final Order shall be sufficient and conclusive evidence of the validity, perfection, and priority of the DIP Liens and Adequate Protection Liens without the necessity of filing or recording any financing statement or other instrument or document which may otherwise be required under the law or regulation of any jurisdiction or the taking of any other action (including, for the avoidance of doubt, entering into any deposit account control agreement) to validate or perfect (in accordance with applicable non-bankruptcy law) the DIP Liens and Adequate Protection Liens, or to entitle the DIP Agent, DIP Lenders, Prepetition Agent, Prepetition Lenders, Indenture Trustee and Noteholders to the priorities granted herein. Notwithstanding the foregoing, each of the DIP Agent, Prepetition Agent and Indenture Trustee is authorized to file, as it deems necessary in its sole discretion, such financing statements, mortgages, notices of liens and other similar documents to perfect in accordance with applicable non-bankruptcy law or to otherwise evidence the applicable DIP Liens and/or Adequate Protection Liens, and all such financing statements, mortgages, notices and other documents shall be deemed to have been filed or recorded as of the Petition Date; *provided, however,* that no such filing or recordation shall be necessary or required in order to create or perfect the DIP Liens and/or the Adequate Protection Liens. The Debtors are authorized and directed to execute and deliver promptly upon demand to the DIP Agent, Prepetition Agent, and Indenture Trustee all such financing statements, mortgages, notices and other documents as any of the DIP Agent, DIP Lenders, Prepetition Agent, Prepetition Lenders or Indenture Trustee may reasonably request. The DIP Agent, Prepetition Agent, and Indenture Trustee, each in its discretion, may file a photocopy of this Final Order as a financing statement with any filing or recording office or with any registry of deeds or similar office, in addition to or in lieu of such financing statements, notices of lien or similar instrument.

20. *Proceeds of Subsequent Financing.* If the Debtors, any trustee, any examiner with enlarged powers, any responsible officer or any other estate representative subsequently appointed in these Cases or any Successor Cases, shall obtain credit or incur debt pursuant to Bankruptcy Code sections 364(b), 364(c) or 364(d) in violation of the DIP Documents at any time prior to the

  

repayment in full of all DIP Obligations, the cancellation, backing or cash collateralization of letters of credit under the DIP Facility, and the termination of the DIP Agent's and DIP Lenders' obligation to extend credit under the DIP Facility, including subsequent to the confirmation of any plan with respect to any or all of the Debtors and the Debtors' estates, then all the cash proceeds derived from such credit or debt shall immediately be turned over to the DIP Agent to be applied as set forth in the DIP Documents.

21. *Maintenance of DIP Collateral.* Until the payment in full in cash of all DIP Obligations, the cancellation, backing, or cash collateralization of letters of credit under the DIP Facility, and the termination of the DIP Lenders' obligations to extend credit under the DIP Facility, the Debtors shall: (a) insure the DIP Collateral as required under the DIP Facility; and (b) maintain the cash management system which has first been agreed to by the required consents under the DIP Documents, or as otherwise required by the DIP Documents.

22. *Disposition of DIP Collateral; Rights of DIP Agent and DIP Lenders.* The Debtors shall not sell, transfer, lease, encumber or otherwise dispose of any portion of the DIP Collateral other than as permitted in the DIP Documents without the prior written consents as required under the DIP Documents (and, other than as set forth in the Intercreditor Agreement, no such consent shall be implied, from any other action, inaction or acquiescence by the DIP Agent, DIP Lenders, Prepetition Agent, Prepetition Lenders, Indenture Trustee, Noteholder Group or Noteholders, or an order of this Court).

23. *DIP Termination.* On the Commitment Termination Date, (a) all DIP Obligations shall be immediately due and payable, all commitments to extend credit under the DIP Facility will terminate, and all letters of credit outstanding shall be cash collateralized, backed or cancelled, and (b) all authority to use Cash Collateral shall cease, *provided, however,* that for the five (5) days after the Termination Declaration Date, the Debtors may use Cash Collateral solely as set forth in paragraph 11 herein.

24. *Events of Default.* The occurrence of an "Event of Default" under the DIP Agreement, including, among other things, the failure of the Debtors to perform the obligations as set forth on and when required by Exhibit 2 attached hereto (subject to any extensions or waivers as permitted under the DIP Documents), shall constitute an event of default under this Final Order, unless expressly waived in writing in accordance with the consents required in the DIP Documents (collectively, the *"Events of Default").*

25. *Rights and Remedies Upon Event of Default.* Immediately upon the occurrence and during the continuation of an Event of Default, (a) the DIP Agent, as directed by the required DIP Lenders as provided in the DIP Documents, may declare (i) all DIP Obligations owing under the DIP Documents to be immediately due and payable, (ii) the termination, reduction or restriction of any further commitment to extend credit to the Debtors to the extent any such commitment remains, (iii) the termination of the DIP Agreement and any other DIP Document as to any future liability or obligation of the DIP Agent and the DIP Lenders, but without affecting any of the DIP Liens or the DIP Obligations, and/or (iv) a termination, reduction or restriction on the ability of the Debtors to use Cash Collateral, except as provided in paragraph 11 hereof; and (b) to the extent any Prepetition Obligations remain outstanding, the Prepetition Agent may declare a termination, reduction or restriction of the ability of the Debtors to use any Cash Collateral, except as provided in paragraph 11 (any such declaration by the DIP Agent or the Prepetition Agent, shall be referred to herein as a *"Termination Declaration").* The Termination Declaration shall be given by email (or other electronic means) to counsel to the Debtors, counsel to the Prepetition Agent, counsel to the Indenture Trustee, counsel to the Noteholder Group, counsel to the Statutory Committee, and the U.S. Trustee (the earliest date any such Termination Declaration is made shall be referred to herein as the *"Termination Declaration* Date"). The DIP Obligations shall be due and payable, without notice or demand, and the use of Cash Collateral shall automatically cease on the Termination Declaration Date, except as provided in paragraph 11. Any automatic stay otherwise applicable to the DIP Agent or the DIP Lenders is hereby modified so that seven (7) days after the Termination Declaration Date (the *"Remedies Notice Period"),* (x) the DIP Agent and the DIP Lenders shall be entitled to exercise all rights and remedies against the DIP Collateral in accordance with the DIP Documents and this Final Order and shall be permitted to satisfy the DIP Obligations and DIP Superpriority Claims, subject to the Carve Out, (y) the Prepetition Agent and the Prepetition Lenders shall be entitled to exercise their rights and remedies to satisfy the Prepetition Obligations, Credit Facility Superpriority Claims, and Credit Facility Adequate Protection Payments,

subject to the Carve Out, and (z) subject to the terms of the Intercreditor Agreement, the Indenture Trustee, for the benefit of itself and the Noteholders, shall be entitled to exercise its rights and remedies to satisfy the Indenture Obligations, Indenture Superpriority Claims, and Indenture Adequate Protection Payments, subject to the Carve Out. Notwithstanding anything to the contrary, during the Remedies Notice Period, the Debtors and/or the Statutory Committee shall be entitled to seek an emergency hearing with the Court for the sole purpose of contesting whether an Event of Default has occurred and/or is continuing. Unless the Court determines during the Remedies Notice Period that an Event of Default has not occurred and/or is not continuing, the automatic stay shall automatically be terminated at the end of the Remedies Notice Period without further notice or order, and the Debtors shall no longer have the right to use or seek to use Cash Collateral, and the DIP Agent, DIP Lenders, Prepetition Agent, Prepetition Lenders, and, subject to the terms of the Intercreditor Agreement, the Indenture Trustee and Noteholders, shall be permitted to exercise all remedies set forth herein, in the DIP Agreement, the DIP Documents, Prepetition Credit Agreement, Prepetition Credit Documents, Indenture, or Indenture Documents, as applicable, and as otherwise available at law against the DIP Collateral and/or Prepetition Collateral, without any further order of or application or motion to the Court, and without restriction or restraint by any stay under sections 362 or 105 of the Bankruptcy Code, or otherwise, against the enforcement of the liens and security interest in the DIP Collateral or any other rights and remedies granted to the DIP Agent and DIP Lenders with respect thereto pursuant to the DIP Agreement, DIP Documents, or this Final Order. Notwithstanding anything to the contrary in this Final Order, the right of any DIP Agent, DIP Lenders, Prepetition Agent, Prepetition Lenders, and, subject to the terms of the Intercreditor Agreement, the Indenture Trustee and Noteholders to occupy and/or use any leased premises shall be limited to any rights: (A) existing under applicable non-bankruptcy law; (B) the applicable landlords provide and/or consent to in writing; and/or (C) granted by the Court on motion and notice, and with an opportunity for the landlords to respond.

26. *Good Faith Under Section 364(e) of the Bankruptcy Code; No Modification or Stay of this Final Order.* The DIP Agent and DIP Lenders each have acted in good faith in connection with negotiating the DIP Documents, extending credit under the DIP Facility, allowing use of Cash Collateral and their reliance on the Interim Order and Final Order was and is in good faith. Based on the findings set forth in this Final Order and the record made during the Interim Hearing and Final Hearing, and in accordance with section 364(e) of the Bankruptcy Code, in the event any or all of the provisions of this Final Order are hereafter reversed, modified, amended or vacated by a subsequent order of this Court or any other court, the DIP Agent and DIP Lenders are each entitled to the protections provided in section 364(e) of the Bankruptcy Code. Any such reversal, modification, amendment or vacatur shall not affect the validity, perfection, priority, allowability, enforceability or non-avoidability of any advances previously made or made hereunder, or lien, claim or priority authorized or created previously or hereby. Any liens or claims granted to the DIP Agent or DIP Lenders hereunder arising prior to the effective date of any such reversal, modification, amendment or vacatur of this Final Order shall be governed in all respects by the original provisions of this Final Order, including entitlement to all rights, remedies, privileges and benefits granted herein.

27. *Indemnification of DIP Agent and DIP Lenders.* The Debtors shall indemnify and hold harmless the DIP Agent and each DIP Lender and their respective shareholders, directors, agents, officers, subsidiaries and affiliates, successors and assigns, attorneys and professional advisors, in their respective capacities as such, from and against any and all damages, losses, settlement payments, obligations, liabilities, claims, actions or causes of action, whether groundless or otherwise, and reasonable costs and expenses incurred, suffered, sustained or required to be paid by an indemnified party of every nature and character arising out of or related to the DIP Documents, or the DIP Facility or the transactions contemplated thereby and by this Final Order, whether such indemnified party is party thereto, as provided in and pursuant to the terms of the DIP Documents and as further described therein and herein, except to the extent resulting from such indemnified party's gross negligence or willful misconduct as determined by a final non-appealable order of a court of competent jurisdiction. The indemnity includes indemnification for the DIP Agent's and each DIP Lender's exercise of discretionary rights granted under the DIP Facility. In all such litigation, or the preparation therefor, the DIP Agent and each DIP Lender shall be entitled to select its own counsel and, in addition to the foregoing indemnity, the Debtors agree to promptly pay the reasonable fees and expenses of such counsel.

28. *Rights of Access and Information.* Without limiting the rights of access and information afforded the DIP Agent and DIP Lenders under the DIP Documents, the Debtors shall be, and hereby are, required to afford representatives, agents and/ or employees of the DIP Agent and DIP Lenders reasonable access to the Debtors' premises and their books and records

  

in accordance with the DIP Documents, and shall reasonably cooperate, consult with, and provide to such persons all such information as may be reasonably requested. In addition, the Debtors authorize their independent certified public accountants, financial advisors, investment bankers and consultants to cooperate, consult with, and provide to the DIP Agent and DIP Lenders all such information as may be reasonably requested with respect to the business, results of operations and financial condition of any Borrower.

29. *Carve Out.*

(a) *Carve Out.* As used in this Final Order, the *"Carve Out"* shall encompass the following expenses: (a) following the occurrence of a Triggering Event, (i) an aggregate amount incurred upon and after the occurrence of such Triggering Event not to exceed $1,500,000 (the *"Carve Out Amount"*) for all (A) allowed fees, and reimbursement for disbursements of, professionals retained by the Debtors and/or the Statutory Committee (the *"Professional Fee Payments"*) and (B) reasonable expenses of members of the Statutory Committee in each case incurred in such member's capacity as a member of the Statutory Committee in connection with the Cases; (ii) fees pursuant to 28 U.S.C. § 1930 and any fees payable to the clerk of the Bankruptcy Court; and (iii) fees payable to a chapter 7 trustee in an aggregate amount not to exceed $50,000 and (b) without reducing the Carve Out Amount, all Professional Fee Payments allowed, or subsequently allowed, and payable under sections 330 and 331 of the Bankruptcy Code, to the extent incurred prior to such Triggering Event (the *"Pipeline Period").* The Carve Out Amount shall be funded with proceeds of the Term Loan (as defined in the DIP Agreement) and segregated in an interest bearing deposit account. As used in this paragraph 29, the term *"Triggering Event"* shall mean the earlier to occur of (a) the date the DIP Agent provides to the Borrowers, with a copy to the Borrowers' counsel and the Statutory Committee's counsel, a notice of (i) an Event of Default and (ii) termination of the Pipeline Period for purposes of the Carve Out or (b) the date upon which the failure of the Borrowers to notify the DIP Agent of the occurrence of a Default (as defined in the DIP Documents) or Event of Default constitutes a failure to comply with the requirement to give such a notice under the DIP Documents.

(b) *No Direct Obligation to Pay Professional Fees; No Waiver of Right to Object to Fees.* The DIP Agent and DIP Lenders shall not be responsible for the direct payment or reimbursement of any fees or disbursements of any professionals retained by the Debtors and/or any statutory committee appointed incurred in connection with the Cases or any Successor Cases. Nothing in this Final Order or otherwise shall be construed (i) to obligate the DIP Agent or DIP Lenders, in any way to pay compensation to or to reimburse expenses of any professionals retained by the Debtors and/or any statutory committee appointed, or to guarantee that the Debtors have sufficient funds to pay such compensation or reimbursement; (ii) to increase the Carve Out Amount if actual Professional Fee Payments incurred after a Triggering Event exceed the Carve Out Amount; (iii) as consent to the allowance of any professional fees or expenses of any professionals retained by the Debtors and/or any statutory committee appointed; or (iv) to affect the right of the Prepetition Agent, Prepetition Lenders, DIP Agent, DIP Lenders or Indenture Trustee to object to the allowance and payment of such fees and expenses.

30. *Limitations on the DIP Facility, DIP Collateral, Cash Collateral, and Carve Out.* The DIP Facility, DIP Collateral, Cash Collateral, and Carve Out may not be used: (a) in connection with or to finance in any way any action, suit, arbitration, proceeding, application, motion or other litigation of any type (i) adverse to the interests of the DIP Agent, DIP Lenders, Prepetition Agent, Prepetition Lenders, Indenture Trustee, Noteholders, or their rights and remedies under the DIP Documents, Prepetition Credit Documents, Indenture Documents or this Final Order, as applicable, including, without limitation, for the payment of any services rendered by the professionals retained by the Debtors, the Statutory Committee or any other statutory committee appointed in connection with the assertion of or joinder in any claim, counterclaim, action, proceeding, application, motion, objection, defense or other contested matter, the purpose of which is to seek, or the result of which would be to obtain, any order, judgment determination, declaration or similar relief (ii) invalidating, setting aside, avoiding or subordinating, in whole or in part, the DIP Obligations, Prepetition Obligations or Indenture Obligations, (iii) for monetary, injunctive or other affirmative relief against any DIP Agent, DIP Lender, Prepetition Agent, Prepetition Lender, Indenture Trustee, or Noteholder, or their respective collateral, or (iv) preventing, hindering or otherwise delaying the exercise by the DIP Agent or any DIP Lender of any rights and/or remedies under this Final Order, the DIP Documents, or applicable law, or the enforcement or realization (whether by foreclosure, credit bid, further order of the Court or otherwise) by the DIP Agent or DIP Lenders upon any of the DIP

  

Collateral; (b) to make any distribution under a plan of reorganization in any of the Cases; (c) to make any payment in settlement of any claim, action or proceeding, before any court, arbitrator or other governmental body without the prior written consents required under the DIP Documents; (d) to pay any fees or similar amounts to any person who has proposed or may propose to purchase interests in any of the Debtors without the prior written consents required under the DIP Documents, (e) subject to the limited use of Cash Collateral set forth in paragraph 11 above, objecting to, contesting, or interfering with in any way the DIP Agent's or DIP Lenders' enforcement or realization upon any of the DIP Collateral once an Event of Default has occurred; (f) using or seeking to use Cash Collateral or selling or otherwise disposing of DIP Collateral without the consents required under the DIP Documents; (g) using or seeking to use any insurance proceeds constituting DIP Collateral without the consents required under the DIP Documents; (h) incurring Indebtedness (as defined in the DIP Agreement) outside the ordinary course of business without the prior consents required under the DIP Documents; (i) objecting to or challenging in any way the claims, liens, or interests (including interests in the Prepetition Collateral or DIP Collateral) held by or on behalf of any DIP Agent, DIP Lender, Prepetition Agent, Prepetition Lender, Indenture Trustee or Noteholder; (j) asserting, commencing or prosecuting any claims or causes of action whatsoever, including, without limitation, any actions under chapter 5 of the Bankruptcy Code, against any DIP Agent, DIP Lender, Prepetition Agent, Prepetition Lender, Indenture Trustee, or Noteholder; (k) prosecuting an objection to, contesting in any manner, or raising any defenses to, the validity, extent, amount, perfection, priority, or enforceability of any of the Prepetition Obligations, Indenture Obligations, Prepetition Liens, DIP Obligations or DIP Liens or any other rights or interests of any of the Prepetition Agent, Prepetition Lenders, Indenture Trustee, Noteholders, DIP Agent or DIP Lender; or (1) preventing, hindering or otherwise delaying the exercise by any DIP Agent, DIP Lender, Prepetition Agent, Prepetition Lender, or Indenture Trustee of any rights and remedies granted under this Final Order. Notwithstanding the foregoing, an aggregate amount not to exceed $50,000 of the DIP Facility, DIP Collateral, Cash Collateral and Carve Out may be used by the Statutory Committee to investigate the Prepetition Facility Liens or Indenture Liens within the Challenge Period (as defined herein).

31. *Reservation of Certain Third Party Rights and Bar of Challenges and Claims.* Nothing in this Final Order or the DIP Documents shall prejudice the rights of the Statutory Committee, if granted standing by the Court, to seek, solely in accordance with the provisions of this paragraph 31, to assert claims against the Prepetition Agent, Prepetition Lenders, Indenture Trustee or Noteholders on behalf of the Debtors or Debtors' creditors or interest holders or to otherwise challenge the Debtors' Stipulations, including, but not limited to those in relation to: (a) the validity, extent, priority, or perfection of the mortgages, security interests, and liens of any Prepetition Agent, Prepetition Lender or Indenture Trustee; (b) the validity, allowability, priority, fully secured status or amount of the Prepetition Obligations; (c) the validity, allowability, priority, or amount of the Indenture Obligations; or (d) any liability of the Prepetition Agent and/or Prepetition Lenders with respect to anything arising from the Prepetition Facility, or of the Indenture Trustee or Noteholders with respect to anything arising from the Indenture. The Statutory Committee must, after obtaining Court-approved standing, commence a contested matter or adversary proceeding raising such claim, objection or challenge, including, without limitation, any claim or cause of action against any Prepetition Agent, Prepetition Lender, Indenture Trustee or Noteholder (each, a *"Challenge"*) within sixty (60) calendar days following the date of entry of this Final Order (the *"Challenge* Period"). The Challenge Period may only be extended with the written consent of the applicable Prepetition Agent, Prepetition Lender, Indenture Trustee, or Noteholder, or by order of the Court for cause shown prior to the expiration of the Challenge Period. Only those parties in interest who commence a Challenge within the Challenge Period may prosecute such Challenge. As to (A) any parties in interest, including the Statutory Committee, who fail to file a Challenge within the Challenge Period, or, if any such Challenge is filed and overruled or (B) any and all matters that are not expressly the subject of a timely Challenge: (1) any and all such Challenges by any party (including, without limitation, the Statutory Committee, any chapter 11 trustee, and/or any examiner or other estate representative appointed in these Cases, and any chapter 7 trustee and/or examiner or other estate representative appointed in any Successor Case), shall be deemed to be forever waived and barred, (2) all of the findings, Debtors' Stipulations, waivers, releases, affirmations and other stipulations as to the priority, extent, and validity as to the Prepetition Agent's, each Prepetition Lender's, Indenture Trustee's and each Noteholder's claims, liens, and interests shall be of full force and effect and forever binding upon the Debtors, the Debtors' bankruptcy estates and all creditors, interest holders, and other parties in interest in these Cases and any Successor Cases, and (3) any and all claims or causes of action against any of the Prepetition Agent, Prepetition Lenders, Indenture Trustee and/or Noteholder relating in any way to the Debtors shall be released by the Debtors' estates, all creditors, interest holders and other parties in interest in these Cases and any Successor Cases.

32. *No Third Party Rights.* Except as explicitly provided for herein, this Final Order does not create any rights for the benefit of any third party, creditor, equity holder or any direct, indirect, or incidental beneficiary.

33. *Continued Effectiveness of Intercreditor Agreement.* The Intercreditor Agreement shall continue in full force and effect and be binding on the Indenture Trustee and Noteholders, to the same extent as it was prior to the Petition Date and the entry of this Final Order, and shall inure to the benefit of the DIP Agent and DIP Lenders with the same force and effect to the DIP Agent as it currently does to the Prepetition Agent as if the DIP Agent were originally named therein as the "Original Senior Agent" and as if the DIP Lenders were originally named therein as the "Senior Lenders" named therein. Except as expressly set forth in the prior sentence, nothing in this Final Order or the DIP Documents shall (a) modify or amend any terms of the Intercreditor Agreement or (b) affect the validity or effectiveness of the Intercreditor Agreement. In the event of any direct conflict between the terms and conditions of the Intercreditor Agreement and this Final Order or the DIP Documents, the provisions of this Final Order and the DIP Documents shall govern and control, except with respect to provisions of this Final Order that are expressly subject to the terms of the Intercreditor Agreement (in which case, the terms of the Intercreditor Agreement shall govern and control).

34. *Section 506(c) Claims.* No costs or expenses of administration which have been or may be incurred in the Cases or any Successor Cases at any time shall be charged against any DIP Agent, DIP Lender, Prepetition Agent, Prepetition Lender, Indenture Trustee or Noteholder, or any of their respective claims or the DIP Collateral or Prepetition Collateral pursuant to sections 105 or 506(c) of the Bankruptcy Code, or otherwise, without the prior written consent of the applicable DIP Agent, DIP Lender, Prepetition Agent, Prepetition Lender, Indenture Trustee or Noteholders and no such consent shall be implied from any other action, inaction, or acquiescence by any such agents or lenders.

35. *No Marshaling/Applications of Proceeds.* The DIP Agent, DIP Lenders, Prepetition Agent, Prepetition Lenders, Indenture Trustee and Noteholders shall not be subject to the equitable doctrine of "marshaling" or any other similar doctrine with respect to any of the DIP Collateral or the Prepetition Collateral, as the case may be, and proceeds shall be received and applied pursuant to the DIP Documents.

36. *Section 552(b).* The Debtors, Committee, DIP Agent, DIP Lenders, Prepetition Agent, Prepetition Lenders, Indenture Trustee and Noteholders agree that they shall not assert the "equities of the case" exception under section 552(b) of the Bankruptcy Code with respect to proceeds, product, offspring or profits of any of the Prepetition Collateral.

37. *Section 363 Sale Proceeds.* In the event that any, all, or substantially all of the Debtors' assets are sold pursuant to section 363 of the Bankruptcy Code, distribution and application of the proceeds of any such sale shall be governed by the order approving such sale or such other order entered by the Court governing the distribution and application of sale proceeds.

38. *Joint and Several Liability.* Nothing in this Final Order shall be construed to constitute a substantive consolidation of any of the Debtors' estates, it being understood, however, that the Debtors shall be jointly and severally liable for the obligations hereunder and in accordance with the terms of the DIP Facility and the DIP Documents.

39. *Discharge Waiver.* The Debtors expressly stipulate, and the Court finds and adjudicates that, the DIP Obligations shall not be discharged by the entry of an order confirming any plan of reorganization, notwithstanding the provisions of section 1141(d) of the Bankruptcy Code, unless the DIP Obligations have been paid in full in cash on or before the effective date of a confirmed plan of reorganization. None of the Debtors shall propose or support any plan of reorganization or sale of all or substantially all of the Debtors' assets or entry of any confirmation order or sale order that is not conditioned upon the payment in full in cash, on the effective date of such plan of reorganization or sale, of all DIP Obligations and the cancellation, backing, or cash collateralization of all letters of credit issued under the DIP Documents.

 

40. *Rights Preserved.* Other than as expressly set forth in this Final Order, any other rights, claims or privileges (whether legal, equitable or otherwise) of the DIP Agent, DIP Lenders, Prepetition Agent, Prepetition Lenders, Indenture Trustee and Noteholders are preserved.

41. *No Waiver by Failure to Seek Relief.* The failure of any DIP Agent, DIP Lender, Prepetition Agent, Prepetition Lender, Indenture Trustee or Noteholder to seek relief or otherwise exercise its rights and remedies under this Final Order, the DIP Documents, the Prepetition Credit Documents, the Indenture Documents, or applicable law, as the case may be, shall not constitute a waiver of any of the rights hereunder, thereunder, or otherwise of the applicable DIP Agent, DIP Lender, Prepetition Agent, Prepetition Lender, Indenture Trustee or Noteholder.

42. *Binding Effect of Interim Order.* Immediately upon entry by this Court (notwithstanding any applicable law or rule to the contrary), the terms and provisions of this Final Order shall become valid and binding upon and inure to the benefit of the Debtors, DIP Agent, DIP Lenders, Prepetition Agent, Prepetition Lenders, Indenture Trustee, Noteholders, all other creditors of any of the Debtors, the Statutory Committee or any other committee appointed by the Court in the Cases, and all other parties in interest and their respective successors and assigns, including any trustee or other fiduciary hereafter appointed in any of the Cases, any Successor Cases, or upon dismissal of any Case or Successor Case.

43. *No Modification of Interim Order.* Until and unless the DIP Obligations and Prepetition Obligations (to the extent any Prepetition Obligations remain outstanding) have been indefeasibly paid in full in cash, and all letters of credit under the DIP Facility and Prepetition Facility shall have been cancelled, backed, or cash collateralized in accordance with the terms thereof (such payment being without prejudice to any terms or provisions contained in the DIP Facility which survive such discharge by their terms), and all commitments to extend credit under the DIP Facility have been terminated, the Debtors irrevocably waive the right to seek and shall not seek or consent to, directly or indirectly: (a) without the prior written consents required in the DIP Documents, the Prepetition Agent (until the Prepetition Facility is indefeasibly repaid in full) and Indenture Trustee (to the extent permitted or required under the Intercreditor Agreement) (i) any modification, stay, vacatur or amendment to this Final Order; (ii) a priority claim for any administrative expense or unsecured claim against the Debtors (now existing or hereafter arising of any kind or nature whatsoever, including, without limitation any administrative expense of the kind specified in sections 503(b), 507(a) or 507(b) of the Bankruptcy Code) in any of the Cases or Successor Cases, equal or superior to the DIP Superpriority Claims, other than the Carve Out, or (iii) any other order allowing use of Cash Collateral; and (b) without the prior written consents required under the DIP Documents, any lien on any of the DIP Collateral with priority equal or superior to the DIP Liens. The Debtors irrevocably waive any right to seek any amendment, modification or extension of this Final Order without the prior written consent, as provided in the foregoing, of the DIP Agent, Prepetition Agent and Indenture Trustee, as applicable, and no such consent shall be implied by any other action, inaction or acquiescence of the applicable DIP Agent, DIP Lenders, Prepetition Agent, Prepetition Lenders, or Indenture Trustee.

44. *Final Order Controls.* In the event of any inconsistency between the terms and conditions of the DIP Documents or this Final Order, the provisions of this Final Order shall govern and control.

45. *Survival.* The provisions of this Final Order and any actions taken pursuant hereto shall survive entry of any order which may be entered: (a) confirming any plan of reorganization in any of the Cases; (b) converting any of the Cases to a case under chapter 7 of the Bankruptcy Code; (c) dismissing any of the Cases or any Successor Cases; or (d) pursuant to which this Court abstains from hearing any of the Cases or Successor Cases. The terms and provisions of this Final Order, including the claims, liens, security interests and other protections granted to the DIP Agent, DIP Lenders, Prepetition Agent, Prepetition Lenders, Indenture Trustee and Noteholders pursuant to this Final Order and/or the DIP Documents, notwithstanding the entry of any such order, shall continue in the Cases, in any Successor Cases, or following dismissal of the Cases or any Successor Cases, and shall maintain their priority as provided by this Final Order until all DIP Obligations have been indefeasibly paid in full and all letters of credit under the DIP Facility shall have been cancelled, backed, or cash collateralized in accordance with the terms thereof and all commitments to extend credit under the DIP Facility are terminated. The terms and provisions concerning the

indemnification of the DIP Agent and/or DIP Lenders shall continue in the Cases, in any Successor Cases, following dismissal of the Cases or any Successor Cases, following termination of the DIP Documents and/or the repayment of the DIP Obligations.

46. *Retention of Jurisdiction.* The Court has and will retain jurisdiction to enforce this Final Order according to its terms.

SO ORDERED by the Court this 18th day of February, 2010.

*/s/ Martin Glenn*

HONORABLE MARTIN GLENN

UNITED STATES BANKRUPTCY JUDGE

Footnotes

1 The other Borrowers are: 8250 International Drive Corporation, Aurora Uno, Inc., B.S. of Woodbridge, Inc., Fairfax Uno, Inc., Kissimmee Uno, Inc., Marketing Services Group, Inc., Newport News Uno, Inc., Newton Takery, Inc., Paramus Uno, Inc., Pizzeria Uno corporation, Pizzeria Uno of 86th Street, Inc., Pizzeria Uno of Albany Inc., Pizzeria Uno of Bay Ridge, Inc., Pizzeria Uno of Bay Side, Inc., Pizzeria Uno of Bethesda, Inc., Pizzeria Uno of Brockton, Inc., Pizzeria Uno of Columbus Avenue, Inc., Pizzeria Uno of East Village Inc., Pizzeria Uno of Fair Oaks, Inc., Pizzeria Uno of Fairfield, Inc., Pizzeria Uno of Forest Hills, Inc., Pizzeria Uno of Kingston, Inc., Pizzeria Uno of Lynbrook Inc., Pizzeria Uno of Reston, Inc., Pizzeria Uno of South Street Seaport, Inc., Pizzeria Uno of Springfield, Inc., Pizzeria Uno of Syracuse, Inc., Pizzeria Uno of Union Station, Inc., Plizzettas of Concord, Inc., SL Properties, Inc., SL Uno Burlington, Inc., SL Uno Ellicott City, Inc., SL Uno Franklin Mills, Inc., SL Uno Frederick, Inc., SL Uno Greece, Inc., SL Uno Gurnee Mills, Inc., SL Uno Hyannis, Inc., SL Uno Maryville, Inc., SL Uno Portland, Inc., SL Uno Potomac Mills, Inc., SL Uno University Blvd., Inc., SL Uno Waterfront, Inc., SLA Brockton, Inc., SLA Due, Inc., SLA Lake Mary, Inc., SLA Mail II, Inc., SLA Mail, Inc., SLA Norfolk, Inc., SLA SU Casa, Inc., SLA Uno, Inc., Saxet Corporation, UR of Bel Air MD, Inc., UR of Bowie MD, Inc., UR of Columbia MD, Inc., UR of Danbury CT, Inc., UR of Dover NH, Inc., UR of Fairfield CT, Inc., UR of Inner Harbor MD, Inc., UR of Keene NH, Inc., UR of Landover MD, Inc., UR of Methuen MA, Inc., UR of Milford CT, Inc., UR of Paoli PA, Inc., UR of Wrentham MA, Inc., Uno Enterprises, Inc., Uno Foods Inc., Uno Restaurant Holdings Corporation, Uno Restaurant of Columbus, Inc., Uno Restaurant of St. Charles, Inc., Uno Restaurant of Woburn, Inc., Uno of America, Inc., Uno of Astoria, Inc., Uno of Aurora, Inc., Uno of Bangor, Inc., Uno of Concord Mills, Inc., Uno of Crestwood, Inc., Uno of Daytona, Inc., Uno of Dulles, Inc., Uno of Falls Church, Inc., Uno of Georgesville, Inc., Uno of Hagerstown, inc., Uno of Haverhill, Inc., Uno of Henrietta, Inc., Uno of Indiana, Inc., Uno of Kingstowne, Inc., Uno of Kirkwood, Inc., Uno of Lombard, Inc., Uno of Manassas, inc., Uno of Manchester, Inc., Uno of Massachusetts, Inc., Uno of New York, Inc., Un of Providence, Inc., Uno of Schaumburg, inc., Uno of Smithtown, Inc., Uno of Victor, Inc., Waltham Uno, Inc., Westminster Uno, Inc., Uno Restaurants II, LLC, UR of Attleboro MA, LLC, UR of Clay NY, LLC, UR of Fayetteville NY, LLC, UR of Fredericksburg VA, LLC, UR of Gainesville VA, LLC, UR of Millbury MA, LLC, UR of Nashua NH, LLC, UR of New Hartford NY, LLC, UR of Newington NH, LLC, UR of Plymouth MA, LLC, UR of Swampscott MA, LLC, UR of Taunton MA, LLC, UR of Tilton NH, LLC, UR of Virginia Beach VA, LLC, UR of Webster NY, LLC, UR of Winter Gardens FL, LLC, URC, LLC, Uno Restaurants, LLC, URC II, LLC, Pizzeria Uno of Westfarms, LLC, Uno Foods International LLC, UR of Merritt Island FL, LLC, UR of Melbourne FL, LLC.

2 Nothing herein shall constitute a finding or ruling by this Court that any such Permitted Prior Liens are valid, senior, enforceable, prior, perfected or non-avoidable. Moreover, nothing shall prejudice the rights of any party in interest including, but not limited, to the Debtors, the Prepetition Agent, the Prepetition Lenders, the Indenture Trustee, the Noteholders, the DIP Agent, the DIP Lenders, and the Statutory Committee to challenge the validity, priority, enforceability, seniority, avoidability, perfection or extent of any such Permitted Prior Lien and/or security interest.

3 The payment of the reasonable fees and expenses for any professionals of the DIP Agent and DIP Lenders shall not be subject to allowance by the Court. Professionals for the DIP Agent and DIP Lenders shall not be required to file fee applications or comply with the U.S. Trustee fee guidelines. Each professional for the DIP Agent and DIP Lenders shall provide a copy (via email or other electronic means) of its detailed invoices (redacted if necessary for privilege) to the U.S. Trustee and counsel for the Statutory Committee contemporaneously with the delivery of such fee and expense statement to the Debtors. To the extent that the U.S. Trustee or the Statutory Committee has an objection to the fees and expenses of any such professional, it shall be afforded ten (10) days

after receipt of such fee and expense statement to raise an objection. If any objection is raised and cannot be resolved and/or is not withdrawn within ten (10) days after such objection has been raised, the Court shall adjudicate the matter.

4 All defined terms in the description of DIP Collateral shall have the meanings ascribed thereto in the DIP Documents. All terms not specifically defined in the DIP Documents shall have the meanings ascribed to such terms in Article 8 or 9 of the Uniform Commercial Code.

5 The payment of the reasonable fees and expenses for any professionals of the Prepetition Agent, Prepetition Lenders, Indenture Trustee and Noteholder Group shall not be subject to allowance by the Court. Professionals for the Prepetition Agent, Prepetition Lenders, Indenture Trustee and Noteholder Group shall not be required to file fee applications or comply with the U.S. Trustee fee guidelines. Each professional for the Prepetition Agent, Prepetition Lenders, Indenture Trustee or Noteholder Group shall provide a copy (via email or other electronic means) of its detailed invoices (redacted if necessary for privilege) to the U.S. Trustee and counsel for the Statutory Committee contemporaneously with the delivery of such fee and expense statement to the Debtors. To the extent that the U.S. Trustee or the Statutory Committee has an objection to the fees and expenses of any such professional, it shall be afforded ten (10) days after receipt of such fee and expense statement to raise an objection. If any objection is raised and cannot be resolved and/or is not withdrawn within ten (10) days after such objection has been raised, the Court shall adjudicate the matter.

**End of Document**

# TAB 12

**Most Negative Treatment:** Check subsequent history and related treatments.

2015 ONSC 2987
Ontario Superior Court of Justice [Commercial List]

Nortel Networks Corp., Re

2015 CarswellOnt 7072, 2015 ONSC 2987, [2015] O.J. No. 2440, 254 A.C.W.S. (3d) 522, 27 C.B.R. (6th) 175

# In the Matter of the Companies' Creditors Arrangement Act, R.S.C. 1985, c. c-36, as Amended

In the Matter of a Plan of Compromise or Arrangement of Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation Application under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as Amended

Newbould J.

Heard: May 12-15, 20-22, 27-30, 2014; June 2, 5, 6, 16-20, 23-24, 2014; September 22-24, 2014
Judgment: May 12, 2015
Docket: 09-CL-7950

Counsel: Benjamin Zarnett, Peter Ruby, Jessica Kimmel, Graham D. Smith, Alan Mark, Julie Rosenthal, Joseph Pasquariello, Jennifer Stam, Ken Coleman, Jacob Pultman, Paul Keller, Laura Hal for Monitor and Canadian Debtors
R. Paul Steep, Elder C. Marques, Byron Shaw, Kenneth T. Rosenberg, Lily Harmer, Max Starnino, Karen Jones, Megan Shortreed, Mark Zigler, Ari Kaplan, Jeff Van Bakel, Barbara Walancik for Canadian Creditors' Committee
Sheila Block, Andrew Gray, Scott A. Bomhof, Avi Luft, James Bromley, Lisa Schweitzer, Jeffrey Rosenthal, Howard Zelbo for U.S. Debtors
Richard Swan, Tom Matz, Jonathan Bell, Gavin H. Finlayson, Kevin J. Zych, Andrew LeBlanc, Nick Bassett for Ad Hoc Group of Bondholders
Matthew P. Gottlieb, Matthew Milne-Smith, James Doris, William Maguire, Neil Oxford, John Whiteoak, Tracy L. Wynne, Derek Adler for EMEA Debtors
Michael E. Barrack, D.J. Miller, John L. Finnigan, Andrea McEwan, Rebecca (Lewis) Kennedy, Michael Shakra, Brian O'Connor Eugene Chang for UKPC
R. Shayne Kukulowicz, Goff Shaw, Abid Qureshi, David H. Botter for U.S. Unsecured Creditors' Committee
Kenneth David Kraft, Karen B. Dine, John Salmas, David Crichlow for Wilmington Trust, National Association, Trustee
Brett Harrison for Bank of New York Mellon, Trustee
John D. Marshall for Law Debenture Trust Company of New York, Trustee

Subject: Contracts; Estates and Trusts; Evidence; Insolvency; Intellectual Property; International; Property

**Related Abridgment Classifications**

Contracts
VII Construction and interpretation
VII.11 Miscellaneous

**Headnote**

Bankruptcy and insolvency --- Administration of estate — Sale of assets — Miscellaneous

Distribution of proceeds — Telecommunications corporation with numerous world-wide subsidiaries commenced bankruptcy and insolvency proceedings — At issue was allocation among debtors of proceeds from sale of assets, primarily intellectual property — Master Research and Development Agreement ("MRDA"), which provided for payment of residual profits to certain entities, did not govern allocation — MRDA was driven by transfer pricing concepts, drafted for tax purposes and not intended to deal with rights after company stopped operating — In unique circumstances of case, it was just to allocate proceeds on pro rata basis — Funds to be directed to each debtor estate based on percentage that claims against that estate bore to total claims against all debtor estates.

Contracts --- Construction and interpretation — Miscellaneous

Telecommunications corporation with numerous world-wide subsidiaries commenced bankruptcy and insolvency proceedings — At issue was allocation among debtors of proceeds from sale of assets, primarily intellectual property — Master Research and Development Agreement ("MRDA"), which provided for payment of residual profits to certain entities, did not govern allocation — MRDA was driven by transfer pricing concepts, drafted for tax purposes and not intended to deal with rights after company stopped operating — In unique circumstances of case, it was just to allocate proceeds on pro rata basis — Funds to be directed to each debtor estate based on percentage that claims against that estate bore to total claims against all debtor estates.

The insolvent corporation was a publicly-traded global networking solutions and telecommunications company, with numerous subsidiaries around the world. NNL, a direct subsidiary of the parent corporation, was the Canadian operating company, which in turn owned 100 per cent of the equity in NNI, the U.S. operating company. Because research and development was the primary driver of the corporation's value and profit, the residual profits were paid to entities ("RPEs") pursuant to a Master Research and Development Agreement ("MRDA"), in accordance with a specified sharing method. Under the MRDA, NNL was the legal owner of the corporation's intellectual property ("IP") and each other RPE was granted an exclusive license by NNL to make and sell products in its territory using or embodying the IP and a non-exclusive license to do so in territories not exclusive to an RPE.

The corporation decided to commence bankruptcy and insolvency proceedings. NNL and the other Canadian debtors filed for protection under the Companies' Creditors Arrangement Act. After sales of the corporation's business lines and residual IP, $7.3 billion ("the lockbox funds") were held in escrow. At issue was how to allocate the lockbox funds among the Canadian, U.S. and Europe, Middle East and Africa ("EMEA") debtors. The differences in the parties' positions arose from the different manner in which each characterized the terms of the MRDA, the interests held by the parties in the IP and the applicability of the terms of the MRDA to the value ascribed to various assets. The trial was held jointly with the U.S. Bankruptcy Court for the District of Delaware, pursuant to a Cross-Border Insolvency Protocol.

**Held:** Order accordingly.

The MRDA did not govern the allocation of the lockbox funds. The U.S. debtors' attempt to parse the language of the grant of license in the MRDA was unpersuasive. There was only one license and its words had to be read harmoniously. When the MRDA was being considered, the company was not in the business of licensing its services to others for the business of others; it was providing a service to its customers to support the technology being acquired by its customers. The MRDA had to be read in that context. Under the MRDA, while the company operated as a going concern business, NNL had all ownership interests of the IP, subject to: (i) the grant to each licensed participant of a non-exclusive right to assert actions and recover damages in their territory; and (ii) the grant of exclusive and non-exclusive licenses to the licensed participants, which were not licenses of all rights, but were subject to field of use restrictions that gave the licensed participants the right to use the IP to make, use or sell products, as defined in the MRDA. This meant products, software or services that were made or sold by, or for, any of the licensed participants. No product that was part of a third party's business, rather than the corporation's business, fell within the definition of "products".

The MRDA was an operating agreement and was never intended to provide an answer to the question of how to allocate among the bankrupt estates the proceeds of the sale of assets following the world-wide insolvency of the corporation. The MRDA and its predecessor agreements were developed for and driven by transfer pricing concepts and drafted for tax purposes. The construct of legal title to the IP being in NNL in return for NNL granting exclusive licenses to the licensed participants was only for the purpose of supporting the proposed method to split profits or losses on a tax efficient basis while the company operated as a going concern business. The MRDA was intended to apply only to the company while it operated, not to deal with rights after it and its subsidiaries stopped operating their businesses. The position of the EMEA debtors, that the proceeds of sale of the IP assets should be allocated according to a theory of joint ownership of the IP, should also be rejected.

NNL would be unjustly enriched by being entitled to all the proceeds of sale at the expense of the other RPEs who contributed to the creation of the IP, just because the patents were registered in NNL's name. It would also unjustly enrich NNI if it were to be allocated the amount from the IP sales that it claimed based principally on its revenues. NNI was able to sell the company's products based on the research and development and resulting IP performed by other RPEs. This was an unprecedented case in which the intangible assets that were sold were not separately located in any one jurisdiction or owned separately in different jurisdiction. They were created by all of the RPEs located in different jurisdictions. Research and development was organized around a particular project, not particular geographical locations or legal entities, and was managed on a global basis. The company's matrix structure allowed it to draw on employees from different functional disciplines worldwide. In these circumstances, it was just to allocate the sale proceeds on a pro rata basis. An allocation of the lockbox funds should be directed to each debtor estate based on the percentage that the claims against that estate bore to the total claims against all of the debtor estates. A pro rata allocation in this case would not constitute an impermissible substantive consolidation, either actual or deemed, nor unduly prejudice bondholders who held bonds with covenants of both NNL and NNI.

**Table of Authorities**

**Cases considered by *Newbould J.*:**

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TRIAL to determine allocation of proceeds of sale of assets of insolvent corporation in proceedings under *Companies' Creditors Arrangement Act*.

***Newbould J.*:**

**Prologue**

1 Until January 14, 2009, Nortel Networks Corporation ("NNC") was a publicly-traded Canadian company and the direct or indirect parent of more than 130 subsidiaries located in more than 100 countries, collectively known as the "Nortel Group" or "Nortel". It operated a global networking solutions and telecommunications business.

2 On January 14, 2009 most of the Nortel entities filed for bankruptcy protection. In Canada, the Canadian incorporated entities (the "Canadian Debtors") filed under the *Companies' Creditors Arrangement Act* ("CCAA"). In the United States, most of the U.S. incorporated entities (the "U.S. Debtors") filed under chapter 11 of the *U.S. Bankruptcy Code*. In England, most of the entities incorporated in Europe, the Middle East and Africa (the "EMEA [1] Debtors") were granted administration orders under the *UK Insolvency Act, 1986.*

3 The initial intent of Nortel was to downsize and carry on those portions of its telecommunications business that it thought could be profitable. However that plan quickly evaporated and in June, 2009 Nortel decided to liquidate its assets. It sold its business lines for approximately $3.285 [2] billion of which approximately $2.85 billion is now available to be allocated. It then sold its residual intellectual property for $4.5 billion. These amounts totalling $7.3 billion are held in escrow (the "lockbox funds"). At issue in these proceedings is how to allocate the $7.3 billion among the Canadian Debtors, the U.S. Debtors and the EMEA Debtors.

4 The trial in this case was unique. It was a joint trial of the Ontario Superior Court of Justice (Commercial List) and the U.S. Bankruptcy Court for the District of Delaware [3] . It arose from the arrangements made by the parties as part of the process of selling assets, and from a Cross-border Insolvency Protocol (the "Protocol"). In short:

> (i) The parties agreed in an Interim Funding and Settlement Agreement before any of the Nortel assets were sold to put the proceeds of sale into escrow and then attempt to agree on a protocol for resolving how the proceeds were to be allocated. If no agreement was reached, the issues were to be tried by the Ontario and U.S. Courts pursuant to the Protocol.

  

(ii) The parties could not agree on the allocation, nor could they agree on a protocol process. By orders of the Ontario and U.S. Courts, the allocation was directed to be determined in a joint trial pursuant to the Protocol. The EMEA Debtors were held to have attorned to the jurisdiction of these courts in the escrow agreements made with respect to the proceeds of the several sales that had occurred. [4]

5 The Protocol was approved early in the CCAA and chapter 15 proceedings by orders the Ontario and U.S. Courts. [5] This type of protocol has become standard in the last number of years to govern the administration of cross-border insolvency proceedings. The Protocol included it its purposes:

> Accordingly, this Protocol has been developed to promote the following mutually desirable goals and objectives in the Insolvency Proceedings:
>
> (a) harmonize and coordinate activities in the Insolvency Proceedings before the Courts;
>
> (b) promote the orderly and efficient administration of the Insolvency Proceedings to, among other things, maximize the efficiency of the Insolvency Proceedings, reduce the costs associated therewith and avoid duplication of effort;
>
> (c) honor the independence and integrity of the Courts and other courts and tribunals of the United States and Canada, respectively;
>
> (d) promote international cooperation and respect for comity among the Courts, the Debtors, the Creditors Committee, the Estate Representatives (which include the Chapter 11 Representatives and the Canadian Representatives as such terms are defined below) and other creditors and interested parties in the Insolvency Proceedings;
>
> (e) facilitate the fair, open and efficient administration of the Insolvency Proceedings for the benefit of all of the Debtors' creditors and other interested parties, wherever located; and
>
> (f) implement a framework of general principles to address basic administrative issues arising out of the cross-border nature of the Insolvency Proceedings.

6 The Protocol contained a number of provisions regarding the independence of the Canadian and U.S. Courts and the exclusive jurisdiction of each Court in the determination of matters arising in the Canadian and U.S. proceedings respectively. Included in the Protocol were the following provisions:

> 7. The approval and implementation of this Protocol shall not divest nor diminish the U.S. Court's and the Canadian Court's respective independent jurisdiction over the subject matter of the U.S. Proceedings and the Canadian Proceedings, respectively...
>
> 8. The U.S. Court shall have sole and exclusive jurisdiction and power over the conduct of the U.S. Proceedings and the hearing and determination of matters arising in the U.S. Proceedings. The Canadian Court shall have sole and exclusive jurisdiction and power over the conduct of the Canadian Proceedings and the hearing and determination of matters arising in the Canadian Proceedings.

7 The Protocol provided in paragraph 12 for the harmonization and co-ordination of the administration of the two proceedings in Canada, including the holding of joint hearings of the two Courts and providing for discussions between the two judges. Included were the following:

> 12. To harmonize and coordinate the administration of the Insolvency Proceedings, the U.S. Court and the Canadian Court each may coordinate activities and consider whether it is appropriate to defer to the judgment of the other Court. In furtherance of the foregoing:

 

(a) The U.S. Court and the Canadian Court may communicate with one another, with or without counsel present, with respect to any procedural matter relating to the Insolvency Proceedings.

. . .

(d) The U.S. Court and the Canadian Court may conduct joint hearings (each a "Joint Hearing") with respect to any cross-border matter or the interpretation or implementation of this Protocol where both the U.S. Court and the Canadian Court consider such a Joint Hearing to be necessary or advisable, or as otherwise provided herein, to, among other things, facilitate or coordinate proper and efficient conduct of the Insolvency Proceedings or the resolution of any particular issue in the Insolvency Proceedings. With respect to any Joint Hearing, unless otherwise ordered, the following procedures will be followed:

(vi) The Judge of the U.S. Court and the Justice of the Canadian Court, shall be entitled to communicate with each other during or after any joint hearing, with or without counsel present, for the purposes of (1) determining whether consistent rulings can be made by both Courts; (2) coordinating the terms upon of the Courts' respective rulings; and (3) addressing any other procedural or administrative matters.

8 A joint hearing was held for this allocation dispute. The court rooms in Toronto and Wilmington were set up electronically so that lawyers and witnesses could and did appear in either courtroom and communicate with a lawyer, witness or the judge in the other courtroom through state of the art telecommunications services.

9 After the evidence was heard, written closing and reply briefs were filed by the parties and oral argument was made. It was agreed that at the conclusion of the case that each Court would release its decision at the same time. This judgment is being released at the same time as the opinion of Judge Gross in Wilmington.

10 Judge Gross in Wilmington and I have communicated with each other in accordance with the Protocol with a view to determining whether consistent rulings can be made by both Courts. We have come to the conclusion that a consistent ruling can and should be made by both Courts. We have come to this conclusion in the exercise of our independent and exclusive jurisdiction in each of our jurisdictions. These insolvency proceedings have now lasted over six years at unimaginable expense and they should if at all possible come to a final resolution. It is in all of the parties' interests for that to occur. Consistent decisions that we both agree with will facilitate such a resolution.

**Nortel history and its matrix structure**

11 NNC was the successor to a long line of technology companies headquartered in Canada dating back to the founding of Bell Telephone Company of Canada in 1883. Prior to being named Nortel, it was known as Northern Telecom. NNC's principal, direct operating subsidiary, also a Canadian company, was Nortel Networks Limited ("NNL"), which in turn was the direct or indirect parent of operating companies located around the world. [6]

12 From the mid-1980s, Nortel expanded substantially through the continued development of ground-breaking technology. The Nortel Group moved from developing and manufacturing traditional landline phone technology and equipment into digital, wireless and photonic technologies. At the same time, the Nortel Group expanded into Europe, Asia, Africa, the Middle East and Latin America.

13 At the time of its insolvency, Nortel had four main product groups (also known as Lines of Business):

• The "Carrier Networks" segment provided wireless networking solutions that enabled service providers and cable operators to supply mobile voice, data and multimedia communications to individuals and enterprises using mobile phone and other wireless devices. The Carrier Networks business also offered products providing local, toll, long distance and international gateway capabilities to telephone service providers as well as providing support to customers transitioning from one network to another.

 

• The "Enterprise Solutions" segment provided enterprise communications solutions addressing the headquarters, branch and home office needs of large and small businesses. The Enterprise Solutions segment's offerings included, among other things, Unified Communications, Ethernet routing and multiservice switching, IP and digital telephony (including phones), wireless LANs, security, IP and SIP contact centers, self-service solutions, messaging, conferencing and SIP-based multimedia solutions.

• The Metro Ethernet Networks ("MEN") segment provided carrier-grade Ethernet transport capabilities focused on meeting customers' needs for higher performance and lower cost emerging video-intensive applications. MEN included optical networking, carrier Ethernet switching products and multi-service switching products.

• The "Global Services" segment provided a broad range of services and solutions including network implementation services, network support services, network managed services (which related to the monitoring and management of customer networks and hosted solutions) and network application services.

14 The Nortel Group consists of more than 140 separate corporate entities located in 60 separate sovereign jurisdictions including Canada, the United States and the EMEA region, as well as the Caribbean and Latin America and Asia. NNC, the Nortel Group's ultimate parent holding company, was publicly listed and traded on both the Toronto Stock Exchange and the New York Stock Exchange.

15 One of NNC's direct subsidiaries is NNL, which was the Canadian operating company of the Nortel Group. NNL in turn owns 100% of the equity of each of NNI, which was the Nortel Group's operating company in the United States, NNUK, which was the Nortel Group's operating company in the United Kingdom, NN Ireland, which was the Nortel Group's operating company in Ireland, and 91.17% of the equity of NNSA, which was the Nortel Group's operating company in France.

16 The Nortel Group operated along business lines as a highly integrated multinational enterprise with a matrix structure that transcended geographic boundaries and legal entities organized around the world. Each entity, such as NNL, NNI, NNUK, NN Ireland and NNSA, was integrated into regional and product line management structures to share information and perform research and development ("R&D"), sales and other common functions across geographic boundaries and across legal entities. The matrix structure was designed to enable Nortel to function more efficiently, drawing on employees from different functional disciplines worldwide, allowing them to work together to develop products and attract and provide service to customers, fulfilling their demands globally.

17 As a result of Nortel's matrix structure, no single Nortel entity, either NNL or any of the other Canadian debtors in Canada, NNI or any of the other US debtors in the United States or NNUK or any of the other EMEA debtors, was able to provide the full line of Nortel products and services, including R&D capabilities, on a stand-alone basis. While Nortel ensured that all corporate entities complied with local laws regarding corporate governance, no corporate entity carried on business on its own.

18 R&D was the primary driver of Nortel's value and profit. Together with NNL, the principal companies that performed R&D were NNI, NNUK, NNSA and NN Ireland. These were known as Integrated Entities or, in transfer pricing terms, Residual Profit Entities ("RPEs") due to their participation from 2001 in a residual profit pool in connection with Nortel's transfer pricing arrangements [7] . Other operating companies performed sales and distribution functions and were known as Limited Risk Distributors or Entities ("LREs").

19 R&D was performed at labs around the world. The advanced technology primary research which was intended to develop novel, cutting edge intellectual property technologies was performed mostly in NNL laboratories in Ottawa, which also did R&D for various lines of business. From 2000 to 2009 NNL accounted on average for just under half of all R&D expenditures, more in the latter years than the earlier years. NNI accounted for 38 to 42% and EMEA accounted for 16 to 20% in the earlier years and 11.7 % from 2005 to 2009. The R&D was shared throughout the Nortel Group as needed by the lines of business and customer needs in the various regions and countries.

 

20 Because R&D was the primary driver of Nortel's value and profit, the residual profits of Nortel, after payment of fixed rates of return to all Nortel companies for sales and distribution functions, were paid to the RPEs under a Master Research and Development Agreement ("MRDA") in accordance with a residual profit split method ("RPSM") based on each RPE's expenditure on R&D relative to the R&D expenditure of all RPEs.

21 Under the MRDA, NNL was the legal owner of the Nortel intellectual property and each RPE other than NNL was granted an exclusive license by NNL to make and sell Nortel products in its territory using or embodying Nortel intellectual property developed by Nortel companies anywhere in the world and a non-exclusive license to do so in territories that were not exclusive to an RPE. What the ownership rights of NNL were and what the license rights were that were granted in the MRDA are highly contested. Also contested is the role that the MRDA should play in this allocation proceeding.

**Bankruptcy filings**

22 Beginning around 2001, the burst of the dot-com bubble had a severe effect on the global economy and on the telecommunications industry in particular, including Nortel. Market forces led to a decline in Nortel's revenues and market share, and a decline in customer demand for Nortel's products. Subsequently, Nortel was faced with accounting issues which impacted Nortel's credit rating and its cost of financing and required Nortel to restate its financial statements for the fiscal years 2000 to 2005. The rating downgrades affected Nortel's access to capital markets and cost of financing for some years. The fortunes of Nortel improved for a few years but for various reasons, including the financial meltdown in the fall of 2008, Nortel saw its business decline in the two profitable lines of business that it was operating.

23 In light of the impact of the deteriorating market conditions and weakening customer commitments on Nortel's financial outlook, Nortel made the decision to commence formal bankruptcy and insolvency proceedings in Canada, the U.S. and England (respecting various EMEA entities) on January 14, 2009.

24 On January 14, 2009 NNC, NNL, the wholly owned subsidiary of NNC which was its operating subsidiary and a number of other Canadian corporations filed for protection under the CCAA. On the same date, Nortel Network Inc. ("NNI"), the principal US subsidiary of NNL, and a number of other US corporations filed for protection under chapter 11 of the US Bankruptcy Code and Nortel Networks UK Limited ("NNUK"), the principal UK subsidiary of NNL, and certain of their subsidiaries (the "EMEA Debtors") save the French subsidiary Nortel Networks S.A. ("NNSA") were granted administration orders under the *UK Insolvency Act, 1986.* On the following day, a liquidator of NNSA was appointed in France pursuant to Article 27 of the European Union's Council Regulation (EC) No 1346/2000 on Insolvency Proceedings in the Republic of France.

25 Subsequent to the filing date, certain other Nortel subsidiaries have filed for creditor protection or bankruptcy proceedings in the local jurisdiction in which they are located. Certain solvent indirect subsidiaries of NNUK are not in administration, but are represented in these proceedings by the Joint Administrators with respect to the allocation issues.

**Decision to liquidate**

26 The initial intent on filing was to attempt to restructure the business and downsize it by focusing on Nortel's legacy CDMA (Code Division Multiple Access) wireless business and a potential business based on LTE (Long-Term Evolution) wireless technology with all other Nortel business lines being sold. However, Nortel's major customers did not support this plan and advised they were not prepared to provide new contracts to Nortel for this purpose. As well, it became clear that it would not be possible for Nortel to obtain the funding that would have been required to restructure around a CDMA business.

27 In June 2009, management and the Debtor Estates collectively determined that the best means to maximize value for its creditors was to sell Nortel's lines of business and other assets and to commence a liquidating insolvency. No party in these proceedings has suggested that it was a viable option to restructure along geographic lines or for a country-specific entity to independently continue in Nortel's business.

**Interim Funding and Settlement Agreement ("IFSA")**

  

28 From the petition date of January 14, 2009, NNL incurred significant expenses to preserve the value of the business, including R&D expenses, and it was experiencing negative cash flow. It had not received any transfer pricing payments from its subsidiaries under the MRDA as a result of the insolvency proceedings.

29 It was evident that there would be significant issues among the parties as to whom the proceeds of the sale of Nortel's assets should be paid. The parties appreciated that if determining the allocation of proceeds from Nortel's assets were a precondition to their sale, sales would be substantially delayed, and the value of the assets would depreciate, resulting in less money for all creditors. Avoiding a dispute during the sale processes about how to allocate the proceeds allowed the parties to obtain the highest monetary value for the assets being sold.

30 On June 9, 2009, the US Debtors (excluding NN CALA, which had not yet filed for bankruptcy), the Canadian Debtors and the EMEA Debtors (excluding NNSA, which later acceded to the agreement) entered into the Interim Funding and Settlement Agreement ("IFSA") to address both interim funding of NNL as well as principles under which collaborative sales of Nortel's businesses and assets could take place.

31 The IFSA provided for a payment by NNI to NNL of $157 million in full settlement of any transfer pricing and other claims NNL might have had against NNI for the period from the petition date through September 30, 2009. The parties also agreed:

(a) to cooperate in the anticipated sales of the Nortel Group's assets;

(b) that their execution of sale documentation or the closing of a sale transaction would not be conditioned upon reaching agreement either on allocation of the sale proceeds or on a binding procedure for determining the allocation question;

(c) that the sale proceeds would be deposited into escrow, and that there would be no distribution out of escrow without either the agreement of all of the selling debtors or the determination of any dispute relating thereto by the relevant dispute resolver;

(d) that in order to facilitate the lines of business sales, the U.S. and EMEA Debtors would enter into appropriate license termination agreements which would provide for the termination of the license rights granted by NNL under the MRDA; termination or relinquishment of a license would be deemed a sale with the licensed participants each being deemed a seller; and

(e) that the agreement would not have any impact on the allocation of proceeds to any Debtor from any asset sale and would not prejudice a party's rights to seek its entitlement to the proceeds from any sale.

32 The US and Canadian Courts entered orders approving the IFSA following a joint hearing on June 29, 2009.

33 On December 23, 2009 the Canadian and U.S. Debtors signed a Final Canadian Funding and Settlement Agreement (the "FCFSA") under which NNI agreed to pay NNL $190.8 million in full and final settlement of all claims that NNL might have against NNI. Further, NNL granted NNI an allowed $2 billion unsecured claim in NNL's CCAA proceedings ranking pari passu with other pre-petition unsecured claims against NNL, with such claim not being subject to offset or reduction. This claim had resulted from the tax authorities reviewing requests by the parties for approval of their transfer pricing arrangements. In 2009 NNL and NNI were advised that an agreement between the CRA and IRS sought a reallocation of income from NNL to NNI in the amount of U.S. $2 billion for the tax years ending 2001 to 2005. The tax authorities did not specify on what basis the $2 billion figure was calculated. The FCFSA, including the $2 billion admitted claim of NNI against NNL, was approved by the Canadian Court on January 21, 2010 and by the U.S. Court on the following day.

**Asset sales**

34 With the IFSA framework in place, the Debtor Estates embarked on a process that resulted in a series of sales of the various business lines, which occurred from mid-2009 through late 2010, with the last transaction closing in March 2011. The

 

total proceeds were approximately $3.285 billion. There remains approximately $2.85 billion of that amount now available to be allocated.

35 In order to sell the lines of businesses separately, Nortel engaged in a "carve-out process" to identify the bundle of assets, rights and obligations that would have to be conveyed in each sale to enable the lines of business to function on a stand-alone basis.

36 An important aspect of the carve-out process was the identification of which IP rights, principally patent rights, needed to be conveyed. Each prospective purchaser of a business line wished to obtain as many patents as possible as part of each sale transaction and, conversely, the Nortel sellers wanted to ensure that the only patents transferred were those incorporated exclusively or principally in the business line in question so as to retain value within Nortel and not to jeopardize the ability to sell the other business lines that might require rights to the same patents.

37 Ultimately, those patents that were "predominantly used" in any given line of business were transferred to the purchaser of that line of business as part of the transaction. In the end, 2,700 patents were transferred as part of the business line sales.

38 For all other patents that were used in each line of business but not predominantly used, a non-exclusive license was granted to the purchaser for use of those patents in the operations of the particular business line being purchased.

39 By the time that all of the business sales were completed in March 2011, Nortel had no remaining operating businesses. What it did retain was a residual patent portfolio consisting of approximately 7000 patents and patent applications. These were principally patents and patent applications that were not used in any of the lines of business and therefore were not subject to licenses to the business sale purchasers. In addition, the residual IP portfolio included patents used by multiple lines of businesses and licensed to the purchasers of those lines of businesses.

40 On April 4, 2011, after significant negotiations with two prospective purchasers, certain Nortel entities (including NNC, NNL, NNI and NNUK) entered into a stalking horse asset sale agreement with a wholly owned subsidiary of Google Inc. with a purchase price of $900 million.

41 An auction was held at the end of June 2011, and the residual patent portfolio was ultimately sold to Rockstar Bidco, LP, a single purpose entity backed by a consortium of major technology companies (Apple, Microsoft, Ericsson, Blackberry, Sony and EMC), for $4.5 billion.

**Position of the parties**

42 In this case the Monitor is acting under what is now referred to as a "super monitor" order of October 3, 2012 in which the Monitor was authorized to exercise any powers which may be exercised by a board of directors of any of the applicants, which includes NNC and NNL. This order occurred after NNC and NNL were left without any board of directors or management and it was necessary for the Monitor to be appointed to advance the interests of NNL and NNC in this CCAA proceeding. While I will refer to the Monitor, I do so in recognition that the Monitor is advancing the position of the Canadian Debtors in this litigation.

43 The intellectual property of Nortel represented by far the largest portion of the assets sold. The Rockstar sale of the residual IP generated $4.5 billion. The lines of business generated $3.285 billion of which approximately $2.85 billion is now available. Intellectual property was a substantial part of the assets of the business lines that were sold, although the experts differed as to its value.

44 The parties and their experts for the most part relied on their interpretation of the MRDA in support of their allocation positions for the proceeds from intellectual property for both the Rockstar sale and the lines of business sales. Two parties, the UKPC (the UK pension claimants, being the trustee of the UK pension plan, and the board of the UK Pension Protection Fund) and the Canadian Creditors Committee [8] contended that the MRDA should not govern the allocation and that a pro rata allocation based on a *pari passu* distribution to all creditors should be used to allocate the lockbox funds.

 

45 It is necessary therefore to consider the MRDA and whether it should govern the allocation.

**The MRDA**

46 The parties look to the rights of the various Nortel entities to intellectual property under the MRDA as a central issue in this proceeding. What these rights are is contested. Many of its terms have been excruciatingly parsed. I will first deal with the meaning of the MRDA as an operating agreement. I will then deal with the issue as to whether it applies, or was intended to apply, to the allocation of the Nortel assets after the world-wide insolvency of Nortel.

47 The MRDA and its predecessor Cost Sharing Agreements [9] ("CSA") were developed for and driven by transfer pricing concepts. Transfer pricing is the act of assigning a monetary value, or price, to movements of resources or economic contributions that occur within a multinational enterprise across different taxing jurisdictions. Against the risk that companies attempt to use transfer pricing to increase operating income (and therefore taxable income) in jurisdictions with low income tax rates and correspondingly to decrease operating income in high-tax jurisdictions, tax authorities around the world have instituted regulations governing intercompany transfer pricing. These regulations centre on the arm's length principle. The arm's length principle necessitates that intercompany transactions be priced in a manner consistent with the way in which similarly situated uncontrolled parties bargaining at arm's length would price the transactions i.e., within an arm's length range.

48 Dr. Eden, a transfer pricing expert who testified on behalf of the U.S. Debtors, well described in her report the way in which transfer pricing agreements are made in light of the fact that governments have developed a dense regulatory framework for transfer pricing due to worries about the potentially negative impacts that transfer pricing can have on government tax and customs duty revenues. The setting of transfer pricing policies for corporate income tax purposes of a multinational enterprise (MNE) is a highly regulated, data-driven and fact-intensive activity dominated by professionals. The establishment of an MNE's transfer pricing policy typically involves not only MNE group in-house staff, but also accountants, economists, lawyers, tax experts and other consultants. Moreover, an MNE's transfer pricing policy may involve the input of revenue authorities through an advance pricing agreement (APA) procedure.

49 All of this applied to Nortel and much evidence was given by tax people as to the process by which the MRDA was made and changed. Evidence was also given by some of them as to their view of the meaning of the agreement, the admissibility of which is contested.

***(i) Governing law of the construction of the contract***

50 The MRDA is by its terms to be construed in accordance with and governed by the law of Ontario. The same applied to the predecessor CSAs.

51 A number of authorities have been cited. A brief consideration of them is required in light of the various arguments made about the MRDA, particularly as it involves the principles of interpreting commercial contracts, what can be looked at when considering the factual matrix of the agreement and the use of recitals in an agreement in the interpretive process.

52 Winkler C.J.O. articulated the test for construing a commercial contract in *Salah v. Timothy's Coffees of the World Inc.* (2010), 74 B.L.R. (4th) 161 (Ont. C.A.) as follows:

> **16** The basic principles of commercial contractual interpretation may be summarized as follows. When interpreting a contract, the court aims to determine the intentions of the parties in accordance with the language used in the written document and presumes that the parties have intended what they have said. The court construes the contract as a whole, in a manner that gives meaning to all of its terms, and avoids an interpretation that would render one or more of its terms ineffective. In interpreting the contract, the court must have regard to the objective evidence of the "factual matrix" or context underlying the negotiation of the contract, but not the subjective evidence of the intention of the parties. The court should interpret the contract so as to accord with sound commercial principles and good business sense, and avoid

  

> commercial absurdity. If the court finds that the contract is ambiguous, it may then resort to extrinsic evidence to clear up the ambiguity.

53 In *Kentucky Fried Chicken Canada v. Scott's Food Services Inc.* (1998), 41 B.L.R. (2d) 42 (Ont. C.A.) Goudge J.A. stated the following regarding the interpretation of a commercial agreement at para. 27

> Where, as here, the document to be construed is a negotiated commercial document, the court should avoid an interpretation that would result in a commercial absurdity. [*City of Toronto v. W.H. Hotel Ltd*. (1966), 56 D.L.R. (2d) 539 at 548 (S.C.C.)]. Rather, the document should be construed in accordance with sound commercial principles and good business sense; [*Scanlon v. Castlepoint Development Corporation et al.* (1992), 11 O.R. (3d) 744 at 770 (Ont.C.A.)]. Care must be taken, however, to do this objectively rather than from the perspective of one contracting party or the other, since what might make good business sense to one party would not necessarily do so for the other.

54 I take the principles in *Kentucky Fried Chicken Canada* and in *Salah*, the latter adopted by Cronk J.A. in *Downey v. Ecore International Inc.*, 2012 ONCA 480 (Ont. C.A.) and by Juriansz J.A. in *Ariston Realty Corp. v. Elcarim Inc.*, 2014 ONCA 737 (Ont. C.A.), as the applicable principles governing this case. See also *Unique Broadband Systems Inc., Re*, 2014 ONCA 538 (Ont. C.A.) at para. 88. [10]

55 The factual matrix of the contract is to be considered. What may be considered was expressed in *Kentucky Fried Chicken* as follows:

> **25** ...While the task of interpretation must begin with the words of the document and their ordinary meaning, the general context that gave birth to the document or its "factual matrix" will also provide the court with useful assistance. In the famous passage in *Reardon Smith Line Ltd. v. Yngvar Hansen-Tangen*, [1976] 1 W.L.R. 989 at 995-96 (H.L.) Lord Wilberforce said this:
>
>> No contracts are made in a vacuum: there is always a setting in which they have to be placed. The nature of what is legitimate to have regard to is usually described as "the surrounding circumstances" but this phrase is imprecise: it can be illustrated but hardly defined. In a commercial contract it is certainly right that the court should know the commercial purpose of the contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating.
>
> **26** The scope of the surrounding circumstances to be considered will vary from case to case but generally will encompass those factors which assist the court "... to search for an interpretation which, from the whole of the contract, would appear to promote or advance the true intent of the parties at the time of entry into the contract." *Consolidated Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co.*, [1980] 1 S.C.R. 888 at 901.

56 More recently, Rothstein J. in *Creston Moly Corp. v. Sattva Capital Corp.*, 2014 SCC 53 (S.C.C.) referred to the use of surrounding circumstances and cautioned as to the extent they can be considered:

> **57** While the surrounding circumstances will be considered in interpreting the terms of a contract, they must never be allowed to overwhelm the words of that agreement (*Hayes Forest Services*, at para. 14; and Hall, at p. 30). The goal of examining such evidence is to deepen a decision-maker's understanding of the mutual and objective intentions of the parties as expressed in the words of the contract. The interpretation of a written contractual provision must always be grounded in the text and read in light of the entire contract (Hall, at pp. 15 and 30-32). While the surrounding circumstances are relied upon in the interpretive process, courts cannot use them to deviate from the text such that the court effectively creates a new agreement (*Glaswegian Enterprises Inc. v. B.C. Tel Mobility Cellular Inc*. (1997), 101 B.C.A.C. 62).
>
> **58** The nature of the evidence that can be relied upon under the rubric of "surrounding circumstances" will necessarily vary from case to case. It does, however, have its limits. It should consist only of objective evidence of the background facts at the time of the execution of the contract (*King*, at paras. 66 and 70), that is, knowledge that was or reasonably ought to have been within the knowledge of both parties at or before the date of contracting. Subject to these requirements and

the parol evidence rule discussed below, this includes, in the words of Lord Hoffmann, "absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man" (*Investors Compensation Scheme*, at p. 114). Whether something was or reasonably ought to have been within the common knowledge of the parties at the time of execution of the contract is a question of fact.

57 It is clear that the factual matrix that can be considered may not include evidence of the subjective intent of a party or what a party believed a contract to mean. See *Sattva*, *supra*, at para. 59. It may also not include evidence of negotiations or create an ambiguity where none exists in an agreement. See also *Primo Poloniato Grandchildren's Trust (Trustee of) v. Browne* (2012), 115 O.R. (3d) 287 (Ont. C.A.) in which Feldman J.A. stated:

> **71** While the scope of the factual matrix is broad, it excludes evidence of negotiations, except perhaps in the most general terms, and evidence of a contracting party's subjective intentions: Geoff R. Hall, *Canadian Contractual Interpretation Law*, 2d ed. (Markham: LexisNexis, 2012), at p. 27. As the cases above suggest, the factual matrix includes only objective facts known to the parties at or before the date of the agreement, and what is common to both parties: Hall, p. 30. Hall goes on to state that while the factual matrix can "be used to clarify the parties' intentions as expressed in a written agreement, it cannot be used to contradict that intention, create an ambiguity which otherwise does not exist in the written document, or have the effect of making a new agreement": p. 31 (footnotes omitted). Ultimately, the words of the agreement are paramount.

58 The recitals in the MRDA are the subject of debate in this case. A clear statement of how recitals may be used in the interpretation of an agreement can be found in *Elliott Estate, Re*, [1962] O.J. No. 164 (Ont. C.A.); aff'd [1963] S.C.R. 305 (S.C.C.). In that case, Kelly J.A. stated that a recital could be used only if there is an ambiguity in the operative parts of the agreement and the recital is clear. He stated:

> **11** I turn therefore to consider to what extent the recital may be used to overcome the patent deficiencies of clauses 6 and 7 and in fact of the whole operative parts of the agreement. In the first instance it must be borne in mind that a recital is not a necessary part of a document and its use in the interpretation of the document as a whole is strictly limited.
>
>> The reciting Part of a Deed is not at all a necessary Part either in Law or Equity. It may be made use of to explain a Doubt of the Intention and Meaning of the Parties but it hath no Effect or Operation. But when it comes to limit the estate, there the Deed is to have its Effect according to what Limitations are therein set forth.
>
> Per Holt, C.J., *Bath and Mountague's Case* (1693) 3 Cas. in Ch. 55 at 101; 22 E.R. 963 at 991. An oft quoted statement of the extent to which reference may be had to recitals is contained in the judgment of Lord Esher, M.R. in *Ex Parte Dawes. In Re Moon*, (1886) 17 Q.B.D. 275 at p. 286:
>
>> Now there are three rules applicable to the construction of such an instrument. If the recitals are clear and the operative part is ambiguous, the recitals govern the construction. If the recitals are ambiguous, and the operative part is clear, the operative part must prevail. If both the recitals and the operative part are clear, but they are inconsistent with each other, the operative part is to be preferred.
>
> It is to be noted that the qualifying condition for the use of a recital in the interpretation of the operative parts is that there must be ambiguity in the operative parts; in such a case the preferred meaning to be given to the operative words should be that consistent with the intention expressed in the recital, provided that the words of the operative part are by themselves capable of such an interpretation. *MacKenzie v. Duke of Devonshire*, (1896) App. Cas. 400; *Ex Parte Dawes. In Re Moon, Supra*; *In re Sugden's Truts, Sugden v. Walker*, (1917) 2 Ch. 92. It is essential, however, that the construction to be placed upon the operative part in the light of the recital be a construction which the words themselves of the operative part are capable of bearing. Where, however, the operative parts of a document, due to the lack of appropriate words, are incapable of a construction which will fulfil the intention expressed in recitals, the recital may not be used for the purpose of reading into the operative clause a meaning which it is incapable of conveying when considered by itself.

59 It was held in *PUC Distribution Inc. v. Brascan Energy Marketing Inc.*, 2008 ONCA 176 (Ont. C.A.), that an elevation of a recital to a mutual promise or operative provision was an error.

  

60 *Eli Lilly & Co. v. Novopharm Ltd.*, [1998] 2 S.C.R. 129 (S.C.C.) at para. 57, in which Iacobucci J. in discussing the meaning of an agreement referred to the recitals, was referred to in argument. Iacobucci J. did not discuss the principles to be used in considering recitals. *Sistem Mühendislik İnsaat Sanayi Ve Ticaret Anonim Sirketi v. Krygyz Republic*, 2012 ONSC 4983 (Ont. S.C.J. [Commercial List]), has also been referred to in argument, a decision in which I did not refer to the principles to be used in considering recitals in interpreting contracts. I consider the decision in *Sistem* to be consistent with the principles enunciated by Kelly J.A. in *Elliott Estate*. I do not see either *Eli Lilly* or *Sistem* establishing any different criteria for the use of recitals from *Elliott Estate*.

61 I turn now to the interpretation of the MRDA and the rights accorded in it keeping these interpretive principles in mind.

***(ii) Position of the parties***

62 The essential differences in allocation positions advanced by the parties flow from the different manner in which each characterizes the terms of the MRDA, the interests held by the parties in Nortel's IP, and the applicability of terms of the MRDA to the value ascribed to various assets.

63 The Monitor, supported by the CCC, contends that under the MRDA, NNL owned the IP and the interests of NNI and the other participants to the MRDA were restricted to certain exclusive and non-exclusive license rights granted to them by NNL pursuant to the terms of the MRDA. The Monitor says that the license rights were not unlimited, as they did not cover all rights in the IP in question, but rather covered only a subset (albeit a substantial subset) of the IP rights, on certain terms, all of which have valuation implications. In particular, the Monitor says that the license rights granted to NNI and the other licensed participants were not all rights to the IP but were subject to "field of use" restrictions that gave the licensees the right to use the IP to make, use or sell "Products" as defined in the MRDA, which meant products, software or services that were made or sold by, or for, any of the licensees. This meant that the Products must have been created or marketed by or for the Nortel Group. No product that was part of a third party's business rather than the business of Nortel could fall within the definition of Products. While the license gave the licensees the right to sublicense, this could not permit the licensees to sublicense what they did not have.

64 The Monitor's position, supported by the CCC, is that what was sold in the Rockstar sale of IP was the ownership of residual patents and patent applications owned by NNL. The purchasers would not have bought the residual IP to make Nortel products, and that as the license rights held by NNI and the other licensees would not have permitted them to sublicense to the Rockstar consortium the right to use the IP for the Rockstar consortium's own purposes, the proceeds of the Rockstar sale belong to NNL.

65 The position of NNI, supported by the other U.S. interests, asserts that each of NNI and the other licensees held all of the rights and all of the value in the IP in their respective exclusive territories as defined in the MRDA. The U.S. Debtors assert that the license rights NNI held were not subject to any field of use or scope restriction or limitation, resulting in an assertion that all of the economic value in the IP in the exclusive territory belonged to the licensee. They contend that the legal title held in the IP under the MRDA was a purely "bare" legal title with no monetary value. They also rely on a right to sue for damages in the U.S. for infringement of NN Technology by others.

66 The position of the EMEA debtors is that each of the parties to the MRDA jointly owned all of the IP in proportion to their financial contributions to research and development, and that all share in the sale proceeds attributable to IP in those same proportions. The joint ownership is said to arise independent of, but recognized in, the MRDA.

***(iii) Analysis***

*(a) The meaning of the exclusive license*

67 The agreement is headed MASTER R&D AGREEMENT. It was entered into on December 22, 2004 with an effective date of January 1, 2001 and states that it confirms and formalizes the operating arrangements of the participants as and from that date. It provided that NNL was the legal owner of the NN Technology (the IP), and it contained grants of licenses from NNL to the other participants, referred to as the Licensed Participants. Each Licensed Participant was given an exclusive license for

  

its territory and a non-exclusive license for those parts of the world other than Canada and where the Licensed Participants had their exclusive territory. The exclusive territory for NNI was the U.S. and Puerto Rico, for NNUK was the United Kingdom, for NNSA was France and for Nortel Ireland was the Republic of Ireland.

68 At its core, so far as the ownership and licensing of the IP is concerned are articles 4(a) and 5(a) and (b). The original language remained in substance but was amended from time to time. These articles as amended are as follows:

**Article 4 — Legal Title to NN Technology**

(a) Except as otherwise specifically agreed, legal title to any and all NN Technology whether now in existence or hereafter acquired, or developed pursuant to the terms of this Agreement, shall be vested in NNL. In consideration therefor, NNL agrees to enter into an Exclusive License and a Non-Exclusive License with each of the Licensed Participants as set forth in Article 5.

**Article 5 — Grant of Exclusive Licenses by NNL**

(a) To the extent of its legal right to do so, and subject to the rights of relevant third parties, NNL hereby:

(i) continues to grant to each Licensed Participant an exclusive, royalty-free license, including the right to sublicense, which except as hereinafter provided shall be in perpetuity, rights to make, have made, use, lease, license, offer to sell, and sell Products using or embodying NN Technology in and for the Exclusive Territory designated for that Licensed Participant, and all rights to patents, industrial designs (or equivalent) and copyrights, and applications therefor, and technical know-how, as necessary or appropriate in connection therewith ("Exclusive License"); and

(ii) grants to each Licensed Participant, as of January 1, 2009 (the "Non-Exclusive License Effective Date"), a non-exclusive, royalty-free license, including the right to sublicense, which except as hereinafter provided shall be in perpetuity, rights to make, have made, use, lease, license, offer to sell, and sell Products using or embodying NN Technology in and for the Non-Exclusive Territory, and all rights to patents, industrial designs (or equivalent) and copyrights, and applications therefor, and technical know-how, as necessary or appropriate in connection therewith ("Non-Exclusive License").

69 To support their differing interpretations of these provisions, the parties augment to some extent their arguments by reference to other provisions in the MRDA. It will be necessary to deal with these. As can be seen from article 5(i), NNL "continues to grant", a reflection of the fact that prior to the MRDA, the parties were governed by Cost Sharing Agreements (CSAs) [11] . Recitals to the MRDA make this clear:

WHEREAS legal title to all NN Technology is held in the name of NNL;

WHEREAS each Licensed Participant held and enjoyed equitable and beneficial ownership of certain exclusive rights under NT Technology for a Specified Territory pursuant to the Amended Research and Development Cost Sharing Agreement entered into on January 1, 1992, and it is the intent of NNL and the Licensed Participants that the Licensed Participants continue, as of the effective date of this Agreement, to hold and enjoy such rights;

70 In considering the various interpretations of the MRDA put forward by the parties, it is helpful to compare those provisions with the earlier CSA provisions. Under the CSA, the parties split the costs of R&D by a certain formula. That agreement did not purport to split profits in any way. However, the tax authorities made it clear that they no longer would permit a cost sharing arrangement at Nortel and instead wanted an arrangement whereby profits would be shared among the participants by a residual profit split method (RPSM) that allocated profits according to the amount each participant spent on R&D. Relevant recitals in the MRDA that were not contained in the previous CSA are:

WHEREAS each Participant bears the full entrepreneurial risks and benefits for the Nortel Networks business;

 

WHEREAS each Participant has performed, in the past, and intends to continue to perform R&D Activity with respect to the Nortel Products;

WHEREAS each Participant desires to avoid the duplication of R&D Activity;

WHEREAS each Participant believes that it is appropriate that each Participant should benefit from its contribution to R&D activity commensurate with the value of its contribution to that R&D activity in the context of the manner in which the Nortel Networks business is conducted and that the residual profit split methodology (RPSM) is the best arm's length measure, in the circumstances of NNL and the Participants, of such contributions with reference to such benefits;

WHEREAS this Agreement reflects the Participants' intent and agreement since January 1, 2001 to enter a license arrangement with the Licensed Participants, and the Participants have operated from January 1, 2001 in accordance with the terms set forth herein;

WHEREAS Participants acknowledge that as a result of a collective review by the Canadian Customs and Revenue Agency, the US Internal Revenue Service, and the UK Inland Revenue regarding the application of the RPSM, the calculation of the RPSM as set forth in Amended Schedule A may be amended which amendments would require the consent of the Participants;

71 These recitals and the RPSM method contained in the MRDA were driven by transfer pricing considerations. The language, for example, that each Participant (NNL and the Licensed Participants) bears the full entrepreneurial risks and benefits for the Nortel Networks business was not in the prior CSA and was part of the rationalization adopted to support a RPSM.

72 The MRDA provided in article 2 that each Participant would perform R&D at a level consistent with past practices and share the results of its R&D with the other participants. Article 3 provided payment for the R&D as follows:

**Article 3 — R&D Activity Payments**

(a) For and as a consequence of the performance of R&D Activity, each Participant shall be entitled to receive a payment in an amount equal to the allocation determined under the RPSM (the "R&D Allocation") as the measure of the benefit to which it is entitled commensurate with its performance of, and contribution to, R&D Activity.

(b) Each Participant hereby accepts and agrees to make the payment determined under the RPSM in Amended Schedule A [12] Participant's share of the R&D Allocation. as representing such

(c) The R&D Allocation will be computed pursuant Amended Schedule A which sets forth the basis of the RPSM as originally proposed to the Revenue Authorities. The Participants understand that the RPSM is the subject of review, discussions and negotiations with the Revenue Authorities. The Participants agree to amend this Agreement and to adjust the RPSM to the extent necessary to reflect any negotiated determination with the Revenue Authorities as to the final R&D Allocation.

73 The U.S. Debtors and EMEA take the position that the legal title that is vested in NNL under article 4 of the MRDA is bare legal title given to NNL for administrative convenience to enable it to administer all NN Technology and that the licensed participants own the equitable and beneficial interest in the NN Technology. It draws on the recital that provides:

WHEREAS each Licensed Participant held and enjoyed equitable and beneficial ownership of certain exclusive rights under NT Technology [13] for a Specified Territory pursuant to the Amended Research and Development Cost Sharing Agreement entered into on January 1, 1992, and it is the intent of NNL and the Licensed Participants that the Licensed Participants continue, as of the effective date of this Agreement, to hold and enjoy such rights;

74 I do not see this recital as clearly stating that a Licensed Participant has equitable and beneficial ownership of the NT Technology. It states that a Licensed Participant held equitable and beneficial ownership of "certain exclusive rights under NT

 

Technology" and would continue to have such rights. The recital does not say what the "certain exclusive rights" were and it is just as consistent with those rights being license rights rather than ownership rights in the technology. As well, having equitable and beneficial ownership of certain exclusive rights "*under* NT Technology" would seem to be something different from having equitable and beneficial ownership of certain exclusive rights "of" or "in" the NT Technology.

75 In the CSA referred to in the recital, the language used is as follows:

> **ARTICLE 4 LEGAL TITLE TO NT TECHNOLOGY**
>
> The Parties hereto acknowledge that, except as otherwise specifically agreed, legal title to all NT Technology whether now in existence or developed pursuant to the terms of this Cost Sharing Agreement, except patents owned by Participant [Northern Telecom Inc., now NNI] on January 1, 1980, shall be vested in Northern Telecom [now NNL]. With respect to patentable inventions and copyrightable property encompassed by NT Technology, Northern Telecom shall have the exclusive right but not the obligation to file and prosecute applications in its name for patent or copyright protection in every country of the world. Participant shall execute or cause to be executed such documents reasonably requested by Northern Telecom as may be necessary or desirable to give effect to the foregoing. (Underlining added).

76 The exception in this provision for patents owned by Northern Telecom Inc., now NNI, suggests that the legal title vested in Northern Telecom (now NNL) was ownership rather than bare legal title. Otherwise there would have been no purpose in excluding the patents owned by Northern Telecom Inc. It would not have been necessary.

77 In article 6 of the CSA, dealing with confidential information, it is stated:

> Participant acknowledges that Northern Telecom is the legal owner of the NT Technology developed pursuant to this Cost Sharing Agreement and that the NT Technology is proprietary and constitutes a trade secret. Participant shall hold the NT Technology in confidence and only make use of or disclose it as permitted by this Cost Sharing Agreement.

78 This provision refers to Northern Telecom being the "legal owner". This is consistent with the language of article 4 of the CSA. If, as stated in the recital to the MRDA, it was the intent of NNL and the Licensed Participants that the Licensed Participants would continue under the MRDA to hold and enjoy such rights as they held under the CSA, those rights would not include legal ownership of the NN Technology.

79 NNI also relies on language in Schedule A of the MRDA to assert its beneficial ownership of the NN Technology. It provides in part:

> **Calculation of Arm's Length R&D Allocation to each Participant**
>
> The purpose of this section is to provide a brief summary of Nortel's transfer pricing policy and to provide clarity as to how each Participant is to be compensated under this Agreement.
>
> The current transfer pricing methodology is the residual profit split method ("RPSM") which was adopted by the Participants at the request of the tax authorities as the most appropriate method for determining the arm's length compensation to each of the Participants for the R&D Activity to be provided pursuant to the Master R&D Agreement. The RPSM acknowledges the fact that the key profit driver in the Nortel business is the development and maintenance of rapidly depreciating intellectual property ("IP").
>
> Accordingly, the R&D Allocation provided to Participants under the RPSM reflects the fact that the Participants bear the full entrepreneurial risk of the Nortel business such as the risks attendant with the substantial and continuous development and ownership of the NN Technology. Mathematically, the RPSM accords the Participants all the upside risk in the Nortel business as well as the downside risk. (Underlining added).

80 Schedule A is part of the MRDA. I do not, however, read it as granting rights. The rights are granted in the operative provisions of the MRDA. Schedule A states at the outset that its purpose is to give a brief summary of Nortel's transfer pricing

  

policy and to provide clarity as to how each participant is to be compensated. Schedule A provides in some detail how the residual profit is to be calculated and split amongst the Participants. Stating that Participants bear risks such as risks attendant with the development and ownership of the NN Technology does not state that ownership of the technology is being granted. What the Licensed Participants were granted in the MRDA were license rights.

81 Various dictionary definitions were resorted to in arguing what the meaning of "legal title" to the NN Technology was that was vested in NNL under article 4 of the MRDA. In the end, I do not think it necessary to get into that debate. NNL had ownership of NN Technology to the extent that NN Technology was not licensed to the Licensed Participants. Rights in inventions were assigned by the inventors to NNL and NNL applied for the patents and was named as owner of them. It was NNL who granted licenses to the Licensed Participants. NNUK, for example, did not provide a license to NNI for IP developed by NNUK. It was NNL that did so. Although NNL had the exclusive right to the NN Technology in Canada under the MRDA, the MRDA did not grant any license to NNL. That was recognition that it was NNL that owned the NN Technology.

82 A licensee does not enjoy property rights. Its rights are contractual. A licence is merely a permission to do that which would otherwise amount to trespass. See *Kraft Canada Inc. v. Euro Excellence Inc.*, [2007] 3 S.C.R. 20 (S.C.C.) at para. 27. A licensee's rights are not necessarily equivalent to those of the patentee; rather, they are limited to, and qualified by, the express terms of the license. See *Eli Lilly & Co. v. Novopharm Ltd.*, [1998] 2 S.C.R. 129 (S.C.C.) at para. 49. It is the determination of what those license rights were that were granted to the Licensed Participants in the MRDA that is important because it is those license rights that were given up by Licensed Participants to permit the business line sales and the sale of the residual IP to Rockstar.

83 The grant of the exclusive license in the MRDA in article 5(i) is:

> ...NNL hereby:
>
> (i) continues to grant to each Licensed Participant an exclusive, royalty-free license, including the right to sublicense, which except as hereinafter provided shall be in perpetuity, rights <u>to make, have made, use, lease, license, offer to sell, and sell Products using or embodying NN Technology</u> in and for the Exclusive Territory designated for that Licensed Participant, and all rights to patents, industrial designs (or equivalent) and copyrights, and applications therefor, and technical know-how, as necessary or appropriate in connection therewith (Exclusive License") (Underlining added);

84 The license is not a license of NN Technology, but rather a license "to make... and sell Products using or embodying NN Technology". Thus the MRDA definition of "Products" is of central importance and the Monitor says that "Products" is defined to mean products, software or services that were made or sold by, or for, NNL and the Licensed Participants. The Monitor contends that products not made for NNL or the Licensed Participants, such as products that would be made by the Rockstar consortium members or their licensees are not covered by the license.

85 The definition of "Products" at Article 1(g) of the MRDA is:

> "Products" shall mean all products, software and services designed, developed, manufactured or marketed, or proposed to be designed, developed, manufactured or marketed, at any time <u>by, or for, any of the Participants,</u> and all components, parts, sub-assemblies, features, software associated with or incorporated in any of the foregoing, and all improvements, upgrades, updates, enhancements or other derivatives associated with or incorporated in any of the foregoing. (Underlining added).

86 The U.S. Debtors parse the language of the license grant and contend that the Licensed Participants obtained all of the rights to the NN Technology. They break down the grant of the exclusive license into four clauses as follows:

> NNL hereby:
>
> continues to grant to each Licensed Participant an exclusive, royalty-free license, including
>
> the right to sublicense, which except as hereinafter provided shall be in perpetuity,

  

rights to make, have made, use, lease, license, offer to sell, and sell Products using or embodying NN Technology in and for the Exclusive Territory designated for that Licensed Participant, and

all rights to patents, industrial designs (or equivalent) and copyrights, and applications therefor, and technical know-how, as necessary or appropriate in connection therewith ("Exclusive License").

87 The U.S. Debtors stated in their opening brief that the opening grant of an exclusive, royalty-free license in the first clause is not limited by the word "including". They say the word "including" does not create a limitation, that the word "including" follows the words "exclusive, royalty-free license" and thus the words that follow cannot, and do not purport to, limit the broad exclusive licenses granted to the licensed participants under the MRDA. In effect they argue that the opening words before the word "including" created a complete grant of a license without reserve.

88 I cannot accept that argument. The words "continues to grant an exclusive, royalty-free license", on their own, do not say what the license is, or what it is for, or for how long. Given that a licensee's rights are limited to, and qualified by, the express terms of the license (*Eli Lilly & Co.* at para. 49), a license grant of uncertain scope, such as proposed by the U.S. Debtors, would have no meaning. Moreover, the words "in and for the Exclusive Territory designated for that Licensed Participant" appear after "including". On the U.S. Debtors' reading of the license, the territorial limitation would only apply to the license to make Products, and would not apply to a broad exclusive license that they say is already created before one gets to the word "including". It would also mean that the words "in perpetuity" which follow the reference to a sublicense would not apply to the broad exclusive license, which is inconsistent with what the U.S. Debtors say is the case.

89 There would be no commercial purpose in the MRDA granting a broad unrestrictive license and then providing more specific grants in the license that are restricted. For example, the third clause restricts the licensee to selling Products, which contains terms of limitation.

90 The U.S. Debtors also contend that the third clause permits NNI or any other Licensed Participant to make or have made for it Products using NN Technology and that the sublicense rights contained in the second clause are not so limited to Products using NN Technology. I cannot accept that contention. A sublicense could not sublicense more than the licensee had under its license and the second clause could not purport to do so. This argument of the U.S. Debtors relies on its argument that the first clause was a broad unrestrictive grant of a license, which argument I cannot accept.

91 The U.S. Debtors contend that the fourth clause is a free-standing or "catch-all" license grant of all rights to patents etc. unconnected to the license to make, use or sell Products. The language of this provision is:

all rights to patents, industrial designs (or equivalent) and copyrights, and applications therefor, and technical know-how, as necessary or appropriate in connection therewith ("Exclusive License");

92 The U.S. Debtors say that the concluding words "in connection therewith" refer to the preceding words "technical know-how". The contention of the U.S. Debtors is that this last clause is like the first clause, being a separate grant not limited by the right to make, use or sell Products. The Monitor says that these all of these words in the clause relate to the license to make, use or sell Products and that the words "in connection therewith" do not relate only to the reference to technical know-how.

93 I must say that I find it difficult to accept that the concluding words "in connection therewith" modify only the words "technical know-how". There would be no need for a comma after the words technical know-how". Those words, even if only applicable to the last clause, could apply equally to "industrial designs (or equivalent)" and "applications therefor".

94 I do not find persuasive at all the attempt of the U.S. Debtors to parse the language of the grant of license as they have done. On their reading, there are several different grants of license. Yet at the end of the paragraph are the words "Exclusive License" in parenthesis. There is only one license and the words should be read together harmoniously.

95 The U.S. Debtors make the point that what they refer to as the last clause in the license grant would be superfluous on the reading of the Monitor. That is because the definition of Products and NN Technology includes patents and the other things

  

contained in that last clause. The U.S. Debtors say that because in interpreting a contract one should strive to give meaning to all of its terms, the last clause should be read as providing rights different from the rights to make, use or sell Products. While this argument on its face has a certain attractiveness, I do not think it right in this case.

96 The grant of license rights in article 5 is one grant. It does not in the paragraph expressly spell out the definition of Product or NN Technology. The draftsman may have thought it prudent to include the final clause. The words "in connection therewith" must be given some meaning and I do not accept the meaning given to them by the U.S. Debtors. I read the words as relating to the grant of a license to make, use and sell Products employing NN Technology, which in my view was the intent of the entire license granted in clause 5(i).

97 The Monitor refers to a statement of Lord Hoffman, no stranger to contract interpretation and a legal giant of his day, in *Beaufort Developments (NI) Ltd. v. Gilbert-Ash (NI) Ltd.* (1998), [1999] 1 A.C. 266 (Ireland H.L.), at 274 that arguments of redundancy should be treated with caution. He stated:

> I think, my Lords, that the argument from redundancy is seldom an entirely secure one. The fact is that even in legal documents (or, some might say, especially in legal documents) people often use superfluous words. Sometimes the draftsmanship is clumsy; more often the cause is a lawyer's desire to be certain that every conceivable point has been covered. One has only to read the covenants in a traditional lease to realise that draftsmen lack inhibition about using too many words.

98 In *Long v. Delta Catalytic Industrial Services Inc.*, [1998] 6 W.W.R. 792 (Alta. Q.B.), Fruman J. (as she then was) said much the same thing:

> Some might argue that this interpretation makes the provision redundant...That may well be the case, but it won't be the first time that a repetitive provision has been inserted into an agreement.

99 Redundancy could also be laid at the feet of the U.S. Debtors in their interpretation of the license grant. If their reading is correct, all of the second, third and fourth clauses would be redundant as the first clause was an unrestricted grant of a license. I think in this case redundancy arguments are just that, arguments that do not deal with the commercial purpose of the agreement.

100 An addendum to the MRDA dated December 14, 2007 with effect from January 1, 2006 was made to adopt changes to the terms of the MRDA that had been reflected in the financial statements of the Participants. The first two recitals of this addendum stated:

> Whereas each Participant holds and enjoys equitable and beneficial ownership of NN Technology as defined in the Prior Agreement,
>
> Whereas this Addendum continues each Participant's rights and obligations in the NN Technology,

101 The reason for this addendum was stated in the third recital

> Whereas given changes in the Nortel business, NNL and certain other Participants are seeking governmental approval of modifications to the RPSM.

102 This was the first of two addenda that changed the way of calculating the residual profit split each year from an amortized 30% spend of each Participant each year on R&D to a five year rolling average spend by each Participant on R&D. The operative parts of this addendum did not change the operative terms of the prior MRDA relating to the licence rights granted to the participants. I do not read the first two recitals that "each Participant holds and enjoys equitable and beneficial ownership of NN Technology as defined in the Prior Agreement" and the addendum "continues each Participant's rights ... in the NN Technology" as changing anything with respect to those rights in the prior MRDA. It is how the prior MRDA defines the rights of the participants that is important.

  

103 Confidentiality provisions are contained in the MRDA. The Monitor contends that because under article 6(a) the licensed participants owe a duty of confidentiality to NNL regarding the NN Technology but NNL does not owe such a duty to the Licensed Participants is an indication of the ownership by NNL of the NN Technology. The U.S. Debtors contend that because exceptions to the duty of confidentiality in article 6(d) give the right to the Licensed Participants to communicate to suppliers, customers and third persons licensing rights to use the NN Technology that they must have been given the authority to license to such third parties.

104 I think too much is made by each side of these confidentiality provisions. There is something perhaps in each side's argument, but I would not read article 6 as expanding on or limiting the ownership or license rights of the NN Technology. That was not its purpose. Regarding article 6(d)(iii), it begs the question as to whom the rights were given to license to third parties, and in light of the evidence of sub-licensing prior to the MRDA, to which I will refer in dealing with surrounding circumstances or the factual matrix, it is clear that NNL was a party to all such sub-licensing and NNI alone never sub-licensed.

105 The U.S. debtors contend that what was intended by IPCo comfortably falls within the definition of a Product and that therefore what was sold to Rockstar embodied rights that NNI had. They contend:

> IPCo was a licensing service business that the Participants proposed to be developed and indeed were actively developing, and which indisputably embodied the entirety of the Patent Portfolio sold to Rockstar, fits comfortably within the plain meaning of a "service" and thus the definition of "Products".

106 I do not agree. IPCo was considered for a time after the insolvency filings in January 2009. It could not be considered to have been part of the operating arrangements of Nortel while it carried on its business or intended to be governed by the MRDA. IPCo was not intended to be a "licensing service" business. The evidence of Sharon Hamilton, which I accept, is that the proposed business of IPCo was to use threatened or actual litigation against technology companies making their own products which arguably used or embodied NN Technology, in an attempt to encourage them to take and pay for a license to NN Technology. That was not a business contemplated in any meaningful way at any time that the MRDA or its predecessor was negotiated or signed.

107 The economic analysis prepared by Horst Frisch in 2002 as part of its work in devising the RPSM for the MRDA referred to Nortel customers choosing Nortel products and services because Nortel is committed to using its R&D resources in providing full pro-active service and support to its customers. A functional analysis for the years 2000 to 2004 sent by Nortel to the tax authorities in 2004 said the same thing. It also stated:

> Nortel's networking solutions generally bring together diverse networking products from its various product families, and related services, to create either a customized or "off the shelf" solution for customers. Nortel's business consists of the design, development, manufacture, assembly, marketing, sale, licensing, servicing and support of these networking solutions.

108 The definition of Products in the MRDA is:

> "**Products**" shall mean all products, software and services designed, developed, manufactured or marketed, or proposed to be designed, developed, manufactured or marketed, at any time by, or for, any of the Participants, and all components, parts, sub-assemblies, features, software associated with or incorporated in any of the foregoing, and all improvements, upgrades, updates, enhancements or other derivatives associated with or incorporated in any of the foregoing.

109 Taken this definition, the license to NNI and the other participants was to "make, use..., license...sell" Products using or embodying NN Technology by, or for, the Participants. The Monitor contends that giving someone else (i.e. not any of the Participants) the right to use or embody NN Technology in their own products are not "services" within the Products definition in the MRDA. The Monitor contends that on the U.S. Debtors' reading of the word "services" in the MRDA, NNI could have provided a "service" to competitors of Nortel by permitting them to use in the U.S. the entirety of Nortel's patent pool to make their own products to compete with Nortel. The plain reading of the MRDA and common sense are contrary to this interpretation.

 

110 I agree with the Monitor's interpretation of the MRDA. At the time the MRDA was being considered, Nortel was not in a business of licensing its services to others for the business of others. It was providing a service to its customers to support the technology being acquired by its customers. The MRDA must be read in that context. What was contemplated for a relatively short period of time after the world wide insolvency of the Nortel Group was simply not in the cards prior to that time.

*(b) The right to sue for infringement*

111 The U.S. Debtors contend that the right to sue is central to their rights as exclusive licensee in the U.S. The right to sue is contained under Article 4 which is headed Legal Title to NN Technology. The right is not contained in the exclusive or non-exclusive licenses under article 5. I cannot read this right to sue as being part of the licenses granted to the licensed participants in article 5. Articles 4 (a) and (e) are relevant, and provide:

> (a) Except as otherwise specifically agreed, legal title to any and all NN Technology whether now in existence or hereafter acquired, or developed pursuant to the terms of this Agreement, shall be vested in NNL. In consideration therefor, NNL agrees to enter into an Exclusive License and a Non-Exclusive License with each of the Licensed Participants as set forth in Article 5.
>
> (e) Licensed Participants have the right to assert actions and recover damages or other remedies in their respective Territories for infringement or misappropriation of NN Technology by others.

112 This right was not contained in the prior CSA. It first appeared in the MRDA.

113 This right in sub-article 4 (e) does not state that the Licensed Participants have the exclusive right to bring action in their territories. The exclusive rights which the Licensed Participants have are contained in the exclusive license rights in article 5. There is no provision in the MRDA that precluded NNL from suing for patent infringement in a territory in which Licensed Participants had exclusive license rights. Indeed, the limited practice in the U.S. before the MRDA was signed was that both NNL and NNI were named as plaintiffs in infringement actions. To the extent those actions can be considered to be part of the factual matrix, it explains why the right to sue granted to NNI was not an exclusive right.

114 The right to sue for damages given to the Licensed Participants in their exclusive territories would obviously require a Licensed Participant to establish that it had been damaged. If the suit involved a breach of rights which the Licensed Participant had under its license, damages could presumably be proven. However, if the suit involved a breach of rights which the Licensed Participant did not have under its license, damages could not be proven.

115 If a Licensed Participant were the only plaintiff, which does not appear to have ever been the case, presumably it would be open to a defendant to contend that the Licensed Participant had not suffered any damages as what was being done by the defendant was not something that the Licensed Participants could have done under its license. That defence would not likely be run if both NNL and the Licensed Participant such as NNI were plaintiffs.

116 The Licensed Participants were not given any right to sue for damages for patent infringement in non-exclusive territories. This right was held by NNL.

***(iv) Surrounding circumstances or the factual matrix***

117 What may be looked at in constructing an agreement is objective evidence of the background facts at the time of the execution of the contract. It may not include evidence of the subjective intent of a party or what a party believed a contract to mean. Whether something was or reasonably ought to have been within the common knowledge of the parties at the time of execution of the contract is a question of fact.

118 There is an issue regarding the timing of the evidence that may be looked at. The exclusive licence to the Licensed Participants was contained in the 1985 CSA between Northern Telecom Limited [now NNL] and Northern Telecom Inc. [now NNI] signed in December 1984 and continued with no substantive changes in the 1992 CSA and in the MRDA and its later

 

addenda. I would not, however, limit the time of the surrounding circumstances to the time that the CSAs were signed. The MRDA was made on December 22, 2004 effective January 1, 2001. Thereafter, while there were a number of changes to the MRDA in various addenda, no changes of substance were made to the operative provisions regarding the rights of the participants in NN Technology. I think the surrounding circumstances to the time of the signing of the MRDA in December 2004 can be looked at. Although there were some modifications to the MRDA after that, none involved any substantive change to the rights of NNL or to the exclusive licenses given to the Licensed Participants.

119 There was a great deal of evidence led by the U.S. and EMEA interests as to the subjective views of the witnesses, mostly tax personnel, regarding the rights of the parties under the CSA or MRDA or what the witnesses understood the language to mean, or in one case as to the witness's understanding of what others understood the documents to mean. Apart from the latter being inadmissible hearsay, all of this evidence was not admissible as it amounted to subjective views as to the meaning of an agreement. Nor was it admissible under the factual matrix rule permitting objective surrounding circumstances at the time of the execution of the agreement to be considered, and I do not consider it [14] . For example, what Mr. Henderson thought about the rights under the CSA license, that he copied from an earlier version of the CSA, or what others thought the MRDA meant or what they thought the intent of it was is not to be taken into account. See *Sattva*, *supra*, at para. 59.

120 I think it right to point out that not all of the evidence was one way. For example, the evidence of Angela De Wilton, the director of Intellectual Property in the Nortel IP law group and the director of IP strategy, was that Nortel was the owner of the patents and not just for administrative reasons. This evidence, elicited on cross-examination, also suffers from it being her subjective view of the rights of the parties under the MRDA. There were other witnesses who said much the same thing, such as Mr. Binning, the Executive Vice-President and CFO of NNC and NNL from November, 2007 to March, 2010 who said on his cross-examination that he understood that NNL owned the IP. This evidence suffers from the same problem of being a subjective view of the rights of the parties. The point is that that not all witnesses agreed with the subjective views of other witnesses.

121 There was also some evidence led of a prior draft of the MRDA and the views of an outside tax lawyer at Oslers who acted for NNL as to the particular draft language. This evidence is also inadmissible as being a prior draft and as constituting that particular lawyer's subjective views as to what the MRDA should contain.

122 A great deal of evidence, including evidence of statements made to tax authorities, had to do with economic theories of transfer pricing. As the transfer pricing principles changed from a cost sharing approach to a residual profit sharing approach, the economic theories and statements to tax authorities changed. One thing that did not change from the CSA approach to the RPSM approach was the language of the license grant from NNL to the other participants. It is that language that must be considered.

*(a) 1996 APA*

123 The 1992 CSA between Northern Telecom Limited (now NNL) and Northern Telecom Inc. (now NNI) was made with effect from January 1, 1992 but was not drafted until 1996 after the negotiations with the CCRA in Canada and the IRS is the U.S. in the advance pricing agreement process, so as to reflect the terms of the APA made with each of those tax authorities.

124 The U.S. Debtors say that the APA makes clear that NNI was entitled to all of the benefits of the NN Technology in the U.S., including all sub-licensing rights. I think they draw too long a bow. The APA between Northern Telecom and the CCRA was an agreement which by its terms was to "establish a cost sharing methodology which will result in the allocation of expenses to NNI by [NNL] for R&D done by [NNL] and its subsidiaries...which will constitute reasonable amounts in the circumstances for the purposes of section 69 of the Income Tax Act". The concern of the tax authorities was that the costs of R&D be properly allocated between NNL and NNI. The purpose of the APA was not to agree how the income of NNL and NNI was to be shared or allocated, but how to apply R&D expenditures to whatever the income was for each of NNL and NNI.

125 Article 1.1 of the APA stated that the allocation of R&D expenses was to be determined in accordance with the cost sharing methodology described in appendix A. Appendix A is headed Cost Sharing Methodology. It contains detailed formulae to determine how R&D is to be allocated. At the outset, it has a section headed Understandings. The first understanding is that all benefit derived from R&D expenses is recognized either in the selling of a finished product to an unrelated customer or from

 

the licensing of the technology resulting from the R&D expense (the "Benefit") within a defined geographical market by a Cost Sharing Participant ("CSP"). It goes on to state that "[NNL], as a CSP, "is entitled to all Benefits in all geographical markets except for the part(s) thereof granted to another CSP" and "NNI is also a CSP and its geographical market is the united States of America and the Commonwealth of Puerto Rico".

126 This statement that NNL is entitled to all Benefits in all geographical markets except for the part(s) thereof granted to another CSP is somewhat unclear. It could refer to all Benefits except for parts thereof granted to another CSP, or to all geographical markets except for those parts granted to another CSP. The former would seem to make sense because there would be no purpose in stating that NNL was entitled to all benefits in all geographical markets except those granted to another CSP as the following sentence states that the geographical market of NNI is the U.S. and Puerto Rico. If as I read it the understanding was that NNL was entitled to all benefits except for those granted to a CSP, the document begs the question as to what benefits were granted to NNI, which is the issue in this case.

127 It is understandable, as Mr. Henderson testified, that the parties needed to wait until the APA was settled with the tax authorities before the 1992 CSA was settled as the APA stated that it was to apply to the taxation years 1992 to 1999. That does not mean, however, that the parties needed to know how revenue was to be allocated by the APA. The purpose of the APA was to obtain an agreement from the revenue authorities how to allocate R&D costs, not revenues. This is borne out by Mr. Henderson's admissions on cross-examination that the 1992 CSA just adopted the license language of the 1985 CSA and that all operative provisions were the same.

*(b) Sub-licences*

128 Both sides refer to the evidence of sub-licensing as refuting the case of the other. In this I think they are incorrect. Not a great deal is clear from this evidence.

129 The reply closing argument of the U.S. Debtors contains a list of "Sublicenses Involving NNI". None were made only by NNI. Many were made by NNL and NNI and others were made by NNL on behalf of itself and its subsidiaries.

130 The sublicenses made by NNL and NNI recited that NNL has granted to NNI "certain rights to license said patents" in the U.S. In the body of the agreement it provides that NNL and NNI "to the extent of their legal right to do so" grants a license to the licensee for the countries and jurisdictions in which Nortel now or in the future holds the Nortel patent. What rights had been licensed to NNI is not stated in the sublicense. Some sublicenses provided that the royalties were payable to NNI, with NNI having the right to direct some or all of the payments to NNL. Others, being a majority of them, provided for the royalties to be payable to NNL with NNL having the right to direct some or all of the payments to NNI. In the case of cross-license agreements, the royalties were payable to NNL and there was no provision for NNL to direct some or all of the payments to NNI.

131 In agreements made by Nortel, defined as NNL on behalf of itself and its subsidiaries, regarding U.S. patents, it was stated that Nortel was the owner of the patents and that Nortel granted world-wide license rights for the patents. Other agreements involving other patents made by Nortel, also defined as NNL on behalf of itself and its subsidiaries, recited that Nortel was the owner of the patents. The effect of the language in this form of agreement is that the patents are owned by Nortel on behalf itself and its subsidiaries, which supports the position of EMEA that all patents were jointly owned by the MREs.

132 The U.S. Debtors point to some evidence of certain Nortel tax personnel to explain the forms of sublicensing agreements used by Nortel. One is an e-mail exchange in 2002 involving two different views from two different tax persons, in which subjective views as to what the license in the CSAs from NNL to the other participants meant and what the theory of the sublicensing agreements was. The other is an e-mail in 2000 from someone professing not to be an expert in tax and passing on his understanding of what the tax people's view was. Apart from the latter being hearsay and inadmissible, this e-mail evidence contains subjective views of the extent of the license in the CSAs from Nortel to the other participants in the CSAs and is inadmissible.

133 Nortel's IP team prepared a presentation after the sale of the business lines in connection with the stalking horse bid process for the residual intellectual property. The presentation reviewed the history of Nortel's portfolio including its past

 

licensing activities. It stated that Nortel previously had a small licensing group which was not a core focus of the company. There were virtually no assertions against major players, customers or partners and they focused on smaller companies with limited ability to fight back. They had earned approximately $37 million per year in royalty income. The licensing operations ceased in 2007 for budgetary reasons but in 2008 Nortel made a decision to restart the licensing organization. Mr. Binning, the Executive Vice-President and CFO of NNC and NNL from November 2007 to March 10, 2010 said that during that time Nortel was not in the license business. I take it from this evidence that for a business as large as the Nortel business, it would appear that sublicensing was an insignificant business for Nortel prior to its bankruptcy.

134 If one follows the money from the sublicenses, the evidence is that the royalties were split on the basis of the MRDA participant's contributions to R&D. The royalties were incorporated into the RPSM calculations even although they were not mentioned in Schedule A to the MRDA. Why this was done was not made clear by Mr. Stephens who gave the evidence of this happening. With one exception, we were not pointed to any evidence as to what was done with any royalties received prior to 2006, which is perhaps a more germane period as being prior to the signing of the MRDA. In 2004 a settlement of $35 million with Foundary Networks, Inc. was split on the basis of the RPSM.

135 In sum, there were no sublicenses when the license was granted by NNL to NNI at the time of the 1985 CSA. There were a number after that which do not indicate any clear pattern of what sublicense rights either NNL or the other participants were recognized to have. Sublicensing was a very insignificant part of the Nortel business prior to its insolvency.

*(c) Representations to tax authorities*

136 I have already discussed the 1996 APA process.

137 In connection with the switch from a CSA approach to a RPSM approach, Horst Frisch, a leading firm of transfer pricing economists, was retained to advise Nortel. Horst Frisch prepared a report dated March 14, 2002 titled Economic Analysis of Nortel Networks' Intercompany Transactions and this report was given to the tax authorities.

138 The U.S. interests point to a statement at page 10 of the report that stated from an economic standpoint, each participant could be considered to "own" the NT Technology. The paragraph in question made clear that what was being discussed was the situation under the CSA that existed up to the end of 1999. It stated:

> Prior to 2000 Nortel shared it global R&D expenses pursuant to its R&D cost sharing arrangement ("R&D CSA"), which dates back to the mid-1970's (with several amendments). Under the arrangement, each cost sharing participant ("CSP") had the right to use the intangible property developed pursuant to the R&D cost sharing arrangement (i.e., the NT Technology") in its respective market. From an economic standpoint, each R&D cost sharing participant could be considered to "own" the NT technology as it related to its specific region.

139 What is meant by "from an economic standpoint" each participant could be considered to "own" the NT technology as it related to its specific region is not clear. The OECD Guidelines and transfer pricing regulations in the U.S. and Canada all define intangible property to include licenses or rights to use assets. The statement of Horst Frisch that each participant had the right to use the IP and from an economic standpoint could be considered to "own" the NT technology could well have referred to owning the license rights held by each participant rather than referring to the underlying NT technology. The U.S. Debtors in their opening brief acknowledged case law to the effect that the rights an exclusive licensee holds are referred to as beneficial ownership.

140 Horst Frisch was clearly not talking about legal rights, nor were they discussing particular language in the CSA. Even had they purported to give their views as to what legal rights the parties had under the CSA or the MRDA, which they were not, those views would not have been admissible. Horst Frisch was discussing economic theory.

141 A few pages further in the report, when Horst Frisch were discussing what would occur under the RPSM method of allocating profits under the MRDA, they stated that the economic theory underlying the CSA was not applicable to the RPSM of allocating profits. The report stated:

  

> As noted above, under the prior R&D CSA the CSP which ultimately made the sale to a third party in its exclusive territory was deemed to have economic ownership of the NT Technology since the third party sale attracted an R&D allocation under the CSA.
>
> In the absence of the R&D CSA, with the two exceptions noted above, each old CSP will incur R&D expense which should entitle it to share in Nortel's global profits or losses. We have not attempted to attach these R&D expenses to the manufacturing or the distribution operation of the old CSPs since there will no longer be a formula by which global R&D expenses are shared (i.e., a third party sale will not attract an R&D allocation so it is not reasonable to assume that only the selling entity will continue to own the valuable intangibles). The amount of R&D performed is not necessarily correlated with third party sales or manufacturing activity. Rather, each entity will perform and pay for its own R&D expenses, and has the ability to sell Nortel products worldwide and share in global profits or losses.

142 What Horst Frisch were saying was that the economic theory of the participant in a third party sale in its territory "owning" the intangibles would not apply to such a sale under the MRDA. Perhaps implicitly they were saying that the economic "ownership" of the intangibles would be owned by all of the participants in accordance with their R&D spend under the MRDA, although this is not expressly stated. If so, from an economic point of view, it would be more consistent with the position of EMEA rather than the U.S. or Canadian interests. [15]

143 After the APAs were applied for in 2002, the tax authorities visited various Nortel sites. They then posed a number of questions. In September 2003 Nortel send a 45 page response to these questions. One of the questions was to update the authorities on any developments since the APA submission was made and whether any changes to the proposed transfer pricing methodology were anticipated. One of the responses of Nortel had to do with restructuring charges. The U.S. interests point to a statement that the residual entities are the owners of the intangible property. The context is important to see what was being said. Included was the following:

> In 2000 and later years, the telecommunications industry experienced a decline in demand unlike any other substantial industry in modem history. For that reason, there does not appear to be any precedent for analyzing the above issues. Accordingly, a reliance on basic economic principles was deemed necessary.
>
> In an arm's length situation, it was determined that the residual entities would agree to reimburse the distribution entities for a portion of their restructuring charges rather than have those entities become insolvent and forced into receivership. Generally, the underlying economic rationale for this argument is this: the residual entities, as the owners of the intangible property, as well as the manufacturers of the tangible goods, would recognize that its distribution network is critically necessary for their long-term survival. Should members of the distribution network become insolvent/cease operations, the residual entities' ability to offer their products for sale may be severely impacted. Therefore, it is in their best economic interests to ensure that a strong global distribution network exists.

144 This is a discussion of economic theory. It cannot be construed as a discussion of legal principles or the meaning of the MRDA. The reference to being owners of the intangible property could well be a reference to license rights rather than the underlying intangibles, as license rights are intangible property.

145 Dr. Timothy Reichert, a transfer pricing expert called by the Monitor, made the following statement about economic ownership as considered in transfer pricing, a statement not contradicted by any witness:

> A central concept in transfer pricing is that of "economic ownership" (referred to, alternatively, as "beneficial ownership," and simply "ownership"). Economic ownership is not a reference to ownership in a legal sense, but rather refers to a party's right to benefit from an income stream attributable to a defined undertaking or activity.

146 This statement cannot be disregarded. An economic right to an income stream attributable to a defined undertaking or activity requires one to know what is the defined undertaking or activity. The economic statements made to the taxing authorities did not purport to define the precise limits to the license granted by NNL to the participants under either the CSA or

 

the MRDA. As seen, the statements made to the taxing authorities did not at all make clear what rights were being referred to and in particular, whether the "economic or beneficial ownership" was in the underlying NN Technology or in the license rights to that technology. They cannot be taken as statements that under the MRDA the licensees legally owned the NN Technology.

147 To the contrary, Mr. Weisz, the Leader of International Tax at NNI who was involved in Nortel's transfer pricing policies, and who was asked by Mr. Dolittle, the VP of Tax for Nortel to become involved in the APA process that had stalled, told the IRS during that process that it was NNL that was the legal owner of the IP.

148 It must also be recognized that the APA process with the tax authorities was to arrive at an agreement with them regarding the Nortel operating business. It was an operating business with profits and losses that the tax authorities were interested in. This was the case both for the APA processes for both the CSA and MRDA. There were no discussions with the tax authorities as to what would happen on the insolvency of the entire business of Nortel. The discussion of the economic theory of economic or beneficial ownership must be considered in that light. They were not discussing such a theory in so far as it might apply to the situation of a cessation of business as occurred with Nortel.

149 The issue in this case has to do with the breadth of the licenses granted to the Licensed Participants and whether that included the right to sublicense the residual patent portfolio that was eventually sold to Rockstar. However at the time of the APA processes, sublicensing was a miniscule part of the business of Nortel and not surprisingly I have been pointed to no presentation to the tax authorities that discussed this issue. It was not on the Nortel radar.

150 The MRDA was provided to the tax authorities. They also had the prior CSA. The U.S. interests do not say that NNI rights were obtained other than in the CSA and then the MRDA. The tax authorities had these agreements and were able to read them, and were in as good a position as anyone to form their own view of what the agreements did or did not do. It cannot be suggested that the tax authorities did not understand transfer pricing. It was their business to know it.

151 There is evidence relied on by the EMEA debtors to support their position that the proceeds of the sale of the residual IP should be allocated in accordance with the relative expenditure on R&D by NNL and the licensed participants. After the APS application was filed by Nortel with the tax authorities in 2002, planning for a June 19, 2002 joint meeting with the three tax authorities took place in earnest, including the preparation of answers to questions Nortel anticipated might be raised by the tax authorities. In preparation for the meeting, Nortel engaged advisors from Deloitte & Touche LLP, KPMG LLP, Horst Frisch, and Sutherland Asbill & Brennan LLP to assist. Mr. O'Connor of Deloitte's prepared the following answer to an anticipated question regarding the sale of any IPCo, an answer that was circulated and agreed before the meeting:

> [Q:] How does Nortel propose to account for any future sale of intellectual property developed prior to or during the term of the APA? Which entities are considered the legal owner of IP and which are considered the economic owners?
>
> [A:] Proceeds from the sale of IP will be allocated to residual profit split participants on the basis of their economic ownership of the IP — that is, on the basis of their share of total R&D capital stock in the year of sale.

152 The document was taken to the joint meeting. There is no evidence one way or the other as to whether the question was asked. While the question does not deal with what would happen if all of the Nortel IP was sold on a world-wide insolvency of Nortel, it is evidence that at the time of the APA process, Nortel was prepared to say that any sale of IP would be split in accordance with the RPSM in the year of the sale.

*(d) Avoiding permanent establishment status in the U.S.*

153 The U.S. interests contend that it was important to NNI not to be considered a U.S. resident for U.S. tax purposes and thus not have "permanent establishment" in the U.S. It is contended that it was this concern that drove separate legal entities to be set up for each country and for the license to be exclusive to the Participants for their territory so that the Participants would be the only ones dealing with customers in that territory.

  

154 Taken that as the situation, I do not see that it gets very far. There is no question that the exclusive license gave NNI the exclusive right to sell Nortel products in the U.S. The important issue in this case is what rights NNI had to sub-license and whether it was restricted to Nortel "Products" as defined in the MRDA. Sub-licensing was a miniscule part of the business of Nortel and there is no evidence at all that sublicensing issues drove the setting up of companies in different jurisdictions.

*(e) Patent litigation*

155 I have previously referred to the patent litigation that had taken place prior to the MRDA. Both NNL and NNI were plaintiffs in the actions in the U.S. Why that was so does not really matter. It explains why the right given to licensed participants to sue in their territories for damages for patent infringement was not an exclusive right.

156 As to what was done with the proceeds of patent litigation, there was a settlement in October, 2004 of an action commenced by NNL and NNI against Foundary Networks, Inc. $35 million was paid for past infringement and for future royalties under a license agreement. The entire payment was treated as royalty income and allocated to NNL and the Licensed Participants in accordance with the RPSM in the MRDA.

*(f) Conclusion of factual matrix evidence*

157 I do not consider the surrounding circumstance or factual matrix evidence to provide much clear assistance in construing the meaning of the terms in the MRDA. Even if it did, I would be required to be guided by the dictates of *Sattva* that while the surrounding circumstances will be considered in interpreting a contract and the goal of examining such evidence is to deepen a decision-maker's understanding of the mutual and objective intentions of the parties as expressed in the words of the contract, they must never be allowed to overwhelm the words of the contract and the interpretation of a contract must always be grounded in the text. While the surrounding circumstances are relied upon in the interpretive process, courts cannot use them to deviate from the text such that the court effectively creates a new agreement.

***(v) Commercial reasonableness***

158 The U.S. interests and EMEA say that the Monitor's interpretation of the MRDA is commercially unreasonable. They contend that no party at arm's length would agree to spend large amounts to develop patents but only one party would be entitled to all of the proceeds from the sale of those patents.

159 It must be remembered that the MRDA and its predecessor CSA were drafted to come to terms with the tax authorities. The parties to the negotiations were Nortel on the one hand and the tax authorities on the other. The resulting CSA and then MRDA were operating agreements premised on cost sharing under the CSA and profit or loss sharing under the MRDA. The tax authorities were interested in the tax that each Nortel entity would pay each year. The tax authorities dealt in only limited periods of time. The 1992 CSA was settled with the tax authorities only in 1996, yet in 1999 they made it clear they wanted Nortel to abandon the CSA agreement and instead change to a RPS method of transfer pricing.

160 Nortel and the tax authorities were not negotiating on what would happen if Nortel stopped operating or in the event of a world-wide insolvency of Nortel. More particularly, they were not negotiating on how the proceeds of the sale of the entire Nortel world-wide patent portfolio would be allocated amongst the various Nortel companies in the event of the insolvency of Nortel. That was not discussed. This is not surprising because, as Dr. Eden testified, transfer pricing rules were developed only in connection with ongoing entities for purposes of determining their corporate tax.

161 The issue of commercial reasonableness must be considered in the context of who was involved in the preparation of the MRDA. It was not the technology people. Mr. Brian McFadden, the Chief Technology Officer of Nortel at the time the MRDA was drafted and signed, was not consulted about its terms and never heard of the MRDA while at Nortel. Ms. Angela de Wilton, the Nortel Director of Intellectual Property had no recollection of ever seeing the MRDA. In order to make the argument that it would have been commercially unreasonable for a Nortel company to agree to do R&D leading to patents and not be paid for the patents on the sale of the business, one would think that the people responsible for the R&D would have at least known of the

 

agreement and its terms. The fact that they did not indicates that a trade-off of R&D for future receipts on a sale of the business was not on the radar screen at all so far as the operating people were concerned. The language of the MRDA was all tax driven.

162 So far as what was on the radar of the tax people at Nortel at the time the terms of the MRDA were settled, in so far as the quid pro quo for doing R&D was concerned, the MRDA expressly provided in Article 2(c) that any compensation for R&D was to be based solely on the RPSM allocation. It stated:

> (c) All costs incurred directly or indirectly by each Participant for R&D Activity shall be borne exclusively by it. Any reimbursement for costs including any other compensation shall be provided to such Participant for its R&D Activity solely as provided in Article 3 below.

163 Article 3 that the annual sharing of profits or losses under the residual profit split method was what was to be received for each participants R&D that year. It stated:

> **Article 3 — R&D Activity Payments**
>
> (a) For and as a consequence of the performance of R&D Activity, each Participant shall be entitled to receive a payment in an amount equal to the allocation determined under the RPSM (the "R&D Allocation") as the measure of the benefit to which it is entitled commensurate with its performance of, and contribution to, R&D Activity.

164 In the context of what the parties were dealing with in the MRDA, I do not see how it can be said that it was commercially unreasonable for them to agree that in return for doing R&D each year, they would share only in the profits or losses in accordance with the RPSM allocation. That is all they had in mind. While Nortel had suffered losses by 2004 when the MRDA was signed, there is no evidence that Nortel expected to have only losses in the future. To the contrary, the operating people at Nortel expected that Nortel would return to profitability.

165 Mr. Henderson testified that a bankruptcy or insolvency of Nortel was not in their minds at the time the RPSM in the MRDA was created. The fact that they did not consider or provide what was to happen to the proceeds if all of the IP was sold after a world-wide insolvency does not make the agreement commercially unreasonable. The time for considering whether an agreement properly interpreted is commercially reasonable or unreasonable is surely the time when it was agreed, not in hindsight.

166 The U.S. Debtors called Dr. Catherine Tucker, a transfer pricing expert, whose evidence was to the effect that under the Monitor's interpretation of the MRDA, the Licensed Participants would lack appropriate incentives to undertake expensive and speculative R&D for the next potential generation of products. I do not think her evidence helpful. It is really an inadmissible subjective view as to how the MRDA license should be interpreted.

167 There is no basis for Professor Tucker's assumption that the MRDA was intended to create incentives for the Licensed Participants to make forward-looking innovations. The fact that Mr. McFadden, the Chief Technology Officer of Nortel at the time of the MRDA, was not consulted about the MRDA and knew nothing about it belies any such assumption. Professor Tucker's assumption also ignores the way in which R&D was carried out at Nortel.

168 The majority of Nortel R&D was directed by the various Business Lines, which had to prepare annual R&D plans for approval. The remaining R&D, the advanced technology research (the "leap from one S-curve to the next" that Professor Tucker describes), was coordinated by the Chief Technology Officer. The evidence of Mr. McFadden was that all advanced technology programs were based in Ottawa and were operated by NNL. While product development R&D groups within each of Nortel's lines of business reported directly to the heads of their business units, the advanced technology programs personnel within each line of business reported directly to the CTO's office at NNL. The R&D was not the bailiwick of any Licensed Participant.

***(vi) Conclusions on the meaning of the MRDA***

169 I interpret the MRDA, and find, that under it, and while Nortel operated as a going concern business, NNL had all ownership interests of the NN Technology subject to grants, being (i) the grant to each Licensed Participant of a non-exclusive

  

right to assert actions and recover damages in their territory under article 4(e) and (ii) the grant of exclusive and non-exclusive licenses to the Licensed Participants under article 5(a).

170 The licenses under article 5(a) were not licenses of all rights to the NN Technology but were subject to field of use restrictions that gave the Licensed Participants the right to use the NN Technology to make, use or sell Products as defined in the MRDA, which meant products, software or services that were made or sold by, or for, any of the Licensed Participants. The Products must have been created or marketed by or for the Nortel Group. No product that was part of a third party's business rather than the business of Nortel fell within the definition of Products. The business considered by IPCo was not covered by the licenses. The Licensed Participants' rights to sublicense were subject to these restrictions.

**Applicability of the MRDA to the allocation issues**

171 Nortel Networks UK Pension Trust Limited and the Board of the UK Pension Protection Fund (the "UKPC") contend that the MRDA was never intended to provide an answer to the question of how to allocate among the bankrupt estates the proceeds of the sale of the Nortel Group's assets following the world-wide insolvency of Nortel.

172 I agree. The MRDA was an operating agreement and was not intended to, nor did it, deal with the disposal of all of Nortel's assets in a situation in which no revenue was being earned and no profit or losses were occurring. The MRDA provided in its opening line that it was an agreement "confirming and formalizing the operating arrangements" of the parties.

173 There is a provision in schedule A to the MRDA added in the third addendum effective January 1, 2006 but signed by the parties late in late December 2008 or early January 2009 that indicates that sales of property were not intended to be dealt with under the MRDA. That schedule A provided that in dealing with the calculations of the Nortel earnings/losses to be used in the RPSM calculation, there was to be deducted "gain/loss on the sale of business". A gain or loss would normally be taken into account on the particular company's statement of profit and loss and the Participants decided they did not want any such gain or loss to influence the calculation of profits or losses for the purposes of calculating the allocation of profits or losses in the RPSM calculation. Mr. Orlando testified that the sale of a business was seen to be a non-operating activity. This provision is an indication that the MRDA was not intended to deal with the sale of any assets, let alone the world-wide assets of the Nortel Group.

174 The MRDA and its predecessor Cost Sharing Agreements ("CSAs") were developed for and driven by transfer pricing concepts. They were drafted to come to terms with the tax authorities. The MRDA expressly provided in a recital that the calculation of the RPSM might have to be adjusted as a result of its review by the tax authorities. The MRDA was drafted by tax lawyers and tax advisors. The primary external counsel involved, and lead drafter of the MRDA, Giovanna Sparagna, testified that the MRDA is "primarily focused on transfer pricing," which is "part of tax law," and it is "primarily [a] tax law document[]." The MRDA was signed on behalf of NNL by John Doolittle, Nortel's Vice-President of Tax. All parties acknowledge that the MRDA was a tax-driven document designed to implement Nortel's transfer pricing policies.

175 Following the insolvency proceedings on January 14, 2009, no transfer pricing payments were made under the MRDA. The two special cash payments made by NNI to NNL were made under different agreements, being the IFSA dated June 9, 2009 and the FCFSA dated December 23, 2009.

176 Dr. Eden, who testified on behalf of the U.S. Debtors, testified that transfer pricing was only for ongoing businesses. She also testified that she saw the MRDA as a transfer pricing document and that the RPSM method contained in it was only used for corporate income tax purposes. She and other transfer pricing experts such as Dr. Richard Cooper, Dr. Steven Felgran and Dr. Timothy Reichert testified to the effect that transfer pricing does not address entitlement to the proceeds of the sale of assets on insolvency.

177 I accept that the MRDA was a transfer pricing document created for tax purposes. The licenses were a part of it. The licenses granted under it were never dealt with separately from the MRDA. Their only purpose was to support the intended tax treatment resulting from the MRDA.

 

178 It can perhaps be argued that under article 9 of the MRDA the rights of NNL under article 4 and of the Licensed Participants under article 5 continued on the expiry or termination of the agreement, indicating a purpose other than tax that survives the insolvency of the Nortel enterprise. I would not construe those provisions that way.

179 The relevant provisions of article 9 of the MRDA provide:

> **Article 9 — Duration and Continuing Rights and Obligations**
>
> (a) This Agreement shall be effective from January 1, 2001 until December 31, 2004, provided however that this Agreement will automatically renew for additional and unlimited one-year terms until terminated by the mutual written consent of all Participants.
>
> (b) Upon the expiry or termination of this Agreement as provided herein, each Licensed Participant shall be deemed to have acquired a fully paid up license permitting it to continue to exercise the rights granted to it herein, and, in particular, the rights granted to it in Article 5 as though this Agreement had continued.
>
> (c) The provisions of Article 4 (Legal Title to NN Technology) with respect to NN Technology acquired or developed pursuant to this Agreement from the Effective Date of this Agreement up to and including its expiry or termination date, Article 6 (relating to confidentiality) and Article 7 (relating to liability) shall survive notwithstanding the expiry of this Agreement, or any termination of this Agreement for any cause whatsoever.

180 Under article 9, the MRDA automatically renewed after 2004 unless terminated by mutual consent of all parties to it. If terminated, the Licensed Participants were to be deemed to have acquired a fully paid up license "permitting it to continue to exercise the rights granted to it herein... as though this Agreement had continued". This provision by its terms contemplated the business of the Licensed Participants continuing to operate. It did not contemplate a situation in which all of the Licensed Participants liquidated their assets and went out of business.

181 The CSAs contained a similar provision regarding the rights of the Licensed Participants on termination to a fully paid up license. At the end of 1999, the tax authorities did not want to renew the APAs and they encouraged Nortel to adopt a RPSM. In December, 2001, Nortel's CSAs for R&D were terminated effective January 1, 2001. In spite of the termination of these agreements, Nortel continued to operate and it was only on December 22, 2004 after negotiations with the tax authorities that the MRDA was executed with an effective date of January 1, 2001. The MRDA stated that it confirmed and formalized the operating arrangements of the Participants as and from that date. That is, the license rights under the CSAs continued to be used in accordance with the terms of the CSAs, and Nortel's tax advisors told that to the tax authorities on April 26, 2004. This was contemporaneous with the MRDA being settled.

182 One can see from this that the purpose of continuing rights under article 9 of the MRDA after a termination was to permit the Participants to continue operating, during which a new agreement would have to be negotiated. Nortel was a multi-national enterprise that had to live with tax authorities where it operated and could not live without a transfer pricing agreement of some kind. As previously discussed, there was no thought at the time of the MRDA being settled that Nortel was not going to return to profitability.

183 Article 11(a) of the MRDA provided that any Participant that was not a party to an APA with the tax authorities could elect to withdraw from the MRDA. Article 11(c)(iv) of the MRDA provided that it was a defaulting event if one of the Participants became insolvent, in which case the Participant automatically was terminated from participation in the agreement. A fourth addendum was made to the MRDA effective December 31, 2008 and signed in early January 2009. It was headed *Standstill Provision* and provided that in the event of an occurrence of an event described at Section (sic) 11(c)(iv), i.e. if a Participant became insolvent, (i) no Participant effected by such insolvency shall be automatically terminated from participating in the agreement, (ii) no Participant shall elect to withdraw from the agreement under Article 11(a), and (iii) NNL would have the right in its sole discretion to terminate participation in the MRDA of any Participant affected by such event, i.e. of a defaulting Participant by reason of its insolvency.

  

184 This provision did not contain provisions expressed to apply in the event of a world-wide insolvency of all of the Nortel companies. It contained provisions of a standstill nature dealing with a situation in which one Participant became insolvent. It was obviously designed to prevent a Participant from declaring insolvency and then trying to take positions contrary to other Participants and to prevent the other Participants in such an event trying to take positions contrary to other Participants. I do not read this provision as an indication that in the event of a world-wide insolvency of all of the Nortel companies with no operations, the agreement was to continue to govern the affairs of a non-operating enterprise. Had that been the parties' intention, they could have said so in the addendum. They did not.

185 I conclude that the circumstances surrounding the creation of the MRDA lead to no other result but that the construct of legal title to the NN Technology being in NNL in return for NNL granting exclusive licenses to the Licensed Participants was only for the purpose of supporting the proposed method to split profits or losses on a tax efficient basis while Nortel operated as a going concern business. The agreement in its application was intended to apply only to Nortel while it operated and not to deal with rights after Nortel and its subsidiaries stopped operating its businesses.

**EMEA position on ownership of the Nortel IP**

186 The EMEA Debtors' position is different from the position of the Canadian and U.S. Debtors. They say that the Participants, or RPEs, have joint ownership of all Nortel IP under common law principles by reason of the IP belonging to the RPEs that employed the inventors. They say that the MRDA recognizes that joint ownership and that the joint ownership should be the basis for allocating the proceeds of the sale of the Nortel residual IP.

187 The basic premise of the EMEA Debtors' argument is that the Participants or RPEs were joint owners of all Nortel IP by reason of law. They argue that under Canadian law, the inventor is the first owner of an invention and is the legal title holder entitled to apply for any related patent. However, where the inventor is employed to invent, as the Nortel Group's researchers were, then the employer by operation of law beneficially owns any resulting IP. While the employee inventor who is listed on the patent application holds legal title, the employer is the beneficial owner. Given the integrated nature of Nortel and its R&D created in multiple jurisdictions, the EMEA Debtors argue that each participant beneficially owned not the IP created in its jurisdiction, but rather a share of the indivisible pool of the Nortel Group's IP.

188 Canadian and U.K. law appears to support the principle that where an employee creates an invention as part of his or her employment, the employer is the beneficial owner of the patent. [16] U.S. law is otherwise. Under U.S. law, unless there is agreement to the contrary, it is the inventor and not the employer who is the owner of his or her invention until he or she assigns it [17] .

189 All Nortel employees, whether employed by NNL or a subsidiary, were required to assign directly or indirectly to NNL any intellectual property which they generated during the course of their employment. At least 98% of the patents and patent applications sold to Rockstar had been assigned by the inventors to NNL.

190 The EMEA Debtors say that while the inventors assigned their rights to NNL, the subsidiaries that employed the inventors did not. Thus they say that NNUK, the employer of inventors in the U.K., continued to have beneficial ownership of the patents for inventions created by its employees. I do not accept that. NNUK was required under article 4 (b) of the MRDA to execute such documents as NNL reasonably required to give effect to article 4 (a), which provided for legal title to NN Technology to be vested in NNL. In light of that obligation, NNUK is in no position now to say that the assignment of the IP from its employees to NNL was ineffective.

191 This argument of the EMEA Debtors would not apply to NNI in the U.S. as under U.S. law NNI did not have any such common law rights to IP developed by its employees who assigned their rights to NNL. Nor would it apply to patents invented by employees of NNL who assigned their rights to NNL. The EMEA Debtors' argument, if accepted, would mean that NNUK would only have rights to the IP developed by its employees and would have no joint ownership interest in the IP developed by employees of NNL, NNI, NNSA or Nortel.

 

192 I cannot accept the joint ownership theory of the Nortel IP or use that theory as a basis for allocating the proceeds of sale of the Nortel IP assets.

**Appropriate method to allocate the proceeds of sale**

193 While the Monitor on behalf of the Canadian Debtors and the U.S. Debtors take diametrically different views as to their rights under the MRDA, they each look to the MRDA and the rights they say were given to them as the basis of their allocation positions. I have not accepted their position that they obtained rights under the MRDA that determine their right to the proceeds of the sale of Nortel's assets.

194 Nor have I accepted the position of the EMEA Debtors that the RPEs have joint ownership of all Nortel IP under common law principles recognized in the MRDA and that such joint ownership should be the basis for allocating the proceeds of the sale of the Nortel residual IP.

195 Without the MRDA to govern the allocation, and without the joint ownership theory of the EMEA Debtors, the issue becomes one of deciding what metric should be used to allocate the proceeds of sale.

196 In so far as the IP is concerned, while the patents were registered in the name of NNL, I would not for that reason hold that NNL is entitled to the proceeds of the IP sales. The patents and application rights to apply for patents were held in the name of IP for administrative purposes. It was best practices in a multi-national enterprise to have all patents assigned to one company, in this case to NNL, as explained by Ms. Anderson and Ms. De Walton, and made management of the portfolio much easier. While these witnesses expressed subjective views that it was NNL who owned the patents, these views are not determinative, as acknowledged in the Monitor's reply brief at paras 65-66.

197 This was not one corporation and one set of employees inventing IP that led to patents. Nortel was a highly integrated multi-national enterprise with all RPEs doing R&D that led to patents being granted. It was R&D that drove Nortel's business. R&D and the intellectual property created from it was the primary driver of Nortel's value and profits. All parties agree on that. It would unjustly enrich NNL to deprive all of the other RPEs of the work that they did in creating the IP just because the patents were registered in NNL's name.

198 Canadian law permits recovery for unjust enrichment whenever a plaintiff can establish three elements: an enrichment of or benefit to the defendant, a corresponding deprivation of the plaintiff, and the absence of a juristic reason for the enrichment: *Kerr v. Baranow*, 2011 SCC 10 (S.C.C.) at para. 32.

199 U.S. law provides that unjust enrichment occurs where a party obtains a benefit which, under the circumstances and in light of the relationship between the parties, it would be inequitable to retain: *Counihan v. Allstate Insurance Co.*, 194 F.3d 357 (U.S. C.A. 2nd Cir. 1999), 361. It requires the retention of a benefit to the loss of another or the retention of money or property of another against the fundamental principles of justice or equity and good conscience. It is not available if there is a contract that governs the relationship between the parties that gives rise to the claim: *Kuroda v. SPJS Holdings, L.L.C.*, 971 A.2d 872 (U.S. Del. Ch. 2009), 891.

200 On either test, I find that NNL would be unjustly enriched by being entitled to all of the proceeds of the sale of Nortel IP at the expense of the other RPEs who contributed to the creation of that IP just because the patents were registered in NNL's name. It would be inequitable. There would be no juristic reason for the enrichment as the MRDA as I have interpreted it does not deal with the allocation rights of the parties in this world-wide insolvency of Nortel.

201 It would also unjustly enrich NNI if it were to be allocated the amount from the IP sales that it claims based principally on its revenues, which is the basis of the claim by the U.S. Debtors. NNI was able to sell Nortel products based on the R&D and resulting IP performed by other RPEs.

202 This is an unprecedented case involving insolvencies of many corporations and bankrupt estates in different jurisdictions. The intangible assets that were sold, being by far the largest type of asset sold, were not separately located in any one jurisdiction

 

or owned separately in different jurisdictions. They were created by all of the RPEs located in different jurisdictions. Nortel was organized along global product lines and global R&D projects pursuant to a horizontally integrated matrix structure and no one entity or region was able to provide the full line of Nortel products and services. R&D took place in various labs around the world in a collaborative fashion. R&D was organized around a particular project, not particular geographical locations or legal entities, and was managed on a global basis. The fact that Nortel ensured that legal entities were properly created and advised in the various countries in which it operated in order to meet local legal requirements does not mean that Nortel operated a separate business in each country. It did not.

203 Nortel's matrix structure also allowed Nortel to draw on employees from different functional disciplines worldwide (*e.g.* sales, R&D, operations, finance, general and administrative, etc.), regardless of region or country according to need. Individuals could be part of a team with horizontal responsibility without removing them from their respective position vertically (or departmentally) within the Nortel group. [18]

204 In these circumstances, what principles should be applied to determine the allocation of the proceeds of the asset sales? In my view, doing what is just in the unique circumstances of this case should govern the allocation.

205 A court has wide powers in a CCAA proceeding to do what is just in the circumstances. Section 11(1) provides that a court may make any order it considers appropriate in the circumstances. Although this section was provided by an amendment that came into force after Nortel filed under the CCAA, and therefore by the amendment the new section does not apply to Nortel, it has been held that the provision merely reflects past jurisdiction. In *Century Services*, Deschamps J. stated:

> **65** I agree with Justice Georgina R. Jackson and Professor Janis Sarra that the most appropriate approach is a hierarchical one in which courts rely first on an interpretation of the provisions of the *CCAA* text before turning to inherent or equitable jurisdiction to anchor measures taken in a *CCAA* proceeding (see G. R. Jackson and J. Sarra, "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters", in J. P. Sarra, ed., *Annual Review of Insolvency Law 2007* (2008), 41, at p. 42). The authors conclude that when given an appropriately purposive and liberal interpretation, the *CCAA* will be sufficient in most instances to ground measures necessary to achieve its objectives (p. 94).
>
> **67** The initial grant of authority under the *CCAA* empowered a court "where an application is made under this Act in respect of a company ... on the application of any person interested in the matter ..., subject to this Act, [to] make an order under this section" (*CCAA*, s. 11(1)). The plain language of the statute was very broad.
>
> **68** In this regard, though not strictly applicable to the case at bar, I note that Parliament has in recent amendments changed the wording contained in s. 11(1), making explicit the discretionary authority of the court under the *CCAA*. Thus in s. 11 of the *CCAA* as currently enacted, a court may, "subject to the restrictions set out in this Act, ... make any order that it considers appropriate in the circumstances" (S.C. 2005, c. 47, s. 128). <u>Parliament appears to have endorsed the broad reading of *CCAA* authority developed by the jurisprudence</u>. (underlining added)

206 This Court has a broad inherent jurisdiction to make orders as required to fill in gaps or lacunae not covered by specific provisions in the CCAA. As a superior court of general jurisdiction, the Superior Court of Justice has all of the powers that are necessary to do justice between the parties. Except where provided specifically to the contrary, the Court's jurisdiction is unlimited and unrestricted in substantive law in civil matters. See *80 Wellesley St. East Ltd. v. Fundy Bay Builders Ltd.*, [1972] 2 O.R. 280 (Ont. C.A.) at para. 9. See also *TCR Holding Corp. v. Ontario*, 2010 ONCA 233 (Ont. C.A.) at para. 26, *Beach v. Moffatt* (2005), 75 O.R. (3d) 383 (Ont. C.A.) at para. 8, *M. (J.) v. Bradley* (2004), 71 O.R. (3d) 171 (Ont. C.A.) at para. 43 and *McVan General Contracting Ltd. v. Arthur* (2002), 61 O.R. (3d) 240 (Ont. C.A.) at para. 56.

207 In *Ted Leroy Trucking Ltd., Re*, 2010 SCC 60 (S.C.C.) at paras. 57-61, it was recognized by the Supreme Court and stated by Justice Deschamps that the CCAA is skeletal in nature and does not contain a comprehensive code that lays out all that is permitted, that the incremental exercise of judicial discretion with respect to the CCAA has been adapted and has evolved to

 

meet contemporary business and social needs and that when large companies encounter difficulty and reorganizations become increasingly complex, CCAA courts have been called upon to innovate accordingly.

208 In this case, insolvency practitioners, academics, international bodies, and others have watched as Nortel's early success in maximizing the value of its global assets through cooperation has disintegrated into value-erosive adversarial and territorial litigation described by many as scorched earth litigation. [19] The costs have well exceeded $1 billion. A global solution in this unprecedented situation is required and perforce, as this situation has not been faced before, it will by its nature involve innovation. Our courts have such jurisdiction.

209 It is a fundamental tenet of insolvency law that all debts shall be paid *pari passu* and all unsecured creditors receive equal treatment. See *Shoppers Trust Co. (Liquidator of) v. Shoppers Trust Co.* (2005), 74 O.R. (3d) 652 (Ont. C.A.) at para. 25, per Blair J.A., *Indalex Ltd., Re* (2009), 55 C.B.R. (5th) 64 (Ont. S.C.J. [Commercial List]), at para. 16 per Morawetz J. and my comments in *Nortel Networks Corp., Re* (2014), 121 O.R. (3d) 228 (Ont. S.C.J. [Commercial List]) at para.12. A pro rata allocation in this case goes partway towards such a result.

210 According to the various protocols, the task in this proceeding is to determine the amount that is to be allocated to each of the Canadian, U.S. and EMEA Debtors' Estates. I do not read the protocols or the IFSA as precluding a pro rata allocation. While payment to the Selling Debtors is to be made from the $7.3 billion in the lockbox funds, neither the protocols nor the IFSA determine how the allocation is to be made.

211 Directing a pro rata allocation will constitute an allocation as required. Once the lockbox funds have been allocated, it will be up to each Nortel Estate acting under the supervision of its presiding court to administer claims in accordance with its applicable law. A pro rata allocation can be achieved by directing an allocation of the lockbox funds to each Debtor Estate based on the percentage that the claims against that Estate bear to the total claims against all of the Debtor Estates.

212 It is argued that a pro rata allocation would constitute an impermissible substantive consolidation of the Estates, or as put by the U.S. Debtors, an impermissible "global substantive consolidation". I do not agree. A pro rata allocation in this case would not constitute a substantive consolidation and, even if it did, it would in my view be permissible within established case law.

213 In a liquidation or reorganization of a corporate group, the doctrine of substantive consolidation has emerged in order to provide a mechanism whereby the court may treat the separate legal entities belonging to the corporate group as one. In particular, substantive consolidation allows for the combination of the assets and liabilities of two or more members of the group, extinguishes inter-company debt and creates a single fund from which all claims against the consolidated debtors are satisfied. In effect, under substantive consolidation, claims of creditors against separate debtors instantly become claims against a single entity.

214 A pro rata allocation in this case would not constitute a substantive consolidation, either actual or deemed, for a number of reasons. First, and most importantly, the lockbox funds are largely due to the sale of IP and no one Debtor Estate has any right to these funds. It cannot be said that these funds in whole or in part belonged to any one Estate or that they constituted separate assets of two or more Estates that would be combined. Put another way, there would be no "wealth transfer" as advocated by the bondholders. The IFSA, made on behalf of 38 Nortel debtor entities in Canada, the U.S. and EMEA, recognized that the funds would be put into a single fund undifferentiated as to the Debtor Estates and then allocated to them on some basis to be agreed or determined in this litigation. Second, the various entities in the various Estates are not being treated as one entity and the creditors of each entity will not become creditors of a single entity. Each entity remains separate and with its own creditors and its own cash on hand and will be administered separately. The inter-company claims are not eliminated.

215 Even if it could be said that a pro rata allocation involved substantive consolidation, which it cannot, I do not see case law precluding it in the unique circumstances of this case international case. Even in domestic cases, CCAA plans involving substantive consolidation are not unknown.

 

216 In Canada, neither the CCAA nor the BIA contains express provisions authorizing substantive consolidation. Similarly, the U.S. Bankruptcy Code does not explicitly permit substantive consolidation. However, courts in both jurisdictions have rendered consolidating orders on the basis of their equitable jurisdiction. See *See* M. MacNaughton and M. Azoumanidis, *Substantive Consolidation in the Insolvency of Corporate Groups: A Comparative Analysis, Annual Review of Insolvency Law, 2007*, J. Sarra, ed. (Carswell: 2008).[20]

217 In *Rescue! The Companies' Creditors Arrangement Act*, by Dr. Janis Sarra, Carswell 2007, the grounds for permitting substantive consolidation were described as follows at page 242:

> The court will allow a consolidated plan of arrangement or compromise to be filed for two or more related companies in appropriate circumstances. For example, in *PSINet Ltd*. the Court allowed consolidation of proceedings for four companies that were intertwined and essentially operated as one business. The Court found the filing of a consolidated plan avoided complex issues regarding the allocation of the proceeds realized from the sale of the assets, and that although consolidation by its nature would benefit some creditors and prejudice others, the prejudice had been ameliorated by concessions made by the parent corporation, which was also the major creditor. Other cases of consolidated proceedings such as Philip Services Canadian Airlines, Air Canada and Stelco, all proceeded without issues in respect of consolidation.
>
> Generally, the courts will determine whether to consolidate proceedings by assessing whether the benefits will outweigh the prejudice to particular creditors if the proceedings are consolidated. In particular, the court will examine whether the assets and liabilities are so intertwined that it is difficult to separate them for purposes of dealing with different entities. The court will also consider whether consolidation is fair and reasonable in the circumstances of the case.

218 In *Lehndorff General Partner Ltd., Re* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]), Justice Farley held that a consolidated plan was appropriate, noting that there was significant intertwining of the debtor companies, including multiple instances of inter-company debt, cross-default provisions and guarantees and the existence and operation of a centralized cash-management system. All of these features were present in Nortel.

219 In *PSINET Ltd., Re* (2002), 33 C.B.R. (4th) 284 (Ont. S.C.J. [Commercial List]), Justice Farley noted that a plan of arrangement based on substantive consolidation avoided the "complex and likely litigious issues" that could result from the allocation of the proceeds of the sale of substantially all of the debtor companies' assets. He also noted that the consolidated plan reflected the intertwined nature of the debtors and their operation. In that case, Farley J. stated that the overall effect of a consolidation was required:

> In the circumstances of this case, the filing of a consolidated plan is appropriate given the intertwining elements discussed above. See *Northland Properties Ltd., Re*, 69 C.B.R. (N.S.) 266 (B.C.S.C.), affirmed (B.C.C.A.), *supra*, at p. 202; *Lehndorff General Partner Ltd., Re*, 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]) at p. 31. While consolidation by its very nature will benefit some creditors and prejudice others, it is appropriate to look at the overall general effect.

220 In *Northland Properties Ltd., Re* [1988 CarswellBC 531 (B.C. S.C.)], a case involving a proposed plan for several companies that operated as a single entity, Justice Trainor considered the tests for permitting a substantive consolidation. He looked to U.S. law for guidance and began his analysis by adopting the balancing test articulated in *Baker & Getty Financial Services Inc., Re*, 78 B.R. 139 (U.S. Bankr. N.D. Ohio 1987):

> The propriety of ordering substantive consolidation is determined by a balancing of interests. The relevant enquiry asks whether "the creditors will suffer greater prejudice in the absence of consolidation than the debtors (and any objecting creditors) will suffer from its imposition".

221 Trainor J. then went on to list seven factors which had been developed to assist in the balancing of interests. Those factors were:

1. difficulty in segregating assets;

 

2. presence of consolidated financial statements;

3. profitability of consolidation at a single location;

4. commingling of assets and business functions;

5. unity of interests in ownership;

6. existence of intercorporate loan guarantees; and

7. transfer of assets without observance of corporate formalities.

222 In considering these factors, it is clear beyond peradventure that Nortel has had significant difficulty in determining the ownership of its principle assets, namely the $7.3 billion representing the proceeds of the sales of the lines of business and the residual patent portfolio. This amount constitutes over 80% of the total assets of all of the Nortel entities [21] . This issue has taken several years of litigation and untoward costs in the parties attempting to establish an entitlement to it. As the MRDA does not govern how the sales proceeds are to be allocated, there is no one right way to separate them. It cannot be said that there is no question which entity is entitled to the sale proceeds or in what amount. It is clear that these assets are in the language of Dr. Janis Serra "so intertwined that it is difficult to separate them for purposes of dealing with different entities".

223 Moreover, the evidence in this case is clear and uncontested that Nortel (a) had fully integrated and interdependent operations; (b) had intercompany guarantees for its primary indebtedness; (c) operated a consolidated treasury system in which generated cash was used throughout the Nortel Group as required; (d) disseminated consolidated financial information throughout its entire history, save for the year before its bankruptcy; and (e) created IP through integrated R&D activates that were global in scope.

224 When consolidation occurs, some creditors may be prejudiced if they would have had a greater recovery of so many cents on the dollar against their debtor if there had been no consolidation. Conversely, other creditors may be benefitted by consolidation if they would have had a lesser recovery against their debtor if there had been no consolidation. In this case, even if a pro rata allocation amounted to a consolidation, the issue would be moot because it cannot be said that without consolidation one class of creditors, including the bondholders, would necessarily have had a greater recovery than with consolidation. The reason for this is that there has been no recognized measurable right in any one of the selling Debtor Estates to all or a fixed portion of the proceeds of sale.

225 The bondholders who hold bonds with covenants of both NNL and NNI contend that they would be unduly prejudiced by a pro rata allocation of the lockbox funds as they are entitled to look to both NNL and NNI for payment of their claims and if one of these companies did not have sufficient funds to pay the bonds in full, they could look to the other. I agree that they are entitled to claim against both companies and this will be recognized in the pro rata allocation that will be ordered.

226 The bondholders have the legal right to be paid in full on their bonds. But so do all of the other creditors. Like the pensioners and other creditors, the bondholders are not secured. Because of a shortfall in funds, all of these creditors cannot be paid in full. The issue is how the pain is to be shared.

227 The total cash on hand in the U.S. Debtors' and Canadian Debtors' Estates as of June 2014 was a little over 25% of the face amount of the outstanding bonds. Without an allocation from the lockbox funds of a sufficient amount to enable NNL and NNI to pay the bonds in full, the bondholders could not be paid in full. The bondholders, however, have no covenants in their bonds requiring the lockbox funds to be allocated in any manner, and specifically, no right to have lockbox funds allocated to NNL or NNI. Nor do NNL or NNI have any such rights. The lockbox funds are not the property of any one of NNL or NNI or any other RPE.

228 The bondholders are like other creditors in this regard. The other creditors of the Canadian Debtors could likewise argue that they will be prejudiced if the argument of the Monitor that all of the IP proceeds should be paid to NNL as the owner of

 

the IP is not accepted. But the prejudice to be considered is not this kind of prejudice, but prejudice to legal rights. Neither the bondholders nor the other creditors of the Canadian Debtors have any legal right to have the lockbox funds allocated in a way that will benefit them.

229 The bondholders with covenants of NNL and NNI contend that their expectations will be disregarded by a pro rata allocation and that it will harm the bond markets if they are not somehow paid in full. I think this argument is overblown in this case and in any event not supported by any evidence of their expectations.

230 The evidence of Peter Currie, the CFO of NNC and NNL from 2005-2007, which is not contested, was that until the early to mid-2000s, Nortel's public debt was issued by NNL without guarantee from any other Nortel entity. In 2006, while Nortel's credit rating was still adversely affected by various factors, NNL issued notes having an aggregate principal amount of US$2 billion, which notes were conditionally guaranteed by NNI. NNI was a conditional guarantor in large part because at that time it carried certain hard assets on its balance sheet and because Nortel could obtain slightly better debt terms given that NNI was domiciled in the same place as the ultimate lenders, that is, the United States.

231 Thus it is quite clear from the evidence that when Nortel went to the bond market in 2006 and 2007 to raise funds, Nortel believed that it required the covenant of NNI in order to get the financing on terms and at a cost that Nortel wanted. However, prior to the Nortel insolvency in January, 2009, the market place did not differentiate in any material way the bonds that were guaranteed by NNI and the bonds not carrying a NNI guarantee.

232 From June, 2006 to December, 2008, Moody's and DBRS issued nine credit ratings for Nortel that did not distinguish between Nortel bonds guaranteed by NNI and those that were not. The UCC's expert witness Robert Kilimnik [22] agreed on his deposition that if a guarantee is a risk differentiator from DBRS's point of view, and there were a series of bonds with a guarantee and a series of bonds without a guarantee, he would expect them to be rated differently. This is an indication that the market did not differentiate between the NNC bonds guaranteed by NNI from those that were not guaranteed.

233 Another indication is the evidence of the Nortel bond spreads compared to U.S. government bonds contained in Ex. 58. The chart demonstrates that that Nortel bonds that carried an NNI guarantee traded at higher or equal spreads to Nortel bonds that did not carry an NNI guarantee. Mr. Kilimnik, an experienced bond trader, said on his deposition testimony was that bonds with a lower spread are considered less risky in the marketplace and that if guarantees were recognized by creditors as reducing the risk of issuances by the same company, he would have expected to see that expectation reflected in spread comparisons.

234 Mr. Paviter Binning, the Executive Vice-President and CFO of NNC from 2007 to March 2010 and an impressive witness to be sure, agreed with that conclusion of Mr. Kilimnik and testified that the data implied that the market was giving no value to the guarantees. He also testified that in his experience, investors generally looked to the overall quality of the company and that the guarantees were neither here nor there. He agreed that part of the reason why the guarantees may have had no meaning for the market was that the bonds were sub-investment grade in the first place. His evidence, which I accept, means that after the bonds were issued, the guarantees by NNI did not have a material effect on the marketplace.

235 John McConnell, a professor of business (finance) at Purdue University, delivered a report and testified on behalf the unsecured creditor's committee of NNI in response to a report of Leif M. Clark and Jay L. Westbrook, the latter of whom did not testify at the trial. Professor McConnell's report contained data from the date that the Nortel Group filed for protection on January 14, 2009 to January 2014 which indicated that the bonds not guaranteed by NNI traded at prices below the bonds guaranteed by NNI.

236 I do not see this data as relevant. Counsel for the bondholders in his opening asserted that the expectations of bondholders that are relevant are the expectations pre-petition and not post-petition.

237 If the expectations of those who purchased bonds post-petition were relevant, there was no evidence at all from such purchasers. Professor McConnell spoke to no bondholder and on cross-examination admitted that he had no way of knowing

 

what factors went into the purchase and/or sale of any of the Nortel bonds by any of the current bondholders in the market post-filing. No bondholder testified or gave any evidence of expectations in acquiring bonds.

238 The evidence of Professor McConnell is based entirely on the fact that after the insolvency filings, bonds without a NNI guarantee traded at a lower price than those with a NNI guarantee. There are two points that can be made. The first is that his conclusion is an inference drawn from the trading price of the bonds after the insolvency as to what motivated those purchasers of the bonds after the insolvency. Second, there was no analysis of Professor McConnell that would lead to the conclusion that his inference of bondholder purchaser expectations could apply to purchasers of bonds prior to the onset of insolvency. He said he could not do such an analysis because before insolvency the bonds had different attributes which would not permit him to draw inferences as to the effect of guarantees. Be that as it may, I would not accept the inference drawn by Professor McConnell regarding the effect of the guarantees on a purchaser of bonds. I prefer the evidence of Mr. Binning to which I have referred. [23]

239 Moreover, the evidence is clear that bonds trade on a much different basis after insolvency. Mr. Binning testified that prior to the threat of insolvency, the bonds traded on a yield to maturity basis, meaning that bondholders take all of the payments that would be expected to be made if the bond is held to maturity, and then calculate a percentage yield based upon the price paid for the bonds. Once insolvency or financial distress is anticipated, Mr. Binning testified that bonds trade in the hands of distressed investors who trade not on a yield to maturity basis but in a classic arbitrage market based upon price and expectations of future price and what they think they can make on the bonds during insolvency. He advised the board of Nortel on September 30, 2008, three and a half months before the Nortel filing, that RBC had advised that approximately 50% of the bonds had traded into the hands of distressed investors.

240 Professor McConnell also testified that as new information came into the marketplace about the likely recoveries, that would be reflected in the price of the bonds. That is another way of saying that distressed investors have bet on the future outcome of this case. This is reflected in the volumes and trading prices of the bonds at various times between January 14, 2009 and June, 2014, including (i) in the immediate aftermath of the Filing Date when the bonds were trading at very low prices, (ii) during the prolonged three-day auction resulting in the residual IP sale to Rockstar at the beginning of July 2011 as purchasers placed bets on bond price increases and recoveries following the completion of that sale; and (iii) in reaction to Delaware Bankruptcy Court Judge Walrath's September 2011 decision in *In re Washington Mutual* holding that post-petition interest must be awarded at the federal judgment rate and not at the rates in the various bonds.

241 The bondholders group that at the time of the trial held a majority of the unsecured guaranteed bonds purchased the vast majority of their holdings after the filing date of January 14, 2009 and at a significant discount to par. Certain members purchased when the bonds were trading at as low as 30 cents on the dollar and others received smaller, but still substantial, discounts. This can be seen in exhibits 59 and 60. The vast majority of their collective holdings were acquired in the period between July 31, 2009, at or around the time when Nortel began to liquidate its assets, and July 18, 2011, at or around the time of the Residual IP Sale.

242 The creditor expectations of the current bondholders, who acquired their bonds post-petition, even if known or supported by evidence, is not something I would take into account in this case. I infer from the evidence that any such expectations would have been based on their views as to litigation outcomes and should not be the basis of any decision by the courts.

243 In considering potential prejudice to the bondholders in the event of a pro rata allocation, consideration must be given to what the bondholders would gain. The bonds provide access to the assets of the issuer and guarantor. They do not provide any right to assets of any other entity in the Nortel Group. The 2006, 2007 and 2008 offering memoranda for the guaranteed bonds set out risks associated with the bonds, including the following notice regarding the lack of access to other Nortel entities:

> The Issuers' subsidiaries are separate and distinct legal entities and any subsidiary that is not a Guarantor will have no obligation, contingent or otherwise, to pay amounts due under the Notes or the Guarantees or to make any funds available to pay those amounts, whether by dividend, distribution, loan or other payment.

 

244 The offering memoranda also contained the following risk that investors would face in the event of insolvency of Nortel entities and the lack of access to the assets of those entities:

> In the event of a bankruptcy, liquidation or reorganization of any direct or indirect non-guarantor subsidiary of NNC, all of the creditors of that subsidiary (including trade creditors and creditors holding secured or unsecured indebtedness or guarantees issued by that subsidiary) and third parties having the benefit of liens (including statutory liens) against that subsidiary's assets will generally be entitled to payment of their claims from the assets of such non-guarantor subsidiary before any of those assets are made available for distribution to any Issuer that is a shareholder of such subsidiary. As a result, the Notes and the Guarantees are effectively junior to the obligations of non-guarantor subsidiaries.

245 Whereas the investors who acquired their bonds pursuant to the offering memoranda were specifically made aware that in the situation in which Nortel now finds itself, they would not have access to assets of other Nortel entities that had not guaranteed the bonds, the effect of a pro rata allocation is to provide the current bondholders with such access. The lockbox funds represent the proceeds of sale of all of the assets of all of the 38 entities under the IFSA. Creditors holding guarantees have access under a pro rata allocation to not only the assets of the principal obligor and guarantor corporations, but the proceeds of sale of all the assets of the selling debtors. This is access to more pools of asserts than that for which the holder of a guarantee bargained.

246 While the current bondholders may have thought, or bet on an outcome, that NNL or NNI would likely achieve a win in this litigation that would provide those two companies with sufficient assets to pay the bonds in full and with post-filing interest, there was no guarantee at all that this would be achieved. The bonds contained no covenants that required the assets of NNL or NNI to be maintained at a certain level and no covenants that required the lockbox funds to be allocated in any manner. Mr. Binning had advised the Nortel board in September, 2008 that there were no maintenance covenants in the bonds, meaning that Nortel did not have to live up to any debt servicing ration. He testified that what the guarantees under these bonds essentially gave the bondholders was access to the assets in Canada and in the US without a great degree of comfort as to what those assets would be from time to time. I accept that evidence.

247 As to the effect of a pro rata allocation on the ability of issuers to issue bonds in the future, Professor McConnell on his cross-examination said that he had no opinion on that subject and that he had not tried to quantify what effect a pro rata allocation would have on the capital markets. Thus there is no evidence that a pro rata allocation in this case will detrimentally affect the capital markets and the ability of issuers to issue bonds in the future. Professor McConnell's statement that he had no opinion on the subject is perhaps not too surprising taken the highly unusual facts surrounding the Nortel insolvency and the difficulty of determining ownership of the IP that was sold.

248 It is said that the $2 billion claim of NNI against NNL that was approved by both courts is an impediment to a pro rata allocation. I do not think that is the case. The $2 billion claim will be treated as one of the unsecured liabilities of NNL.

249 The same principles that apply to the US$ 2 billion claim by NNI against NNL will apply to the admitted claim of NNUK and Nortel Networks SpA against NNL pursuant to the Agreement Settling EMEA Canadian Claims and Related Claims dated July 9, 2014, and to the claim of the UKPC for £339.75 million recognized in my judgment of December 9, 2014.

**Appropriate pro rata allocation method**

250 The allocation each Debtor Estate will be entitled to receive from the lockbox funds is the percentage that all accepted claims against that Estate bear to the total claims against all Debtor Estates.

251 In determining what the claims against a Debtor Estates are, a claim that can be made against more than one Debtor Estate can only be calculated and recognized once. The one that is known is the bondholder claim for $4 billion, referred to as the claim on cross-over bonds. All but one of such bond issues was issued by NNC or NNL and guaranteed by NNI. One bond issue for $150 million was issued by NNCC, a subsidiary of NNI, and guaranteed by NNL [24] . The claims on the bonds in determining the claims are to be made on the Debtor Estate of the issuer. If a claim on a guaranteed bond is not paid in full

 

by the issuer Debtor Estate, a claim for the shortfall can be recognized by the Debtor Estate that guaranteed the bond, but that shortfall claim will not be taken into account in determining the claims against the Debtor Estates.

252 One of the known claims is the claim of the UKPC for the approximately £2.2 billion deficit in the NNUK pension plan. If the UKPC makes a claim for this amount against NNUK and also against other EMEA Debtors, those claims against the other EMEA Debtors will not be taken into account in determining the claims against the Debtor Estates. The claim may be taken into account only once in the pro rata allocation.

253 I understand that for the Canadian Debtors and the U.S. Debtors, the claims for the most part are generally known although there are some claims still unresolved, such as the SNMPRI claim. The U.K. Administrator has not yet instituted a claims procedure, apparently awaiting a determination of this allocation proceeding. In my view, the process should be undertaken now and I expect this will happen.

254 Interim distributions have been proposed. In my view, this would be especially important for the predominantly elderly pensioner population and disabled employees who have endured hardship as a result of the loss of their benefits but also for other creditors who have waited more than five years for a distribution on their claims. An interim distribution should be made if possible.

255 Briefs should now be filed by those parties supporting an interim distribution with full details of what is requested. Opposing briefs would of course be required. The procedures and timing could be discussed at a 9:30 am appointment.

**Allocation on a basis other than pro rata**

256 The evidence on this subject was complex and varied dramatically from party to party. To wit:

(a) The Monitor on behalf of the Canadian Debtors contended for an allocation of $6.034 billion to the Canadian Debtors, $1.001 billion to the U.S. Debtors and $300.7 million to the EMEA Debtors. [25]

(b) The U.S. Debtors contended for an allocation of $0.77 billion to the Canadian Debtors, $5.3 billion to the U.S. Debtors and $1.23 billion to the EMEA Debtors.

(c) The EMEA Debtors contended for an allocation of $2.32 billion to the Canadian Debtors, $3.636 billion to the U.S. Debtors and $1.325 billion to the EMEA Debtors.

257 I have given consideration to the valuation issues. To a great extent, they are dependent on the various interpretations of the MRDA asserted by the parties. For that reason I would not use any of the valuations for the purpose of the pro rata allocation as I have found that the MRDA does not govern the allocation. However, my views and findings on the valuations are set out in Appendix A for the business line sales and Appendix B for the residual IP sale to Rockstar.

**Conclusion**

258 A judgment is to go that the lockbox funds are to be allocated on a pro rata allocation basis with the following principles to govern:

(1) Each Debtor Estate is to be allocated that percentage of the lockbox funds that the total allowed claims against that Estate bear to the total allowed claims against all Debtor Estates.

(2) In determining what the claims are against the Debtor Estates, a claim that can be made against more than one Debtor Estate can only be calculated and recognized once in accordance with these reasons for judgment. Claims on bonds are to be made on the Debtor Estate of the issuer. A claim for any shortfall can be recognized by the Debtor Estate that guaranteed the bond, but that shortfall claim will not be taken into account in determining the claims against the Debtor Estates. If the UKPC makes a claim against more than one Debtor Estate, such additional claims will not be taken into account in determining the claims against the Debtor Estates.

 

(3) Intercompany claims against a Debtor Estate are to be included in the determination of the claims against that Estate.

(4) Cash on hand in any Debtor Estate will not be taken into account in the pro rata allocation. Each Debtor Estate with cash on hand will continue to hold that cash and deal with it in accordance with its administration.

(5) An interim distribution may be allowed upon further submissions. Briefs in favour of and opposed to an interim distribution are to be filed on a time-line to be considered at a 9:30 am appointment.

(6) Proposed schedules for expediting any remaining claims procedures are to be provided without delay.

**Epilogue**

259 I cannot leave these reasons without commenting on the persons who made this unique case possible.

260 First, to the technical staff who provided the facilities to permit this trial to be conducted in two different countries at the same time, I say it was a job more than well done. It was outstanding and we are indebted to you all. Judge Gross and I have no idea how it was all set up and operated, but I know he is as grateful for the facilities as I am. Thank you.

261 Second, to the reporters and their staff, it was also a job more than well done. Apart from the instantaneous real time reporting that permitted all parties to see the evidence as it was being given, we were blessed with draft transcripts being electronically sent to us shortly after the evidence concluded each day and final transcripts later that evening.

262 Third, to the lawyers. We were blessed with outstanding counsel on both sides of the border. In a case such as this with the amount at stake, one can understand the pressures on counsel and how those pressures could get in the way of a smooth preparation and presentation of the case. From what I could see, all acted in a professional manner that does them credit. Without that, the case could not have proceeded as well as it did. Their staff should also be congratulated for the smooth way in which the case was electronically presented. It was a marvel.

263 Finally, I want to thank Judge Gross for his courtesies and good humour. It has been a pleasure to work with him. Without such a good relationship and the trust that we developed for each other, this trial and its conclusion would not have been possible.

*Order accordingly.*

## Appendix A

**Allocation of the proceeds of the line of business sales**

The experts for the various parties differ on the way that the proceeds of the sales of the LOB should be allocated amongst the Canadian estate, the U.S. estate and the EMEA estate.

Mr. Kinrich, the valuer called by the U.S. Debtors, did not value the various assets sold and attempt to allocate them by any particular method. Rather he allocated the entire sale proceeds by taking the revenues of each company whose businesses were sold and allocating to each company (and the group they were in) the percentage of its revenues to the total revenues of all companies whose businesses were sold. His resulting allocation was 11.9% or $340 million to the Canadian Debtors, 18% or $510 million to the EMEA debtors and 70% or $1.99 billion to the U.S. Debtors.

Mr. Malackowski called by the EMEA debtors valued the IP rights sold by using a revenue or license valuation method. His valuation of the IP sold in the business sales was $765.2 million.

Mr. Huffard called by the EMEA debtors then allocated the various kinds of assets sold. He valued the tangible assets that were sold at $118 million and allocated this amount to the companies that sold them. He allocated the IP that was sold and valued by Mr. Malackowski at $765.2 million by a contribution approach which allocated the IP according to the amount of R&D expenditures of each of the RPEs. He attributed the balance of the LOB sale proceeds as "customer related assets and goodwill" and allocated them on the basis of the percentage of revenues generated by each entity in 2008. Mr. Huffard did not give a separate total figure in his report for the allocation of the LOB sale proceeds.

Mr. Green called by the Canadian Debtors dealt with each kind of the various assets sold. He allocated the tangible assets sold by giving to the companies that sold them their book value, which he calculated to be $534.19 million. He valued the workforces sold by their cost that the selling companies would incur to replace them at $255.33 million and allocated those costs to the companies. He allocated the IP and customer relations by valuing what the licensed participants gave up to enable the sales on the basis that their license rights were limited to the "Products" "by or for the Participants" as defined in the MRDA, and allocated the balance of the sale proceeds to NNL as the "owner" of the IP. His resulting allocation was 54.8% or $1.58 billion to the Canadian Debtors, 10.4% or $300.97 million to the EMEA debtors and 34.7% or $1001.5 billion to the U.S. Debtors.

***(i) Mr. Kinrich***

Mr. Kinrich's view is that the RPEs that were licensed participants had all license and sublicense rights as owners. Assuming that to be the case for this analysis, I have some concerns with his analysis. Mr. Kinrich allocated all of the assets sold in the business sales on a revenue basis. He stated in his report that the value of the sold assets is reflected in the revenue generated by each entity that sold the assets. That is, value he said was reflected in revenue figures.

Mr. Kinrich himself in his report said that financial economists agree that a discounted cash flow analysis is the preferred technique for asset valuation and that one of the requirements is to have projected future cash flows less costs. In his report he did not say why he had not done such an analysis when dealing with the business sales. At trial he relied on texts to support his use of a revenue approach in firms with losses, one of which is *Valuing Small Businesses and Professional Practices*, which suggests gross revenue multiples may be used in restricted situations, being to approximate a range of possible values with a minimum effort, conclude an estimate of value when other data are unavailable or inadequate or as one indicator of value used in conjunction with more rigorous valuation methods. The text also said that for companies with losses or erratic earnings, multiples of price to revenue for other comparative companies may give some indication of how others asses the future of the industry or profession. But that is not what Mr. Kinrich did. He did not look at revenue multiples from the sale of any comparable companies. I viewed his attempt to bolster his revenue approach by resort at trial to texts to be an attempt at *ex post facto* rationalization. It would have been a little more persuasive if these rationales has been provided in his report, particularly as in his report he did a sensitivity check based on gross margin (revenue less cost of goods sold) and contribution margin (revenue less selling, general and administrative expenses).

Mr. Kinrich said at trial that he did not have available forecasts that would divide income streams by territory but that is beside the point so far as a gross revenue valuation is concerned. The issue is whether it would have been preferable to take costs into account in his revenue approach to allocation.

Because the U.S. market had the highest revenues, it follows that using a revenue approach as Mr. Kinrich did will result in the high allocation of the business sale proceeds to the U.S. (70%) and a low allocation to Canada (11.9%). However, because revenue does not consider costs, this result ignores the way in which Nortel operated as a matrix structure and the reliance by all operating areas, including the U.S., on IP generated by R&D elsewhere. The 2009 revenue that Mr. Kinrich used in his analysis to compare revenues, the basis of which was assumed license rights under the MRDA, was subject to the obligation in the MRDA to make payments pursuant to the RPSM measured by R&D expenditures of each RPE. Mr. Kinrich did not take into account.

Mr. Kinrich acknowledged on his cross-examination that while he assumed that the set of license rights as he saw them would continue in the future to exist, he gave no effect to sharing obligations that might arise under the MRDA, his reason being that he understood that the sharing provisions did not apply to sales proceeds. That in my view was no answer. What he undertook was to determine the relative value surrendered by each of the selling entities, including the RPEs. To determine the value of rights of each of the RPEs without taking into account the RPSM sharing obligations failed to properly determine relative values among the RPEs. I accept the opinion of others, including Dr. Bazelon and Mr. Green, on the point. The various businesses in Nortel historically operated on varied operating margins.

 

Mr. Green pointed out, with reference to texts including those that Mr. Kinrich referred to at trial, that a disadvantage of focusing on revenues is that it can lull one into assigning high values to firms generating high revenue growth while losing money and that the method assumes that the businesses are equally profitable. His view was that a revenue based allocation was inappropriate in a matrix structure such as Nortel with interrelated operating businesses in which certain entities bore disproportionate shares of expenses like R&D which would be ignored.

EMEA and the UKPC contend that Mr. Kinrich should not have used 2009 revenue figures as 2009 was an anomalous year for Nortel. Nortel filed for insolvency protection in January 2009 and from then on was operating under the supervision of courts in Canada, the US, the UK, and elsewhere. Throughout 2009, Nortel was actively engaged in selling its businesses, signing seven out of eight of its sale agreements in that year. All of this affected its ability to generate revenues. Four of the business sales were concluded before the year's end. Because of these dispositions, complete financials for 2009 were not even available for certain businesses and revenues had to be estimated based upon performance prior to the sale closing date.

Dr. Bazelon's evidence was that NNI's share of global revenue plateaued by 2008 at about 65% but in 2009 it increased by about 4%. In my view, EMEA and the UKPC have a valid point. 2009 was not a typical year for Nortel. While NNI contends that 2009 resembles the weighted average over the years 2001 to 2008, but that ignores the steadily declining trend from NNI having 74% in 2001 to about 65% in 2008. Using 2009 for his revenue analysis was overly aggressive. The effect was to shift about 4%, or $100 million, from EMEA to the U.S. Debtors.

***(ii) Mr. Malackowski and Mr. Huffard***

The allocation of the proceeds of the LOB sales on behalf of the EMEA Debtors is based on the evidence of Mr. Malackowski who valued the IP sold at $765.2 million and on the evidence of Mr. Huffard who allocated all of the sales proceeds using different methods for each type of asset sold. There are problems with the EMEA allocation.

Mr. Malackowski used a discounted cash flow analysis to value the IP. He said there was a defensive component and a synergistic component to the IP. To measure the defensive component, he took the revenue forecasts of Nortel in the "deal books", market derived growth rates, and royalty rates from an IPCo model. For a discount rate he used an average of weighted average cost of capital rates of the industry in which the Nortel business operated. To measure the synergistic component, he used revenues of a hypothetical market participant for each line of business sold, market derived growth rates, and royalty rates derived from what he said was the implied rate paid by Ericcson as a member of the Rockstar consortium. He added 15% to the discount rate used in his defensive component.

Mr. Malackowski's valuation of the IP sold at $765.2 million, if accepted, means that the IP represented roughly 25 % of the total sales proceeds of $3.1 billion. Yet, the evidence is overwhelming that IP created by Nortel's R&D was the driver of the profitability of the business. Even Mr. Huffard view was that within Nortel, IP was considered the driver of revenue in each of the businesses and purchasers of the businesses would have considered the acquisition of IP as a critical aspect. Mr. Britven, an expert called by the CCC, arrived at figures based on the purchase price allocations made by the purchasers that stated what the purchasers considered the fair value of the various acquired assets to be. Those figures put the percentage of the IP of the total business sale proceeds at 40%.

In his rebuttal report, Mr. Malackowski in an attempt to show the size of what he considered to be a windfall if the position of Mr. Green were accepted, said that all of the Nortel the IP in total in the hands of Nortel could be worth $10.4 billion, of which he allocated $3.761 to the business sales and $6.6 billion to the residual sale to Rockstar. His reason for this extra value in his report was that some of the residual IP sold to Rockstar was encumbered by the non-exclusive licenses given to the purchasers of the lines of business. Rockstar paid $4.5 billion. If Mr. Malackowski's figures are right, it means that the non-exclusive licenses given to the purchasers of the lines of business reduced the value of the residual IP sold to Rockstar from $6.6 billion to $4.5 billion, or by $2.1 billion. That reduction in value to Rockstar attributed to the non-exclusive licenses granted in the business sales means that those non-exclusive licenses were worth $2.1 billion, and it does not make sense that Mr. Malackowski valued both the outright licenses and the non-exclusive licenses given to the purchasers of the lines of business at only $765.2 billion.

  

The Monitor points out that the royalty rates used by Mr. Malackowski in establishing revenues to be valued were taken from the IPCo litigation light model and that within that litigation light model he chose the lowest of three rates. He did not use any Nortel intercompany-stated royalty rates. The Monitor suggests that is an explanation why the IP valuation of Mr. Malackowski is too low. For certain the royalty rates charged directly affect the revenues and thus the value obtained by a DCF method of valuation. Whether it is the only reason for the low valuation is another matter. There are many inputs in a valuation.

Mr. Huffard was the expert called by EMEA to opine on the allocation to be made of each component of the business sales. The Monitor is critical of his qualifications. Mr. Huffard is an investment banker with considerable experience advising distressed companies who has "led valuation analyses" for companies and their assets. He holds a Master of Management degree from Kellogg Graduate School of Management at Northwestern University. Mr. Huffard is not accredited as a valuator and said that in the field of investment banking that is typical.

I must say that Mr. Huffard was not forthcoming in his evidence about his experience. When asked if he had done any valuations or the allocating of assets in connection with intellectual property companies, he said several times that he had trouble understanding what an intellectual property company was and asked if Nortel was an intellectual property company. Yet when asked on his deposition whether he had done any valuations or the allocating of assets in connection with intellectual property companies, he answered "Not in connection with intellectual property companies." I think it fair to consider this answer in dealing with his evidence.

Mr. Huffard believed that there were three classes of assets to be valued and examined in the business sales. The first is net tangible assets. The second is the IP. The third is customer-related assets and goodwill not otherwise encompassed in goodwill. Mr. Huffard did not do any valuation exercise for his third class. Rather he just took the balance of the purchase price and allocated it. The values attributed to the first two classes therefore directly affected the value of his third class.

For the tangible assets, Mr. Huffard took the book values of the assets, which consisted of accounts receivable and prepaid expenses, inventory and fixed assets. This book value in his report totalled $403 million. At trial, in his demonstrative exhibit, his total was $361 million. Why the difference was not explained. From the book values, Mr. Huffard deducted liabilities assumed by the purchasers of the lines of business, the largest of which was deferred revenue. He viewed the assumed liabilities as a fourth asset class that resulted in an increase in the purchase price from the buyer's perspective and a reduction from the seller's perspective. They had to be deducted from the assets and he did this the tangible asset class. This resulted in net tangible assets in his report of $124 million, being $39 million for Canada, a negative $27 million for EMEA, $106 million for the U.S. and $6 million for Asia and the Caribbean. At trial, his demonstrative showed the net tangible assets at $118 million with the same net figures for Canada, EMEA and the U.S. as in his report. How this occurred on the different book values in his report and in his demonstrative was not explained.

For the allocation of the IP, Mr. Huffard took Mr. Malackowski's figure of $765.2 billion. He allocated them amongst the RPEs using Mr. Malackowski's contribution approach using historical R&D spending from 1992 to 2008. His view was that the portions of the sale proceeds attributable to IP were, in effect, a capitalization of future revenues that would otherwise have been shared among the RPEs in accordance with the RPS methodology. This resulted in 40.8% or $312.2 million being allocated to Canada, 42.6% or $326 million being allocated to the U.S. and 16.5% or $126.2 million being allocated to EMEA. In his demonstrative at trial, these percentages were rounded, with 41% to Canada, 43% to the U.S. and 16% to EMEA.

Mr. Huffard then included the balance of the sale proceeds of $2.198 billion into his third class of customer-related assets and goodwill. He did no analyses of the value of either the customer-related assets or of the goodwill and allocated them based on the revenue generated by each entity in fiscal year 2008. He said he did not use net revenues to allocate among the entities because in his view cash flows are influenced by transfer pricing and inter-company arrangements for tax purposes. Based on the revenues alone, he allocated 9.2% or $202 million to Canada, 62.6% or $1.375 million to the U.S., 18.6% or $155 million to EMEA, 2.6% or $57 million to the Caribbean and 7.1% or $155 million to Asia.

  

While Mr. Huffard did not provide a total for the business sales allocation, by adding up the different classes, his total allocation to Canada was $553.2 million to Canada, $1.807 billion to the U.S. and $254.2 million to EMEA. This is somewhat less than the $2.85 billion available from the business sales proceeds.

As Mr. Huffard did not undertake any valuation of his third residual category, his conclusion of the amount to be included in it is dependent upon the amount of his tangible asset valuation and Mr. Malackowski's IP valuation. If Mr. Mr. Malackowski's IP valuation is too low, then the amount in this residual class allocated by Mr. Huffard will be too high.

There are problems with allocating this residual class entirely by revenues of each company or groupings of companies. Mr. Huffard described it as the value of customer-related assets and goodwill not otherwise associated with IP. He acknowledged that these assets, like any other assets, have their value fundamentally related to their ability to generate profits, and that while Nortel operated the businesses, it was not revenue that allocated those values but the RPS method of sharing profits after revenues and costs were calculated. This is the same criticism made of Mr. Kinrich in using a revenue tool to allocate the sales proceeds rather than a profitability tool.

Mr. Huffard acknowledged that in circumstance where, because of decisions made and cost-effectiveness and historic reasons, sales and customer support was done in a country which had low domestic revenues, his revenue allocation method for the customer-related assets and goodwill category was not going to compensate that country because it had low revenues. This circumstance was commonplace in Nortel with its matrix structure, with customer support carried out in one country for sales in another. He acknowledged if a large percentage of the workforce is in a place like Canada, which does R&D and which does sales support and supports the global organization but doesn't have a large native revenue stream, he was allocating the value of that workforce to the other entities where there is a revenue stream and not to Canada.

***(iii) Mr. Green***

Mr. Green valued different asset classes differently. He first valued tangible assets by taking their book value and allocating them to the companies which owned them. This was the same method used by Mr. Huffard. However, different from Mr. Huffard, he did not deduct any deferred liabilities from the tangible asset amount. His evidence was that deferred liabilities are essentially amounts that would be due that are related to projects that have already been billed and perhaps paid for and so they didn't offset the physical assets, the tangible assets such as the accounts receivable, the other things that were sold. He pointed out that by his not deducting deferred liabilities, it was to the relative benefit to the U.S. Debtors because they had the highest deferred revenues and, accordingly, deducting the liabilities would most significantly decrease the U.S. Debtors' share of the value of net tangible assets. He also pointed out in his rebuttal report that not all liabilities recorded on the books of Nortel were assumed by the purchasers and for those that were it was not possible to determine on which entity's books those liabilities were recorded. I accept this position of Mr. Green in not deducting assumed liabilities in valuing and allocating the tangible assets on the basis of book values recorded on each entity's books.

Mr. Green's value for the tangible assets was $534.19 million, and he allocated $121.74 million to the Canadian Debtors, $317.59 million to the U.S. Debtors and $94.86 million to the EMEA Debtors.

Mr. Green next valued the workforce in the lines of businesses that were transferred to purchasers. His opinion was that generally speaking, the cost approach is applied to the valuation of an assembled or in-place workforce. He valued the workforce by calculating the cost to replace the work force. He concluded that the total value of the work force was $255.33 million and he allocated $78.68 million to the Canadian Debtors, $134.74 million to the U.S. Debtors and $41.91 million to the EMEA Debtors.

In the sale of the Enterprise business, several corporate entities owned by NNI were sold. Mr. Green valued these assets based on contemporaneous fair market valuations done at the time these businesses were sold. There is no evidence that these assets had a value other than as set out by Mr. Green. Mr. Green made an allocation to NNI of proceeds attributable to the sale of its subsidiaries in the amount of $110,970,000. No other valuer dealt with this asset.

 

Mr. Green was of the view that once the tangible assets and the workforce were valued, the balance of the business sale proceeds was attributable to IP, the primary driver of Nortel's value, and customer relationships. He valued and allocated the IP and customer relationships sold in the business sales by valuing the license rights of NNI and the EMEA RPEs surrendered by them to permit the sales to take place on the basis that their licenses were restricted to Products by or for the Participants as defined in the MRDA and as contended by the Monitor. The balance he attributed to NNL as the owner of the IP.

Mr. Green performed a DCF valuation. He projected revenues and expenses for each business sold and for this to project the future revenues of the Nortel businesses he used forecasts prepared by Nortel that were referred to as "Retained by Nortel" forecasts. They projected the revenues that would have been earned and the expenses that would have been incurred, if the operating businesses had been retained by Nortel. After calculating the operating profits of each business sold, Mr. Green aggregated those profits and applied the RPSM on the assumption that the MRDA would have remained in place, using the capital stock percentage for the first quarter of 2010, which covered a rolling average from 2005 to 2009. He applied a discount rate of 12% for the operating profits derived from existing technology and 30% for operating profits to be derived from yet to be invented technology and thus more risky. He concluded that the value of the license rights surrendered by NNI was $438.2 million and by the EMEA RPEs was $164.2 million. The balance of his residual amount, being $1.379 billion was allocated to NNL.

Mr. Green's resulting allocation was 54.8% or $1.58 billion to the Canadian Debtors, 10.4% or $300.97 million to the EMEA debtors and 34.7% or $1001.5 billion to the U.S. Debtors.

EMEA and the U.S. Debtors contend that a basic problem with Mr. Green's analysis is his conclusion or assumption that NNL was the owner of the IP and entitled to its residual value after deducting the license rights of EMEA and NNI which he limited to Nortel Products by or for the Participants. This is a basic legal issue.

EMEA argues that customer relationships were very important to Nortel and that they should have been valued and allocated separately from IP and not included in Mr. Green's residual category. Mr. Green's explanation for not doing so was that customer intangibles represented historical relationships in which customer files and ongoing agreements exist, the value of which was represented in his revenue figures that he used and were thus subsumed in the IP license rights which he valued. He said that a separate valuation of customer relationships would be duplicative of the values of the license rights surrendered because it would be based on the same revenues and profits as used in the license rights valuation.

Mr. Malackowski argued that the MRDA did not transfer customer relationships to NNL. This does not strike me as a valuation concept and one can argue, as the Monitor does, that NN Technology was owned by NNL and it included all intangibles.

This is a valuation issue. There is no question that customer relationships were important to Nortel. However that is not the issue. The issue is how to value them. Mr. Berenblut was of the opinion that customer relations were co-mingled with IP rights because the value to use them depended on the ability to sell Nortel products and that their value would be included in the value of rights to sell Nortel products. Dr. Bazelon, an EMEA expert, agreed on cross-examination that goodwill and customer relationships are entangled with the IP and take their value from the IP, at least in part. Brian McFadden, the Chief Technology Officer at Nortel for some time, said that R&D was crucial in initiating relationships with and developing sales from customers for Nortel products. I accept Mr. Green's opinion that no separate valuation needed to be made for customer relationships.

It is also argued that Mr. Green should have separately valued and allocated goodwill. Mr. Huffard included goodwill in his residual class, although he did not attempt to value it. Mr. Britven, called by the CCC, included a value for goodwill in his business sales analysis. He took what the purchasers had allocated in their PPAs as goodwill, and referred to it as Purchaser Goodwill.

Mr. Green's response to this is that Nortel wrote off all of its acquired goodwill at the end of 2008. This indicated that, at the time, Nortel management did not believe it would be able to realize the value of the goodwill from these acquisitions in the future. As for its own "internal goodwill," Nortel was suffering losses from its operations and was not generating positive cash flows. Thus, from an accounting and finance perspective, Nortel had no goodwill from its own operations. By classifying the residual value as goodwill, Mr. Huffard accounted for an asset that did not exist within Nortel and was not transferred to the buyers. By applying the buyer's perspective, Mr. Huffard failed to answer the question of how to allocate the sales proceeds according to the value of the interests each of the Debtors transferred and rights each of them relinquished.

There is actually support for Mr. Green's position in Mr. Britven's report in which he included a value for goodwill taken from the purchasers' PPAs. These purchaser allocations are done by purchasers for accounting purposes and usually are driven in part at least by tax considerations. Mr. Britven said that Nortel wrote off the value of substantially all of the goodwill that it had on its balance sheet. He said that Nortel did not have sufficient value to support any significant goodwill value and that the goodwill in the business sales related to the attributes of the buyer, not the attributes of Nortel. He said that any goodwill recognized by purchasers in their PPAs did not reflect amounts that could have been realized by the licensed participants through the continued operations of their lines of business.

I agree with Mr. Green's approach to goodwill and accept his opinion that there was no goodwill value in the Nortel businesses that were sold.

Regarding the DCF method used by Mr. Green to value the U.S. and EMEA license rights, Mr. Kinrich was critical of the revenue forecasts used by Mr. Green and stated that he had not followed the International Financial Reporting Standards which state that in measuring value in use, an entity shall base cash flow projections on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the useful life of the asset.

This IFRS material was not put to Mr. Green on his cross-examination, which it should have been for this argument to be made. However, I do not think the criticism is justified. Mr. Green used projections made by Nortel. He used projections referred to as a "Retained by Nortel" scenario which projected what revenues and expenses would be either retained by Nortel or spun-out on its own as a stand-alone company. He declined to use Nortel's "Safe Hands" projections for several reasons that he explained, including the fact that they forecasted the businesses in the hands of a well-capitalized third party who could invest adequate capital in the business and who could earn greater profits than if they remained in Nortel's hands. Mr. Green did no DCF analysis as he allocated the business sales solely on revenues.

Mr. Kinrich was also critical of Mr. Green for not including a terminal value in his DCF valuation. Mr. Green's explanation for this on his deposition was that in his present value analysis, at year nine the present value factors were close to zero. So even if there were a terminal value, it would be virtually of no value in a present value computation. In his report, he said he thought that to include potential profits after nine years was too speculative. There is no competing DCF valuation to indicate what Mr. Green did was wrong.

Mr. Green's analysis in part is dependent on the interpretation of the MRDA advanced by the Monitor on behalf of the Canadian Debtors. One cannot quarrel with the logic of it if that interpretation were to govern the allocation.

## Appendix B

**Residual IP proceeds allocation**

The residual IP was sold to Rockstar for $4.5 billion. After payment of a break fee and expense reimbursement to Google, the remaining net proceeds held for allocation amount to $4.45 billion.

There is differing expert opinion as to how to allocate the proceeds of the Rockstar sale amongst the Canadian debtors, the U.S. debtors and the EMEA debtors.

Mr. Green allocated the proceeds on the basis of his interpretation of the MRDA under which it was NNL that owned all of the patent rights that were sold to Rockstar.

Mr. Kinrich for the U.S. debtors allocated the proceeds on a revenue approach on the basis that each Participant owned all of the economic rights to the patent rights sold to Rockstar in their exclusive jurisdictions and that their revenue streams that they gave up should be valued. Mr. Green as an alternative analysis for the Canadian debtors and Mr. Malackowsi as an alternative analysis for the EMEA debtors prepared valuations correcting what they saw as errors by Mr. Kinrich.

Mr. Malackowski allocated the proceeds on a contribution basis by calculating what he saw as the contributions by each of the Participants to R&D over the life of the patents that were sold to Rockstar.

***(i) Mr. Kinrich's license approach to value***

Mr. Kinrich assumed that each of NNL, NNI and the EMEA debtors owned all of the economic benefits of the residual IP. He allocated all of the Rockstar proceeds to NNL, NNI and EMEA by taking what he said would be the revenue earned in each of those three geographical areas and then doing what he said was a discounted cash flow analysis ("DCF") on those revenue streams. I have held that the Licensed Participants did not own all of the economic benefits of the residual IP. However, on the assumption that they did, I will consider Mr. Kinrich's analysis.

Mr. Kinrich obtained his revenue streams by taking one of the IPCo revenue model assumptions. He then apportioned the net revenues after costs and taxes to each of the three geographical areas by using those countries' relative telecom infrastructure expenditures for six of the eight IPCo franchises that Nortel had and apportioning all of the net revenues after costs and taxes for two of the franchises (PC and Internet advertising) to the U.S. He then applied a discount rate to those net cash flows allocated to each country.

I have considerable difficulty with a number of aspects of Mr. Kinrich's analysis. If the value of the net cash flows as stated by Mr. Kinrich is overstated, the overstated amount would belong to NNL, as the amount of the sales proceeds from the Rockstar transaction would represent more than the value of the net cash flows, which on Mr. Kinrich's assumption is what the Licensed Participants gave up in the Rockstar sale. The expert evidence called by the Monitor is exactly to that effect, contending that Rockstar paid more than the value of the cash flow projections from the IPCo model for other motives.

Nortel had no material business licensing its IP or monetizing its technology by suing others, either before or after filing for protection from creditors in early 2009. Mr. John Veschi had been hired in July 2008 to take responsibility for Nortel's IP group and to look at options for licensing its IP.

Development of the IPCo option was led by Mr. Veschi after the insolvency filings. The premise of IPCo was that the residual patents would be monetized by the threat of patent infringement litigation and, if necessary, actual infringement proceedings against various technology companies in an attempt to force such companies to pay royalties to IPCo. It was considered important that IPCo not carry on any telecommunications or other technology business, because, if it did, it would be vulnerable to counterclaims for alleged infringement being brought by the targets of its infringement litigation, which would undercut its revenue generating ability.

Over the course of 2009 and 2010, Mr. Veschi and his team, assisted by Lazard Frères & Co, Nortel's financial advisor, and Global IPCo, a law firm specializing in patent sales, prepared several versions of a preliminary financial model, in an attempt to forecast the operating profit that could be earned by IPCo so that the potential economic benefits could be weighed against value expected to be received on a sale of the portfolio.

The various versions of the preliminary financial model had three sub-models, with differing assumptions relating to how much litigation IPCo would pursue. The scenarios were dubbed "Harvest" (assuming very little litigation), "Litigation Light" and "Litigation Heavy". More litigation resulted in greater forecast revenues, at greater forecast cost. Assumptions regarding litigation success of 60 percent, 70 percent and 100 percent were used. A wide variety of assumed net cash flows were used and a variety of discount rates to value the cash flows were used.

There is a difference in the evidence of Sharon Hamilton, a partner of Ernst & Young, the Monitor, and Mr. John Ray, the principal officer of NNI, as to how reliable the IPCo forecasts were. Ms. Hamilton was of the view that the projected cash flows were largely guesswork, given that Nortel had little experience in licensing and there were no good precedents about the estimated cash flow. Mr. Ray was more confident of the forecasts taken the work that went into them.

 

What is clear is that there were a number of different models. Version 1 was presented on March 10 2010, version 2 on April 27, 2010, version 2.2 on May 6, 2010, version 3 undated, version 3.1 on October 25, 2010 and version 4 on November 18, 2010. Each version had different cash flow forecasts.

I think it fair to conclude that the forecasts were not considered to be in any way certain. There were many permutations and combinations, and at no time did Nortel agree that any one forecast was the appropriate one. The process never got that far before the decision was made not to operate IPCo but rather to sell the residual IP.

Mr. Kinrich chose to use version 3.1, although he did not explain why. Version 3.1 had the highest cash flows of all versions. It is noteworthy that the latest version 4 had projected cash flow forecasts of approximately half of what was projected in the earlier version 3.1 used by Mr. Kinrich.

Mr. Green, an expert valuer called by the Monitor, points out that version 3.1 itself was not a finalized document or accepted by Nortel or its advisors. Within it there were a number of scenarios and options still being explored. The unreliability of the forecasts in the various models can be seen by the wide disparity in discount rates used. Lazard used discounts of 25, 35 and 45% to value the various projected cash flows. These are very high discounts, as more than one expert testified, and indicated a high risk to the cash flows being achieved. Mr. Kinrich used much lower discount rates of 12% and 15%, which I will come back to, which did not reflect the risks in the IPCo forecasts and which caused a higher valuation of the cash flows than would be the case if the discounts used by Lazard in the IPCo models were used.

While there were multiple scenarios in the version 3.1 model, Mr. Kinrich used only the most aggressive case that maximized revenue. Mr. Green's view is that there is inadequate explanation by Mr. Kinrich why the specific scenarios of Version 3.1 were selected for the analysis as opposed to other lower cash flow scenarios or the later Version 4 model with lower cash flows and as the analysis is unsupported, it makes the valuation unreliable. I must say that in reviewing the details of Mr. Kinrich's report it is not at all apparent what his justification was for using the cash flows that he did. It leaves an open question as to the reliability of what Mr. Kinrich was doing.

The value allocated to each of the debtors by Mr. Kinrich is based on the attribution to the geographic regions of the debtors of the projected operating cash flows in the IPCo model chosen by Mr. Kinrich. Those cash flows projected royalty payments on a regional level, namely North America, EMEA and China.

The IPCo model estimated North American licensing revenue based on sales in Canada and the U.S. Mr. Kinrich apportioned the revenue to Canada and the U.S. using those countries' relative telecom infrastructure expenditures, saying that relative telecom expenditures were a reasonable basis on which to estimate relative market size and were consistent with the structure of the IPCo model that used market size as the driver of royalty revenues. He did the same thing for EMEA as the IPCo model estimated EMEA revenue based on sales in France, Germany and the U.K.

Global IPCo, the IPCo law firm retained to assist in preparing the models, stated early on in their work that they had no opinion regarding the territorial split of patents or patent-related revenue. There was certainly no agreement by any of the Nortel entities as to how the projected IPCo cash flows would be split territorially.

Mr. Kinrich then deducted costs from the revenue streams including a number of litigation costs. It is not possible from looking at his report to know exactly what level of litigation costs was assumed by him.

After calculating the net cash flows for each country, Mr. Kinrich then said he did a discounted cash flow calculation to arrive at a valuation for each country. In my view, Mr. Kinrich did not carry out a valid DCF valuation. The discount rate he used was not appropriate and was not derived by any conventional valuation approach.

Mr. Kinrich acknowledged in his evidence that a DCF analysis requires knowledge about the cash flows over time and requires a discount rate to take those cash flows over time and convert them to present value. He acknowledged in his report that typically a discount rate is derived from the cost of capital (the cost of debt and equity split on some basis), referred to by valuators as the weighted average cost of capital. However, he did not do this. Instead he said that the value of the residual IP was known from the $4.5 billion paid for it by Rockstar and by taking his projected cash flows that he used from the IPCo model, he could back into (or reverse-engineer) a discount rate, being 12.2% when China is not included and 15% when China is included.

This analysis proceeds on the assumption that the amount paid by Rockstar was based on the revenues taken by Mr. Kinrich from the particular IPCo model that he used. However, neither Mr. Kinrich nor anyone else knew what revenue streams were used by Rockstar to base their purchase price on or indeed, if Rockstar based their purchase price solely on anticipated revenues they could earn from the patent portfolio they acquired. Without knowing that, it is not possible to say that the Rockstar purchase was based on a discount rate of 12.2% or 15%. A discount rate, as Mr. Kinrich conceded, should reflect the risk of the cash flows being achieved, but without knowing what cash flows Rockstar based its purchase price on, saying the Rockstar purchase reflected a certain discount rate is artificial. Rockstar did not even know what the various IPCo cash flow models were.

Mr. Green, Mr. Berenblut and Dr. Cox and Mr. Malackowski, all expert valuers, were critical of the method used by Mr. Kinrich to arrive at his discount rates of 12.2% and 15%. I accept their criticism. These discount rates were much lower than the rates used by Lazard in the IPCo models, including the very net cash flow model used by Mr. Kinrich, of 25% to 45%. Mr. Berenblut testified that he would expect the range of discount rates to be between 30% and 70%, recognizing the fact that this was a contemplated rather than an established business and recognizing the risks associated with it.

Mr. Malackowski used a discount rate of 30% in his analysis of the potential revenue from the residual IP portfolio. He derived that rate by examining risk-adjusted hurdle rates associated with implementation of technology-based IP. These rates account for a buyer's required rate of return or the associated risk of commercializing a technology.

Mr. Kinrich in his report stated that the inferred rates of 12.2% and 15% that he obtained were consistent with discount rates observed in the market place at the time, being the median weighted average cost of capital for communication equipment companies. However, even Mr. Kinrich noted in his report that IPCo would not have been a communications equipment manufacturer. There was no analysis by Mr. Kinrich to lead to a conclusion that the cost of capital for a start-up litigation and licensing business would be comparable to an established communications equipment manufacturer. Messrs. Berenblut and Cox in their reply report stated:

> The Kinrich Report's use of discount rates for established publicly traded companies in the communications industry as benchmarks for its selection of discount rates for its valuation of a yet-to-be established business to exploit the Residual IP is not supportable. A discount rate of 30 percent or more for this type of business is consistent with our understanding and experience and is also consistent with the discount rates used in the IP Co Model. The academic literature reports venture capital discount rates in the range of 30 to 70 percent.

I accept the criticism of Messrs. Green, Berenblut and Malackowski that the discount rates obtained by Mr. Kinrich were too low. Had Mr. Kinrich used higher rates such as those used by Lazard in the IPCo models, or the rate used by Mr. Malackowski, the value of the revenues given up by the Licensed Participants, assuming they belonged to the Licensed Participants, would have been far less than opined by Mr. Kinrich.

Mr. Green calculated the values from the IPCo models using the discount rates used by Lazard in the models. Taking the most optimistic cash flows from the IP Co. model, the lowest discount rate used by Nortel and its advisors, and a litigation success rate of 100%, the maximum DCF value of IP Co. is only $2.7 billion, compared to the $4.5 billion paid by Rockstar. Messrs. Berenblut and Cox calculated that if a 30 percent discount rate is used to discount the cash flows used by Mr. Kinrich, the resulting net present value of the expected cash flows from the IP Co Model is $1.8 billion. They think this figure is overstated because of the range of values for all of the various scenarios in the IPCo models with various discounts of 25 to 45% and litigation strategies and assumed success rates of the litigation strategies from 60 to 75 to 100%. That range went from $424 million to $2.7 billion. Mr. Green put the range of values in the IPCo models from $400 million to $2.7 billion.

The report of Messrs. Berenblut and Cox explains why Rockstar would be likely to have paid more for the residual IP than Nortel could have made from it, that is, on the theory that the Licensed Participants owned all of the benefits sold to Rockstar, more than what the Licensed Participants gave up in the Rockstar transaction. The defensive value of the residual IP to the members of the Rockstar consortium made the residual IP far more valuable to Rockstar than it was in the hands of Nortel.

As explained by them, Rockstar obtained ownership of the residual IP and each of the members of the consortium (including Apple, Microsoft, Ericsson and Blackberry) received a license to the residual IP. The structure enabled Rockstar to exercise all rights of ownership of the residual IP against third parties, while providing the individual consortium members with the defensive benefits to prevent others from suing them for patent infringement. As a single company, Nortel was less likely to be able to derive defensive benefits equal to the combined and cumulative defensive benefits that could be gained by several large companies with extensive product and service lines that ranged well beyond what Nortel offered. Several members participating in the Rockstar portfolio are more likely to find patents contained in the Residual IP that will be useful to responses to litigation. Furthermore, as a company in financial difficulty, Nortel was less likely to be an attractive target for patent litigation and therefore less in need of patents to assert in response.

Mr. Green also made the same this point. He stated that the members of the Rockstar consortium purchased the residual IP portfolio, at least in part, as a defensive measure. It was his experience that having access to a large patent portfolio can help protect a large technology firm from lawsuits from other large companies. Access to a large patent portfolio, like the residual IPCo portfolio, can act as a deterrent because potential opposing parties must factor in the probability of a counter-suit. The defensive value of access to a significant patent portfolio is valuable to purchasers like the Rockstar consortium members, but would not be relevant to an entity like IPCo which intended to pursue an offensive licensing and litigation strategy, but had no operating business in the technology sector as all such businesses had been sold. The defensive value of such a portfolio to large companies is not measured exclusively by the present value of the cash flows from licensing.

Dr. Catherine Tucker, an economist called by the U.S. Debtors with considerable technology experience, stated the same thing. In her report she said that patents are not just used in litigation to assert rights to a particular technology or domain. There is also the important role of a patent being used in a counter-suit should the company itself be sued for patent infringement. She referred to Kent Walker, Google's General Counsel, who wrote at the time of the Rockstar bid that it was supposed to create a disincentive for others to sue Google. This defensive attribute, of course, would not have been available to IPCo if it decided to operate a patent licensing business as it would not have been in a product producing business that would be vulnerable to patent suits.

Mr. Green also expressed the view that the identity of the bidders themselves in the residual IP auction also illustrates that the basis on which value of the residual IP portfolio was determined is not consistent with that in the Kinrich report. The bidders included Google, Apple, Microsoft, Ericsson and other large technology companies with worldwide operations rather than companies whose primary business model was patent licensing and litigation. If the value of the residual IP sale was closely related to the cash flows from a licensing/litigation strategy, one would expect licensing/litigation businesses to have been bidders in the auction. Instead, the bidders in the auction were operating technology companies, which suggests that the value of the residual IP was determined in the market on some strategic basis in addition to the value of the IP in a licensing/ litigation business.

I accept the evidence of Messrs. Berenblut and Cox and Mr. Green that the approach of Mr. Kinrich of allocating proceeds based on cash flows from a licensing /litigation business model such as the IPCo models is inappropriate and that what Rockstar paid for was more than the value of the potential revenues from the business that was being considered by IPCo. That is, it was more than what the Licensed Participants gave up in the Rockstar sale, assuming it was theirs to give up.

The U.S. Debtors contend that it is wrong to say that Rockstar paid more than the value of what the Licensed Participants gave up when they terminated their licenses in anticipation of the Rockstar sale and to say that the extra value belongs to NNL as the owner of the NN Technology. They say that NNL could not transfer its rights without the consent of NNI and the EMEA Licensed Participants, just as NNI and the EMEA Licensed Participants required the consent of NNL to do so. They say that all parties consented to the transfer of their MRDA interests as part of the Rockstar sale, effectively agreeing to the assignment of their rights under article 14(e) of the MRDA which permitted an assignment of a party's rights under the MRDA only with the consent of all of the other parties.

  

I do not accept that contention. The MRDA did provide in article 14(a) that the MRDA could not be assigned by any licensed participant without the consent of the other Licensed Participants. But neither the MRDA nor the licenses of the Licensed Participants were assigned to Rockstar. Rockstar would not have taken an assignment of the MRDA with its obligations and duties amongst the participants. I accept the evidence of Mr. Britven, an expert valuer and the national intellectual property consulting practice leader with Duff & Phelps in Houston, that no third party would want to step into the shoes of a Licensed Participant by taking a transfer of the MRDA with its obligations to share profits and transfer ownership of patents to NNL, among other things. Even Mr. Ray eventually admitted that there was no transfer of license rights to Rockstar.

What occurred was a sale of the residual IP to Rockstar with NNI and the EMEA debtors terminating their licenses under the MRDA as a condition precedent to the sale. What is at issue is the value of those licenses that were terminated. If the value of what could be earned from the licenses was less than Rockstar paid for the residual IP, the difference would belong to NNL, the legal owner of that IP.

Mr. Green did an alternative valuation on the assumption, with which he disagreed, that IPCo would have operated on a stand-alone business and that the licenses surrendered by U.S. Debtors and EMEA debtors would have included the rights to the residual IP portfolio. He used version 3.1 of the IPCo model, as Mr. Kinrich had, but made some changes. He used the three discount rates that had been used by Lazard in the various IPCo models and used the three assumptions in the IPCo models as to the anticipated success in litigation against infringing third parties. He also deducted from the revenue streams going out to 2020 the RPS percentages for 2010 under the MRDA on the theory that if the Licensed Participants had rights under their licenses to earn the revenues proposed in the IPCo models, those licenses came with an obligation to make RPS adjustments in favour of the other Licensed Participants. Any gain on the sale above the DCF valuations on the revenue streams was allocated to Canada.

If one assumed the median discount rate (of 35%) and the median litigation success rate (of 70%), and excluding the revenues from China, then Mr. Kinrich's allocation of the Rockstar Sale proceeds, as adjusted by Mr. Green, would be as follows. Also shown is the allocation advocated by Mr. Kinrich.

| | ***Adjusted Kinrich Allocation of Rockstar Sale Proceeds*** | ***Kinrich's Actual Proposed Allocation of Rockstar Sale Proceeds*** |
|---|---|---|
| Canada | $4,003.06 million | $430 million |
| U.S. | $346.12 million | $3,310 million |
| EMEA | $105.19 million | $710 million |
| Total | $4,454.37 million | |

If revenues from China were included, the results would be an allocation of $3905.44 million to Canada, $420.99 million to the U.S. and $127.94 million to EMEA.

The U.S. Debtors contend that Mr. Green was wrong to apply the RPSM to the value of the cash flows. They say firstly that the MRDA expressly provided in the third addendum signed in December 2008 that it does not apply to the sale of a business. What that amendment provided was that the operating income or loss used to calculate the RPSM was to exclude "gain/loss on the sale of business". That is not a reference to the proceeds of the sale of a business, but rather a reference to the gain or loss, presumably capital gain or loss, recognized on a sale of a business. That makes sense because the RPSM was dealing with the split of profits or losses from operating earnings to be allocated to the participants under the MRDA. Ordinarily the gain or loss on the sale of capital assets would be recognized in an earnings statement but the parties to the MRDA did not want that taken into account in the RPSM.

However, what Mr. Green was valuing in this analysis was the annual profits that would be earned by the Licensed Participants from operating IPCo in the future, assuming the Licensed Participants had the right to do so under their licenses. He was assuming that the profits would be split in accordance with the RPSM in the MRDA. I agree with the theory that if one is to value the benefits that could have been earned by the Licensed Participants if they had operated IPCo, which is what the U.S. Debtors say they would have done but for the Rockstar sale, the Licensed Participants would have been subject to some profit split.

  

The U.S. debtors point out that what the profit split would be is a matter of conjecture and that it is not possible to assume, as Mr. Green did, that it would be the same in the future. The RPSM under the MRDA was based on the amount of R&D spend each year by Nortel and the Licensed Participants. After Nortel became insolvent, the R&D expenditures essentially stopped after 2009 and there is no evidence of what R&D would have been undertaken if IPCo had been run as a business by Nortel.

Certainly there would have had to be some transfer pricing in place if Nortel had run IPCo as a business. What the parties would have worked out is unknown. The tax authorities would certainly have been interested in the transfer pricing associated with the running of the IPCo had that occurred and it does not mean that the parties would not have had to agree on a profit split of some sort. They would have been required to do so.

It is perhaps fair to be critical of Mr. Green for assuming the transfer pricing would continue to be the same under an IPCo business run by Nortel as it had been before. It is also fair, however, to ask that if the U.S. debtors contend, as they do, that they are entitled to be paid for what they gave up in the Rockstar sale and that the present value of the anticipated net cash flows is what they gave up, one may have expected them to lead some transfer pricing evidence as to what transfer pricing would have been appropriate.

The assumption that the transfer pricing that the parties would have worked out in the event that Nortel operated IPCo would have been the same as provided in the MRDA has some logic to it. The residual IP was created by R&D conducted by the parties, at least in part, during the MRDA that split profits on the basis of the R&D expenditures of NNL and the Licensed Participants. R&D was the driver of the profitability of Nortel and the RPSM was chosen at the request of the tax authorities as the most appropriate method for determining the compensation to each of the participants for the R&D performed by them. The profits to be earned from operating IPCo could perhaps be seen to be an extension of the results of the R&D that had been spent.

The lack of transfer pricing evidence and analysis on the point, however, as to how the profits would be split in an IPCo business casts some doubt on the accuracy of Mr. Green's alternative analysis. It is not a basis, however, to reject it out of hand as contended by the U.S. debtors.

Mr. Malackowski's preferred allocation approach is a contributions approach based on R&D expenditures made by each of the participants to the MRDA. He prepared an alternative revenue or licensed based allocation which contained dramatically different results from his contributions approach. His revenue approach allocated 33.6% of the Rockstar sale proceeds to the EMEA debtors versus 17.6% using his contribution approach. It allocated 11% to the Canadian debtors versus 39.5% using his contribution approach and it allocated 55.4% to the U.S. debtors versus 42.9% using his contribution approach.

For his revenue or license approach, Mr. Malackowski used the data generated as a result of his valuation methodology to allocate the proceeds of the Residual IP Sale. He valued the Residual IP Portfolio by determining what revenues were expected to be generated by a worldwide licensing strategy in specific geographic territories and allocating the values to those territories. He estimated global revenues for the business areas in which the technology was used, royalty rates, licensing expenses, tax and discount rates. Mr. Malackowski concluded that the value of the residual IP was $3.570 billion, approximately one billion less than actually paid by Rockstar. He then "reconciled" this value with the actual purchase price of $4.5 billion by increasing pro rata the values he had calculated for each business franchise.

For the exclusive territories of Canada, United States, Britain, Ireland and France, he allocated all of the value for those territories to each of the countries. For the rest of the world ("ROW") he allocated 20% to each of the countries. It was this latter allocation of ROW that was the main cause of the increase in the allocation to EMEA as it had what he called "three seats at the table of five".

I have difficulty with Mr. Malackowski's revenue or license model of allocating the Rockstar sale proceeds. The first is that there is no explanation by Mr. Malackowski why his market based valuation was $1 billion less than the actual sale proceeds. Rather than simply grossing his value up to "reconcile" it with the actual proceeds, it seems to me that his valuation was an indication that Rockstar paid for more than what could be achieved in revenues from the acquired IP portfolio. Mr. Green expressed the opinion that the adjustment was inappropriate and unsupported by valuation principles, and assumed that Rockstar just used different royalty or revenue assumptions. I accept that criticism.

Mr. Green also expressed other criticisms of Mr. Malackowski's calculations, all of which appear logical and which I accept. For example:

(i) Mr. Malackowski assumed all revenues for a country should be included in the royalty base, whereas he should have considered that only revenues from products and not services on which no patent royalty would likely be available.

(ii) Mr. Malackowski assumed that revenues from all licensees will begin to be earned in 2011 i.e. he assumed that all licensing efforts against dozens of targets across multiple jurisdictions would be 100% successful within a few months of the portfolio being sold. Mr. Green's view is that his assumption is hard to credit and is inconsistent with the fact that the royalty rates selected by Mr. Malackowski are the IPCo "litigation light" rates, which would, by definition, require at least some form of enforcement action, which would necessarily delay the receipt of royalty payments.

(iii) Mr. Malackowski assumed increasing royalties through 2022 without considering that the patents and technologies are wasting assets and many are likely to expire before the end of the period used by Mr. Malackowski.

(iv) Mr. Malackowski deducted costs of 20% of royalty revenues, stating that he based the rate on the observed financial performance of sophisticated non-practicing entities such as Acacia Research Group. Mr. Green reviewed Acacia's public filings and those of other licensing entities and have found a significant discrepancy between their reported costs and those that the Malackowski Report asserts are representative. The Acacia public filings disclosed that the company's costs of operation from 2005 through 2012 have ranged from 112% of revenue in 2005 to a low of 52% of revenue in 2012. Other licensing entities, such as Interdigital and Rambus, report operating costs from 2005 to 2012 ranging from a low of 28% of revenues to as much as 164% of revenues.

These errors lead to the conclusion that Mr. Malackowski's valuation of $3.570 billion of the residual IP sold to Rockstar was likely overstated, indicating an even greater discrepancy between his value and the actual sale price. It also indicates issues with the territorial split of the revenues. The assumption of Mr. Malackowski that the entire sale proceeds were based on revenue forecasts by Rockstar, permitting him to simply increase his $3.570 billion value by another $1 billion without analyses ignores the likelihood that Rockstar paid what it did in part as a defensive move for its participants to protect their operating businesses, which Nortel no longer had. I do not have confidence in using Mr. Malackowski's analysis to allocate the proceeds of the Rockstar sale on a license or revenue basis.

In the end, I also cannot accept Mr. Kinrich's calculation of the amounts from the Rockstar sale to be allocated to NNL, NNI and EMEA. Assuming the Licensed Participants had a right to the value of the residual IP that Nortel could have achieved, and looking at the various scenarios in the IPCo models, I would recalculate those values and allocate the proceeds by adjusting the calculations of Mr. Kinrich and averaging them with the calculations of Mr. Green in his alternative approach.

I would take the mid-point between the low value of $400 million to $2.7 billion, or $1.5 billion using the discount rates of Mr. Green and Messrs. Berenblut and Cox. Using the same split as Mr. Kinrich, on the assumption that value would not be realized in China, would result in an allocation of 9.3% or $139.5 million to the Canadian debtors, 14% or $210 million to EMEA and 76.7% or $1.15 billion to the U.S. debtors. The balance of the $4.45 billion, or $2.9 billion, would be allocated to Canada. On the assumption that value could be realized in China, the resulting allocation would be 11.1% or $166.5 million to the Canadian debtors, 22% or $330 million to EMEA and 66.9% or $1.0 billion to the U.S. debtors. The balance of the $4.45 billion, or $2.9 billion, would be allocated to the Canadian debtors.

I would then average these allocations with the allocations arrived at by Mr. Green in his alternative analysis, set out in paragraphs 358 and 359 above, which were based on the median discount rates and litigation success rates used in the IPCo models.

  

The results of that allocation, assuming the revenues from China are included, would be an allocation to Canada of $3,485.97 million, to EMEA of $228.97 million and to the U.S. of $710.5 million, or a total of $4,425.44 million. I would round these figures up on a pro rate basis to arrive at the proceeds available of $4,454.37.

The results of that allocation, assuming the revenues from China are not included, would be an allocation to Canada of $3,521.28 million, to EMEA of $157.6 million and to the U.S. of $748.06, or a total of $4,426.94 million. I would round these figures up on a pro rate basis to arrive at the proceeds available of $4,454.37.

The U.S interests assert that on a license or revenue analysis, very little revenue should be attributed to China. They assert that the IPCo models included both a "China in" and "China out" option. I must say I have carefully looked at the IPCo model 3.1 used by Mr. Kinrich and I cannot find a China out option. On cross-examination of Mr. Malackowski, who thinks China revenues should be included, it was put to him that the IPCo model had a "toggle" for China, which I take to be a sheet with revenues for China.

In any event, Mr. Kinrich testified that he at first took the mid-point of the particular China forecasts he used after doing an economic literature search on patent value and speaking with Mr. Zenkich, who told him that the market would pay little to nothing for a China patent, he reduced his revenues for China downward more towards the US in some qualitative fashion. He reduced then by 75%. Mr. Zenkich, an expert in valuing patents, testified that in 2009-2010 participants in the market for patent portfolios assigned little to no value to Chinese patents.

The thinking of Nortel's patent people changed over time. In December 2000, Angela Anderson, Director, Intellectual Property Law in the U.K stated that China was a sizeable and growing market accessible at moderate cost. She said that the target filing % (3% of cases) would be higher but for enforcement issues. "Show the flag, but don't over-invest." She testified that at that time, it was clear that China was going to become more of a potential marketplace for Nortel products. In addition, the patent system was starting to look like a real patent system, so it made sense to start using the patent system in China at that time.

By 2006, Nortel intended to file far more patents in China. The plan was to file up to 30% of the top patents in China and in 18 months' time raise this to up to 50%, selecting those having the highest commercial potential. In the IPCo model of May, 2010 that included revenues from China, it stated that early 2010 modelling did not include China in its royalty base but the new plan included China but only in the years 2015 to 2020. It stated that 80% of its patents and 70 % of the applications in China were for wireless 4G technology. The logic of waiting until 2015 was the time for 4G market maturity. EMEA contends, and I have no reason to question it, that the assumptions in the IPCo model regarding China were conservative.

Mr. Malackowski's view was that in doing a revenue or license approach, it would be wrong to exclude China revenues. His reasoning was that Nortel had decided to file high interest patents in China, that patent protection was improving in China and had improved over the past five to ten years and that China was a very important and large market. He has had experience in China. His firm has a partner in Shenzhen for addressing the work they do in China.

Mr. Zenkich testified that the basis for his conclusion that no one would pay anything for a Chinese patent was based on his business of being a patent broker. He testified that when his clients had large patent portfolios, there was no interest expressed in the Chinese patents that were part of those portfolios. Similarly, they were never asked by clients who looked to purchase patents to identify Chinese assets for purchase. I take this to be no evidence of knowledge of values that could be achieved for a Chinese patent, but only that Mr. Zenkich had no knowledge of a client being interested in in a Chinese patent. Included in material referred to in his report was a 2011 report entitled "China's Emerging Patent Trading Market" that referred to a patent auction in China in 2010 which sold 38 lots and the intention of the seller to hold another auction in 2011. The article also referred to efforts being made to set up an exchange in China with the support of governments that would facilitate transactions. That article was contradictory of the view expressed by Mr. Zenkich.

Mr. Zenkich referred to a 2012 publication by the U.S. Patent Office that referred to comments it had received to the effect that there were difficulties with enforcing Chinese patents. That is certainly anecdotal evidence of statements made by others, and it cannot be belittled. How accurate are all of the statements is perhaps a matter of some debate. For example, a comment by one person as to the cap on damages in China was shown during the evidence to be incorrect. While Mr. Zenkich had stated in his report his belief that that significant interest in patent granting activity in China over the last ten years has increased the risk that patents may be challenged as invalid, even if granted, he acknowledged on cross-examination that he had no experience in trying to enforce patents in China and that his company had no experience in trying to enforce a patent anywhere in the world. He also acknowledged that he did not independently conduct surveys or seek out patent data of this kind of activity and that he was unable to identify a single instance where a Chinese patent was found invalid and its US or European counterpart was not. One of the documents cited by Mr. Zenkich in his report was a publication by a Beijing law firm of October 2009 that stated that the major cities, in particular Beijing, Shanghai and Guangzhou, can be considered as a reliable forum for patent infringement actions. Mr. Zenkich chose instead to rely on the U.S. Patent Office document that contained comments regarding the difficulty of enforcing patents in China.

I am afraid that I cannot put a great deal of reliance on Mr. Zenkich's evidence of the unreliability of the Chinese patent system. I accept he may be of the view that it is unreliable, but his view was not supported by any cogent, reliable and admissible evidence. The views of Mr. Kinrich are also not supported by any cogent evidence. He appears to have largely relied on Mr. Zenkich.

In my view, if a license or revenue approach to value is to be used to value the residual IP, it should include revenues from China that were used in the IPCo model, mainly for the reasons expressed by Mr. Malackowski and the fact that the projections were somewhat conservative.

The conclusion I come to, if an allocation of the proceeds of the Rockstar sale were to be based on a license or revenue approach, would be an allocation to Canada of $3,485.97 million, to EMEA of $228.97 million and to the U.S. of $710.495 million, or a total of $4,425.435 million. I would round these figures up slightly on a pro rate basis to equate to the proceeds available of $4,454.37.

***(ii) Mr. Malackowski's contribution approach to value***

The EMEA debtors contend that the allocation of the proceeds of the Rockstar sale should be made on the basis of the contribution to R&D made by each of the RPE entities that created the residual IP sold to Rockstar. They contend that the contributions by each RPE to measure this should not be the contributions made during the five year look-back period used to allocate the residual profits under the MRDA but rather the contributions made during the period of time that the residual IP that was sold to Rockstar was invented. Based on the evidence of Mr. Malackowski, they say the look-back period should be from 1991 to 2006 [26] .

There are two fundamental issues that have been raised to the calculations if the contribution approach to allocation is to be used. The Canadian Debtors contend that there is no basis to use a contribution approach to allocate the proceeds of the Rockstar sale or the business line sales. They say that if a contribution approach is nevertheless used, the look-back period for looking at R&D contributions should be the five year look-back period under the MRDA from 2005 to 2009. The U.S. Debtors also disagree that a contribution approach should be used to allocate the Rockstar and business line sale, but contend that if a contribution approach is used, they agree with the EMEA debtors as to the length of look-back period but contend that all R&D spending must be taken into account. They contend that what must be taken into account is not only the R&D costs incurred by each RPE in their own exclusive territory, but also all transfer pricing adjustments made by an RPE, particularly the adjustments made under the CSA agreements prior to the MRDA coming into force.

Mr. Malackowski said in his report that to measure contribution, ideally, the contributions of the RPE's labs to the development of the patented technologies could be fully and accurately determined by interviewing all of the firm's R&D staff, and by reviewing all the documentation related to the firm's research (e.g. lab notebooks, invention disclosures, meeting minutes, research presentations etc.). This approach was not possible for Nortel's IP due to the size of the portfolio, the limitations on time and the availability of information. Mr. Malackowski did not have access to lab notebooks and R&D staff. Moreover, as R&D was organized across the Nortel Group and carried out in a highly coordinated and integrated manner across the various RPEs, it was even more difficult to separate out the distinct contributions of the various RPEs. In these circumstances he said he had to select a proxy data that reasonably reflected the research efforts of the various RPE's labs.

 

Mr. Malackowski chose to measure contributions to the development of the IP by measuring each RPE's spending on R&D. He stated that in a large organization, where R&D funding supports a large number of R&D personnel and results in a large number of patents over time, this funding can be valid and indeed the most accurate proxy measurement for determining the contribution of each research group to the development of IP. He stated that it is common practice to regard each dollar spent on R&D as fungible for the purposes of measuring relative contribution to R&D in a group, as Nortel did under the RPSM.

Mr. Malackowski stated that in his experience, in large IP portfolios the vast majority of the value of the portfolio is usually derived from a minority of the patents. This is due in part to the fact that technology IP can be overlapping and duplicative. Value is often derived from a relatively small number of patents that are essential to industry standard technology or that cover an essential process or solution to a common problem. Mr. Malackowski expressed the view that the patents that were categorized as high interest by Global IP likely represented the vast majority of the value of the residual patent portfolio. Approximately 37% of the total residual patent portfolio was identified as high interest.

The evidence was that it generally took one year for Nortel R&D spending to result in a patent application for an invention. He therefore thought it appropriate to determine contribution to the creation of Nortel's IP by measuring R&D spending starting the year before the filing of the earliest unexpired patent categorized by Global IP as high interest, i.e. in 1991. He stated that the most logical end point was in 2006, the year before the last high interest patent was filed. He provided calculations for four look back periods produced by two different start points and end points. His two start points were 1991, reflecting the year before the earliest unexpired high interest patent in the residual patent portfolio, and 2001. His two end points were 2006, representing the year before the last high interest patent in the residual patent portfolio, and 2008, representing the last year of ordinary course operations[27] . 2001 was the start of the MRDA.

By looking at the expenditures on R&D for this period from 1991 to 2006, Mr. Malackowski allocated 39.5% or $1.777 billion to Canada, 42.9% or $1.930 billion to U.S. and 17.6% or $793 million to EMEA. For the period 1991 to 2008, he allocated 40.6% or $1.827 billion to Canada, 43% or $1.935 billion to U.S. and 16.4% or $738 million to EMEA.

The effect of using the longer look-back period substantially reduces the amount allocated to Canada, the reason being that the R&D expenditures from 2005 to 2009 during the five year RPSM were proportionally done more by Canada than EMEA and the U.S. The percentages from 2005 to 2009 were 49.5 for Canada, 38.8 for the U.S. and 11.7 for EMEA.

Mr. Malackowski's report contains discussion why he looked at a long period back to 1991 to measure R&D spending. He said that old patents maybe more valuable than recently filed ones. He said that technologies are adopted by the market slowly over time and do not realize their full value until later in the life of the patent. He did recognize that newer patents will have longer life before they expire and they may have favour due to technological obsolescence, but pointed out that there is risk in newer technologies that they may not be accepted by the market. Based on these considerations he concluded that he should take into account R&D spending from the year before the first high interest patent.

Mr. Malackowski did not consider what Nortel's thinking was about the life to its technology. In the first version of the MRDA the R&D spending used to split residual profits was calculated using an amortized 30% rate, with expenditures from any one year declining by 30% in the following years. In Nortel's response to questions from the tax authorities in 2003 in connection with its request for an APA for that MRDA, Nortel stated:

> It is difficult to ascertain the exact useful life of R&D developed at Nortel; however, Nortel's analyses indicated that a 30% amortization was conservative yet reasonable. Numerous sources suggest that the useful life of telecommunications R&D is short; however, there is no one definitive external source that explicitly determines that a 30% amortization rate is correct.

The tax authorities did query this response in a question that referred to information from Nortel that it said seemed to suggest that the useful life of R&D is equivalent to product useful life. "However, isn't it the case that benefits from R&D may persist beyond product useful life? For instance, value may result from further developing the intangible."

  

In preparation for APA negotiations with the tax authorities, Gilles Fortier, NNL's taxation manager for transfer pricing, circulated a document among Nortel tax executives dated May 10, 2002 summarizing the "key drivers" for Nortel, on the one hand, and the tax authorities, on the other, with regard to the APA. The position of the tax authorities was stated to be that the life of Nortel's intellectual property was 7-10 years or more whereas Nortel was suggesting 4-7 years. This position of Nortel was consistent with using a 30% amortization rate for R&D spending in allocating profits under the CSA. Nortel wanted a shorter period because using a longer period would increase the profits in NNI for tax purposes that Nortel did not want. Canada had a lower tax rate due to its generous research and development policies.

A later application by NNL and NNI for an APA with the tax authorities for the years 2007 to 2011, in which a straight five year R&D expenditure would be used to allocate profits, indicated that NNL and NNI thought that the useful life of the Nortel intangibles was estimated to be approximately five years with a gestation lag of one year. Included in the APA request was the following:

> The economic life of technology is difficult to measure because as long as the technology is being sold, it is also being continuously updated and enhanced. Indeed, software and hardware development in the telecommunications industry is widely understood to be an iterative process, because of the tendency to superimpose improvements upon older versions of the technology. Therefore, any discussion of product useful life must consider when an individual product was originated, how to apportion the impact of successive improvements, and when the product was completely superseded.
>
> Nortel's telecommunications technology consists of hardware and software, and it continues to grow and change as demand for bandwidth and functionality grows. As a result, there has been an evolution in the commercial and economic life span of technologies from longer to shorter cycles.
>
> Nortel's Chief Technology Office estimated that a dollar spent on R&D typically has a shelf life of about five years, and additionally, the time from when the investment in the R&D is made to the time when revenue can be generated from the investment ranges from about 6 to 12 months.
>
> Recognizing the difficulties inherent in estimating the useful life, based on information obtained in our discussion with Nortel management, and our review of the R&D policy documents, the useful life of the Nortel intangibles is estimated to be approximately five years with a gestation lag of one year.

The evidence from Mr. Malackowski's report is that 99% of the high-interest patents sold to Rockstar had an invention date prior to 2006 and the bulk were from 1995 to 2004. This is considerable evidence that what Nortel was telling the tax authorities did not turn out to be the case. This is not to suggest that Nortel did not believe what it was representing to the tax authorities, or perhaps more appropriately put, that Nortel's transfer pricing tax people did not think that a legitimate tax case could be asserted supporting its 30% declining amortization calculation in the first MRDA and then its five year look-back period in the second version of the MRDA. It is clear, however, that Nortel expected negotiations with the tax authorities would take place that could alter the 30% amortization rate and the later five year flat rate, and the MRDA expressly contemplated that in Schedule A. It cannot be said that Nortel as an enterprise conclusively concluded that its profit allocation keys of 30% or five years were necessarily correct. It was a tax position prepared by Nortel and its advisors.

If a contribution theory is to be used to measure the value of what the parties gave up, I think it inevitable that a longer look-back period would be appropriate. The market has indicated that. However, I would lengthen the time to be taken into account. One of the weaknesses of using a contribution approach is that not every dollar spent results in valuable technology. The theory then must be that what one loses in the corners is gained in the straights. That being the case, I see no reason to disregard the R&D expenditures in 2007 to 2009. They were real and cannot be said to have contributed to the residual IP sold to Rockstar [28]. The fact that Rockstar has started out by enforcing earlier patents does not mean that later patents or patent applications will not be of value or that Rockstar did not pay anything for them.

  

I would take the R&D expenditures from 1991 to 2009. The data is available from exhibit B.1.7.1 of Mr. Malackowski's report. The resulting percentage of expenditures is 40.93% for Canada, 42.87% for the U.S. and 16.2% for EMEA.

The U.S. Debtors contend that because under the CSA agreement NNI was required to allocate transfer payments to other RPEs, those payments should be included in what is considered to have been contributed to R&D. They rely on upon the opinion of Laureen Ryan, a forensic accountant who went through the transfer pricing worksheets and calculated $4.4 billion allocated to other RPEs under the CSA agreement. On her figures, the percentages for R&D expenditures for 1989 to 2000 would be 21% for Canada, 6% for EMEA and 73% for the U.S.

There is a problem with Ms. Ryan's evidence. The first is that she did no cash analysis to determine if NNI actually paid out any cash to any other RPE as part of its transfer pricing requirements under the CSA and later MRDA. There is no evidence in the record that anything allocated to any party was actually transferred by way of cash and Ms. Ryan conceded that she could not say if anything was actually paid. She did speak to her general understanding that money was transferred by NNI to NNL but I take that to be hearsay evidence and not any cogent evidence that any funds were transferred in fact. Just as important, there was no evidence as to how cash transferred from NNI or any other RPE was actually used. Cash was moved throughout the Nortel Group as required, but what those requirements were at any time is not a matter of record or available evidence. Ms. Ryan also conceded that she was not able to say where any of the money came from to actually do the R&D spending, whether from customers, governments, shareholders or other Nortel entities.

While Ms. Ryan in her report and evidence calculated what she said were allocations for R&D made by NNI to the other RPEs under the MRDA, the U.S. Debtors made no argument in their closing briefs that these payments should be attributed to NNI. One problem with the evidence on this point is that Ms. Ryan assumed that the RPEs used transfer pricing adjustments for only for only two types of expenses: direct R&D spending figures, and sales, general, and administrative costs. Ms. Ryan pro-rated the intercompany funding between those two expenses. That assumption was obviously incorrect because, as Ms. Ryan conceded, it ignores very significant additional costs incurred by the RPEs, including restructuring costs, costs of revenues, manufacturing, and distribution. The very need for an assumption to be made was because Nortel never kept records of what transferred cash from one Nortel company to another was used for. Ms. Ryan also erred in failing to deduct the $2 billion settlement with the IRS and CRA regarding the $2 billion that was deemed to be a dividend paid by NNI to NNL. She also failed to take into account the sale of Nortel's UMTS business to Alcatel.

As stated above, Mr. Malackowski thought that ideally to determine contribution to R&D by any particular RPE, he would need to have access to lab notebooks and other records and to Nortel R&D personnel. As he did not have that he had to select a proxy data that reasonably reflected the research efforts of the various RPE's labs. He chose to measure contributions to the development of the IP by measuring each RPE's spending on R&D. He testified that this would be reflective of the types of activities that we know lead directly to the inventive process. It is the engineering time and the related expenses that result in the innovation. He testified that a transfer pricing adjustment is an allocation that is done for other purposes, specifically tax efficiency, not for recording the matching between the inventive nature of contribution and results, and he viewed it as inappropriate.

Ms. Ryan is a specialist in accounting and forensic investigations. I prefer the evidence of Mr. Malackowski on this point that for his contribution analysis, it is not appropriate to add to any RPE's contribution amounts that were allocated from that RPE under the transfer pricing regimes in the CSA or MRDA.

Mr. Malackowski did an "inventorship" analysis in his reply report of the countries in which the inventors of the residual patent portfolio resided. He stated that while he did not consider inventorship to be the appropriate basis for allocation, it was a useful metric for testing the allocations of the various parties.

The results of Mr. Malackowski's analysis indicated that for the high interest patents, 46.3% were from Canada, 33% from the U.S., 18.7% from EMEA and 2.6% from ROW. For the entire portfolio, 51.9% were from Canada, 27.4% were from the U.S., 17.7% were from EMEA and 2.9% were from ROW. Using the percentages for the entire residual patent portfolio, which is what was sold, and allocating ROW equally to the others, would give Canada 52.9% of $4.45 billion or $2.35 billion, U.S. 28.4% or $1.26 billion and EMEA 18.7% or $832 million.

Mr. Britven, an expert called by the Monitor, while of the opinion that a contribution allocation theory was not correct, also did an inventor based analysis. That analysis allocated 51.3% to Canada, 28.9% to the U.S., 18.2% to EMEA and 1.6% to others. That is very close to the figures from Mr. Malackowski's inventorship analysis

I conclude that if the contribution allocation theory asserted by the EMEA debtors is accepted, the percentage allocation of the residual IP sold to Rockstar of $4.45 billion is 40.93% or $1.82 billion for Canada, 42.87% or $1.92 billion for the U.S. and 16.2% or $720 million for EMEA to be rounded down pro rate to get a total of $4.45 billion.

***(iii) Mr. Green's approach***

Mr. Green allocated virtually all of the proceeds of the Rockstar sale to Canada. [29] There were two categories of patents involved in the sale:

1. patents that had been used in several business lines and in respect of which non-exclusive licenses had been granted to the business line purchasers; and

2. the remaining patents, which had not been used in any Nortel business.

For the group of patents identified in (1) i.e. patents that had been used in several business lines and in respect of which non-exclusive licenses had been granted to the business line purchasers, the value of the U.S. and EMEA Debtors' licenses with respect to those patents (which is the value that they would have earned had they continued to operate the businesses) was determined by Mr. Green and allocated to them as part of his allocation of the business line sale proceeds.

With respect to those patents described in (2) that were not used in any of Nortel's operating businesses, Mr. Green considered whether there was any evidence that the U.S. and EMEA Debtors had any prospect of generating earnings through the exercise of their license rights in connection with those patents. He concluded that they did not because the U.S. and EMEA Debtors' license rights were limited to the right to make Products — i.e. products made or designed (or proposed to be made or designed) by or for a Participant, embodying or using the Nortel IP. This was consistent with the position taken by the Monitor in this case. Thus he allocated none of the proceeds of the Rockstar sale to the U.S. and EMEA Debtors and all of the proceeds to Canada.

Mr. Green's valuation is a straight result of the interpretation put on the MRDA by the Monitor. One cannot quarrel with the logic of it if that interpretation were to govern the allocation.

Footnotes

1 EMEA is an acronym for 19 Nortel subsidiaries in Europe, the Middle East and Africa.

2 All reference to dollars is to U.S. currency.

3 Judge Kevin Gross is the U.S. bankruptcy judge.

4 See *Nortel Networks Corp., Re* (2013), 2 C.B.R. (6th) 1 (Ont. S.C.J. [Commercial List]); aff'd (2013), 5 C.B.R. (6th) 254 (Ont. C.A.); 2013 WL 1385271; aff'd 737 F.3d 265 (U.S. C.A. 3rd Cir. 2013).

5 A later Allocation Protocol which set out procedural matters to govern the allocation hearing was made and approved by orders of both Courts in May, 2013.

6 Unless otherwise indicated, statements of fact in these reasons are findings of fact.

7 Nortel Networks Australia was also a RPE until December 31, 2007.

8 This was an alternative argument for the CCC to its first argument that the MRDA should govern the allocation.

9 There were different CSAs for different types of costs. The relevant CSAs were the R&D CSAs that provided for the sharing of costs of the R&D carried out by the Nortel entities doing R&D. NNL made a separate CSA with each of those entities.

10 I prefer this test to that articulated in *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust* (2007), 85 O.R. (3d) 254 (Ont. C.A.), in which it was said that interpreting a contract that accords with sound commercial principles is limited to situations in which there is some ambiguity. I do not think that is correct and it is not what other cases of appellate authority have stated. See my comments in *Thomas Cook Canada Inc. v. Skyservice Airlines Inc.* (2011), 83 C.B.R. (5th) 106 (Ont. S.C.J. [Commercial List]) at para. 13 and *Oncap L.P. v. Computershare Trust Co. of Canada* (2011), 94 B.L.R. (4th) 314 (Ont. S.C.J. [Commercial List]) at paras. 21 to 24. See also Geoff R. Hall, *Canadian Contractual Interpretation Law*, 2$^{nd}$ ed. (Markham Ont.:LexisNexis 2012 at p. 46 fn. 191.

11 There was a separate R&D CSA made with each participant. They were the same. Reference during argument was to the CSA made between Northern Telecom Limited [now NNL] and Northern Telecom Inc. [now NNI], and I refer to it in these reasons.

12 The amended Schedule A was effective January 1, 2006 and reflected a change in the calculation of the amount spent on R&D by each participant.

13 The NN Technology in the MRDA was called the NT Technology in the CSA as the parties at the time of the CSA in 1992 were Northern Telecom, later changed to Nortel Networks.

14 Rulings on admissibility of evidence were left for decision to be made after argument at the conclusion of the trial.

15 At page 30 of the report, Horst Frisch, in referring to intercompany transactions between participants under a RPSM allocation, state-"The old CSPs possess and will continue to possess valuable intangible property." What property is being referred to is not stated. It could be a reference to license rights.

16 *C.I. Covington Fund Inc. v. White*, [2000] O.J. No. 4589 (Ont. S.C.J.) paras. 38-39), *aff'd* [2001] O.J. No. 3918 (Ont. Div. Ct.). *G.D. Searle & Co. v. Novopharm Ltd.*, [2007] F.C.J. No. 625 (F.C.A.), *leave to appeal to SCC refused* [2007] S.C.C.A. No. 340 (S.C.C.). *Sterling Engineering Co. v. Patchett* (1955), 72 R.P.C. 50 (U.K. H.L.). This has now been codified in section 39 of the *Patents Act 1977* (U.K.), c. 37.

17 *Board of Trustees of the Leland Stanford Junior University v. Roche Molecular Systems, Inc.* (2011), 131 S.Ct. 2188, 98 U.S.P.Q.2d 1761 (U.S. Sup. Ct. 2011) at p. 2195-2196, quoting *United States v. Dubilier Condenser Corp.*, 289 U.S. 178 (U.S. Sup. Ct. 1933) at p. 189.

18 See the affidavit of Peter Currie sworn April 11, 2014 for a full description of Nortel's matrix structure and operations.

19 Early in these proceedings, on the motion in 2009 to approve the IFSA, counsel to the U.S. Debtors stated in its written brief that NNL owned the IP. The report of the administrators for the EMEA Debtors of June 14, 2009 stated that all IP rights belonged to NNL. Once the size of the sale proceeds became known, these positions of the U.S. Debtors and EMEA Debtors changed.

20 In *Corning, Re*, 419 F.3d 196 (U.S. C.A. 3rd Cir. 2005), at 205 the U.S. Court of Appeals observed that substantive consolidation "treats separate legal entities as if they were merged into a single survivor left with all the cumulative assets and liabilities, (save for inter-entity liabilities which are erased). The result is that claims of creditors against separate debtors morph to claims against the consolidated survivor."

21 The projected cash on hand in all of the Nortel entities as of June 30, 2014 after payment of secured creditors was $1.525 billion, being $343 million in the Canadian Debtors, $744 million in the U.S. Debtors and $438 million in the EMEA Debtors. See schedule 5 of the Britven report, ex. 45.

22 Mr. Kilimnik prepared an expert report on which he was deposed prior to the trial. At the opening of the trial, counsel for the ad hoc group of bondholders said that Mr. Kilimnik would be called as a witness. However, on the day before he was scheduled to testify, his report was withdrawn by the bondholders and he was not called as a witness at the trial.

  

23 I also prefer the evidence of Mr. Kilimnik and Mr. Binning as to the data in exhibit 58 that compared Nortel bond spreads to government yields and what could be drawn from it. Professor McConnell said he could not draw an inference from the data but also said that he was not contradicting Mr. Binning.

24 There was one series of bonds for $200 million issued by NNL with a NNC guarantee but no guarantee by NNI.

25 The CCC contended for an "ownership" allocation very similar to the Monitor, being $5.805 billion to the Canadian Debtors, $1.009 billion to the U.S. Debtors and $488 million to the EMEA Debtors.

26 For the IP sold in the business line sales, EMEA says that the look-back period should be from 1991 to 2008, two years longer than for the Rockstar sale.

27 Mr. Malackowski said he did not think it appropriate to look at 2009 R&D expenditures post-filing as he understood that little basic research was being performed during this time given that R&D spending was cut dramatically and none of the patents designated as high interest by Global IP were filed during this time period. The R&D expenditures in 2008 were $1.458 billion and in 2009 were $1.076 billion. Mr. Malackowski also said an appropriate look-back period for the business sales would be 2001 to 2008.

28 The Canadian expenditure in 2009 was not just to preserve the business lines as asserted by EMEA. Canada spent $564 million in 2009 on R&D, far more than the $180 million spent on the CDMA and LTE businesses.

29 He allocated $426,097 to the U.S. representing the value of the workforce transferred to Rockstar, being very few people.

**End of Document**

# TAB 13

532 B.R. 494
United States Bankruptcy Court, D. Delaware.

IN RE: NORTEL NETWORKS, INC., et al., Debtors.

Case No. 09–10138(KG) (Jointly Administered)
|
Signed May 12, 2015

**Synopsis**
**Background:** Trial was held jointly with Ontario court in Chapter 11 cases of multinational corporation and certain affiliates regarding allocation of proceeds from sales of debtors' assets.

**Holdings:** The Bankruptcy Court, Kevin Gross, J., held that:

[1] allocation of sales proceeds should be made on pro rata basis to all debtor entities;

[2] master research and development agreement did not govern inter-company allocation of proceeds from liquidated assets developed in common by debtor entities;

[3] Canadian debtor entities held bare legal title to intellectual property of the enterprise, and thus, were not entitled to all of the proceeds from sale of intellectual property;

[4] bankruptcy court had authority to adopt pro rata allocation of sales proceeds pursuant to Bankruptcy Code provision permitting courts to issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of the Code; and

[5] bankruptcy court's ruling that sales proceeds should be made on pro rata basis to all debtor entities was not a substantive consolidation.

Ordered accordingly.

West Headnotes (41)

**[1]** **Bankruptcy** Application of Proceeds

Allocation of proceeds from liquidation of assets developed in common by Chapter 11 debtor entities in an integrated multinational enterprise should be made on pro rata basis to all debtor entities, in the absence of some guiding law or agreement governing how debtor parent corporation was to allocate the proceeds between the various insolvency estates or subsidiaries spread across the globe.

**[2]** **Bankruptcy** Application of Proceeds

Master research and development agreement (MRDA), which memorialized internal transfer pricing policy of Chapter 11 debtor multinational corporation and certain affiliates and was subject to approval by tax authorities, did not govern inter-company allocation of proceeds from liquidated assets developed in common by the entities, as the MRDA did not include any provisions addressing the global insolvency or liquidation of the entities.

**[3]** **Contracts** Agreements relating to actions and other proceedings in general

Choice of law provision is binding under both Ontario law and United States law.

**[4]** **Contracts** Intention of Parties

Under Ontario law, the goal of contractual interpretation is to give effect to the underlying objective intention of the contracting parties.

**[5]** **Contracts** Language of contract

Under Ontario law governing contract interpretation, to determine the parties' intent, the court examines two related components: (1) the words of the contract and (2) their context.

**[6]** **Contracts** Extrinsic circumstances

**Evidence** Grounds for admission of extrinsic evidence

Under Ontario law, the parol evidence rule does not apply to preclude evidence of the surrounding circumstances.

[7] **Contracts** Reasonableness of construction

Under Ontario law, where a document to be construed is a negotiated commercial document, the court should avoid an interpretation that would result in a commercial absurdity, rather, the document should be construed in accordance with sound commercial principles and good business sense; care must be taken, however, to do this objectively rather than from the perspective of one contracting party or the other, since what might make good business sense to one party would not necessarily do so for the other.

[8] **Contracts** Language of contract

**Contracts** Presumptions and burden of proof

Under Ontario law, the cardinal presumption about the primacy of the language of a contract involves determining the parties' intentions in accordance with the language that they have used.

[9] **Contracts** Language of contract

Under Ontario law, the court's goal in interpreting a contract is to determine the parties' intent as expressed by the words that they have chosen.

[10] **Contracts** Language of contract

Under Ontario law, the contractual intent of the parties is to be determined by reference to the words they used in drafting the document.

[11] **Contracts** Admissibility

Under Ontario law, evidence of subjective intention, i.e., evidence of what a party understood the contract to mean, is wholly inadmissible.

[12] **Contracts** Intention of Parties

Under Ontario law governing contract interpretation, the court's inquiry as to the parties' intent does not seek to determine what the parties actually intended or what they believed the words of their contract to mean.

[13] **Contracts** Admissibility

Under Ontario law, parties' subjective understandings of the meaning of a contract do not become admissible by characterizing those understandings as forming part of the factual matrix.

[14] **Contracts** Extrinsic circumstances

Under Ontario law, while the surrounding circumstances will be considered in interpreting the terms of a contract, they must never be allowed to overwhelm the words of that agreement.

[15] **Contracts** Extrinsic circumstances

Under Ontario law governing contracts, while the surrounding circumstances are relied upon in the interpretive process, courts cannot use them to deviate from the text such that the court effectively creates a new agreement.

[16] **Contracts** Construction by Parties

**Contracts** Admissibility

Under Ontario law, evidence of the parties' post-contracting conduct by definition is not part of the factual matrix and is generally inadmissible to interpret the contract unless a court finds ambiguity.

[17] **Contracts** Existence of ambiguity

  

Under Ontario law, a contract is not ambiguous merely because it is difficult to interpret, rather, a contractual provision is only ambiguous if it is reasonably susceptible of more than one meaning.

[18] **Contracts** Recitals

Under Ontario law, introductory recitals in a contract may not alter the operative terms of the contract, but may be used as an interpretive guide to the parties' intent.

[19] **Contracts** Intention of Parties

**Contracts** Reasonableness of construction

Under Ontario law, a contract should always be interpreted so as to accord with sound commercial principles and good business sense, and avoid commercial absurdity; in this analysis, courts may also consider objective manifestations of the parties' intent.

[20] **Contracts** Application to Contracts in General

Under Ontario law, ordinary principles of contract law apply equally to the interpretation of a license agreement.

[21] **Patents** Patents

**Patents** In general; assignability of patents

A patent is a bundle of rights which may be retained in whole or in part, divided and assigned.

[22] **Patents** In general; nature of license

The bundle of rights that comprise a patent may be transferred to another party through a license.

[23] **Bankruptcy** Application of Proceeds

Canadian entities in Chapter 11 cases of multinational corporation and certain affiliates held bare legal title to intellectual property of the enterprise, with other entities holding an economic and beneficial ownership interest in the intellectual property, and thus, were not entitled to all of the proceeds from sale of intellectual property.

[24] **Contracts** Extrinsic circumstances

Under Ontario law, a court should consider the factual matrix even if a contract is unambiguous.

[25] **Contracts** Extrinsic circumstances

Under Ontario law governing contracts, while the evidence of the factual matrix may not include the subjective intent of the parties, it does include the genesis of the transaction, the background, the context and the market in which the parties are operating.

[26] **Patents** Assignments and sublicenses

The right to sublicense enables a patent licensee to grant another party the ability to stand in its shoes and exercise its rights.

[27] **Patents** What law governs

Effect of a transfer of title to a United States patent on the rights of an existing licensee to the patent is governed by United States patent law, even if the underlying license agreement is governed by foreign law.

[28] **Patents** Construction and Operation of Assignments and Grants

Party cannot place a buyer of its patent interests in any better position than the party itself occupied or confer upon the buyer rights that the party itself did not hold.

[29] **Patents** Construction and Operation of Licenses

Under Ontario law, an assignment of a patent cannot defeat the rights of the licensee under a license.

[30] **Bankruptcy** Carrying out provisions of Code

**Bankruptcy** Application of Proceeds

Bankruptcy court had authority to adopt pro rata allocation of proceeds from sales of debtors' assets in Chapter 11 cases of multinational corporation and certain affiliates pursuant to Bankruptcy Code provision permitting courts to issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of the Code. 11 U.S.C.A. § 105(a).

[31] **Bankruptcy** Collection and Recovery for Estate; Turnover

**Bankruptcy** Distribution

In an international bankruptcy case, there is the principal that assets should be collected and distributed on a worldwide basis.

[32] **Bankruptcy** Chapter 11 cases

**Bankruptcy** Application of Proceeds

Bankruptcy court's ruling, that allocation of proceeds from liquidation of assets developed in common by Chapter 11 debtor entities in an integrated multinational enterprise should be made on pro rata basis to all debtor entities, was not a substantive consolidation, as no one estate was entitled to any specific asset, a pro rata allocation did not merge the debtors into a single survivor and did not erase intercompany claims, and all claims against each debtor, including intercompany claims and court approved settlements, would receive distributions from the separate debtor estates.

[33] **Bankruptcy** In general; effect of substantive consolidation

Basic principle of substantive consolidation of debtors' bankruptcy estates is the treatment of separate legal entities as if they were merged into a single survivor left with all cumulative assets and liabilities, save for inter-entity liabilities, which are erased.

[34] **Bankruptcy** Factors, grounds, and objections

Proponent of substantive consolidation of debtors' bankruptcy estates must show that either (1) prepetition the debtors disregarded separateness so significantly that their creditors relied on the breakdown of entity borders and treated them as one legal entity, or (2) postpetition the debtors' assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors.

[35] **Bankruptcy** In general; effect of substantive consolidation

**Bankruptcy** Equitable powers and principles

Bankruptcy courts must respect entity separateness, absent compelling circumstances calling equity, and possibly substantive consolidation, into play.

[36] **Bankruptcy** In general; effect of substantive consolidation

Harms that substantive consolidation addresses are nearly always those caused when debtors, and entities that they control, disregard separateness.

[37] **Bankruptcy** Factors, grounds, and objections

Mere benefit to administration of bankruptcy case is insufficient basis for calling substantive consolidation into play.

[38] **Bankruptcy** In general; effect of substantive consolidation

“Rough justice” remedy of substantive consolidation of bankruptcy estates should be rare and, in any event, one of last resort after considering and rejecting other remedies.

[39] **Bankruptcy** In general; effect of substantive consolidation

Substantive consolidation of bankruptcy estates may not be used offensively, such as with primary purpose to disadvantage tactically a group of creditors in the plan process or to alter creditor rights.

[40] **Bankruptcy** Creditors Entitled to Assert Claims

**Bills and Notes** Parties to transaction, and rights of assignee or purchaser

Purchaser of a debt instrument on the secondary market is entitled to the exact same rights as the original purchaser of that instrument, and thus, in a bankruptcy case of the issuer, the secondary purchaser can assert the same rights subject to the same limitations that the original lenders could have asserted if they still owned the loans.

[41] **Bills and Notes** Parties to transaction, and rights of assignee or purchaser

Price paid by a secondary purchaser of a debt instrument has no impact on its substantive rights.

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**Re Dkt No. 13208**

***ALLOCATION TRIAL OPINION*** [1]

KEVIN GROSS, UNITED STATES BANKRUPTCY JUDGE

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## ***INTRODUCTION*** [2]

The gargantuan bankruptcy cases giving rise to the opinions of two courts on either side of the Canadian border emanate from the tragic, almost unimaginable collapse of the Nortel Enterprise. The how and why for the downfall are the subject of numerous books and articles and the Court will not gratuitously add its views which are not necessary to the work at hand. It is sufficient to note that even a writer of fiction would not dare to compose the story of the death of this multi-national enterprise and the harm it inflicted on tens of thousands of employees and creditors. The Nortel Enterprise in 2000 had stock with a value of $124.50 per share and a market capitalization of approximately $260 billion. It employed nearly 100,000 people worldwide and had annual sales of $30 billion. Two years later, the Nortel Enterprise had laid off 60,000 employees and its market capitalization had fallen to $2 billion. Nortel had shifted its focus from research and development to acquisition and expansion and thereby found itself overextended. Scandal among management added to Nortel's problems and it was repeatedly restating its earnings. Soon, Nortel was in bankruptcy.

In issuing this opinion, the Court (sometimes referred to as "U.S. Court") is addressing the allocation of Sales Proceeds among numerous debtor entities from numerous countries. [3] The decision follows 21 days of trial held jointly with the Ontario ***500** Superior Court of Justice, Commercial List (Honourable Frank J.C. Newbould, presiding) (the "Canadian Court"). At the trial, held simultaneously in two cross-border courtrooms linked by remarkable and effective technology, the Court and the Canadian Court heard the testimony of many witnesses and admitted into evidence over 2,000 exhibits and designations from numerous depositions. Thereafter, the parties submitted post-trial briefs and proposed findings of fact and conclusions of law exceeding 1,000 pages. The parties also presented two days of closing arguments to the U.S. Court and the Canadian Court. It is from this massive and complex record that the Court and the Canadian Court must formulate their decisions.

The issue to be decided by the U.S. Court and Canadian Court is:

> What is the appropriate allocation of the sums paid to Nortel in the bankruptcy sales (the "Sales Proceeds") among the Nortel Entities?

The parties identified below have submitted widely varying approaches for deciding the issue leaving virtually no middle ground. Their strong criticism of each other's allocation methodology also reveals why the parties were unable to resolve the dispute without the expenditure of time and expense. The Court can only speculate why the parties, all represented by the ablest of lawyers and sparing no expense, were unable to reach a settlement on allocation. For the reasons described and discussed in this opinion, the Court and the Canadian Court have arrived at the same conclusion: a modified pro rata allocation is required.

***PROCEDURAL SUMMARY***

On January 14, 2009 (the "Petition Date") Nortel Networks Inc. ("NNI") and certain of its affiliates, as debtors and debtors in possession (collectively, the "U.S. Debtors") [4] other than Nortel Networks (CALA) Inc., [5] filed voluntary petitions for relief under chapter 11 of the Bankruptcy Code in the U.S. Court, which cases are consolidated for procedural purposes only.

As of the Petition Date, Nortel Networks Corporation ("NNC"), a publicly-traded Canadian company, was the indirect parent of more than 130 subsidiaries, located in more than 100 countries (collectively "Nortel or the Nortel Entities"). [6] NNC was the successor of a long line of technology companies, always headquartered in Canada, dating back to the founding of Bell Telephone Company of Canada in 1883. [7] NNC's principal, direct operating subsidiary, also a Canadian company, was Nortel Networks Limited ("NNL"), ***501** which in turn was the direct or indirect parent of operating companies located around the world. [8] Together with NNL, the principal companies that performed research and development ("R & D") were NNI, a U.S. company, Nortel Networks (UK) Ltd. ("NNUK"), a United Kingdom company, Nortel Networks S.A. ("NNSA"), a French company and Nortel Networks Ireland ("NN Ireland"), an Irish company. These were known as Residual Profit Entities ("RPEs") due to their participation in a residual profit pool in connection with Nortel's transfer pricing arrangements. [9] Other operating companies performed sales and distribution functions and were known as Limited Risk Entities ("LREs"). [10] LREs were incorporated in most of the countries where Nortel products were sold, including in the Europe, Middle East and Africa ("EMEA") regions. [11]

On the Petition Date, the U.S. Debtors' ultimate corporate parent, NNC, together with NNI's direct corporate parent, NNL, and certain of their Canadian affiliates (collectively, the "Canadian Debtors" or the "Canadian Estate") [12] commenced a proceeding with the Canadian Court under the Companies'

Creditors Arrangement Act (Canada) (the "CCAA"), seeking relief from their creditors (collectively, the "Canadian Proceedings"). The Canadian Court appointed a Monitor, Ernst & Young Inc. (the "Monitor") Also on the Petition Date, the High Court of England and Wales placed nineteen of Nortel's European affiliates (collectively, the "EMEA Debtors" or the "EMEA Estates") [13] into administration (the "UK Proceedings") under the control of individuals from Ernst & Young LLP (collectively, the "Joint Administrators"). Other Nortel affiliates commenced insolvency and dissolution proceedings around the world.

On the Petition Date, the U.S. Debtors filed the Motion for Entry of an Order Pursuant to 11 U.S.C. § 105(a) Approving Cross–Border Court–to–Court Protocol (the "Protocol") [D.I. 18], which established procedures for the coordination of cross-border hearings between the Courts. The U.S. Court approved the Protocol on January 15, 2009 [D.I. 54] and the Canadian ***502** Court approved the Protocol on the Petition Date. The Courts later amended the Protocol by order of this Court on June 29, 2009 [D.I. 990] and by an order of the Canadian Court on that same date (as amended, the "Cross Border Protocol"). Subsequently, the Courts approved an Allocation Protocol which governed the trial on allocation. Order Entering Allocation Protocol, dated May 17, 2013. (the "Allocation Protocol") [D.I. 10565].

On January 22, 2009, the Office of the United States Trustee for the District of Delaware appointed an Official Committee of Unsecured Creditors (the "Committee") [D.I.s 141, 142]. An Ad hoc Group of Bondholders (the "Bondholders" or the "Bondholder Group") was also organized.

On June 19, 2009, Nortel announced that it was in discussions with third parties to sell its businesses and that it would consider alternatives if it was unable to maximize value through sales. As discussed below, Nortel did, in fact, sell all of its business units and associated assets to various purchasers. Most of Nortel's intellectual property ("IP") remained unsold until later.

To facilitate the sales of the businesses and defer the issue of the allocation of the sales proceeds, the Nortel Entities entered into the Interim Funding and Settlement Agreement (the "IFSA"), which the U.S. Court approved by Order, dated June 29, 2009 [D.I. 993], and the Canadian Court approved by Order, dated June 29, 2009.

On April 4, 2011, the U.S. Debtors, together with NNF and NNC, announced an agreement with an affiliate of Google Inc. to sell Nortel's remaining patent portfolio and related assets (the "IP Assets") for $900 million (the "Google Bid"), subject to higher or better offers. The sale of the IP Assets through an auction to Rockstar Bidco L.P. ("Rockstar" and "Rockstar Transaction") resulted in a price of $4.6 billion. Rockstar is a consortium comprised of Apple, Ericsson, Microsoft, Blackberry, EMC and Sony. [14]

The IFSA provided, *inter alia,* that proceeds from the sales would be and have been held in escrow pending an agreement of the parties on allocation among them or decision by the U.S. and Canadian Courts in a joint trial to be conducted in accordance with the Cross–Border Protocol, and later the Allocation Protocol. Although the parties engaged in extensive negotiations and there were two formal mediations, the parties could not agree on an allocation. The U.S. and Canadian Courts have therefore been called upon to make the allocation determination.

## *FACTS*

### A. *The Business Lines*

Nortel was organized such that each entity was integrated into regional and product line management structures to share information and perform R & D, sales and other common functions across geographic boundaries and across legal entities. The structure was designed to enable Nortel to function more efficiently, drawing on employees from different functional disciplines worldwide, allowing them to work together to develop products and attract and provide service to customers, fulfilling their demands globally. [15] The matrix structure was reflected in Nortel's R & D, sales organization, distribution ***503** channels and transfer pricing arrangements. [16]

As of January 2009, Nortel's lines of business ("Business Lines") were:

(a) Carrier Networks—wireless networking solutions for providers of mobile voice, data and multimedia communications services over technologies including:

(i) Global System for Mobile Communications ("GSM");

(ii) Code Division Multiple Access ("CDMA");

(iii) Carrier Voice Over Internet Protocol Applications Solutions ("CVAS"); and

(iv) the development of long-term evolution ("LTE") wireless technology;

(b) Enterprise Solutions—enterprise communications solutions addressing the headquarters, branch and home office needs of large and small businesses; and

(c) Metro Ethernet Networks—optical networking and carrier grade ethernet data networking solutions, including:

(i) Carrier Ethernet switching products;

(ii) optical networking products; and

(iii) multi-service switching products. [17]

As part of the extensive sale processes (see Appendix B), Nortel sold its businesses and assets, including: (i) the sale of certain portions of its Layer 4–7 data portfolio to Radware Ltd. [D.I. 539] (the "Layer 4–7 Sale"); (ii) the sale of substantially all of its CDMA business and LTE Access assets to Telefonaktiebolaget LM Ericsson (publ) ("Ericsson") [D.I. 1205]; (iii) the sale of substantially all of the assets of the Enterprise Solutions business globally, including the shares of Nortel Government Solutions Incorporated and DiamondWare Ltd. to Avaya Inc. [D.I. 1514]; (iv) the sale of the assets of its Wireless Networks business associated with the development of Next Generation Packet Core network components to Hitachi Ltd. [D.I. 1760]; (v) the sale of substantially all the assets of its Optical Networking and Carrier Ethernet businesses associated with its Metro Ethernet Networks business unit to Ciena Corporation [D.I.2070]; (vi) the sale of substantially all of its GSM/GSMR business to Ericsson and Kapsch CarrierCom AG [D.I.2065]; (vii) the sale of certain assets of its Carrier Voice Over IP and Application Solutions business to GENBAND U.S. LLC [D.I. 2632]; (viii) the sale of certain assets of the Debtors' Multi–Service Switch business to Ericsson [D.I. 4054]; and (ix) certain other sale transactions.

At the time the EMEA, U.S. and Canadian Debtors (collectively, the "Debtors") filed for creditor protection in January 2009, only the GSM and CDMA lines of business were profitable. [18] Overall, Nortel was losing vast sums of money, its customers were, in large part, no longer supporting it, and NNC had by the fall of 2008, ***504** written off all of its goodwill. [19]

B. *Research & Development*

Nortel spent significant amounts on R & D; in 2004, for example, Nortel spent more on R & D as a percentage of revenue than its competitors. [20] R & D played a critical role in the sales process of the Business Lines. [21] Before the 1980s, all of Nortel's R & D was performed in Ottawa—R & D which led to revolutionary telecommunications products that established Nortel's reputation. [22] Subsequently, Nortel opened R & D facilities in other jurisdictions. Nortel also acquired numerous technology companies during the 1990s and early 2000s and merged their R & D organizations into those of the Nortel subsidiaries operating in their jurisdictions. [23]

Subsidiaries commenced their operations and produced "state of the art" products which allowed them to become important participants in their markets. [24] R & D was coordinated through two different management structures. Decisions about the majority of R & D funding were made by the Business Lines to create, develop and improve technology for products within their particular technology areas. [25] Advanced technology research, which was intended to develop novel, cutting edge technologies with a longer time horizon to product creation (if successful) was coordinated by Nortel's Chief Technology Officer and allocated funding through a central budget. [26] The advanced technology research produced the greatest impact in terms of innovation and patent filings. [27]

The following chart summarizes Nortel R & D spending for the years 2000 to 2009. [28]

***505**

| R&D Spend | NNL | NNI | EMEA |
|---|---|---|---|
| 2000 | 42% | 42% | 16% |
| 2001 | 43% | 39% | 18% |
| 2002 | 39% | 41% | 20% |
| 2003 | 42% | 38% | 20% |
| 2005-2009 | 49.8% | 38.5% | 11.7% |

Nortel's billions in R & D expenditures over the decades preceding January 2009 generated the IP, but it is impossible to trace which R & D expenses produced which IP. [29] As of January 2009, NNL held approximately 8,800 worldwide patents and applications. [30] The majority of all rights, title and interest in inventions by Nortel employees worldwide were assigned directly or indirectly to NNL. [31] As a result, nearly all of the patents and applications were assigned to Canadian entities; approximately 7000 patents and applications in the portfolio sold in the transaction discussed below had been assigned to NNL. [32]

### C. *Transfer Pricing*

Transfer pricing is the process by which a multi-national enterprise ("MNE") sets prices for transactions between related corporate entities across taxing jurisdictions. [33] The intercompany transactions take place between entities that are commonly controlled. Therefore, transfer prices are assigned by management rather than being the result of arm's length negotiation between parties. [34] Transfer prices are assigned rather than bargained for and because effective tax rates across jurisdictions may vary, MNEs are incentivized to minimize their global effective tax rate when setting transfer prices. [35]

In light of these incentives, taxing authorities have implemented regulations that govern transfer pricing generally require that intercompany transactions be priced in a manner consistent with the way that similarly situated, uncontrolled parties would price comparable transactions at arm's length. [36]

***506** Nortel had transfer pricing arrangements that governed how it reported income in each of the jurisdictions in which it did business. [37] Within Nortel companies were treated as separate legal entities. These individual entities ("IEs") had their own books and records, financial statements, bank accounts and cash reserves. Each company was organized in accordance with and operated under local laws. [38] Subsidiaries within Nortel filed separate financial statements with the appropriate local regulatory agency and Nortel kept detailed revenue figures for different countries and regions. [39] Nortel entities had separate boards of directors. [40]

### D. *Advanced Pricing Arrangements*

If a tax authority disagrees with the transfer pricing methodology reflected in an MNE's tax return for a particular year, the tax authority may initiate an audit, which could potentially lead to an adjustment in taxes owed by the MNE, penalties, tax court litigation and/or double taxation. [41] To mitigate this risk, taxpayers may avail themselves of the advanced pricing arrangement ("APA") process offered by tax authorities. An APA is a contract between a member of an MNE, such as NNL, and a tax authority, such as the Canadian Revenue Authority ("CRA"), the U.S. Internal Revenue Service ("IRS") and the Inland Revenue Service ("Inland Revenue") in the U.K., typically specifying the transfer pricing methodology that the affiliate will be permitted to use for an agreed period of *ti* me. APAs can include multiple tax authorities and members of an MNE. [42]

### E. *Cost Sharing Agreements*

From the late 1970s to December 31, 2000, Nortel operated under a series of Cost Sharing Agreements (each a "CSA"), which were bilateral agreements between NNL and each of the other R & D performing Nortel entities, including NNI, NNUK, NN Ireland and NNSA (referred to together with NNL as the "Cost Sharing Participants" or "CSPs"). [43] During the period of the final series of CSAs, NNL and each of the other CSPs entered ***507** into three separate cost-sharing agreements, which governed pricing for different types of intercompany transactions: an agreement governing R & D (an "R & D CSA"), another for tangible property and another for headquarters expenses. [44]

The last R & D CSA between NNL and NNI was drafted in 1996 and made effective from January 1, 1992 to reflect the terms of a 1996 APA between NNL, NNI, the CRA and the IRS. The 1992 NNL–NNI R & D CSA provided a mechanism for sharing the "costs and risks of research and development services or activities in return for interests in any NT Technology that [was] produced by such services or activities."

### F. *New Transfer Pricing Arrangement*

At the end of 1999, each of the three CSA APAs in effect between NNL and each of the other then-CSPs (governing R & D, tangible property, and headquarters cost sharing) had expired or was nearing expiration. [45] The CRA, IRS and Inland Revenue did not want to renew the R & D CSA APA after 1999. They had encouraged Nortel to adopt a residual profit sharing method ("RPSM").

Beginning in late 2000, Nortel formed a team of employees (the "APA Team") to determine the appropriate transfer pricing policy to propose to taxing authorities in the upcoming APA process. Nortel's APA Team investigated alternatives to the R & D CSA "[i]n an effort to minimize Nortel's long-term effective tax rate, to make the transfer pricing administrative processes more efficient and to, over time, improve the global allocation of profits among Nortel affiliates." In December 2001, Nortel's R & D CSAs were terminated effective January 1, 2001. [46] Termination of the R & D CSAs resulted in each license-holding CSP receiving "a fully paid up license" to all Nortel intellectual property in existence as of that date with respect to its Exclusive Territory.

From December 2001 through March 2002, the Nortel tax group worked with external advisors to craft the specific mechanics of a RPSM for Nortel that could be submitted simultaneously to the CRA, IRS and Inland Revenue as the basis for proposed APAs for the 2000 to 2004 period. [47] The resulting APA applications to those three tax authorities were filed on or about March 14, 2002. [48] Each APA application included a functional analysis prepared by Horst Frisch entitled "Economic Analysis of Nortel Networks' Intercompany Transactions" (the "Horst Frisch Report"), setting forth Nortel's justification for its proposed RPSM on the basis of various Nortel affiliates' roles and functions, as required to demonstrate that the proposed RPSM satisfied the arm's length standard. [49]

***508** Nortel's RPSM distinguished between the IEs (then consisting of NNL, NNI, NNUK, NN Ireland, NNSA and Nortel Networks Australia)—who, as discussed above, performed ongoing R & D, had previously been parties to R & D CSAs and performed the full range of functions—and LREs, who were routine distributors whose primary function was to sell Nortel products in their respective geographic regions, did not perform R & D and had not previously participated in an R & D CSA. [50] The RPSM allocated operating profits or losses to IEs and LREs under a two-step process. [51]

To determine the total "pool" of operating profits (or losses) to be allocated among the IEs and LREs, the RPSM started with Nortel's consolidated operating profits or losses and recalculated this figure on an "economic" basis for each entity through a series of adjustments including adding back R & D expenses and then subtracting an amortized portion of those expenses. This calculation resulted in the gross "economic profit or loss." [52]

In the second step of the RPSM, "residual" operating profits or losses remaining after the payout of routine returns were allocated to the IEs only, based on each IEs' relative proportion of capitalized R & D expenses from that year and preceding years, assuming a 30% amortization rate. [53]

One of the objectives of Nortel when implementing the RPSM was to minimize tax payments globally. Nortel personnel and advisors designed the RPSM to shift taxable income from NNI to NNL. [54] Trial testimony of NNL's former chief financial officers further corroborates that minimizing tax was a key goal for Nortel. [55]

Over the course of eight years (2001–2008) as APA negotiations with the tax authorities continued regarding Nortel's RPSM, the IEs made or received billions of dollars in transfer pricing payments under that system. As summarized in the following table, NNL was the chief recipient of these payments, totaling more than $4.7 billion, while NNI was the largest payor, transferring over $6.7 billion to other Nortel entities:

***509 Table 2: Transfer Pricing Payments, 2001–2008** [56]

| *IE* | *2001* | *2002* | *2003* | *2004* | *2005* | *2006* | *2007* | *2008* | *Total* |
|---|---|---|---|---|---|---|---|---|---|
| *NNL* | 589.0 | 482.3 | 391.0 | 652.4 | 496.0 | 511.1 | 725.9 | 879.8 | 4,727.5 |
| *NNI* | -1,931.2 | -1,140.2 | -857.8 | -722.7 | -631.8 | -371.8 | -508.9 | -537.3 | -6,701.7 |
| *NNUK* | 902.7 | 198.0 | 443.8 | 307.2 | 205.5 | 36.5 | 28.1 | 20.5 | 2,142.3 |
| *NNSA* | -92.1 | 81.1 | -27.4 | -145.7 | -12.7 | 3.7 | -95.3 | -46.9 | -335.3 |
| *NN Ireland* | -44.2 | -70.5 | -67.4 | -64.9 | -50.0 | -102.6 | -119.5 | -147.6 | -666.7 |
| *NN Australia* | 38.2 | 24.2 | -17.8 | 1.5 | 8.2 | -95.6 | -0.4 | 0.0 | -41.7 |

As shown, in each year covered by the RPSM, NNI paid out hundreds of millions of dollars—more than a billion dollars in some years—to the other IEs. NNL received hundreds of millions of dollars in transfer pricing payments each year. In part, these transfer pricing payments by NNI were used by NNL to fund its R & D. [57]

The amount of transfer pricing payments attributable to R & D and the Total R & D Funded for each entity each year in the Master Research and Development Agreement (discussed below) period are summarized below.

Table 3: R & D Funding Under the RPSM, 2001–2008

| | NNL | NNI | EMEA | Total |
|---|---|---|---|---|
| Direct R&D | 7,372 | 6,467 | 2,667 | 16,506 |
| TP – R&D | (2,986) | 3,006 | (205) | (185) |
| Total R&D Funded | 4,385 | 9,473 | 2,462 | 16,321 |
| % of Total R&D Funded Directly and Indirectly | 27% | 58% | 15% | 100% |

Neither the IRS nor the CRA approved Nortel's RPSM. In 2009, following Nortel's insolvency and more than seven years after the 2002 APA applications, the IRS and CRA directed an income adjustment of $2 billion from NNL to NNI as a condition for resolving the APA for those years. [58]

G. *The Master R & D Agreement*

From 2001 until the end of 2004, Nortel operated under the RPSM without any written intercompany agreement memorializing its terms. [59] In December 2004, ***510** Mark Weisz circulated the final Master R & D Agreement ("MRDA") to the IEs for execution. The agreement was signed by NNL, NNI, NNUK, NNSA and NN Ireland at various dates and made effective January 1, 2001. John Doolittle signed the MRDA on behalf of NNL. [60]

H. *Rights to Intellectual Property Under the MRDA*

The MRDA sets forth a clear exchange of consideration between the signatories. Pursuant to Article 4(a), each Licensed Participant ("Licensed Participant") vested legal title in NNL to the intellectual property it created. Expressly "in consideration therefor," NNL granted an exclusive license ("Exclusive License") back to each Licensed Participant: [61]

> Except as otherwise specifically agreed, legal title to any and all NN Technology whether now in existence or acquired or developed pursuant to the terms of this Agreement shall be vested in NNL. In consideration therefor, NNL agrees in enter into an Exclusive License with each of the Licensed Participants as set forth in Article 5.

I. *The MRDA Was Tax Driven*

The risk that Nortel would be audited by tax authorities without an agreement in place prompted Nortel to draft the MRDA. [62] Accordingly, the MRDA was a tax-driven contract, drafted primarily by Nortel's tax team and external tax counsel, and it was intended to memorialize the group's transfer pricing policy in place from 2001 forward. [63]

Nortel also was aware that the transfer pricing policies it had proposed in its 2002 APA application and which were reflected in the MRDA were subject to approval by the tax authorities, and intended that arrangements in the MRDA would ultimately either be approved by those authorities or be revised to secure approval. [64]

The MRDA enabled Nortel to maintain separate and distinct legal entities in order to avoid NNL having a "permanent establishment" in another jurisdiction by conducting business there, particularly in the United States. Nortel management was aware that under U.S. tax law, if a partnership is engaged in a U.S. trade or business, non-U.S. resident partners that own an interest in that partnership are also deemed to have a U.S. trade or business, and may be subject to tax in the United States if that trade or business is treated as creating a permanent establishment for the non-U.S. partner. [65]

J. *The Interim Funding and Settlement Agreement*

On the Petition Date, with the approval of the U.S. Court, NNI loaned to NNL $75 million under a new revolving loan agreement (the "Intercompany DIP Loan"). The amounts owing to NNI under the Intercompany DIP Loan were repaid with proceeds from the sale of Nortel's Carling facility. [66] Also in January 2009, NNI paid ***511** to NNL an additional $30 million, as a transfer pricing payment. [67]

On June 9, 2009, the U.S. Debtors (excluding NN CALA, which had not yet filed for bankruptcy), Canadian Debtors and EMEA Debtors (excluding NNSA, who later acceded to the agreement) entered into the IFSA to address both interim funding of NNL as well as principles under which collaborative sales of Nortel's businesses and assets could take place. [68]

The IFSA provided for a payment by NNI to NNL of $157 million (net of the $30 million previously paid in January) in full settlement of any transfer pricing and other claims NNL might have had against NNI for the period from the Petition Date through September 30, 2009. In April 2009, the Monitor reported that NNL needed this payment in order to have "adequate cash resources to fund operations." [69] The process allowed, but did not obligate, the U.S. Debtors, Canadian Debtors and EMEA Debtors to jointly sell Nortel's assets without a prior agreement on allocation, but it required the parties to negotiate in good faith to reach agreement on allocation before submitting the question to the Courts. [70] The IFSA made explicit that there was no obligation for any Debtor to proceed with a sale transaction if it determined that it was not in the best interests of its creditors. [71]

The IFSA also referred to the U.S. Debtors, the Canadian Debtors and the EMEA Debtors as "Selling Debtors." The IFSA required that any agreement or determination by either the U.S. Debtors or Canadian Debtors related to license termination agreements and the allocation of Sales Proceeds required the prior consent of the Bondholder Group, acting in good faith. The U.S. Debtors had to obtain similar consent from the Committee. [72] Each Licensed Participant agreed under the IFSA that if, and only if, it determined to participate in a sale that was in the best interests of its creditors, it would enter into a license termination agreement relinquishing its Exclusive License. [73] The IFSA provided that the termination or relinquishment of a license would be deemed a sale with the Licensed Participant being deemed a seller. [74] The IFSA made clear that any such license terminations would be provided "in consideration of a right to an allocation to be determined" from such sale. [75] The IFSA was not an "amendment, modification or waiver of rights" of any party under any other agreement, including the MRDA. [76] The U.S. Court and Canadian Court entered orders approving the IFSA following a joint hearing on June 29, 2009 (the "U.S. IFSA Order" and the "Canadian IFSA Order"). [77]

K. *The Final Canadian Funding and Settlement Agreement*

At the end of 2009, NNL approached NNI and requested additional financing, ***512** stating that without additional cash, NNL would have to shut down. [78] At the time of NNL's request for additional financing, NNL's and NNI's requests to the CRA and IRS for approval of an APA governing the RPSM regime for the 2001–2005 and 2006–2011 periods were still unresolved. [79]

The parties addressed both NNL's cash needs and the tax settlement in a new agreement entitled the Final Canadian Funding and Settlement Agreement (the "FCFSA"). The provisions of the FCFSA included the following: [80]

(a) NNI agreed to pay NNL $190.8 million in full and final settlement of any and all claims that NNL might have (or could have through the final conclusion of the Canadian Debtors' proceedings) against NNI, whether based on transfer pricing arrangements, other intercompany agreements or otherwise.

(b) NNI and NNL agreed to enter into APAs with the IRS and CRA, respectively, for the years 2001–2005 on the terms set by the tax authorities.

(c) NNL granted NNI an allowed $2.06 billion claim in NNL's CCAA proceedings, with such claim not being subject to offset or reduction.

(d) NNL and NNI agreed not to exercise any rights of termination under the MRDA without the prior written consent of the other parties to the MRDA, the Committee and the Bondholder Group.

The EMEA Debtors and NNL separately agreed that they would not exercise any right of termination. [81]

On December 23, 2009, NNI, NNL, the Monitor and other U.S. and Canadian Debtors executed the FCFSA. [82] The U.S. Court and Canadian Court entered orders approving the FCFSA following a joint hearing on January 21, 2010. The order entered by the Canadian Court approving the FCFSA expressly allowed NNI's $2.06 billion claim against NNL, which was not subject to offset or reduction. [83]

L. *The Sale of Nortel's Business Lines*

Nortel's Business Lines were sold in a consensual, "cooperative and coordinated fashion."[84] From shortly after the IFSA was approved through April 4, 2011, all parties worked together and successfully sold the following businesses in joint sale processes across multiple jurisdictions, most of which involved vigorous auctions conducted pursuant to Section 363 of the United States Bankruptcy Code and Court-approved sales processes in accordance with the CCAA. These sales (together, the "Business Line Sales") generated $3,285 billion of which approximately $2.85 billion is now available. The specific details of the Business Line Sales are set forth in Appendix A to this opinion.

As part of the Business Line Sales process, the U.S. and EMEA Debtors entered into License Termination Agreements (the "LTAs"). Prior to the U.S. Debtors executing an LTA for any Business Line Sale, ***513** the U.S. Creditors Committee and the Bondholder Group needed to, and did, consent to the transactions.[85]

Only some of Nortel's patents were sold in the Business Line Sales. If a patent was not "predominantly used" in a Business Line it was not transferred to a purchaser, and the purchaser was generally granted a nonexclusive right to practice the patent in a limited field of use.[86]

Nortel transferred 2,700 patents as part of the Business Line Sales.[87] NNL retained ownership of the patents licensed to the Business Line Sales purchasers.[88] Thousands of R & D personnel, principally in Canada but also in the other RPE jurisdictions, were transferred to the purchasers of the lines of business.[89] The transfer of the valuable assembled workforce, including R & D personnel, enabled the purchasers to continue to operate the businesses without interruption.

As all Debtors, the Committee, Bondholders and the Canadian Creditors Committee ("CCC") agree, and the U.S. Court and the Canadian Court found when they approved them, the Business Line Sales proceeds generated through the auction process represent the fair market value of the Business Lines.[90]

M. *Patent Identification*

In the Business Line Sales, it was important that Nortel identify which IP rights—principally patent rights—needed to be conveyed; each prospective purchaser wished to obtain as many patents as possible as part of each sale transaction. Conversely, Nortel wanted to ensure that the only patents transferred were those incorporated exclusively or principally in the business line in question so as to retain value within Nortel and not to jeopardize the ability to sell the other Business Lines that might require rights to the same patents.[91]

When the Business Lines were being sold, Nortel's IP Group undertook a patent segmentation process to determine which patents would be transferred with each of the Business Lines. The standard for transfer of a patent in the sales was whether the IP in question was "predominantly used" in a given Business Line. IP that was used in multiple Business Lines ("shared" IP) was not sold with the businesses and rights to use that IP were instead conveyed to Business Line purchasers as necessary, generally via limited, non-exclusive licenses.[92] There is no evidence that, pre-petition, Nortel had ever undertaken such an exercise to determine whether a given patent was predominantly used in a specific Business Line, used in multiple Business Lines or not used in any Business Line in the normal course of its business or that Nortel ever monitored ***514** which patents were used or not used in Business Lines. In conducting the patent segmentation process, Nortel's IP Group sought to reduce the number of patents sold in the Business Line Sales to maximize the number of patents that would remain outside the Business Line Sales and retain such patents as part of a large portfolio to maximize value for creditors.[93] [94]

N. *Nortel's Patents Had a Useful Life of Many Years*

U.S. patents are granted for a 20–year period.[95] A patent is within its economic useful life if it can be sold. As Canadian Debtors' expert Timothy Reichert wrote in an article, "commercial transferability is the most objective of the three definitions of economic life."[96] When measuring the useful life of a patent, it is necessary to distinguish between the life of a product utilizing a patent and the life of a technology or patent itself. While a particular product may become obsolete in a relatively short period, the patents incorporated into that product may survive through many generations of products and be utilized and built upon for a far longer period than the initial product itself. [97] The useful economic life of many Nortel patents well exceeded five years. [98] The vast majority of the patents that sold collectively for approximately $4.5 billion were more than a decade old at the time of the sale. [99] Nortel's valuable patents were largely created in the late 1990s to early 2000s, corresponding to Nortel's peak. [100] 99% of the high-interest patents that were sold to Rockstar had been developed before 2006, more than 5 years before the sale to Rockstar in 2011. [101] 80% of the high-interest patents sold to Rockstar were developed in 2000 or earlier, during the period that Nortel employed a cost-sharing arrangement to fund R & D. [102]

O. *A Licensing Business—IPCo*

After completing the Business Line Sales, Nortel retained a substantial number of intellectual property assets (the "Patent Portfolio" or the "Residual IP"). Over the course of more than a year, the Debtors, other stakeholders and their advisors carefully weighed a possible sale of Nortel's Patent Portfolio against the alternative of an IP licensing service and enforcement business ("IPCo"), a proposed business that Nortel began considering before the insolvency filings as set forth below. [103]

***515** IPCo would monetize the Residual IP by licensing patents to technology companies that were suspected of infringing on them in exchange for the payment of royalties. IPCo would license the Residual IP by threatening patent infringement litigation and bringing such litigation if necessary. [104]

Early in 2008, as discussed below, Nortel began to explore options for more effectively monetizing its intellectual property through developing a more robust licensing and enforcement business than it had to date. John Veschi was hired by NNI in July 2008 as Chief Intellectual Property Officer to "look at options for licensing." [105] Veschi had extensive licensing and IP experience. [106]

One possibility was for the licensing business to be a separate Business Line with direct reporting to Nortel's CEO. [107] Veschi initiated a program to license group IP to infringing third-parties in four initial technology families or "franchises"—mobile handsets, internet search, TV/display/projector and video game/PC—with plans to license to additional franchises as the licensing business progressed. [108] Coordinating with the leaders of Nortel's Business Lines, in November 2008, Veschi and his team prepared notices of infringement. [109]

Post-petition, Veschi's team made presentations in the summer of 2009 addressing the options for monetizing the Patent Portfolio. [110] Several monetization alternatives were considered: the sale of patents, further developing and operating IPCo, or further developing and then selling IPCo. [111]

Following these presentations, Nortel issued a request for proposals to find a firm to assist in the evaluation of the Patent Portfolio and the further development of IPCo. [112] Thereafter, Nortel jointly retained the Global IP Law Group ("Global IP") in October 2009, [113] to provide advice on monetizing the portfolio, including exploring monetization "options for licensing as opposed to outright sale." [114]

On March 20, 2009, the U.S. Court entered an order approving the retention of Lazard Freres & Co. LLC as financial advisor to the U.S. Debtors ("Lazard"). The U.S. Court subsequently entered an order amending the terms of Lazard's compensation to allow for a "IP Transaction Fee" if Nortel consummated "a restructuring and reorganization around all or substantially all of the Company's intellectual ***516** property assets." [115] Lazard was involved in evaluating the financial aspects of IPCo on behalf of all Nortel Entities. [116]

As part of its evaluation, Global IP reviewed more than 11,000 patent claims, categorized patents by technology field, mapped claims to markets for potential enforcement and licensing and screened the patents for encumbrances. [117] Global IP confirmed that Nortel's Patent Portfolio was valuable. [118] Global IP presented its initial findings to stakeholders of Nortel in December 2009. [119] Global IP and Lazard made a follow-on presentation to the boards of directors of NNC and NNL in January 2010. [120]

The Debtor Estates weighed several options for monetizing the Patent Portfolio. Stakeholders from the EMEA, Canadian and U.S. Debtors seriously considered IPCo as an alternative to the sale of the Patent Portfolio. A committee of representatives of Nortel and their advisors (the "IP Steering Committee") was formed in January 2010, which led the evaluation process. [121] The IPCo option and the sale option were considered in parallel, so Nortel could determine how best to monetize the patent assets. In the words of the Monitor's lead representative Murray McDonald, IPCo and a sale were considered "concurrently" as "parallel alternatives." [122]

In September 2010, the Monitor advised the IP Steering Committee that IPCo should remain an option for consideration. [123] In their 201010–K, filed with the U.S. Securities and Exchange Commission, NNC disclosed that "[w]e are seeking expressions of interest from potential buyers and partners regarding options that could maximize the value of our intellectual property portfolio. No decision has been made as to how to realize this value, whether through sale, licensing, some combination of the two or other alternatives." [124] IPCo remained a viable option into 2011. [125]

As the Monitor's representative testified, "[o]ver the course of 2009 and 2010, Mr. Veschi and his team, assisted by Lazard and Global IP, prepared various versions of a model that attempted to forecast the revenues that could be earned by IPCo ***517** so that its potential economic benefits could be assessed. The initial IPCo Model had three different sub-models that forecast the revenues of IPCo based on different scenarios, in particular the amount of litigation that IPCo would engage in as part of its business model." [126]

The details of the IPCo Model were updated and refined in several revised versions. Later versions of the IPCo Model (including version 4.0) do not dissuade the Court's view that IPCo was a viable option. [127]

The IPCo revenue projections were included in the presentations and models circulated to stakeholders for comment. [128] The United States is the most profitable market for exploiting patents. [129] The IPCo Model did not separate North American revenue between Canada and the United States, but the vast majority of North American revenue from IPCo would have been earned in the United States. [130] This is consistent with where the patents in the portfolio were filed because the value of a patent comes from the right to exploit, license and enforce that patent and can only be extracted in the jurisdiction where that patent is filed. [131]

Nortel assembled its IP into groups, or "technologies," which represented an idea that was patented (or one for which an application was filed) in one or more territories. [132] 97% of Nortel's technologies (which includes all patents and applications in a family) were protected by patents filed in the United States. [133] 73% of Nortel's technologies were protected by patents ***518** filed only in the United States. [134] Of the highest value patents that were in IPCo, as determined by Global IP, 99.5% of Nortel's technologies were protected by patents filed in the United States. [135] Of the highest value patents that were in IPCo, as determined by Global IP, 77% of Nortel's technologies were protected by patents filed only in the United States. [136]

### P. *All Integrated Entities Expected to Benefit from IP Monetization*

While the stakeholders were considering the alternatives for IP monetization, the expectation was always that the Licensed Participants, and in turn their creditors, would benefit from an eventual sale of the Patent Portfolio or running a business based off of the IPCo Model. As the Monitor's representative noted at trial, the IEs cooperated to maximize the value of the Patent Portfolio, including developing the IPCo Model. [137] The expectation that the Licensed Participants would share in the benefit from the monetization of the Patent Portfolio is reflected by the financial burdens they shared in evaluating that option. The IEs jointly retained Global IP. [138] The IEs, in turn, jointly owned all "[d]eliverables, including Intellectual Property rights in the Deliverables" created by Global IP. [139]

### Q. *Residual Patent Portfolio*

By the time that all of the Business Line Sales were completed in March 2011, Nortel had no remaining operating businesses. What it did retain was a residual patent portfolio, consisting of approximately 7000 patents and patent applications. [140] These were principally patents and applications that were not used in any of the Business Lines and therefore were not subject to licenses to the Business Line Sales purchasers. [141] In addition, the Residual IP portfolio included patents used by multiple Business Lines and licensed to the purchasers of those Business Lines. The costs to capitalize an IPCo Model were estimated to have been between $269 million and $417 million. [142] Ultimately, the Canadian Debtors and the Monitor advised the representatives of the other Debtors and the other stakeholders that the Canadian Debtors would not provide any funding to establish IPCo. [143]

If any Debtor or other interested party wished to pursue IPCo, they would need to purchase the residual patents from NNL. [144] No Estate or other interested party ever sought to effect such a purchase. Instead, ***519** all of the Estates agreed to pursue a sale process for the Residual IP and to terminate consideration of the IPCo option.

### R. *The Sale of Nortel's Residual Patent Portfolio*

When Google submitted a non-binding indication of interest of $900 million in February 2011, the proposed price was sufficient for the Estates to discuss a sale as a credible alternative to IPCo. [145] Negotiations with Google commenced in earnest in early 2011. [146]

In the IP Stalking Horse Agreement, Google requested a provision pursuant to which Nortel definitively agreed to sell the Residual IP to a third party. [147] Nortel therefore agreed to terminate consideration of IPCo as part of the sale process. [148] However, the IPCo option could be pursued if done in the context of a qualified competing bid, such as a proposal by a third party to sponsor a transaction that would allow Nortel to retain the Patent Portfolio and operate IPCo. [149] Google insisted that the current licenses be terminated as part of the sale. [150]

Extensive negotiations culminated with the signing of a stalking horse agreement dated April 4, 2011, between each of the IEs as Sellers and Ranger, Inc., a wholly owned subsidiary of Google for a purchase price of $900 million, (the "IP Stalking Horse Agreement"). [151] The U.S. and Canadian Debtors each filed motions seeking approval of their entry into the IP Stalking Horse Agreement and the related auction process. [152] The Monitor filed a report in support of the Canadian Debtors' entry into the IP Stalking Horse Agreement in which it stated that title to Nortel's intellectual property was held by NNL, but that each of the IEs had Exclusive Licenses to that intellectual property in their Exclusive Territories. [153]

A joint hearing was held before the U.S. and Canadian Courts to consider these motions on May 2, 2011. [154] The U.S. and Canadian Courts issued orders approving the entry into the agreement for a purchase price of $900 million and the rules for the conduct of a subsequent auction for the Patent Portfolio. [155]

***520** When the auction commenced on June 27, 2011, senior representatives of Apple, Microsoft, Intel, Sony, Ericsson, RIM (now Blackberry) and EMC, among others, assembled at the New York offices of NNI's counsel. [156] Over the course of four days in late June 2011, vigorous bidding took place. [157]

The final winning bid of $4.5 billion came from Rockstar and resulted in an agreement of sale (the "Rockstar Sale Agreement"). [158] As part of the Rockstar Sale Agreement, the relevant U.S. and EMEA Sellers executed a License Termination Agreement pursuant to which their license rights in relation to the residual patents were terminated and they would be granted a right to an allocation of a portion of the sales proceeds in consideration for such termination. [159] Through the Rockstar Sale Agreement and the License Termination Agreement, the Debtors agreed to transfer all of their rights in the Patent Portfolio to Rockstar. [160]

### S. *The Rockstar Sale Approval Hearing*

The Rockstar Sale Agreement was presented for approval to the U.S. and Canadian Courts at a joint hearing on July 11, 2011. [161] At that hearing, representations were made about the sale process and the substantial benefit of the result for all of the IEs. [162] Both the U.S. and Canadian Courts approved the sale. [163] The Monitor's public report recommending the sale to the Courts represented that NNL's legal title in the Patent Portfolio was "subject to ... intercompany licensing agreements with other Nortel legal entities around the world ... in some cases on an exclusive basis," referring to NNI and the other Licensed Participants. [164]

## ***THE PARTIES AND THEIR ALLOCATION POSITIONS***

The parties who participated in the trial and briefing are described below, together with their positions on allocation. The Court is merely reciting their arguments without comment.

A. *The U.S. Interests*

The U.S. Interests include NNI and certain affiliates as debtors and debtors in possession, the Committee and the Bondholders. The Committee and the Bondholders also participated in the trial and submitted their own briefs.

Allocation involves a two-step process. First, the Courts must identify and characterize the property or legal rights transferred or surrendered by each debtor—here grouped by interest. Second, the Courts must value the property or legal rights. The buyers of the Business Lines and Patent Portfolio paid fair market value, ***521** determined through auctions for the assets. Allocation is therefore based on the relative value of the assets each debtor transferred. The Courts should apply standard valuation methods which courts have consistently followed, including in insolvency proceedings. Also, the Courts must take into account that in insolvency, equity takes last. Simply, NNTs position is that allocation must be the value of the assets it sold or surrendered.

Allocation must be premised on fair market value, the foundational valuation metric widely accepted in the law and economics throughout the world. *See United States v. Cartwright,* 411 U.S. 546, 550–51, 93 S.Ct. 1713, 36 L.Ed.2d 528 (1973); *Pocklington Foods Inc. v. Alberta (Provincial Treasurer)* (1998), 218 A.R. 59, para. 197, 354 (Can.Alta.Q.B.), *aff'd* (2000), 250 A.R. 188 (Can.Alta.C.A.) (explaining that "the most common value standard is fair market value"); *Phillips v. Brewin Dolphin Bell Lawrie Ltd,* [2001] UKHL 2, [2001] 1 W.L.R. 143 (H.L.), 154 (appeal taken from Eng.). [165]

Basing allocation on the fair market value of the assets each selling debtor transferred or relinquished in the Sales is consistent with the MRDA. The MRDA states that if a Licensed Participant becomes insolvent it may be required to surrender the Exclusive License, but only in exchange for the fair market value of the license. The MRDA, Schedule A, RPSM formula that the parties used to divide operating income for transfer pricing purposes when operating as a functioning MNE does not control. MRDA at Arts. 1, 11. The MRDA explicitly provides that the RPSM transfer pricing formula does not apply to the sale of a line of business.

The RPSM formula was designed to shift income from the U.S. to Canada (within the confines of the arm's length principle) so that NNL and Nortel as a whole could take advantage of the much lower effective tax rate for NNL in Canada rather than the effective tax rate for NNI in the U.S. Indeed, the IRS criticized and never approved the RPSM formula, which ultimately led to a settlement increasing NNI's revenue and decreasing NNL's revenue by $2 billion for 2001–2005. The RPSM formula is therefore inappropriate for use in connection with allocation.

Similarly, the parties' transfer pricing formula is irrelevant because the buyers were in no way bound by and thus would not have been concerned with how Nortel divided operating profits for transfer pricing purposes among affiliated entities. None of the Debtors advocate an approach based solely on the manner in which Nortel divided up operating profits (or, in fact, losses) when it was an operating MNE (*i.e.,* pursuant to the RPSM formula set forth in Schedule A to the MRDA).

In insolvency, a debtor's assets must be made available to satisfy the creditors of that debtor before equity may recover. [166] ***522** Each Selling Debtor is entitled to the value of the assets it sold and the allocated are Sales Proceeds available for distribution to that debtor's creditors. The key drivers of the value of a business are revenue and cash flow. [167] NNI generated approximately $46 billion in revenue from 2001 to 2009, which amounted to 69.5% of the revenue generated by the IEs during that same period. [168] NNI generated 75.9% of the cash flow of the IEs during that period. [169]

The vast majority of patents and patent applications in the Patent Portfolio were filed only in the United States. [170] This was a clear recognition by NNL that the U.S. market as to which NNI alone had the exclusive right in perpetuity to exploit—was the most valuable market for Nortel. It was the only market where NNL determined it was worth seeking patent protection for a majority of the inventions the IEs created and, consequently, the only market where those inventions have value (because filing in the U.S. but not in any other jurisdictions means that any third party may use these inventions outside the U.S. without fear of patent infringement suits). By designating the U.S. as the sole jurisdiction where the vast majority of Nortel's Patent

Portfolio was filed, NNL acknowledged that the U.S. is the most profitable market for exploiting Nortel's IP and, accordingly, that NNI's exclusive rights in the U.S. market were by far the most valuable.

The allocation of the Patent Portfolio Sales proceeds by debtor group is as follows:

| | $ Billions | Percent |
|---|---|---|
| Canadian Debtors | $0.43 | 9.7% |
| EMEA Debtors | $0.71 | 16.0% |
| U.S. Debtors | $3.31 | 74.3% |
| **Total** | $4.45 | 100% |

Each of the Business Lines was sold as a going concern in a coordinated auction ***523** and sales transaction. Similar to the Patent Portfolio, the buyers of the Business Lines paid for the amount of value they expected to generate from the assets, not the value each Nortel estate may have derived from the assets in bankruptcy if they were not sold.

The U.S. Debtors contributed the majority of the value in the Business Line Sales. The U.S. Debtors relinquished 70% of the total value of the Business Line Sales. [171] By contrast, the Canadian and EMEA Debtors contributed 11.9% and 18%, respectively, to the Business Line Sales. [172]

| Business Line Sales Valuation Summary | | |
|---|---|---|
| | Total Value Relinquished ($ Billions) | Percentage |
| Canadian Debtors | $ 0.34 | 11.9% |
| EMEA Debtors | $ 0.51 | 18.0% |
| U.S. Debtors | $ 1.99 | 70.0% |
| **Total** | $ 2.85 | 100.0% |

A potential buyer naturally would be most interested in acquiring the Business Lines in the territories that are expected to generate the most future cash flows. Here, NNI was the only Nortel entity operating in the most valuable U.S. market. It was the only Nortel entity with the exclusive right to operate in the U.S. market and it had the customer relationships in the U.S. NNI had the exclusive right to convey and did convey those rights, and is entitled to be paid accordingly.

### B. *The Committee*

The Committee participated in the trial and supports the U.S. Interests.

### C. *The Bondholders*

The Bondholders consist of entities holding bonds which NNC, NNL, NNI and NNC issued or guaranteed. Pursuant to the Indenture dated as of July 5, 2006, NNL issued multiple series of senior notes guaranteed by NNC and NNI, including two series of fixed rate 10.75% senior notes in the aggregate principal amounts of $450 million and $675 million due 2016, and a series of floating rate senior notes in the aggregate principal amount of $1 billion due 2011. Pursuant to the Indenture dated as of March 28, 2007, NNC issued 2.125% convertible senior notes due 2014 in an aggregate principal amount of $575 million and 11.75% convertible senior notes due 2012 in an aggregate principal amount of $575 million. The 2007 Indenture Notes are each guaranteed by NNI and NNL.

The Bondholder Group represents over half of the Nortel Entities' bonds. It is the single largest creditor group of both the U.S. Debtors and Canadian Debtors. The Bondholder Group fully supports the fair market approach which the U.S. Interests advocate and opposes the other parties' positions in accordance with the arguments of the U.S. Interests.

### D. *The EMEA Debtors*

The EMEA [173] Debtors are acting ***524** through the Joint Administrators [174] for Nortel Networks UK Limited and certain of its affiliates in proceedings under the Insolvency Act of 1986, pending before the High Court of Justice of England. The EMEA Debtors' position is that each party's share of the Nortel asset sales proceeds should be determined according to its relative contributions to creating the value of what was sold. This approach is consistent with (i) the way the Nortel companies allocated the fruits of their business prior to the insolvency filings, (ii) the rights of the parties, and (iii) fundamental principles of justice and fairness.

In determining how to allocate the approximately $7.3 billion in proceeds from the sales of Nortel's global businesses (the “Business Line Sales”) and pool of residual patents (the “Residual Patent Sale”) among the three estates, i.e., the U.S. Debtors, the Canadian Debtors, and the EMEA Debtors, it is first necessary to identify what classes of assets were conveyed in each of the sales, because the rights of the parties differ in relation to each class of assets. The largest portion of the proceeds from the Business Line Sales and the Residual Patent Sale is attributable to the value of Nortel's IP, which had been the main economic driver of Nortel's business. The biggest issue in the case is therefore how to allocate the asset Sales Proceeds attributable to IP.

The EMEA Debtors want allocation based on the relative contributions to the creation of the IP. The IP that was conveyed in the Business Line Sales and the Residual Patent Sale was the product of collaborative joint R & D efforts by each of the five Nortel residual profit split ("RPS") entities, *i.e.,* NNL, NNI, NNUK, NNSA, and NN Ireland. Each spent billions of dollars on R & D. The product of this R & D was a large portfolio of valuable technology in which the contributions of the individual RPS entities were integrated and indivisible. Prior to insolvency, Nortel allocated the fruits of exploitation of the jointly created IP based on the relative financial contributions of the Nortel entities to the creation of that IP. The EMEA Debtors contend that the benefits of the sale of Nortel's IP should be allocated among the estates using the same approach.

The contribution approach is consistent with the preexisting rights of the parties, as confirmed by how the parties behaved in sharing proceeds, agreements, dealing with third parties including the IRS and CRA, in allocating the proceeds from a prepetition sale and other indicia.

In their prepetition arrangements, the parties have themselves already created an objective formula for how to allocate the value of Nortel's IP based on their respective contributions to the creation of that value: Because of the integrated and additive nature of R & D at Nortel, and the indivisible character of the IP portfolio that was the product of that R & D, the parties agreed that every dollar spent on R & D by any Nortel party had the same value as any other dollar. The parties therefore agreed that the value of IP should be allocated based on their relative R & D spending during the period when a particular commercially exploitable technology was developed, *i.e.,* during the useful (or economic) life of the IP. Accordingly, the task for the Courts in allocating IP value is to determine (i) the value of the IP transferred to the purchaser in each of ***525** the asset sales, and (ii) the relative R & D spending of each of the five RPS entities during the period when that IP was developed. This was the approach taken by Nortel in allocating the proceeds of the one major prepetition asset sale, and it is the approach that would have been taken if the Business Line Sales or the Residual IP Sale had taken place prior to the insolvency filings.

E. *The Monitor and the Canadian Debtors*

The Canadian Interests consist of the Canadian Debtors, NNC and NNL, and Ernst & Young who the Canadian Court appointed to serve as Monitor by Order, dated January 14, 2009.

In addition to the powers and duties set out in the CCAA Initial Order dated January 14, 2009, the Monitor's powers were expanded by order dated August 14, 2009 ("the First Expansion of the Monitor Powers Order"). [175] The First Expansion of the Monitor Powers Order provides, among other things, the Monitor with the authority to cause the Canadian Debtors to take various actions in connection with the sale of the business units and to conduct, supervise and direct any procedure regarding the allocation and/or distribution of proceeds of any sale. [176] In its Eighty–Eight Report dated September 26, 2012, following the Business Line Sales and sale of the Residual IP, the Monitor reported that, in light of the cessation of public reporting obligations, the directors and officers of the Canadian Debtors indicated they would resign their positions. [177] By order dated October 3, 2012 (the "Second Expansion of Monitor Powers Order"), the Court added to the powers of the Monitor by, among other things, authorizing and empowering, but not obligating, the Monitor to exercise any powers which may be properly exercised by a board of directors of any of the Canadian Debtors. [178] The Second Expansion of the Monitor Powers Order in no way limited the powers and protections provided to the Monitor under prior orders of the Court, the CCAA or applicable law. [179]

The central question before the Courts concerns the basis on which approximately $7.3 billion in Sales Proceeds, realized on the sales of Nortel assets following the insolvency filings in 2009, should be allocated among the Estates. The Monitor's position on this question is that the proceeds should be allocated based upon the value of the property rights transferred or surrendered by each Debtor in connection with the Business Line Sales and the Rockstar Transaction. In the context of insolvency, it respects the legal rights of each creditor to recover, from the Debtor indebted to it, out of funds that represent that Debtor's legal entitlement to a portion of the Sales Proceeds. This approach is, in essence, the one that the Courts would follow in a priority dispute over property or over funds derived from property—that is, to determine the priorities and how funds will flow according to the applicable legal rights.

The proper approach to allocation involves a two-step process. First, the specific ***526** property or legal rights that were transferred or surrendered by each Debtor must be identified and correctly characterized. The second step involves the valuation of those rights.

The Business Line Sales involved the transfer to purchasers of certain categories of assets, including, most importantly, IP. The Rockstar Transaction involved almost exclusively the transfer of IP. The identification and characterization of the property rights in, or legal rights to, the IP that was transferred or surrendered in the sales are at the center of the dispute between the parties.

The Monitor's position is that the IP transferred in each of the sales was legally owned by NNL, the parent operating company of Nortel. It is also the Monitor's position that the only legal rights related to the IP which were held by NNL subsidiaries who are certain of the U.S. and EMEA Debtors were not ownership of the IP, but were license rights that had been granted to them by the IP's owner, NNL, pursuant to, in accordance with, and limited by, the terms of the MRDA.

This position follows from the clear words of the MRDA, most notably (i) the MRDA's express provision that legal title to the IP is and shall be vested in NNL and (ii) the MRDA's express grant of license rights by NNL (a grant which would be impossible if NNL were not the owner of the IP in question). It is consistent with the controlling Ontario law which governs the MRDA and which provides that a license grants no property interest, but is rather a contractual consent by an owner which gives rights that are limited by the terms of the license. It is also consistent with the history of NNL as the technology-rich parent of the U.S. and EMEA Debtors, the agreements that preceded the MRDA, the thousands of patent registrations which identified NNL as the owner of the patents, and the description, and inclusion as a plaintiff, of NNL as the patent owner in actions that were taken to enforce patent rights.

NNL's ownership of the IP bears directly on the second aspect of the allocation question, namely, the value of the property rights transferred. It was ownership of IP that was transferred in the Business Line Sales and, accordingly, it was ownership for which the purchasers paid. The proceeds that are attributable to that transfer of ownership is allocable to NNL as the IP's owner.

The characterization (including the scope) of the rights of the U.S. and EMEA Debtors as license rights, also bears directly on the second aspect of the allocation question, because it goes to the value of the rights that were surrendered. The license rights of the U.S. and EMEA Debtors were not transferred to the purchasers in any of the sales. They were non-transferrable rights, which were surrendered or terminated but not transferred. The question to be determined with respect to the terminated licenses raises a valuation issue: not one which inquires into what the purchasers paid for licenses (since the purchasers did not acquire the licenses), but rather one which inquiries into the value of what the U.S. and EMEA Debtors gave up. When a license is given up, what the licensee loses is the future opportunity to earn profit from using the license in accordance with its terms. A valuation of those license rights must be based upon the terms and scope of the license, in order to determine the profits, if any, that the licensees would have earned had they not surrendered their licenses but had operated under them in accordance with the licenses' terms. To the extent that, in terminating their license rights in connection with the sales, the U.S. and EMEA Debtors gave up something ***527** of value then the value of those license rights is properly allocated to the U.S. and EMEA Estates.

The scope of the license rights requires careful examination. That examination, conducted pursuant to the Ontario law of contractual interpretation, reveals that the license rights granted by NNL under the MRDA were not unlimited. They did not grant to the licensees the right to use, for all purposes, the IP that NNL owned; they granted only the right, exclusive in the designated territories, to use the IP for the purpose of making or selling “Products”, a term defined by the MRDA. The definition of “Products” is limited to those products, software and services that were developed or proposed to be developed by or for one or more of the signatories to the MRDA (each a Nortel entity), and no one else. In other words, the MRDA license grant only permitted the use of the IP in connection with Nortel Products made (or proposed to be made) by or for Nortel Entities.

Thus, with respect to the assets sold or surrendered in the Business Line Sales, the proper approach is as follows. First, tangible assets are valued based on their net book value, which approximates to their fair market value. Each Debtor should receive an allocation equal to the net book value, as identified in Nortel financial statements, of the tangible assets it contributed to each sale. Second, in-place workforce transferred to the purchasers in each sale is valued based on the cost that would be incurred to replace the employees in question. Each Nortel Debtor should receive an allocation equal to the replacement cost for the employees that were transferred to each purchaser in the Business Line Sales. Third, it is necessary to value the license rights the U.S. and EMEA Debtors had to the Nortel IP, which license rights were terminated in connection with the sales of Nortel's then operating businesses. As with any other contract-based right, the value of the license rights is equal to the amounts that the licensees could have earned had the licenses not been terminated. Thus, the value of the license rights is equal to the present value of the future operating profit that could have been earned by the U.S. and EMEA Debtors had the Nortel businesses continued to operate. This value includes the value of any customer relationships associated with the U.S. and EMEA Debtors, since the value of customer relationships is determined by the present value of the future cash flows that those relationships could produce—the very same cash flows that the licenses would have generated. Thus, a determination of the present value of the future cash flows that would have accrued to the U.S. and EMEA Debtors, if the Nortel businesses had continued to operate, gives them appropriate credit both for any interests they had in customer relationships and for the licenses they terminated. This approach takes into account the cash inflows (such as revenues) and cash outflows (such as the costs associated with earning those revenues, including the sharing of operating profits and losses required by the MRDA). Any Sales Proceeds that are in excess of the aggregate of the foregoing values (i.e. the aggregate of the value of the tangible assets, the in-place workforce, and the license rights) are attributable to the value of the IP (unencumbered by the license rights) owned by NNL and to the value of any customer relationships owned by NNL, being assets which NNL transferred to the purchaser. Those proceeds are properly allocated to NNL.

With respect to the sale of the residual patent portfolio, this involved the transfer of ownership of IP by NNL to Rockstar. There were no tangible assets and virtually no in-place workforce transferred as ***528** part of this sale transaction. License rights were surrendered, but that fact does not imply that they were valuable. On the contrary, the License Termination Agreement for the Rockstar Transaction specifically provided that the termination itself would not affect the ownership rights that any of the sellers may have to any IP.

A valuation of the license rights surrendered by the U.S. and EMEA Debtors in connection with the Rockstar Transaction requires consideration of the scope of the license as it relates to two categories of patents that were sold:

(a) First, there were patents transferred in the sale that were not incorporated into any proposed or actual Nortel Products. Due to the terms of the license, properly construed, the license rights had no value in so far as they related to such patents.

(b) Second, with respect to the patents that had been incorporated into proposed or actual Nortel Products, the value of the license rights in so far as they related to those patents has already been accounted for in valuing the license rights surrendered in connection with the Business Line Sales. This is because the Business Line Sale purchasers acquired and paid for licenses to some of the IP later sold in the Rockstar Transaction.

Accordingly, since there is no value attributable to the U.S. and EMEA license rights over and above the value that has already been ascribed to them in the context of the Business Line Sales, the proceeds realized on the Rockstar Transaction are attributable to the transfer of NNL's ownership of the patents and properly allocated to NNL.

The Monitor submits that the Courts should allocate the Sales Proceeds as follows:

| Allocation of Sales Proceeds (In Millions of USD) | | | | |
|---|---|---|---|---|
| **Asset** | **Canada** | **U.S.** | **EMEA** | **Total** |
| Tangible Assets | $1,221.74 | $317.59 | $94.86 | $534.19 |
| IP Rights and Customer Relationship | 1,379.85 | 438.20 | 164.20 | 1,982.25 |
| In-Place Workforce | 79.07 | 135.17 | 41.91 | 256.15 |
| Wholly-Owned Businesses | - | 110.97 | - | 110.97 |
| Residual Intellectual Property | 4,453.45 | - | - | 4,453.45 |
| **Total Allocation** | **$6,034.11** | **$1,001.93** | **$300.97** | **$7,337.01** |
| % of Total – Excluding Residual IP | 54.8% | 34.7% | 10.4% | |
| % of Total – Including Residual IP | 82.2% | 13.7% | 4.1% | |

F. *Canadian Creditors' Committee*

The CCC represents the interests of more than 20,000 Canadian creditors and includes pensioners, pension interests, and current and former employees who have approximately

$3 billion in claims against the Canadian Estate. The Sales Proceeds consist of approximately $2.8 billion from ***529** the sales of Nortel's Lines of Business and $4.5 billion resulting from the Residual IP Sale.

The Sales Proceeds should be allocated to the owners of the assets sold. Nortel was a Canadian-based technology company and its most valuable asset was its intellectual property, which was owned by Nortel's Canadian parent corporation, NNL. In contrast, NNL's main operating subsidiaries in the U.S. and the Europe, Middle East and Africa Regions (EMEA), held limited licenses granted by NNL within a carefully circumscribed field of use. As the owner of the most valuable asset owned and relinquished, NNL is entitled to receive most of the Sales Proceeds.

In the alternative, the Sales Proceeds should be allocated to the Nortel Debtors on a *pro rata* basis so as to provide each creditor having a valid claim the same common dividend. A *pro rata* allocation is the only fair and equitable alternative to an allocation based on the legal rights of the Nortel Debtors in the underlying assets sold.

G. *Wilmington Trust Company as Trustee*

Wilmington Trust, National Association ("Wilmington Trust"), appears in its capacity as indenture trustee for the notes NNL issued namely NNL 6.875% Notes due 2023, issued pursuant to that certain Indenture, dated as of November 30, 1988 (as amended, supplemented or modified) between Nortel Networks Limited and the Trustee, as successor trustee to The Bank of New York Mellon (formerly known as The Bank of New York) as successor trustee to the Toronto–Dominion Bank Trust Company.

Wilmington Trust argues that the proceeds from the sale of the Nortel IP should be distributed according to the legal ownership interests in those assets established by the unambiguous written agreement of the parties, and that NNL is the legal owner of the Nortel IP. The license rights, the only property interest of the Licensed Participants, as defined in the MRDA with respect to the Nortel IP, should be determined by analyzing the value of those licenses had Nortel continued operating. Once that determination is made, such value should be distributed to those respective Licensed Participants. The remainder of the proceeds, which Wilmington Trust expects to be the vast majority thereof, would then inure to the unquestioned title holder and the only party with a legally recognized ownership interest in those assets, NNL.

The U.S. Interests and EMEA Debtors as the Licensed Participants seek to have these Courts: (i) rewrite the clear terms of the MRDA so that they are more to the Licensed Participants liking and (ii) engage in a hindsight reevaluation of the propriety of the conduct of the parties and their respective disclosures in the sale process. The Licensed Participants post-facto arguments cannot change the plain meaning of the MRDA, or the fact that all of the parties acted in the best interests of all of the Nortel Estates when pursuing sales that undisputedly maximized value for all of the Estates and their respective creditors, while prudently setting aside what all knew could be protracted and heated disagreement about allocation.

There is no question that NNL owned the Nortel IP. The only source of rights of any of the parties to the Nortel IP arise from the terms of the MRDA. The MRDA could not be more clear that NNL owned the Nortel IP and licensed the use of specific Nortel IP in specifically designated territories to the Licensees. The Licensees owned beneficial interests in such license rights—but did not own rights to the Nortel IP itself.

***530** The MRDA does not address the rights of the Licensees to any share of the value of the Nortel IP, except as arising from the split of the profits and losses from Nortel's operations and sales of Products (as defined in the MRDA). It does not provide terms for the allocation of Sales Proceeds from the ultimate sale of the Nortel IP.

If the Courts conclude that the MRDA is not clear with respect to the ownership of the assets that were surrendered in the sale, and choose to allocate the Sales Proceeds instead in a manner tailored to combat unfairness, Wilmington Trust submits that an approach based on the UK Pension Claimants' and/ or the CCC's "*pro rata*" theory leads to the most equitable result. Allocation theories that have been advanced by the parties, including the U.S. Interests' "revenue" theory, the EMEA Debtors' "contribution" theory and the Pro Rata Theory are not based on the actual ownership of the assets that the Licensed Participants claim is the key question for allocation.

H. *UK Pension Claimants*

The Board of the UK Pension Protection Fund and Nortel Networks UK Pension Trust Limited (together, the "UK Pension Claimants" or "UKPC") represents over 36,000 involuntary creditors of Nortel who were former employees of Nortel. There is a deficit in excess of $3 billion in the pension plan of which they are members.

The UK Pension Claimants submit that the Courts should determine the Allocation Litigation on the basis of a Pro Rata Distribution Model which has the effect of allocating sufficient funds from the Lockbox to permit a distribution within each Estate to all unsecured creditors on a *pro rata, pari passu* basis, relative to the amount of their unsecured claim, irrespective of the entity against which they may have a claim. There are no secured creditors of Nortel, and only a small number of preferred or priority claims. The return to unsecured creditors from a pro rata distribution model would be dictated by a number of factors including the ultimate level of unsecured claims and equitable alternative to an allocation based on the legal rights of the Nortel Debtors in the underlying assets sold. Nortel operated prior to insolvency as a highly integrated multinational that derived significant benefits from operating as "one Nortel".

Based on the evidence, a pro rata distribution model is the most appropriate and just result for several reasons, including:

(a) Nortel was a technology company whose must valuable asset was its intellectual property assets;

(b) the assets that were co-developed, jointly used and collectively sold by the members of Nortel giving rise to the proceeds in the Lockbox were so profoundly integrated in creation, ownership and use that they should properly be considered as representing a common pool of assets of the Nortel as a whole;

(c) there exists no more credible, reliable, equitable or economically rational manner with which to disentangle those assets (most of which are intangible) and ascribe value to component parts rather than the Pro Rata Distribution Model; and

(d) in particular, and contrary to the allocation position of the U.S. Debtors and the Canadian Debtors, there was no ex ante agreement as to the distribution of the jointly used assets of Nortel when it ceased to do business, whether under the MRDA or otherwise.

The Allocation Litigation should establish a precedent for future international insolvencies involving integrated multinational ***531** enterprises, which eliminates territorial wrangling over what entity in a global insolvency involving a highly-integrated multinational enterprise whose assets are entangled should receive what recovery.

If the Courts conclude that ownership should not form the basis for allocating the Sales Proceeds, then the only fair and equitable alternative is to allocate the Sales Proceeds, taking into account approximately $1.7 billion in additional "Residual Assets" (cash and other assets in the possession of Nortel Debtors in various jurisdictions), among the Nortel Debtors so as to effect a *pro rata* distribution among creditors, such that each creditor receives a common dividend on its claim. A *pro rata* allocation is appropriate in light of the globally integrated nature of Nortel's business. Pre–Petition, Nortel was an integrated multinational technology business operating along four interdependent Lines of Business that spanned borders and legal entities. Employees served dedicated Lines of Business for the benefit of the group as a whole.

The Business Line Sales reflected the integrated nature of the business. Purchasers bought Business Lines consisting of assets residing in various Nortel Entities scattered throughout multiple jurisdictions. Substantive consolidation, which contemplates the merger of the Estates under the supervision of a single court, is neither requested by the CCC nor necessary to effect an allocation that would yield a *pro rata* result. The Canadian Court and the U.S. Court each have equitable jurisdiction to order and direct that the Sales Proceeds be allocated in a manner that achieves a fair and equitable distribution to Nortel's creditors, including the retired, disabled pensioners and other employees who relied and depended on the promise of pensions, health, disability and other benefits as part of their compensation for the significant value they contributed to Nortel. A pro rata distribution would result in all Creditors receiving an approximate 71% return on their Claims.

The Courts have an opportunity to set a precedent that will avoid the time and expense that has plagued the Nortel proceedings for more than five years and has cost more than $1.3 billion in professional fees to date from occurring again in future. Territorial wrangling significantly diminishes value for stakeholders in a global insolvency involving a highly-integrated multinational enterprise whose assets are entangled, and ought not to be condoned or rewarded.

### *LEGAL ANALYSIS*

The parties contemplated and agreed that it would be appropriate and necessary for the U.S. Court and the Canadian Court to confer. In the Protocol which the parties presented and the Courts approved [180] the parties identified the "mutually desirable goals and objectives in the Insolvency Proceedings" as follows:

(a) harmonize and coordinate activities in the Insolvency Proceedings before the Courts;

(b) promote the orderly and efficient administration of the Insolvency Proceedings to, among other things, maximize the efficiency of the Insolvency Proceedings, reduce the costs associated therewith and avoid duplication of effort;

(c) honor the independence and integrity of the Courts and other courts ***532** and tribunals of the United States and Canada, respectively;

(d) promote international cooperation and respect for comity among the Courts, the Debtors, the Creditors Committee, the Estate Representatives (as such terms are defined in the Protocol) and other creditors and interested parties in the Insolvency Proceedings;

(e) facilitate the fair, open and efficient administration of the Insolvency Proceedings for the benefit of all of the Debtors' creditors and other interested parties, where located; and

(f) implement a framework of general principles to address basic administrative issues arising out of the cross-border nature of the Insolvency Proceedings.

Debtors' Motion for Entry of an Order Pursuant to 11 U.S.C. § 105(a) Approving Cross–Border Court to Court Protocol, ¶ 13 (D.I.18).

The Courts have conducted the cases independently, while cooperatively. They are mindful that the parties expect them to communicate and determine whether they can arrive at consistent rulings. Thus, the Protocol further provides that:

> The Judge of the U.S. Court and the Justice of the Canadian Court, shall be entitled to communicate with each other during or after any joint hearing, with or without counsel present, for the purposes of determining whether consistent rulings can be made by both Courts, coordinating the terms upon of the Courts' respective rulings, and addressing any other procedural or administrative matters.

Protocol, ¶ 12 d(vi). The parties recognized the problems that could result were rulings by the Courts to diverge and one of the reasons the cases have progressed to date is that the Courts have communicated and have arrived at consistent rulings even while exercising their judicial independence.

The Courts have had discussions following the trial of the Allocation Dispute in an effort to avoid the travesty of reaching contrary results which would lead to further and potentially greater uncertainty and delay. Based on these discussions, the Courts have learned that although their approaches to the complex issues differ, they agree upon the result. The Courts have different interpretations of the MRDA, but agree that the MRDA does not apply to or control the allocation of the Sales Proceeds for reasons discussed below. The Courts also agree that the self-serving allocation positions of the Canadian Interests, the U.S. Interests and the EMEA Debtors are not determinative or helpful.

**[1]** It is incumbent upon the Court to determine a presumptive, baseline allocation approach which leads to an equitable result in the absence of some guiding law or agreement. The Court is convinced that where, as here, operating entities in an integrated, multi-national enterprise developed assets in common and there is nothing in the law or facts giving any of those entities certain and calculable claims to the proceeds from the liquidation of those assets in an enterprise-wide insolvency, adopting a pro rata allocation approach, which recognizes inter-company and settlement related claims and cash in hand, yields the most acceptable result.

There is nothing in the law or facts of this case which weighs in favor of adopting one of the wide ranging approaches of the Debtors. There is no uniform code or international treaty or binding agreement which governs how Nortel is to allocate the Sales Proceeds between the various insolvency ***533** estates or subsidiaries spread across the globe.

**[2]** The MRDA, a tax document, was clearly not meant to, nor does it even purport to, govern inter-company allocation of the proceeds from liquidated Nortel assets. The MRDA does not include any provisions addressing the global insolvency or liquidation of the Nortel Group. The evidence at trial was overwhelming and undisputed that the MRDA was not intended to address that contingency:

a. Former Chief Legal Officer Clive Allen testified that the group-wide insolvency and liquidation of the Nortel enterprise was "inconceivable" and never a risk he addressed; [181]

b. Former Sutherland Asbill & Brennan attorney Walter Henderson, who worked on transfer pricing for Nortel, testified that no consideration was given to how the RPSM methodology would work in the event of a liquidation of the Nortel entities "because we never thought about that eventuality coming to pass"; [182]

c. Former director of transfer pricing at Nortel Michael Orlando testified that there is no provision in the MRDA that deals with the insolvency of the entire organization; [183] and

d. Former director of international tax at Nortel Mark Weisz testified that the MRDA "was not intended to address [global] insolvency" and Nortel did not have any discussions about what would happen in the event of global insolvency. [184]

Pursuant to an amendment executed in December 2008 to January 2009 and effective retroactive to January 1, 2006, proceeds from business sales are expressly excluded from global revenues within the RPSM calculation. [185] Mr. Orlando confirmed that the MRDA did not address how to allocate proceeds from the sale of any Nortel business and that the third addendum made explicit that the MRDA did not apply to asset sales. [186] the MRDA was an attempt to allocate annual operating profits, and sales of assets were non-operating activities. [187]

The U.S. Debtors, Canadian Debtors, and EMEA Debtors advance allocation positions which suffer from fatal, substantive flaws. EMEA fails to recognize that spending does not necessarily create value. The Canadian Debtors are nothing short of narcissistic in allocating the bulk of the Sales Proceeds to themselves and in their failure to recognize the contributions of the other Nortel companies and the realities of the manner in which the Nortel enterprise operated on a day-to-day basis. And the U.S. Debtors equate revenue to value without any regard to where the value-generating assets were developed or recognition of the fact that the $2.02 billion inter-company claim already accounts for their contributions as the primary bread-winner of Nortel. The Court's determination to recognize inter-company and settlement claims as well as the cash in hand relegates the arguments raised against a pro rata approach to concerns for process ***534** rather than substance. The Court has every confidence that the tribunals overseeing the Nortel insolvency proceedings across the globe will adjudicate the claims at issue therein in a just, efficient manner. The Court is prepared to act if they do not. In any event, such hypothetical, procedural hurdles simply do not persuade the Court against adopting the allocation approach which clearly yields the most equitable result in these circumstances.

To be clear, the Court is not ordering cross-border, global substantive consolidation. The Court will respect the corporate separateness of the various Nortel operating subsidiaries by recognizing cash in hand and both the inter-company and settlement claims. The Court's recognition of the inter-company claims and, in particular, the FCFSA $2.06 billion allowed claim, pays heed to the undeniable fact that NNI generated the lion's share of enterprise-wide revenues. In other words, the fact that NNI is entitled to a greater share of the Sales Proceeds based on revenues is already baked into the case by virtue of the IFSA inter-company claim, thus making the U.S. Debtors' revenue-based approach redundant. Further, the Court is not ordering a consolidated or coordinated global distribution to ensure that each creditor of the various insolvency estates actually receives a set, pro rata distribution. The Court is merely ordering that each estate be allocated a pro rata share of the Sales Proceeds based on the amount of claims against it, recognizing all inter-company claims. Each Estate will distribute the funds as appropriate, through a plan process within the bounds of the applicable law.

The parties devoted great efforts to support their position on the MRDA. The Court and the Canadian Court do not agree on the meaning of the MRDA, but do agree that their respective analyses do not control the Allocation Dispute because the MRDA was never intended to govern the liquidation scenario which they are now deciding. The Canadian Court favors the ownership position which the Canadian Interests advocate for reasons the Canadian Court explains in its

Endorsement. The U.S. Court finds that the U.S. Debtors' and the EMEA Debtors' positions that the factual matrix contravenes the "ownership" claim of the Canadian Interests is what the evidence shows. The Court's discussion of the MRDA explains why the Court is fully satisfied that even in the MRDA, there is no basis to find that the Canadian Debtors owned all rights to the IP. Reading the MRDA in the manner required, the Court finds that the Canadian Debtors held bare legal title.

## THE MRDA

### A. *Governing Law and Applicable Principles of Contract Interpretation*

The Court and the Canadian Court have concluded that the MRDA does not control the Allocation Dispute. Nonetheless, because the MRDA is at the very center of the parties views of the Allocation Dispute, the Court must address the parties respective arguments. The starting point for the analysis of the MRDA is the law on contract interpretation.

**[3]** All the parties agree that Ontario law governs the interpretation of the MRDA. Article 14(f) of the MRDA so provides. Such a choice of law provision is binding under both Ontario law and U.S. law. *Hilgraeve Corp. v. Symantec Corp.* 265 F.3d 1336, 1340–1341 (Fed.Cir.2001), cert. denied 535 U.S. 906, 122 S.Ct. 1206, 152 L.Ed.2d 144 (2002); *Vasquez v. Delean Corp.* (1998), 38 C.C.E.L. (2d) 230 at paras. 30–31 (Ont.S.C., Gen.Div.), citing *Vita* ***535** *Food Products Inc. v. Unus Shipping Co.,* [1939] A.C. 277 (Canada P.C.).

**[4]** **[5]** **[6]** The goal of contractual interpretation is to give effect to the underlying objective intention of the contracting parties. *See, e.g., Sattva Capital Corp. v. Creston Moly Corp.,* 2014 SCC 53 at para. 47; *Consolidated–Bathurst Export Ltd. v. Mutual Boiler & Machinery Insurance Co.,* [1980] 1 S.C.R. 888 at paras. 25–26; *Toronto–Dominion Bank v. Leigh Instruments Ltd.,* 1998 ONSC 14806, para. 415 (Can.Ont.S.C.J.). To determine the parties' intent, a court examines two related components: (i) the words of the contract and (ii) their context. *See* G.R. Hall, *Canadian Contractual Interpretation* (Markham: LexisNexis Canada, 2d ed.2012) at 9; *Sattva Capital Corp. v. Creston Moly Corp.,* 2014 SCC 53 at para. 50 (holding that "[c]ontractual interpretation involves issues of mixed fact and law as it is an exercise in which the principles of contractual interpretation are applied to the words of the written contract, considered in light of the factual matrix."). As the Supreme Court of Canada has recently held, "[t]he parole evidence rule does not apply to preclude evidence of the surrounding circumstances." *Sattva Capital Corp. v. Creston Moly Corp.,* 2014 SCC 53 at para. 60. The basic principles of contractual interpretation were clearly and concisely set out by the Ontario Court of Appeal in *Salah v. Timothy's Coffees of the World Inc.* (2010), 74 B.L.R. (4th) 161 explained as follows:

> The basic principles of commercial contractual interpretation may be summarized as follows. When interpreting a contract, the court aims to determine the intentions of the parties in accordance with the language used in the written document and presumes that the parties have intended what they have said. The court construes the contract as a whole, in a manner that gives meaning to all of its terms, and avoids an interpretation that would render one or more of its terms ineffective. In interpreting the contract, the court must have regard to the objective evidence of the "factual matrix" or context underlying the negotiation of the contract, but not the subjective evidence of the intention of the parties. The court should interpret the contract so as to accord with sound commercial principles and good business sense, and avoid commercial absurdity. If the court finds that the contract is ambiguous, it may then resort to extrinsic evidence to clear up the ambiguity.

See also In *Kentucky Fried Chicken v. Scott's Food Services Inc.* (1998), 41 B.L.R. (2d) 42 (Ont. C.A.) stating the following regarding the interpretation of a commercial agreement at para. 27

> **[7]** Where, as here, the document to be construed is a negotiated commercial document, the court should avoid an interpretation that

> would result in a commercial absurdity. [*City of Toronto v. W.H. Hotel Ltd.* (1966), 56 D.L.R. (2d) 539 at 548 (S.C.C.) ]. Rather, the document should be construed in accordance with sound commercial principles and good business sense; [*Scanlon v. Castlepoint Development Corporation et al.* (1992), 11 O.R. (3d) 744 at 770 (Ont.C.A.) ]. Care must be taken, however, to do this objectively rather than from the perspective of one contracting party or the other, since what might make good business sense to one party would not necessarily do so for the other.

**[8]** **[9]** The "cardinal presumption" about the primacy of the language of the contract involves determining the parties' intentions in accordance with the language that they have used. The court's goal in ***536** interpreting a contract is to determine the parties' intent as expressed by the words that they have chosen. As the Supreme Court of Canada said in the seminal *Eli Lilly v. Novopharm* case:

> **[10]** [T]he contractual intent of the parties is to be determined by reference to the words they used in drafting the document ...

*Eli Lilly & Co. v. Novopharm Ltd.,* [1998] S.C.J. No. 59 at para. 54 (S.C.C), *See also Merck & Co. Inc. v. Apotex Inc.*, 2010 FC 1265 at para. 47.

**[11]** **[12]** Evidence of subjective intention—*i.e.,* evidence of what a party "understood" the contract to mean—is wholly inadmissible. A courts inquiry does not seek to determine what the parties actually intended or what they believed the words of their contract to mean. A leading text on contractual interpretation Canada provides:

> [T]he exercise is not to determine what the parties subjectively intended but what a reasonable person would objectively have understood from the words of the document read as a whole and from the factual matrix.

Geoff Hall, *Canadian Contractual Interpretation Law* (2012) at para. 2.4.1; *see also Ontario v. Imperial Tobacco Canada Ltd.,* 2012 ONSC 6027 at para. 29

The Ontario Court of Appeal in *Dumbrell* held that the interpretive exercise should focus on the words used, and not on the parties' subjective beliefs:

> *Eli Lilly* instructs that the words of the contract drawn between the parties must be the focal point of the interpretative exercise. The inquiry must be into the meaning of the words and not the subjective intentions of the parties.

*Dumbrell v. The Regional Group of Companies Inc.,* 2007 ONCA 59 at para. 51; *see also Eli Lilly & Co. v. Novopharm Ltd.,* [1998] S.C.J. No. 59 at para. 54

Courts simply must not consider evidence of what a party says he or she intended to agree to at the time of contracting, nor can courts consider evidence of what a party understands the words of the contract to mean. In *Zaccardelli v. Kraus* the Court explained that:

> What [a party] thinks the documents mean is irrelevant and so not admissible What [a party] understood or intended is not relevant and so not admissible.

*Zaccardelli v. Kraus,* [2003] A.J. No. 442 at paras. 29–30 (Master).

**[13]** Subjective understandings of the meaning of a contract do not become admissible by characterizing those understandings as forming part of the factual matrix. As the

Court of Appeal stated in *Primo Poloniato Grandchildren's Trust (Trustee of) v. Browne:*

> While the scope of the factual matrix is broad, it ***excludes*** evidence of negotiations, except in the most general terms, ***and evidence of a contracting party's subjective intentions.*** [emphasis added]

*Primo Poloniato Grandchildren's Trust (Trustee of) v. Browne,* 2012 ONCA 862 at para. 71 *See also Sattva Capital Corp. v. Creston Moly Corp.,* 2014 SCC 53 at para. 57:

> **[14]** **[15]** While the surrounding circumstances will be considered in interpreting the terms of a contract, they must never be allowed to overwhelm the words of that agreement.... While the surrounding circumstances are relied upon in the interpretive process, courts cannot use them to deviate from the text such that the court effectively creates a new agreement.

**[16]** **[17]** Evidence of the parties' post-contracting conduct by definition is not part of the factual matrix and is generally ***537** inadmissible to interpret the contract unless a court finds ambiguity. Geoff R. Hall, *Canadian Contractual Interpretation Law* (2012) at para. 3.2.2; *York Bremner Development Ltd. v. FHR Properties Inc.,* [2007] O.J. No. 3484 at paras. 31–32 (S.C.J.) A contract is not ambiguous merely because it is difficult to interpret. *Geoffrey L. Moore Realty Inc. v. Manitoba Motor League,* 2003 MBCA 71 at para. 25; *Paddon Hughes Development Co. v. Pan continental Oil Ltd.,* 1998 ABCA 333 at para. 29. Rather, a contractual provision is only ambiguous if it is "reasonably susceptible of more than one meaning". *Geoffrey L. Moore Realty Inc. v. Manitoba Motor League,* 2003 MBCA 71 at para. 25.

**[18]** Introductory recitals in a contract may not alter the operative terms of the contract, but may be used as an interpretive guide to the parties' intent. *See, e.g., Eli Lilly & Co. v. Novopharm Ltd.,* [1998] 2 S.C.R. 129 at para. 57 (relying on recitals to determine whether an agreement was a sublicense); *Sistem v. Kyrgyz Republic,* 2012 ONSC 4983 (Newbould, J.) at paras. 25–26 (using recitals to find that a party had an equitable interest in the property at issue). *Accord Time Warner Entm't Co., L.P. v. Everest Midwest Licensee, L.L.C.,* 381 F.3d 1039, 1048 (10th Cir.2004) (relying on a preamble to determine the purpose of a licensing agreement); *Blackstone Consulting Inc. v. United States,* 65 Fed.Cl. 463, 470 (Fed.Cl.2005) (noting that "recitals may be read in conjunction with the operative portions of a contract in order to ascertain the intention of the parties" (internal quotations omitted)); *see also Stowers v. Cmty. Med. Ctr., Inc.,* 340 Mont. 116, 172 P.3d 1252, 1255 (2007) ("Recitals in a contract should be reconciled with the operative clauses of the contract and given effect as far as possible.")

**[19]** A contract should always be interpreted "so as to accord with sound commercial principles and good business sense, and avoid commercial absurdity." *Downey v. Ecore International Inc.,* 2012 ONCA 480 at para. 38 (quoting *Salah v. Timothy's Coffees of the World Inc.,* 2010 ONCA 673 at para. 16); *see also Unique Broadband Systems, Inc. (Re),* 2014 ONCA 538 at para. 88 ("[A]n interpretation which defeats the intentions of the parties and their objective in entering into the commercial transaction in the first place should be discarded in favour of an interpretation of the policy which promotes a sensible commercial result." (quoting *Consolidated–Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co.,* 1979 CanLII 10(SCC), [1980] 1 S.C.R. 888, at p. 901)); *id.* at para. 89 ("[C]ommercial contracts should be 'interpreted in the way in which a reasonable commercial person would construe them.' "). *Accord Pan Am. Realty Trust v. Twenty One Kings, Inc.,* 408 F.2d 937, 939 n. 4 (3d Cir.1969) ("Business contracts must be construed with business sense, as they naturally would be understood by intelligent men of affairs." (quoting *N. German Lloyd v. Guar. Trust Co. of New York,* 244 U.S. 12, 24, 37 S.Ct. 490, 61 L.Ed. 960 (1917) (internal quotations omitted))); *see also Baldwin Piano, Inc. v. Deutsche Wurlitzer GmbH,* 392 F.3d 881, 883 (7th Cir.2004) ("When there is a choice among plausible interpretations, it is best to choose a reading that makes commercial sense, rather than a reading that makes the deal one-sided."). In this analysis, courts may also consider objective manifestations of the parties' intent. *See Sattva Capital Corp. v. Creston Moly Corp.,* 2014 SCC 53 at para. 57 (holding that the purpose of examining the "surrounding circumstances" of a contract "is to deepen a decision-maker's understanding of the mutual and objective intentions of the parties as expressed in the words of the contract").

***538** **[20]** Finally, the foregoing ordinary principles of contract law apply equally to the interpretation of a license agreement such as the MRDA. *See, e.g., Merck & Co. Inc. v. Apotex Inc.,* 2010 FC 1265 (Can.F.C.); *Hemosol Corp., Re,* [2006] O.J. No. 4018 (Can. Ont. S.C.J. [Commercial List] ); *Eli Lilly & Co. v. Novopharm Ltd.,* [1998] 2 S.C.R. 129; *Walt Disney Co. (Canada) Ltd. v. Philhobar Design Canada Ltd.;* (2008), 47 B.L.R. (4th) 306 (Can.Ont.S.C.J.); *White v. E.B.F. Manufacturing Ltd.,* 2005 NSCA167; *Verdellen v. Monaghan Mushrooms Ltd.,* 2011 ONSC 5820; *see also* Roger T. Hughes & Dino P. Clarizio, *Halsbury's Laws of Canada—Patents, Trade Secrets and Industrial Designs (2012 Reissue)* at para. HPT–138 (QL).

B. *The Valuable "Bundle of Rights" that a Patent Affords*

A patent confers valuable exclusivity by providing the party holding rights to the patent the ability to prevent others from making, using or selling the patented invention. See 35 U.S.C. § 154(a)(1); Patent Act (Canada), § 42. Patents are territorial; thus, a patent filed in the United States, for example, excludes others from utilizing the patent or the patented invention in the United States or importing the patented product into the United States. *See* 35 U.S.C. § 271(a). A Canadian patent likewise confers in Canada "the exclusive right, privilege and liberty of making, constructing and using the invention and selling it to others to be used, subject to the adjudication in respect thereof before any court of competent jurisdiction." Patent Act (Canada), § 42.

**[21]** **[22]** A patent "is a bundle of rights which may be retained in whole or in part, divided and assigned." *Morrow v. Microsoft Corp.,* 499 F.3d 1332, 1341 n. 8 (Fed.Cir.2007); *see also* Patent Act (Canada), § 42; *Harvard College v. Canada,* [2002] 4 S.C.R. 45 at para. 64. The bundle of rights" that comprise a patent may also be transferred to another party through a license. See, e.g., *McCoy v. Mitsuboshi Cutlery, Inc.,* 67 F.3d 917, 920 (Fed.Cir.1995); *see also* Patent Act (Canada), § 50(2); *Rite Manufacturing Ltd. v. Ever–Tite Coupling Co.* (1976), 27 C.P.R. (2d) 257 at para. 20 (Can. Registrar of Trade Marks) *citing National Carbonising Co., Ltd. v. British Coal Distillation Ltd.* (1936), 54 R.P.C. 41 (C.A.) at 56–57 (noting that "a patentee is fully entitled to assign his rights under the Letters Patent to another").

1. *NNL's Claim to Legal Title to the IP*

**[23]** The Canadian Debtors' position in the Allocation Dispute is that the MRDA establishes that they own all of the IP and therefore are entitled to all of the IP Sales Proceeds less a relatively minor value attributable to what they view as limited licenses held by the U.S. Debtors and the EMEA Debtors. The Canadian Debtors rely on the words of the MRDA which support them.

NNL's claim of legal title to the IP is reflected in the MRDA's first recital, which states: "Whereas legal title to all NN Technology is held in the name of NNL." Article 4(a) of the MRDA states:

> Except as otherwise specifically agreed, legal title to any and all NN Technology whether now in existence or hereafter acquired or developed pursuant to the terms of this Agreement shall be vested in NNL.

The MRDA further provides that "legal title" survives termination of the MRDA:

> The provisions of Article 4 (Legal Title to NN Technology) with respect to NN Technology acquired or developed pursuant to this Agreement from the Effective ***539** Date of this Agreement up to an including its expiry or termination date ... shall survive notwithstanding the expiry of this Agreement, or any termination of this Agreement for any cause whatsoever.

The Canadian Debtors argue that with this language and the MRDA taken as a whole, legal title meant ownership. The Canadian Debtors point to other provisions of the MRDA describing the ownership rights of NNL which include:

(a) NNL's sole and exclusive right (without the obligation to anyone else, including the Licensed Participants) to file and prosecute patent applications (in the absence of which right, intellectual property could not be protected in the form of valuable patents); [188]

(a) Licensed Participants owed to NNL (but NNL did *not* owe to the Licensed Participants) obligations of confidentiality regarding the IP; [189]

(b) If a Participant withdrew from the MRDA, its exclusive license would terminate and be cancelled and NNL would be able to exercise all rights in the former Participant's exclusive territory, [190] ; and

(d) NNL granted license rights to that IP to the U.S. and EMEA Debtors, pursuant to Article 5(a)(i) of the MRDA. Under Ontario law, the right to grant a license is a right enjoyed by the owner of the IP.

In support of its ownership claim, the Canadian Debtors look to the licenses under the MRDA. Article 5(a) grants two licenses: an exclusive license and a non-exclusive license. Those two licenses confer rights to perform the same activities, with those rights being granted on an exclusive basis to the Licensed Participants in their respective "exclusive territories", and the rights being granted on a non-exclusive basis in the designated "non-exclusive territories". Article 5(a) states as follows:

To the extent of its legal right to do so, and subject to the rights of relevant third parties, NNL hereby:

(i) continues to grant to each Licensed Participant an exclusive, royalty-free license, including the right to sublicense, which except as hereinafter provided shall be in perpetuity, rights to make, have made, use, lease, license, offer to sell, and sell Products using or embodying NN Technology in and for the Exclusive Territory designated for that Licensed Participant, and all rights to patents, industrial designs (or equivalent) and copyrights, and applications therefor, and technical know-how, as necessary or appropriate in connection therewith ("Exclusive License"); and

(ii) grants to each Licensed Participant, as of January 1, 2009 (the "NonExclusive License Effective Date"), a non-exclusive, royalty-free license, including the right to sublicense, which except as hereinafter provided shall be in perpetuity, rights to make, have made, use, lease, license, offer to sell, and sell Products using or embodying NN Technology in and for the NonExclusive Territory, and all rights to patents, industrial designs (or equivalent) and copyrights, and applications therefor, and technical know-how, as necessary ***540** or appropriate in connection therewith ("Non–Exclusive License").

NNL granted a license to make "Products" that use or embody such IP. Article 5(a) states that the license is "to make, have made, use, lease, license, offer to sell, and sell *Products* ..." and "rights to patents ... as necessary or appropriate in connection therewith". The definition of "Products" at Article 1(g) of the MRDA states:

> "Products" shall mean all products, software and services designed, developed, manufactured or marketed, or proposed to be designed, developed, manufactured or marketed, at any time *by, or for, any of the Participants,* and all components, parts, sub-assemblies, features, software associated with or incorporated in any of the foregoing, and all improvements, upgrades, updates, enhancements or other derivatives associated with or incorporated in any of the foregoing.

The license rights thus consist of a right to make, use or sell products, software or services that used or embodied Nortel IP and that were made or sold (or proposed to be made or sold) by, or for, any of the parties ("Participants") to the MRDA, and the use of certain Nortel IP as necessary or appropriate in connection with the making, using or selling of "Products". The license also included a right to sublicense.

The MRDA also granted Licensed Participants the right to assert actions and recover damages in their respective territories for infringement or misappropriation of NN Technology by others.

The Canadian Debtors' reliance on a strict interpretation of the MRDA ignores both the factual matrix from which the MRDA arose and a reading of the MRDA as an integrated whole. The MRDA simply does not capture the economic reality that the non-Canadian participants, and the U.S. Debtors in particular, were generating the majority of the value of the Nortel Enterprise. The U.S. Debtors' interpretation of the MRDA accurately incorporates the MRDA as a whole.

**[24]** **[25]** As discussed earlier, the Court is required to review the MRDA in the context of the factual matrix which aids in determining the meaning of the words against the relevant background. *Sattva Capital Corp. v. Creston Moly Corp.,* 2014 SCC 53 at para. 48. Indeed, a court should consider the factual matrix even if a contract is unambiguous. *Sattva,* 2014 SCC at 53. While the evidence of the factual matrix may not include the subjective intent of the parties, it does include "the genesis of the transaction, the background, the context [and] the market in which the parties are operating." *Kentucky Fried Chicken Canada v. Scott's Food Services, Inc.,* [1998] O.J. No. 4368 at para. 25 (Can. Oct. C.A.)

Contrary to the arguments of the Canadian Debtors, the MRDA establishes the Participants' shared ownership of the Nortel assets which are now the Sales Proceeds. The facts make it clear to the Court that the U.S. Debtors and the EMEA Debtors held an economic and beneficial ownership interest in Nortel's assets and thereby are entitled to an equitable allocation of the Sales Proceeds.

2. *The Factual Matrix Surrounding Transfer Pricing, Historical Business Practices and Custom of the Industry*

The MRDA grants the Licensed Participants all valuable rights to and beneficial ownership in NN Technology in their respective territories. The Court looks to the purpose, rules, and representations underlying Nortel's transfer pricing agreements, including the R & D CSAs and the ***541** MRDA; Nortel's pre-petition business practices; and custom in the industry. [191]

Transfer pricing rules and regulations require that each entity in an MNE "price its related party transactions as if the entity were at arm's length from its parent and affiliated entities within the MNE." [192] Transfer pricing regulations emphasize economic ownership that arises from the actual functions, assets, and risks of each entity rather than the holding of legal title. [193] The OECD (Organization for Economic Co-operation and Development) Guidelines state that each party to a CSA must be "entitled to exploit its interest in the [CSA] separately as an effective owner thereof and not as a licensee." [194] If a CSA participant's "contribution entitles [that party] to obtain only a right to use intangible property ... and the [party] does not also obtain a beneficial interest in the intangible property itself," then that contribution "would constitute a royalty for the use of intangible property." [195] Similarly, CRA Information Circular 87–2R affirms these principles, providing that "each participant in a [CSA] is not required to be a legal owner of [intangible] property, but each participant must enjoy substantially similar rights, benefits, and privileges as a legal owner (effective or beneficial ownership)." [196]

Nortel's transfer pricing agreements satisfied these principles:

(a) The final R & D CSAs, the cost-sharing agreements that preceded the MRDA, provided that each CSP other than NNL held an "Exclusive Royalty–Free License to NT Technology" in the geographic territory assigned to that CSP, while "legal title to all NT Technology whether now in existence or developed pursuant to the terms of [the] Cost Sharing Agreement[s]" was vested in NNL. [197]

(b) The third recital of the final R & D CSAs provided that the CSPs "wish[ed] to share the costs and risks of research and development services or activities in return for interests in any NT Technology that may be produced by such services or activities." [198]

(c) Article 7 of the final R & D CSAs provided that each licensed CSP held "the primary right and obligation to bring and defend in and for [its exclusive territory], at its own expense, and for its own benefit, any proceedings relating to alleged infringement of its rights to the NT Technology by a third party or the alleged infringement by Participant's use of the NT Technology ***542** of the rights of third parties," with NNL having the right to enforce only if the licensed CSP failed to do so. [199]

(d) Article 10 of the final R & D CSAs established that upon the expiration or termination of the agreement, each licensed CSP acquired "a fully paid up license" permitting it to continue to exercise its rights in its exclusive territory, without being subject to any further cost sharing payments to NNL. [200] The Licensed Participants maintained their effective ownership of NN Technology under the MRDA. *See, e.g., supra* Findings of Fact, Section III.C.1 (explaining how tax authorities would have required NNL to make "buy out" payments had the Licensed Participants' rights to Nortel technology been diminished during the transition from the 1992 R & D CSA to the MRDA).

Nortel personnel represented to tax authorities that each Licensed Participant enjoyed economic and beneficial ownership of Nortel IP in its exclusive territory under the R & D CSAs and the MRDA. *See, e.g., The Canada Trust Co. v. Russell Browne et al.,* [2012] ONCA 862 at paras. 21–23,83–88 (ruling that correspondence with the CRA regarding the potential adverse tax consequences of a proposed amendment to a contract, as well as a CRA advanced ruling on that subject, must be considered to discern the parties' intent). For example:

(a) In March 2002, Nortel reported to the IRS, CRA and Inland Revenue that from an economic standpoint dating back to the previous R & D CSA, each IE "could be considered to 'own' the [Nortel] technology as it related to its specific region." [201]

(b) This echoed Nortel's previous representation to Inland Revenue that "although Nortel Canada has legal ownership of Nortel's Intellectual Property, each participant [in the R & D CSA] has beneficial ownership, within their country of incorporation." [202]

(c) In July 2003, Nortel wrote in its Transfer Pricing Report that the parties to the R & D CSA each "contribute to the development of the intangible, and as such share in its ownership." [203]

(d) In 2003, in response to questions posed by the relevant taxing authorities, Nortel stated that all IEs were "owners of the intangible property." [204]

(e) In November 2004, in a response to an IRS Information and Document ***543** Request for Functional Analysis, Nortel explained that the IEs "have agreed to continue participating in the future benefits of new IP" under the RPSM because they were "responsible for ongoing entrepreneurship and risk-taking functions with respect to the IP arising from their collective R & D efforts." [205]

(f) In 2008, in a joint request for a new APA to cover the years 2006–2011, NNL and NNI told the CRA and IRS that although IP was "registered" in NNL's name, "[e]ach IE maintain[ed] an economic ownership in the IP." [206]

Nortel's enforcement and sublicensing practices prior to the bankruptcy confirm the Licensed Participants' exclusive economic and beneficial ownership and rights. For example:

(a) NNI exercised its enforcement rights with respect to Nortel IP by suing third parties for infringement of Nortel patents in the United States, even when NNI was not in the business of making anything similar to the third party's infringing products. [207]

(b) Nortel's legal department recognized that NNI, as the exclusive license holder in the United States, held substantially all rights to Nortel's U.S. patents, and therefore had the right to bring such suits on its own. [208]

(c) In 2004, NNI pleaded in *NNI v. Vonage Holdings Corp.* that it was the "exclusive licensee" of all U.S. patents legally owned by NNL and that it "possesse[d] substantially all rights" with respect to these patents, such that it "ha[d] standing to assert these patents against infringers." NNL was aware of this pleading and never disputed NNI's position. [209]

(d) During the MRDA period, NNL entered into worldwide IP sublicenses "on behalf of itself and its Subsidiaries," because the Licensed Participants, not NNL, had the right to sublicense Nortel IP in their respective territories. [210]

(e) The Licensed Participants granted licenses to third parties that conveyed the right to use Nortel IP in the third parties' own businesses, with no requirement that such third parties engage in the manufacture, use or sale of products for Nortel and often permitted the third parties to use the IP for a business in which Nortel did not operate. [211]

This interpretation of the MRDA is further supported by evidence on custom and practice. Daniel Bereskin, an expert on the custom and practice in the field of intellectual property, concluded that a sophisticated business person would understand the MRDA as follows:

(a) The MRDA conveyed to the Licensed Participants (1) the right to use, make and have made "Products" embodying NN Technology, where "Products" is broadly defined; (2) the right to all Nortel ***544** patents (and other intellectual property including technical know-how); and (3) the right to sublicense the rights in (1) and (2) to a third party for its own use. [212]

(b) These rights conveyed to the Licensed Participants are exclusive, perpetual, and royalty-free for each

Licensed Participant in its Exclusive Territory and "essentially comprise all attributes of ownership deemed by custom and practice to be commercially important and valuable." [213]

(c) Because Article 4(e) of the MRDA gives each Licensed Participant an unrestricted right to enforce NN Technology within its exclusive territory, the affirmative grant of license rights in Article 5 would be read to be coextensive and likewise unrestricted. [214]

(d) No rational buyer would have purchased the Patent Portfolio without the Licensed Participants first terminating or disavowing their interests in the Patent Portfolio. [215]

3. *Each Participant Exclusively Held Valuable Rights to NN Technology, Including Patents, in Its Respective Territory*

The MRDA provides that each participant holds exclusive rights to practice, sublicense and enforce NN Technology, including patents, in its territory. [216] The parties to the MRDA agreed to conduct research and development and to grant to each Participant, in its respective territory, an exclusive license to the patents and other intellectual property generated as a result of such research and development. *See id.* at 4, 6 (Arts.2(a), 4(a)).

In Article 4—titled "Legal Title to NN Technology"—the parties agreed to vest "legal title" to NN Technology in NNL "in consideration" for a grant to each of the Licensed Participants of exclusive, perpetual, and royalty-free rights to NN Technology in its respective territory. *See id.* at 6 (Art. 4(a)). "NN Technology" is broadly defined as "any and all intangible assets including but not limited to patents, industrial designs, copyrights and applications thereof, derivative works, technical know-how, drawings, reports, practices, specifications, designs, software and other documentation or information produced or conceived as a result of research and development by, or for, any of the Participants, but excluding trademarks and any associated goodwill." [217] NNL agreed that the Licensed Participants would have "an exclusive, royalty-free license, including (i) the right to sublicense, which except as hereinafter provided shall be in perpetuity, (ii) rights to make, have made, use, lease, license, offer to sell, and sell Products using or embodying NN Technology in and for the Exclusive Territory designated for that Licensed Participant, and (iii) all rights to patents, industrial designs (or equivalent) and copyrights, and applications therefor, and technical know-how, as necessary or appropriate in connection therewith ('Exclusive License')." *Id.* at 6–7 (Art. 5(a)).

4. *Under the MRDA, Each Licensed Participant Held the Right to Sublicense in Its Exclusive Territory*

**[26]** The right to sublicense enables a licensee to grant another party the ability ***545** to stand in its shoes and exercise its rights. *See, e.g., Eli Lilly & Co. v. Novopharm Ltd.,* [1998] 2 S.C.R. 129 at para. 48. Under the plain language of the MRDA, the exclusive license of each Licensed Participant includes the right to "sublicense" to other parties. [218]

The MRDA also grants the Licensed Participants both a "have made" right and the right to sublicense. Article 5(a) states that the exclusive license includes the "rights to make, have made, use, lease, license, offer to sell, and sell." [219] Accordingly, each Licensed Participant held the right to sublicense in its exclusive territory distinct from any right to have a supplier make products.

5. *Article 4(e) Grants the Right to the Right to Assert Actions and Recover Damages*

Under Article 4(e) of the MRDA, the "Licensed Participants have the right to assert actions and recover damages or other remedies in their respective Territories for infringement or misappropriation of NN Technology by others," with no requirement to join NNL or any other entity as a plaintiff. [220] Article 4(e) grants the Licensed Participants the right to enforce any infringement or misappropriation of NN Technology "by others," which includes third parties and other Participants. *Id.* The enforcement right in Article 4(e) "survive[s] notwithstanding the expiry of [the MRDA], or any termination of [the MRDA] for any cause whatsoever." [221]

A licensee's right to bring infringement suits is a particularly critical factor in the "all substantial rights" analysis. *See, e.g., Vaupel Textilmaschinen KG v. Meccanica Euro Italia SPA,* 944 F.2d 870, 875 (Fed.Cir.1991) ("This grant [of the right to sue for infringement] is particularly dispositive here because the ultimate question confronting us is whether [the licensee] can bring suit on its own or whether [the patentee] must be joined as a party."). Given the expansive scope of rights that the MRDA conveyed to NNI, the MRDA comfortably meets the "all substantial rights" test, such that NNI could unilaterally bring infringement actions in the United States.

Even if NNI did not have "all substantial rights" to NN Technology in the United States, NNI could enforce its rights as an exclusive licensee simply by joining or inviting or compelling NNL as a party, which NNL could not prevent. *See, e.g., Intellectual Prop. Dev. Inc. v. TCI Cablevision of California, Inc.,* 248 F.3d 1333, 1348 (Fed.Cir.2001) ("As a prudential principle, an exclusive licensee having fewer than all substantial patent rights possesses standing under the Patent Act as long as it sues in the name of, and jointly with, the patent owner and meets the [Article III standing] requirements."); *Abbott Labs. v. Diamedix Corp.,* 47 F.3d 1128, 1133 (Fed.Cir.1995) ("A patentee that does not voluntarily join an action prosecuted by its exclusive licensee can be joined as a defendant or, in a proper case, made an involuntary plaintiff if it is not subject to service of process."); *see also Indep. Wireless Tel. Co. v. Radio Corp. of Am.,* 269 U.S. 459, 469, 46 S.Ct. 166, 70 L.Ed. 357 (1926).

6. *The MRDA's Further Confirmation that Licensed Participants Held All Valuable Rights to NN Technology*

The MRDA grants the Licensed Participants the rights to exploit, exclude, and ***546** sublicense in their exclusive territories. Consistent with the broad scope of that grant, the MRDA and its amendments repeatedly describe the Licensed Participants as having "ownership" of NN Technology in their respective territories.

The recitals to the MRDA describe the Licensed Participants' ownership rights, stating that "each Licensed Participant held and enjoyed equitable and beneficial ownership of certain exclusive rights under [NN] Technology" for its exclusive territory under the R & D CSAs and that "it is the intent of NNL and the Licensed Participants that the Licensed Participants continue ... to hold and enjoy such rights." [222] The MRDA further states that each Participant "bears the full entrepreneurial risks and benefits for the Nortel Network business." *Id.* (Whereas Clauses).

Schedule A to the MRDA—an operative provision—repeats these statements, explaining that the "Participants bear the full entrepreneurial risk of the Nortel business such as the risks attendant with the substantial and continuous development and ownership of the NN Technology." *Id.* at 18 (Sched.A). Amended Schedule A to the Second Addendum, signed in December 2007, provides the same, as does Second Amended Schedule A, introduced as part of the Third Addendum signed in December 2008 through January 2009, *Id.* at 30 (Second Addendum, Sched. A), *Id.* at 48 (Third Addendum, Sched. A). Again, the Second Addendum states that "each Participant holds and enjoys equitable and beneficial ownership of NN Technology." *Id.* at 27 (Second Addendum, Whereas Clauses).

Similarly, the Memorandum of Understanding ("MOU")—which was drafted "to provide a record of" the Participants' "understandings" with respect to the MRDA and related agreements—states that the Licensed Participants enjoyed "ownership" of NN Technology. [223] The MOU explains that the MRDA "memorializes the agreements of NNL and the Licensed Participants as to the development and deployment of existing and future NN Technology and ownership of the NN Technology, with NNL holding legal title thereto." *Id.* ¶ 3.

Article 9(b) provides that: Upon termination of the MRDA, each Licensed Participant "shall be deemed to have acquired a fully paid up license permitting it to continue to exercise the rights granted to it herein, and, in particular, the rights granted to it in Article 5 as though this Agreement had continued." *Id.* at 9 (Art. 9(b)).

Article 10(a) provides that: NNL Licensed Participants could not add Participants without the consent of all other Licensed Participants.

Article 11 provides that: When a Participant exits from the MRDA due to insolvency, NNL is obligated to pay fair market value in exchange for the cancellation of the exclusive license and the acquisition by NNL of the rights held by the former Licensed Participant. The entitlement of each Licensed Participant to be paid fair market value for its exclusive license in an insolvency substantiates the Licensed Participants' broad rights to NN Technology.

7. *NNL Had Nothing of Value to Sell in the Licensed Participants' Exclusive Territories*

The Licensed Participants held the right to enforce all the NN Technology in the Exclusive Territories, including the patents ***547** included in the Patent Portfolio, and no other party was entitled to control or interfere with their enforcement rights. As a result, no buyer of the Patent Portfolio would have purchased the patents and other intellectual property rights in the sales unless Licensed Participants terminated those rights. Absent such termination, if the buyer had sought to exploit NN Technology, Licensed Participants would have had the right and ability to prevent the buyer from doing so.

**[27]** **[28]** **[29]** In the United States the effect of a transfer of title to a U.S. patent on the rights of an existing licensee to the patent is governed by U.S. patent law, even if the underlying license agreement is governed by foreign law. *Innovus Prime, , LLC v. Panasonic Corporation,* 2013 WL 3354390, at *3 (N.D.Cal.2013). Under U.S. law, a party cannot place a buyer of its patent interests in any better position than the party itself occupied or confer upon the buyer rights that the party itself did not hold. *See id.* at *5. The same is true under Ontario law. *See National Carbonising Co., Ltd. v. British Coal Distillation, Ltd.* (1937), 54 R.P.C. 41 (C.A.) (holding that an assignment of a patent cannot defeat the rights of the licensee under a license); *see also* P. Bradley Limpert, *Technology Contracting: Law, Precedents and Commentary* (Toronto: Carswell, 2011) at 5–31.

Therefore, NNL had no right to practice or otherwise exploit Nortel patents or other NN Technology in the United States and could not place a buyer of its interests in any better position than NNL itself occupied or protect such a buyer from an infringement suit by NNL

THE FLAWED POSITIONS

The Court has concluded that the MRDA does not govern allocation. In the absence of agreement, and because the Estates' allocation positions are flawed, the Court finds that a modified pro rata allocation method is appropriate by default.

A. *Canadian—Ownership*

The U.S. Debtors and the EMEA Debtors had broad, exclusive licenses to use the NN Technology. Accordingly, NNL's "legal title" to IP was fully encumbered by the Exclusive Licenses in the Licensed Participants' territories. It had little to sell in the Rockstar Sale and, in fact, the IP Sale could only have been the success it was because the Licensed Participants agreed to terminate their Exclusive Licenses.

NNI held the right to enforce all of the NN Technology in the United States. This right included the IP in the Patent Portfolio. It is obvious that no buyer of Nortel IP would purchase the IP if NNI—and Exclusive Licenses in other territories—did not terminate such rights. Otherwise, the Exclusive Licensees, including NNI, could enjoin a purchaser from exploiting the IP it purchased.

The Monitor also claims that NNL could freely transfer its rights in NN Technology, but that NNI and the other Licensed Participants could not do so. This is wrong, and the Monitor's "value in use" approach to allocation that rests on this claim is thus necessarily wrong.

The Monitor's value in use analysis inflates NNL's allocation. On the Business Line Sales, the Monitor and its expert, Philip Green do not value what portion of the purchase price paid for the Business Lines was due to the transfer or surrender of assets and rights by any of the Selling Debtors. The Canadian Interests value—only for NNI and the EMEA IEs, but not for NNL—what the assets and rights might have been worth if not sold. Thus, the Monitor and Mr. Green allocate to ***548** NNI and the EMEA IEs (but not to NNL) the discounted cash flow value that NNI and the EMEA IEs would have earned had the Business Lines not been sold, which Mr. Green then understates by downwardly adjusting Nortel's cash flow projections. Yet the Monitor and Mr. Green fail to perform any valuation with respect to the intellectual property rights NNL contributed in the Business Line Sales, but instead simply allocate to NNL the remainder of the purchase prices paid.

Had the Monitor and Mr. Green applied to NNL the same value in use methodology and cash flow projections they used for NNI and the EMEA IEs, their allocation to NNL would be reduced by approximately $1 billion. Moreover, applying their methodology consistently to all parties would leave this $1 billion unallocated to any Selling Debtor. The Monitor and Mr. Green simply "allocate" this $1 billion solely to NNL without any basis.

On the IP Sale, the Monitor's theory is that NNL is entitled to all of the proceeds. In addition, Green conducts an alternative analysis whereby the Monitor and Green calculate an aggregate value in use that is short by $1.8 to $4.1 billion. Again, they allocate these billions to NNL for no good reason despite admitting they do not know to what that value is allegedly attributable. [224] Their premise is that NNI's and the EMEA IEs' interest in NN Technology was non-transferable but NNL's interest was transferable. The right of the NNI and EMEA IEs to transfer their interests greatly reduces the Canadian Interests' valuation.

B. *The EMEA Debtors—Contribution*

The EMEA Debtors agree with NNI's allocation position (with certain modifications) as an alternative theory, but argue as their principal allocation theory that allocation should be based on the Selling Debtors' contribution to the development of NN Technology. The contribution theory erroneously equates the cost of developing an asset with its value. The EMEA Debtors' own valuation expert, Paul Huffard, conceded that the contribution approach is not a valuation approach:

> Q. Whereas in the contribution approach, you're not valuing any rights that were contributed to the sale; you're doing an analysis based on somebody's sense of what is an equitable way to allocate the proceeds once received.
>
> A. I think that's fair. [225]

Were the Court to adopt the EMEA Debtors' contribution approach, which it is not, the amounts allocated to the Selling Debtors must be adjusted to reflect properly the parties' actual contributions to the development of NN Technology, including using an appropriate useful life and accounting for the costs actually incurred by the parties in developing NN Technology.

C. *U.S.—Revenue*

The basic problem with the U.S. Debtors' revenue approach to allocation is that it is not based upon valuation of specific assets and rights transferred by each Estate in the sales. For the Business Line Sales, the U.S. Debtors' expert, Mr. Kinrich, did not perform a valuation but, instead, compared the relative revenues. A discounted cash flow analysis, i.e., a projection ***549** of future cash flow (revenues minus costs) discounted to the present value at a discount rate is the preferred valuation method.

Mr. Kinrich did not perform such a calculation. [226] Instead, he compares the relative revenue earned in each geographical region by the various Nortel entities for each business line in a single year, namely, 2009. [227] He then allocates the Sales Proceeds from each business line sale to each Debtor Estate based upon the claimed proportionate share of the revenues earned in the Estates' respective geographies.

Although the U.S. Debtors argue that the revenue-based approach is a "standard income-based method" of valuing the assets that were relinquished, [228] Mr. Kinrich acknowledged that this was not the preferred method. Rather, the preferred method for valuing income-producing assets, such as the IP licenses in the present case, is the discounted cash flow method. [229]

Mr. Kinrich agreed that the value of a license is driven by the profits that the licensee could earn by using the patented technology, but he did not determine what those profits would have been in the case of the U.S. and EMEA Debtors. [230] Nonetheless, in determining the value of those licenses, Mr. Kinrich took no steps to attempt to forecast those profits. [231]

The "authoritative" text relied upon by Mr. Kinrich as supporting his revenue-based methodology in fact made it clear that his approach was not appropriate to the valuation task at hand. The authority Mr. Kinrich relied on, *Valuing Small Businesses and Professional Practices,* stated that valuing a business based on a revenue approach may be useful:

> (a) to approximate a range of possible values with a minimum of time and effort;
>
> (b) to conclude an estimate of value when other data are unavailable or inadequate; or
>
> (c) as one indicator of value, used in conjunction with other "more rigorous" valuation methods. [232]

The text explained that a revenue approach would require the comparable businesses to have a fairly standard cost structure. [233] Mr. Kinrich acknowledged that the various Nortel entities, among which he was allocating proceeds based on revenue, did not have a standard cost structure.

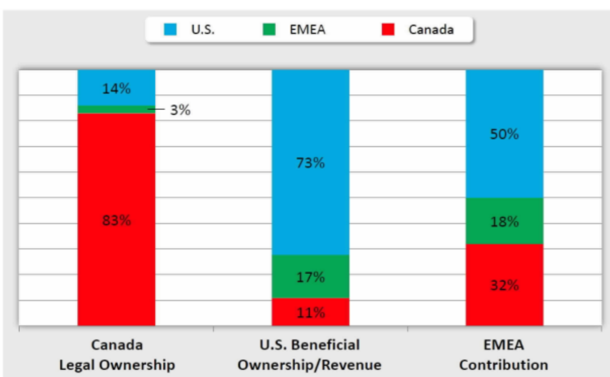
## PRO RATA ALLOCATION

The MRDA does not control allocation. In the absence of an agreement governing allocation or a preponderance of evidence showing entitlement to assets and the value of those assets, the Court's task is to arrive at a fair and equitable mechanism to ***550** allocate the billions of dollars of Sales Proceeds to numerous international entities for the benefit of their creditors who have now waited years for their recoveries. The Court's decisions will impact investors and pensioners, as well as other unsecured creditors.

The parties' complex arguments for their positions and against others supported by the enormous volume of supporting papers go around and around without end and without a definitive correct answer. It is fair to find that there is validity and error in all of the arguments, largely because the arguments are not rooted in an agreement which applies to the facts. In the meantime, the case remains *in stasis.* The evidence presented to the U.S. Court and the Canadian Court only serves to magnify the differing and irreconcilable approaches taken by the U.S. Debtors, the Canadian Debtors and the EMEA Debtors. All of their approaches yield an unsatisfactory result and the evidence upon which they rely does not comport with the manner in which Nortel operated.

The Court's answer to the dilemma is to a adopt a modified pro rata allocation model which recognizes both the integrated approach which the CCC and the NNUK urge, while maintaining—or at least recognizing—the corporate integrity of the Nortel Entities.

The extreme allocation proposals of the various debtors is best conveyed by reference to the following comparison chart contained in the UK Pension post trial brief which the Court copies here:




These allocation positions, of course, stand on the shoulders of the parties' interpretations of the MRDA. Yet the evidence establishes that the MRDA simply does not apply to allocation. The chart reveals that the Debtors have lost sight of the irrationality of their respective positions. The variance of the positions are of such magnitude that highly capable and responsible attorneys were unable, or in the heat of the fight were unwilling, to find a middle ground despite three extensive and costly mediations. Because the Debtors have been unable to prove the plausibleness ***551** of their answers to allocation, the Courts are left to determine an appropriate outcome. The Courts are in agreement that the pro rata approach is the most satisfactory allocation method. They also agree that their methodology does not constitute global substantive consolidation. The Courts will recognize the rights to cash-on-hand, settlements and intercompany claims, one of which resulted in an allowed $2 billion claim of NNI against NNL.

Similarly, the Courts are not dismembering the guaranties provided to the Bondholders which can only be accomplished if the Courts do not recognize separate corporate identities of the Nortel Entities. Doing so would ignore the facts discussed above that the Nortel Entities carefully maintained separate corporate identifications. It could also dangerously impair multinational businesses from raising capital.

A. *Global General and Administrative Support Functions*

Much of Nortel's global General and Administrative support ("G & A") was largely performed by NNL. There were four primary global G & A organizations within Nortel: (1) Finance; (2) Information Technology; (3) Human Resources, and (4) Other Real Estate, Legal, Compliance, and Strategy groups. [234] The matrix structure "allowed Nortel to draw on employees from different functional disciplines worldwide (*e.g.,* sales, R & D, operations, finance, general and administrative, etc.), regardless of region or country according to need." [235] Nortel operated as "an integrated, global whole," [236] for the benefit of all of Nortel. [237]

Ernie Briard, an accountant with the Chief Technology Office, testified: "[W]e did not run the business with any real knowledge of the statutory entities at all. We ran it as a global Nortel corporation." [238] Decisions to allocate resources and performance were not based on legal entity lines, but by lines of business. [239] Nortel reported its finances on a consolidated basis without regard for its different legal entities. [240]

Employees testified there was one Nortel. [241] Simon Brueckheimer, a Nortel Fellow and prolific inventor based in the UK, testified that in customer activities he "was representing Nortel. I didn't differentiate any particular geography.... I took on the mantle essentially of representing the company as a whole." [242] Although employed by a particular legal entity, employee work responsibilities were directed to ***552** the entire Nortel. [243]

The Nortel Networks name and logo were used throughout Nortel to refer to an integrated whole. To the outside world, including Nortel's customers, suppliers, and the rest of the world, the logo referred to all of Nortel, and not to any one geographic entity. [244] Within Nortel, employees "use[d] the term 'Nortel Networks' to be the consolidated global Nortel Networks ... irrespective of any entity or jurisdiction. It was the total—it was the one Nortel." [245]

B. *R & D Functions Were Collaborative Across Borders*

R & D was geographically distributed. Nortel's R & D operations were distributed and were conducted across the globe. "Nortel's R & D function [was] a global undertaking aligned with its business strategy of technology leadership. Engineers in each of Nortel's geographic markets work[ed] to develop next generation products." [246] By 2002, Nortel had 14,000 R & D employees spread across over 20 regions, with its most significant presence in Canada, the U.S., and the UK. [247] R & D operations relating to Nortel's Business Lines —*e.g.,* Wireless, Enterprise, and Optical—were distributed globally as well. [248] Nortel's globally distributed R & D distinguished it from other high technology companies which centralized their R & D in a single site. Examples are Microsoft which conducted over 90 percent of its R & D at its core facility in Seattle, and Cisco Systems conducted over 80 percent of its R & D at its San Francisco Bay campus. [249]

Nortel's laboratories often worked collaboratively and as a unified whole to develop technology. As Simon Brueckheimer testified:

> Research & Development ... at Nortel was generally a collaborative process. Other NNUK employees and I not only worked together, we routinely shared our expertise, developed foundational technologies and also coinvented patents with Nortel employees based in other geographic locations, which was to the advantage of the Nortel Group. I never perceived that there was any difference between particular Nortel entities, always thinking of Nortel as a unified whole. [250]

Technology assisted collaboration. As Mr. McFadden testified: "At Cisco they'd use a water cooler. We used telephones." [251] It was common for R & D personnel from around the world to be involved in the process of addressing customer requests and responding to customer bids. Nortel's bid response to AT & T in 1997 involved the collaboration of multiple labs. The effort was led by Simon Brueckheimer, who along with others at Nortel's Harlow, UK, lab contributed the voice compression solution selected for the bid. [252]

***553** Solutions to problems did not stop at borders. [253] As Mr. Brueckheimer testified: "[I]n my experience on many, many bid responses, for example the [British Telecom] bid response in 2004, again which I ran, I had 85 people reporting to me from many labs around the world." [254]

Nortel determined R & D priorities and budgets world-wide. Nortel did not allocate R & D budgets by geographic entity or subsidiary, but rather by line of business. [255] Spending on R & D was against the budget for the appropriate line of business, regardless of the geographic location in which it occurred. [256] Most Nortel laboratories did work pertaining to multiple lines of business. [257]

The goal of Nortel's R & D was to create technology that could be commercialized, although it was not necessarily possible to trace research efforts to immediate commercial results. In its Functional Analysis (2000–2004) prepared for the tax authorities, Nortel explained:

> All R & D projects are ultimately intended to produce commercially exploitable products or knowledge; however, there may be R & D undertaken for which no recognizable commercial gain is immediately evident. Longterm research projects are undertaken in a somewhat academic environment with the long-term goal of producing a commercially exploitable product. The information obtained from those projects is intellectual property; however, the

ability to commercially exploit that knowledge is not yet available. [258]

Pro rata allocation takes into account Nortel's operations as a unified endeavor. The pro rata allocation model reflects the underlying economics of the "One Nortel" integrated global business. The U.S., Canadian and EMEA Debtors allocation methods do not account for the complete absence of any *ex ante* agreement among the Nortel entities as to the division of assets in the event of a global insolvency. They wrongly assert that the individual geographic regions functioned autonomously and can thus claim credit for, and retain proceeds from the sale of Nortel's assets. Their proposals lead to wildly divergent allocation outcomes. Each proponent seeks to obtain a disproportionate share of the proceeds.

The RPEs' common endeavor was to maximize global profits and the sales of assets likewise crossed borders. The parties signed the IFSA, affirming that they would share proceeds from the sales to further the best interests of Nortel's creditors. They recognized that a cooperative, multi-jurisdictional sale of the Business Lines was the only way to maximize proceeds. Likewise, the RPEs recognized that a collaborative sale of the Residual IP would create the most value and they agreed to facilitate that sale by executing LTA's.

C. *Authority for Pro Rata Allocation*

**[30]** **[31]** In this unprecedented, complex and massive dispute involving highly integrated MNE's, the U.S. Court has the authority to adopt a pro rata allocation. The Bankruptcy Code permits courts to "issue any order, process, or judgment ***554** that is necessary or appropriate to carry out the provisions of [the Code]". 11 U.S.C. § 105(a). The Third Circuit has construed this provision to give bankruptcy courts "broad authority" to provide appropriate equitable relief to assure the orderly conduct of reorganization proceedings, See, e.g., *In re Combustion Eng'g, Inc.,* 391 F.3d 190, 236 (3d Cir.2004), and to "craft flexible remedies that, while not expressly authorized by the Code, effect the result the Code was designed to obtain." *Official Comm. of Unsecured Creditors of Cybergenics Corp. ex rel. Cybergenics Corp. v. Chinery,* 330 F.3d 548, 568 (3d Cir.2003) (en banc). In an international case such as this, there is the principal "that assets should be collected and distributed on a worldwide basis." *Maxwell Commc'n Corp v. Barclays Bank (In re Maxwell Commc'n. Corp.),* 170 B.R. 800, 816 (Bankr.S.D.N.Y.1994). See also *In re ABC Learning Centres Limited,* 728 F.3d 301, 305–306 (3d Cir.2013).

The Court has toiled mightily to reach a correct and equitable result, consistent with the evidence adduced at trial. The Court, like the Canadian Court, is ordering a modified pro rata allocation—not distribution—which both recognizes the integrity of the corporate separateness and the integrated synergistic operations of Nortel. The Court's adoption of pro rata allocation is the only outcome that reflects uncontroverted evidence and leads to a just result. The master facts are that Nortel functioned as a unified global enterprise and there was no agreement which governed how the individual entities would or could allocate their assets in the event of an insolvency. All parties agree, as they must, that Nortel was centrally managed with employees and assets from many countries and subsidiaries contributing to the R & D which led to the businesses, IP, products and licenses to which they now lay claims of ownership and beneficial interest. The ramifications of the insolvency must be borne by all of the Nortel Entities and, consequently, all of its creditors. A pro rata allocation is driven by the unique facts, the after the fact justifications by parties for their positions and the disparity of those positions.

**[32]** The Court's ruling is not a substantive consolidation because no one estate is entitled to any specific asset. In *In re Owens Corning,* the U.S. Court of Appeals for the Third Circuit observed that substantive consolidation "treats separate legal entities as if they were merged into a single survivor left with all the cumulative assets and liabilities, (save for inter-entity liabilities which are erased). The result is that claims of creditors against separate debtors morph to claims against the consolidated survivor." [259] A pro rata allocation does not merge the Nortel Debtors into a single survivor and does not erase intercompany claims. All claims against each Nortel Debtor, including intercompany claims and court approved settlements, will receive distributions from the separate Debtor Estates.

The decision of the Third Circuit Court of Appeals in *In re Owens Corning,* 419 F.3d 195 (3d Cir.2005), is a clear and concise exposition of the law on substantive consolidation for domestic insolvencies. It includes the history of the legal precept, the standards and the economic ramifications of substantive consolidation. Therefore, *Owens Corning* is worthy of a detailed discussion.

The Third Circuit succinctly framed the issue as follows:

> We consider under what circumstances a court exercising bankruptcy powers may ***555** substantively consolidate affiliated entities.

*Owens Corning,* 419 F.3d at 199.

In the case, Banks had made $2 billion in unsecured loans to *Owens Corning* and certain subsidiaries, and obtained guarantees from other subsidiaries. The Banks appealed from the district court's order consolidating the assets and liabilities of the borrowers and guarantors. The Third Circuit's discussion included the following:

> Substantive consolidation, a construct of federal common law, emanates from equity. It "treats separate legal entities as if they were merged into a single survivor left with all the cumulative assets and liabilities (saved for inter-entity liabilities, which are erased). The result is that claims of creditors against separate debtors morph into claims against the consolidated survivor." *Genesis Health Ventures, Inc. v. Stapleton (In re Genesis Health Ventures, Inc.),* 402 F.3d 416, 423 (3d Cir.2005). Consolidation restructures (and thus revalues) rights of creditors and for certain creditors this may result in significantly less recovery.

*Id.* at 205.

* * *

Corporate disregard as a fault may lead to corporate disregard as a remedy. *Id.* The Third Circuit further discussed approaches courts take for allowing substantive consolidation. The two "themes" are:

> (i) whether creditors dealt with the entities as a single economic unit and did not rely on their separate entity in extending credit, ... or (ii) whether the affairs of the debtors are so entangled that consolidation will benefit all creditors...."

*Id.* at 207–208, quoting from *Union Sav. Bank v. Augie/Restivo Baking Co., Ltd.,* 860 F.2d 515, 518 (2d Cir.1988).

After thoroughly discussing the approaches and the economic impact of substantive consolidation, the Third Circuit settled on the following requirement for substantive consolidation:

> In our Court what must be proven (absent consent) concerning the entities for whom substantive consolidation is sought is that (i) prepetition they disregarded separateness so significantly that their creditors relied on the breakdown of entity borders and treated them as one legal entity, or (ii) postpetition their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors.

*Id.* at 211. The Third Circuit found that substantive consolidation on the facts presented in *Owens Corning* was inappropriate.

D. *Pro Rata Allocation is Not Substantive Consolidation*

The discussion of a pro rata allocation requires a discussion of substantive consolidation and, more importantly, why the Court's approach is not that seemingly offensive outcome. The Court understands that the NNUK is campaigning for global substantive consolidation; and to a lesser extent the CCC is doing likewise. The Court's methodology departs from those views. The Court, for one, is not ordering payments to the "most deserving" creditors as the Bondholders fear. The Court is not ordering a distribution scheme. Instead, the Court is directing an allocation among the Estates for the Estates to distribute in an appropriate manner. It is a distinction with a difference. The difference is that intercompany claims, settlements, cash-on-hand will all be honored in the allocation. The logistics and practical concerns with the pro rata calculation are manageable—certainly as much if not more than any prospect of ***556** continued litigation and appeals, still more litigation and more appeals.

**[33]** The basic principal of substantive consolidation is the treatment "of separate" legal entities as if they were merged into a single survivor left with all cumulative assets and liabilities (save for inter-entity liabilities, which are erased)." *In re Owens Corning,* 419 F.3d 195, 205 (3d Cir.2005). The more relevant inquiry, as the U.S. Debtors point out, is whether creditors of each Nortel estate would have to "share those assets with all creditors of all consolidated entities", thereby raising the specter for some of a significant distribution diminution." *Id.* at 206.

The Estates opposing the pro rata allocation are correct to express concerns over "rough justice" and "free floating discretion." But in giving validity to IFSA, intercompany claims, settlements, and guaranties, there is nothing rough about the justice. Instead, the Court is attempting to apply an equitable result where parties could not agree upon one and did not prove the validity of any one of the conflicting views. The bases asserted—ownership, revenue, contribution—result in valuations which simply do not match operations. It is highly significant that the U.S. Court and the Canadian Court independently arrived at the same conclusion.

One only has to read the parties' briefs (as the Court has done numerous times) and to have presided over the trial to understand that no Estate—U.S., Canadian or EMEA—was able to raise its position above the others. The Court compares the Allocation Dispute to three people trying to reach the top of a mountain by pulling the others down. In other words, no one gets to the top.

**[34]** Under U.S. law, a proponent of substantive consolidation must show that either "[1] prepetition [the debtors] disregarded separateness so significantly [that] their creditors relied on the breakdown of entity borders and treated them as one legal entity, or [2] postpetition [the debtors'] assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors." *In re Owens Corning,* 419 F.3d at 211.

**[35]** **[36]** **[37]** **[38]** **[39]** The following principles govern: (1) the "general expectation" is that "courts respect entity separateness absent compelling circumstances calling equity (and even then only possibly substantive consolidation) into play"; (2) the "harms substantive consolidation addresses are nearly always those caused by *debtors* (and entities they control) who disregard separateness"; (3) "[m]ere benefit to the administration of the case ... is hardly a harm calling substantive consolidation into play"; (4) the "rough justice" remedy of substantive consolidation "should be rare and, in any event, one of last resort after considering and rejecting other remedies"; and (5) substantive consolidation "may not be used offensively (for example, having a primary purpose to disadvantage tactically a group of creditors in the plan process or to alter creditor rights)." *Id.* at 211. Although not for the Court to decide, the law in Canada appears to be similar. *Northland Properties Ltd., Re.,* [1988] 69 C.B.R. (N.S.) 266 at para. 49 (Can.B.C.S.C.), citing *In re Baker and Getty Fin. Services Inc.,* 78 B.R. 139 (Bankr.N.D.Ohio 1987). This is accomplished with reference to the following seven factors: (1) difficulty in segregating assets; (2) presence of consolidated financial statements; (3) profitability of consolidation at a single location; (4) commingling of assets and business functions; (5) unity of interests in ownership; (6) existence of intercorporate loan guarantees; and (7) transfer of assets without observance of corporate formalities. *Northland Properties Ltd., Re.,* [1988] 69 ***557** C.B.R. (N.S.) 266 at para. 49 (Can.B.C.S.C.) citing *In re Vecco Constr. Indus., Inc.,* 4 B.R. 407, 410 (Bankr.E.D.Va.1980).

The record of Nortel's operations does not satisfy the legal and factual requirements for substantive consolidation. While Nortel operated as a highly integrated multinational enterprise, the evidence establishes that the Nortel affiliates respected corporate formalities and did not commingle their distinct assets or liabilities. Given that Nortel respected and maintained corporate separateness among its distinct legal entities both before and during its insolvency, substantive consolidation cannot be applied in this case.

Again, the Court is not adopting pro rata distribution. Pro rata distribution would result in substantial prejudice to creditors who have bargained for separate contractual rights. It would make the Sales Proceeds available for distribution to all debtor entities regardless of whether a debtor sold assets in a particular sale, with the practical effect of moving cash from one Estate to another to the detriment of creditors. [260] Implementation of a pro rata distribution would further prejudice creditors by unwinding the effect of Court-approved settlements and intercompany claims. [261]

In ruling that substantive consolidation is not justified here, the Court wants to be clear that pro rata allocation does not constitute substantive consolidation. Nonetheless, it is worth noting that the *Owens Corning* facts differ from the Nortel facts. The affiliated *Owens Corning* entities had different, independent, separate business purposes, logos and trade names, and other features which made separating their assets and liabilities straightforward.[262] In contrast, Nortel was highly integrated, organized along Lines of Business operating for the same purpose under the same logo and trade name, and all of the entities engaged in the development, manufacture, and sale of various products of a single company. The very issue of this litigation is who owns Nortel's assets and is entitled to receive the Sales Proceeds. The reason the issue is unsettled is because there is no predetermined answer.

In further contrast to Nortel, *Owens Corning's* affiliated debtors were contractually bound to maintain their corporate separateness. The *Owens Corning* loan agreement guaranteed by all affiliated debtors, expressly limited how a borrower could deal with its subsidiaries. The Nortel cross-over bonds indentures do not contain such restrictive characteristics.

### E. *Pro Rata Criticism is Misplaced*

The evidence at trial established the uniquely integrated nature of Nortel's global enterprise and the extensive integration of IP assets giving rise to the proceeds of the sale in the Lockbox. The evidence further confirmed that Nortel was a truly global enterprise.

By agreeing to the IFSA, the Estates confirmed that the Courts had jurisdiction to determine the appropriate allocation of the Sales Proceeds absent agreement. The IFSA does not require or suggest any allocation method. The IFSA does not suggest the fair market value of the assets and rights sold or relinquished in connection with the sale of Nortel's Business Lines and Residual IP as argued by the U.S. Debtors. Nor does the IFSA indicate any preference for the EMEA Debtors' ***558** contribution allocation. The IFSA was entered into and approved by the Courts in June, 2009, before the Estates on behalf of the Selling Debtors had each disclosed the diametrically polar views as to their respective rights to the proceeds of the sale of the Business Lines and Residual IP. Nor is there any suggestion in the IFSA that all of the value for Residual IP belonged solely to NNL and no other entity, as the Canadian Debtors and Monitor argue.

The pro rata allocation method which the Court is adopting is not substantive consolidation of the Estates. The Court is not directing a central insolvency administrator in one jurisdiction, that all of the Nortel Entities be treated as one, that all claims be determined within one proceeding under the supervision of one insolvency administrator, that there be one plan of reorganization for all Nortel Entities or that creditors receive a common dividend on a pro rata, *pari passu* basis.

The Court is not adopting a pro rata distribution, but an allocation to separate interests. The Court's pro rata model recognizes that separate Estates exist, will continue to exist, and will ultimately be utilized to make distributions to creditors through whatever means is determined by the Courts following the Allocation Dispute.

Moreover, the Court recognizes the separate and distinct integrity of each of the Debtors by recognizing cash-on-hand intercompany claims and settlements. To be clear, the Court's pro rata allocation is not the “new order” which the pro rata proponents urge with terms such as “universalism”.

The UKPC's call for Modified Universalism is premised upon the Model Law on Cross–Border Insolvency which the United Nations Commission on International Trade Law proposed in 1997.[263] These cases are not proceeding under the purview of the Model Law which is purely a proposal at this time. These cases are proceeding under the dictates of Chapters 11 and 15 of the Bankruptcy Code.

The pro rata proponents also argue that rejecting the guaranties will not negatively impact the marketplace. The pro rata proponents also cite in support of disregarding the guaranties to the following from Widen, Corporate Form and Substantive Consolidation, 75 Geo. Wash. L.Rev. at 274, 277:

> Before the Third Circuit's decision in *Owens Corning* ... no sophisticated lending syndicate ever relied on a mere covenant prohibiting merger, consolidation, or dissolution to create priority when the syndicate itself employed a web of guarantees. The reason for non-reliance on such covenants is simple: the market believed that the presence of intercompany guarantees virtually assured that imposition of substantive consolidation would be proper for

> any companies forming part of an intercompany guarantee web (and no competent counsel would have opined otherwise). In *Owens Corning,* rather than a *bona fide* case of reliance on asset partitions, we have a case of simple good fortune for the lenders, the asset partitions and guarantees happened to remain in place until the bankruptcy filing, and the continued presence of the guarantees' structure afforded them a priority. [264]

***559** There is insufficient trial evidence establishing pre-filing reliance by Bondholders on the corporate separateness of the various entities that comprise Nortel. Credit rating agency reports confirmed the trial evidence that the market did not distinguish between Nortel's bonds that were guaranteed by NNI and those that were not. [265] Data in respect of Nortel bonds confirms that the market did not view Nortel bonds that carried an NNI guarantee as being less risky than Nortel bonds that did not carry an NNI guarantee. The chart containing the data, "Nortel Bonds Spreads to U.S. Government Yield Curve (Basis Points), appears as Appendix C to this opinion.

The chart shows that Nortel bonds that carried an NNI guarantee traded at higher or equal spreads to Nortel bonds that did not carry an NNI guarantee. Bonds with a lower spread are considered less risky in the marketplace. [266] Since the marketplace did not more favorably view Nortel bonds guaranteed by NNI, creditor expectations do not support the contention that Nortel's guaranteed bonds would enjoy a greater percentage recovery upon insolvency or should otherwise entitle them to a higher recovery than Nortel's other unsecured creditors.

Additionally, the documents evidencing the issuance of the bonds (i.e., the offering memoranda and indentures) do not provide a basis for any Bondholders to have reasonably relied on any particular partitioning of assets among the individual entities.

The guarantees did not restrict NNC or its subsidiaries from lending cash to, or making investments in, affiliates, or from incurring substantial amounts of additional indebtedness, [267] investors were warned of the possibility of consolidation, [268] and that under applicable law principal and interest might not be paid. [269] Thus, the Bondholders' allegations of reliance on the outcome they now advocate are unfounded.

In addition, the June 29, 2006 Offering Memorandum for NNL's Senior Notes due 2011, 2013, and 2016, [270] the related Indenture dated July 5, 2006 and the related Prospectus dated December 21, 2007 (and all documents incorporated by reference therein) only contained consolidated financial information for Nortel. Similarly, the March 22, 2007 Offering Memorandum for NNC's Convertible Senior Notes due 2012 and 2014, the related Indenture dated March 28, 2007 and the related Prospectus ***560** dated December 21, 2007 (and all documents incorporated by reference therein) only contained consolidated financial information for Nortel. No bondholder could have formed the reasonable expectation that on insolvency, a guarantee would have entitled bondholders to access distinct pools of assets that may or may not have been held by the entity that guaranteed the bonds.

**[40]** The pro rata proponents suggest the Courts should consider the identities of the Bondholder Group's members, their purchase history, and the prices they paid for the Bonds when evaluating allocation. The Court answers with a resounding "No." When and at what prices the members of the Bondholder Group acquired their Bonds is irrelevant to this litigation. The purchaser of a debt instrument on the secondary market is entitled to the exact same rights as the original purchaser of that instrument. *See In re 785 Partners, LLC,* 470 B.R. 126, 133 (Bankr.S.D.N.Y.2012) (if a creditor is the assignee of the original lenders, then that creditor "stands in the shoes of the assignor, and takes neither more nor less than the assignor had"). [271] Thus, in a bankruptcy case of the issuer, the secondary purchaser "can assert the same rights subject to the same limitations that the original lenders could have asserted if they still owned the Loans." *Id.*

**[41]** Moreover, the price paid by a secondary purchaser has no impact on its substantive rights. In *785 Partners,* the court found that although "the Debtor's existing default may have been factored into the price that [the creditor] paid to the Original Lenders," this was "a matter between those parties." *785 Partners,* 470 B.R. at 133. Were the Court to accede to the suggestion that secondary purchase prices are relevant, the effect on the distressed market would be devastating.

F. *Implementation of the Pro Rata Allocation*

The U.S. Interests and the EMEA Debtors take strong exception to a pro rata allocation. The Court understands their disagreement. [272] Pro rata is, to say the least, an extraordinary result, and the Canadian Interests, the U.S. Interests and the EMEA Debtors devoted enormous skill, time, money and energy in professionally presenting their cases for a revenue and contribution approach, respectively. Likewise, the Canadian Interests forcefully advocate for an ownership allocation, not a pro rata allocation.

The EMEA Debtors and U.S. Interests argue that the pro rata "distribution" theory is not legally or factually supportable. The pro rata "distribution" theory does not allocate to each Selling Debtor the fair market value of the assets it sold or relinquished in the Sales. It would therefore ***561** also violate the absolute priority rule insofar as NNL—NNTs equityholder—would recover before NNTs own creditors from the proceeds generated by the sale of NNI's property interests. Implementation of the pro rata allocation will neither result in equity receiving preferential treatment nor violate the absolute priority rule.

The parties opposing the pro rata allocation argue that it is "unadministrable" due to uncertain treatment of claims, timing and creditor recoveries. In particular, there is concern with inflated claims, particularly the UKPC $3 billion claim against the EMEA Debtors. Inflated claims would, of course, skew a pro rata allocation and destroy the equitable allocation method.

The Court has answers to the concerns expressed.

1. Any claims not resolved by a date certain would not be recognized.

2. The Court will resolve any disputed claims to prevent claim inflation.

3. Claims will be recognized only once. For example, the UKPC claim will be included in the allocation calculation only once and not against multiple EMEA Debtors. Similarly, for allocation purposes the Bondholder claims will be included only against the primary obligor, but the guarantees will be entitled to seek distribution from the appropriate Debtor of any deficiency resulting from the allocation.

4. Intercompany claims and settlements approved by the U.S. Court and the Canadian Court will be included in calculating the allocation. They will not be deducted as the UK Pension Claimants propose. Doing so would violate the Courts' Orders.

5. Once all claims are resolved, the amount in the Lock Box will be divided by the total claims and each Estate will be allocated its proportionate amount.

6. The U.S. Estate will then propose a distribution plan for the Court's consideration.

The administrative steps for allocation contained in the accompanying Order will be prompt, fair and definitive, thereby addressing the concerns expressed by those opposing a pro rata allocation.

## ***CONCLUSION***

Over three years ago, the Third Circuit Court of Appeals noted with both poignancy and command, which the parties disregarded, that:

> We are concerned that the attorneys representing the respective sparring parties may be focusing on some of the technical differences governing bankruptcy in the various jurisdictions without considering that there are real live individuals who will ultimately be affected by the decisions being made in the courtrooms. It appears that the largest claimants are pension funds in the U.K. and the United States, representing pensioners who are undoubtedly dependent, or who will become dependent, on their pensions. They are the pawns in the moves being made by the Knights and the Rooks.
>
> Mediation, or continuation of whatever mediation is ongoing, by the parties in good faith is needed to resolve the differences. No party will benefit if the parties continue to clash over every statement and over every step in the process. This will result in wasteful depletion of the available assets from which each seeks a portion. There appears to be one constructive solution—the protocol agreed upon by appointing Justice Winkler to resolve the allocation issues. He apparently has the respect ***562** of all parties and we hope (although it is not in our power to order) that the parties promptly devise a process by which all conflicting claims are put in his hands for resolution.

*In re Nortel Networks, Inc.,* 669 F.3d 128, 143–44 (3d Cir.2011) (footnote omitted).

The Courts have now ruled on allocation of what remains of Nortel. It is now the parties who have to make a decision: accept the Court's rulings and give them effect, take appeals and thereby prolong the hardship and deplete the remaining estate, or utilize the Courts' rulings to resolve any remaining differences.

The Court will issue its Order making its ruling final.

## APPENDIX A

### Glossary of Terms

| | |
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| Allocation Protocol | Order Entering Allocation Protocol, dated May 17, 2013 |
| APA | An advanced pricing arrangement, which is a contract between a multi-national enterprise and a tax authority specifying the transfer pricing methodology that the affiliate will be permitted to use for an agreed period of time. |
| APA Team | A team of employees formed by Nortel to determine the appropriate transfer pricing policy to propose to taxing authorities in the APA process. |
| Bondholders | The Ad hoc Group of Bondholders, consisting of entities holding bonds which NNC, NNL, NNI and NNC issued or guaranteed. |
| Business Line Sales | The post-filing sales in 2009 to 2011 involving tangible and intangible assets of, for the most part, operating Nortel businesses. |
| Business Lines | Nortel's lines of business |
| Canadian Court | The Ontario Superior Court of Justice. |
| Canadian Debtors | The Canadian Nortel companies that, on January 14, 2009, filed for and obtained protection under the *Companies' Creditors Arrangement Act* from the Ontario Superior Court of Justice, being Nortel Networks Corporation (NNC), Nortel Networks Limited (NNL), Nortel Networks Technology Corporation, Nortel Networks International Corporation and Nortel Networks Global Corporation. |
| Canadian Estate | Collectively, the entities that make up the Canadian Debtors. |
| Canadian Proceedings | Canadian Debtors commenced a proceeding with the U.S. and Canadian Courts under the Companies' Creditors Arrangement Act (Canada), seeking relief from their creditors |
| CCAA | Companies' Creditors Arrangement Act (Canada) |
| CCC | The Canadian Creditors Committee, which represents the interests of Canadian pensioners and other pension interests, long-term disabled and other employees and former employees of Nortel who have claims against the Canadian Debtors. |
| CDMA | Code Division Multiple Access line of business |

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| Committee | The Official Committee of Unsecured Creditors, appointed by the United States Trustee for the District of Delaware on January 22, 2009. |
| Cost Sharing Participants | Parties involved in cost sharing agreements, including NNL, NNI, NNUK, NN Ireland, and NNSA (the "CSPs"). |
| Courts | The U.S. Court and the Canadian Court. |
| CRA | The Canadian Revenue Authority |
| Cross Border Protocol | Canadian Court approved the Court-to-Court Protocol on the Petition Date, which was later amended by order of this Court on June 29, 2009 [D.I. 990] and by an order of the Canadian Court on that same date. |
| CSA | Cost Sharing Agreements between NNL and each of the other R&D performing Nortel entities. |
| CTO | Nortel's Chief Technology Officer |
| CVAS | Carrier Voice Over Internet Protocol Applications Solutions line of business |
| Debtor(s) | The companies or entities comprising the Canadian Debtors, the U.S. Debtors and the EMEA Debtors, either individually or collectively. |
| EMEA | The Europe, Middle East and Africa regions |
| EMEA Debtors | The 23 Nortel entities that, on January 15, 2009, were granted administration orders in the U.K. under the *Insolvency Act, 1986* and whose registered offices were in England, Europe, the Middle East and Africa, including Nortel Networks UK Limited (NNUK), Nortel Networks S.A. (NNSA) and Nortel Networks (Ireland) Limited (NN Ireland). |
| EMEA Estates | Collectively, the entities that make up the EMEA Debtors. |
| Ericsson | Telefonaktiebolaget LM Ericsson (publ) |
| Exclusive License | The MRDA sets forth a clear exchange of consideration between the signatories (NNL, NNI, NNUK, NNSA, and NN Ireland). Pursuant to Article 4(a), each Licensed Participant vested legal title in NNL to the intellectual property it created. Expressly "in consideration therefor," NNL granted an exclusive license back to each Licensed Participant. |

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| FCFSA | Final Canadian Funding and Settlement Agreement |
| First Expansion of the Monitor Powers Order | An order expanding the Monitor's powers, dated August 14, 2009. The Order provides, among other things, the Monitor with the authority to cause the Canadian Debtors to take various actions in connection with the sale of the business units and to conduct, supervise, and direct any procedure regarding the allocation and/or distribution of proceeds of ay sale. |
| G&A | Nortel's global General and Administrative support. There were four primary global G&A organization within Nortel: (1) Finance; (2) Information Technology; (3) Human Resources; and (4) Other Real Estate, Legal, Compliance, and Strategy groups. |
| Global IP | The Global IP Law Group, which Nortel retained to provide advice on monetizing its Patent Portfolio. |
| Google Bid | The U.S. Debtors', NNL's, and NNC's agreement with an affiliate of Google Inc. to sell Nortel's residual patent and patent-related assets for $900 million, subject to higher or better offers. |
| GSM | Global System for Mobile Communications line of business |
| Horst Frisch Report | Functional analysis prepared by Horst Frisch for APA applications covering the 2000 to 2004 period. The reports set forth Nortel's justification for its proposed RPSM. |
| IEs | Individual entities |
| IFSA | Interim Funding and Settlement Agreement, June 9, 2009 (TR43794) |
| Inland Revenue | The Inland Revenue Service in the U.K. |
| Intercompany DIP Loan | NNI loaned to NNL $75 million under a revolving loan agreement. This loan was approved by the U.S. Court on the Petition Date. |
| IP | Intellectual Property |
| IP Assets | Nortel's remaining patent portfolio and related assets |
| IP Stalking Horse Agreement | Agreement dated April 4, 2011 between each of the IEs as Sellers and Ranger, Inc., for a purchase price of $900 million |

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| IP Steering Committee | Formed in January 2010, a committee of representatives of Nortel and their advisors which led the evaluation process. |
| IPCo | A proposed IP licensing service and enforcement business that Nortel began developing even before the insolvency filings. |
| IRS | The U.S. Internal Revenue Service |
| Joint Administrators | Ernst & Young LLP was appointed administrator of the EMEA Debtors by the High Court of England and Wales on January 14, 2009 |
| Layer 4-7 Sale | Nortel sold its businesses and assets, including the sale of certain portions of its Layer 4-7 data portfolio to Radware Ltd. [D.I. 539] |
| Lazard | Lazard Freres & Co. LLC, financial advisor to the Debtors. |
| Licensed Participant(s) | As defined in Article 1(e) of the MRDA, a Participant (or all Participants) other than NNL. |
| LREs | Limited Risk Entities which were incorporated in most of the countries where Nortel products were sold, including in the EMEA region. |
| LTAs | License Termination Agreements |
| LTE | Long-term evolution wireless technology line of business |
| MNE | A multi-national enterprise |
| Monitor | Ernst & Young Inc. in its capacity as monitor of the Canadian Debtors appointed in the Initial Order granted January 14, 2009. By various orders, the Ontario Superior Court of Justice expanded the Monitor's powers and authorized it to exercise the powers of the boards of directors of the Canadian Debtors. |
| MOU | The Memorandum of Understanding, which was drafted "to provide a record of the Participants' "understandings" with respect to the MRDA and related agreements. |
| MRDA | Master R&D Agreement dated December 22, 2004 but with an effective date of January 1, 2001, between NNL, NNI, NNUK, NNSA, NN Australia and NN Ireland, as amended at least four times (TR21003). |

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| NN Ireland | Nortel Networks Ireland, being an entity formed under the laws of the Republic of Ireland, one of the EMEA Debtors, and a direct subsidiary of NNL. |
| NN Technology | As defined in Article 1(f) of the MRDA, NN Technology "shall mean, any and all intangible assets including but not limited to patents, industrial designs, copyrights and applications thereof, derivative works, technical know-how, drawings, reports, practices, specifications, designs, software and other documentation or information produced or conceived as a result of research and development by, or for, any of the Participants, but excluding trademarks and any associated goodwill." |
| NNC | Nortel Networks Corporation, being a corporation incorporated under the laws of Canada, which was the publicly traded, parent holding company of NNL and its subsidiaries. |
| NNI | Nortel Networks Inc., being a corporation incorporated under the laws of the State of Delaware, the main U.S. operating entity and a direct subsidiary of NNL. |
| NNI Guaranteed Bonds | In 2008, NNL issued an additional approximately $675 million in public debt also guaranteed by NNI (together with the 2006 Bond Issuance). |
| NNL | Nortel Networks Ltd., being a corporation incorporated under the laws of Canada, and the main Canadian operating entity. |
| NNSA | Nortel Networks, S.A., being an entity duly formed under the laws of France, one of the EMEA Debtors, and a direct subsidiary of NNL. |
| NNUK | Nortel Networks UK Limited, being an entity formed under the laws of the United Kingdom, one of the EMEA Debtors, and a direct subsidiary of NNL. |
| Non-Exclusive License | As defined in the MRDA, a non-exclusive, royalty-free license, including the right to sublicense, which except as hereinafter provided shall be in perpetuity, rights to make, have made, use, lease, license, offer to sell, and sell Products using or embodying NN Technology in and for the Non-Exclusive Territory, and all rights to patents, industrial designs (or equivalent) and copyrights, and applications therefor, and technical know-how, as necessary or appropriate in connection therewith. |

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| Nortel | Collectively, NNC and all of its direct and indirect subsidiaries, including the businesses they operated. |
| Nortel Entity(ies) | Any of the companies or entities, either individually or collectively, within the Nortel Group. |
| Participant(s) | As defined in the MRDA, any of the parties to the MRDA, namely NNL, NNI, NNUK NNSA, NN Australia, NN Ireland |
| Petition Date | January 14, 2009 |
| PR&D | Pricing payments attributable to R&D each year. |
| Products | As defined in Article 1(g) of the MRDA, Products "shall mean all products, software and services designed, developed, manufactured or marketed, or proposed to be designed, developed, manufactured or marketed, at any time by, or for, any of the Participants, and all components, parts, sub-assemblies, features, software associated with or incorporated in any of the foregoing, and all improvements, upgrades, updates, enhancements or other derivatives associated with or incorporated in any of the foregoing" (equivalent to "Nortel Products"). |
| Protocol | The Motion for Entry of an Order Pursuant to 11 U.S.C. § 105(a) Approving Cross-Border Court-to-Court Protocol, filed by the U.S. Debtors on the Petition Date. |
| R&D | Research and Development |
| R&D CSA | A cost sharing agreement governing R&D |
| Residual IP | A substantial number of intellectual property assets belonging to Nortel's "Patent Portfolio." |
| Residual Patent Sale | The $4.5 billion sale of Nortel's Residual IP to Rockstar. |
| Rockstar | Rockstar Bidco L.P. is a consortium comprised of Apple, Ericsson, Microsoft, Blackberry, EMC and Sony |
| Rockstar Transaction | The sale to Rockstar Bidco, LP in 2011 of the residual patent and patent-related assets owned by NNL (equivalent to "Rockstar Sale"). |
| RPEs | Residual Profit Entities (NNL, NNI, NNUK, NNSA and NN Ireland) |

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| RPS | Residual profit split |
| RPSM | Residual Profit Split Methodology – the transfer pricing methodology used by Nortel from 2001. |
| Sales Proceeds | The money received from Line of Business Sales and the Residual IP. |
| Second Expansion of Monitor Powers Order | An order dated October 3, 2012, adding to the powers of the Monitor by, among other things, authorizing and empowering, but not obligating, the Monitor to exercise any powers which may be properly exercised by a board of directors of any of the Canadian Debtors. |
| U.S. Court | The United States Bankruptcy Court for the District of Delaware. |
| U.S. Debtors | The U.S. Nortel companies that, on January 14, 2009, filed voluntary petitions in the United States Bankruptcy Court for the District of Delaware for protection under Chapter 11 or Title 11 of the U.S. *Code*, being Nortel Networks Inc. ("NNI") and several of its U.S. affiliates, namely Nortel Networks Capital Corporation, Nortel Altsystems Inc., Nortel Altsystems International Inc., Xros, Inc., Sonoma Systems, Qtera Corporation, CoreTek, Inc., Nortel Networks Applications Management Solutions Inc., Nortel Networks Optical Components Inc., Nortel Networks HPOCS Inc., Architel Systems (U.S.) Corporation, Nortel Networks International Inc., Northern Telecom International Inc., Nortel Networks Cable Solutions Inc. and Nortel Networks (CALA) Inc. |
| UK Pension Claimants | Collectively, the Nortel Networks UK Pension Trust Limited and the Board of Directors of the Pension Protection Fund. (the "UKPC") |
| UK Proceedings | On the Petition Date, the High Court of England and Wales placed the EMEA Debtors into administration under the control of the Joint Administrators. |
| Wilmington Trust | Wilmington Trust, National Association |

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*569 APPENDIX B

  

## Business Line Sales

**APPENDIX B**[1]

**Business Line Sales**

| Asset Name (Code Name) | Key Dates | Stalking Horse (Code Name) | Auction | Other bidders | Purchaser & Price |
|---|---|---|---|---|---|
| Layer 4-7 (Velocity) | Sale hearing: 3/26/2009<br>Signing: 2/19/2009<br>Closing: 3/31/2009 | Radware (Velocity)<br>SH agmt. signed: 2/19/2009 | No auction | N/A | Radware<br>**$17.7 million** |
| CDMA/LTE (Eckberg) | Sale hearing: 7/28/2009<br>Signing 7/24/2009<br>Closing: 11/13/2009 | Nokia Siemens Networks (Narnia)<br>SH agmt. signed: 6/19/2009 | Auction 7/24/2009 | Yes | Ericsson<br>**$1.13 billion** |
| Enterprise (Equinox) | Sale hearing: 9/16/2009<br>Signing : 9/14/2009<br>Closing: 12/18/2009 | Avaya (Equinox)<br>SH agmt. signed: 7/20/2009 | Auction 9/11/2009-9/14/2009 | Yes | Avaya<br>**$900 million** |
| Next Generation Packet Core (Seville) | Sale hearing: 10/28/2009<br>Signing: 10/25/2009<br>Closing: 12/8/2009 | N/A | Auction | No | Hitachi<br>**$10 million** |
| Metro Ethernet Networks (Snow) | Sale hearing: 12/2/2009<br>Signing: 11/24/2009<br>Closing: 3/19/2010 | Ciena (Snow)<br>SH agmt. signed: 10/7/2009 | Auction 11/20/2009-11/22/2009 | Yes | Ciena<br>**$774 million** |
| GSM/GSM-R (Isis) | Sale hearing: 12/2/2009<br>Signing: 11/24/2009<br>Closing: 3/31/2010 | N/A | Auction 11/24/2009 | Yes | Ericsson & Kapsch CarrierCom<br>**$103 million** |
| CVAS (Paragon) | Sale hearing: 3/3/2010<br>Signing: 12/22/2009<br>Closing: 5/28/2010 | GENBAND (Paragon)<br>SH agmt. signed: 12/22/2009 | No auction | N/A | GENBAND<br>**$282 million** |
| GSM Retained Contracts (Horus) | Sale hearing: 5/24/2010<br>Signing: 5/11/2010<br>Closing: 6/4/2010 | N/A | No auction | N/A | Ericsson<br>**$2 million**<br>(add-on to GSM sale) |
| Multi Service Switch (Pluto) | Sale hearing: 9/30/2010<br>Signing: 9/24/2010<br>Closing: 3/11/2011 | PSP Holding LLC (Marlin)<br>SH agmt. signed: 8/26/2010 | Auction 9/24/2010 | Yes | Ericsson<br>**$65 million** |

**Layer 4-7**: See TR50324 (Transcript of Proceedings, In re: Nortel Networks, Inc., et al., Hearing re: Layer 4-7 Sale) (Hearing Date); TR50171 (NNI Proposed Disclosure Statement) at 38 (Closing Date); TR50165 (U.S. Motion to Approve the Layer 4-7 Sale) at 2,8 (Signing Date and Purchase Price); TR50188 (U.S. D.I. 539 Sale Order re Layer 4-7), TR50033 (Mar. 30 2009 Layer 4-7 Approval and Vesting Order) (Sale Approval).

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**CDMA/LTE**: See TR50114 at 2 (U.S. D.I. 1205 CDMA and LTE Sale Order) (Hearing Date); TR50171 (NNI Proposed Disclosure Statement) at 39 (Closing Date); TR49971 (Canadian Motion Record, Approval and Vesting Order CDMA & LTE Business Sale Transaction) at 5 (Signing Date); TR21541 (2010 NNC 10-K) Purchase Price) at 24-25; TR50114 (U.S. D.I. 1205 CDMA and LTE Sale Order), TR50029 (July 28, 2009 CDMA and LTE Approval and Vesting Order), TR49998 (Oct. 28, 2009 Amendment to Approval and Vesting Order re CDMA and LTE) (Sale Approval).

**Enterprise**: See TR50128 (U.S. D.I. 1514 Enterprise Sale Order) (Hearing Date); TR50171 (NNI Proposed Disclosure Statement) at 39-40 (Closing Date); TR50570 (Canadian Motion Record, Approval and Vesting Order Enterprise Solution Business) at 5 (Signing Date); TR21541 (2010 NNC 10-K) at 25 (Purchase Price); TR50128 (U.S. D.I. 1514 Enterprise Sale Order), TR50030 (Sept. 16, 2009 Enterprise Approval and Vesting Order) (Sale Approval).

**Next Generation Packet Core**: See TR50361 (Transcript of Proceedings, In re: Nortel Networks, Inc., et al., Hearing re: Next Generation Packet Core Sale) (Hearing Date); TR50171 (NNI Proposed Disclosure Statement) at 40 (Closing Date); TR50136 (U.S. D.I. 1760 Next Generation Sale Order) at 1 (Signing Date); TR21541 (2010 NNC 10-K) at 25 (Purchase Price); TR50136 (U.S. D.I. 1760 Next Generation Sale Order), TR50001 (Oct. 28, 2009 Next Generation Approval and Vesting Order) (Sale Approval).

**Metro Ethernet Networks (MEN)**: See TR50336 (Transcript of Proceedings, In re: Nortel Networks, Inc., et al., Hearing re: MEN Sale and GSM Sale) (Hearing Date); TR50171 (NNI Proposed Disclosure Statement) at 41 (Closing Date); TR40551 (Canadian Motion Record, Approval and Vesting Order MEN) (Signing Date) at 5; TR21541 (2010 NNC 10-K) at 25 (Purchase Price); TR50140 (U.S. D.I. 2070 MEN Sale Order), TR50060 (Dec. 2, 2009 MEN Approval and Vesting Order) (Sale Approval).

**GSM/GSM-R**: See TR50336 (Transcript of Proceedings, In re: Nortel Networks, Inc., et al., Hearing re: MEN Sale and GSM Sale) (Hearing Date); TR50171 (NNI Proposed Disclosure Statement) at 42 (Closing Date); TR50139 (U.S. D.I. 2065 GSM/GSM-R Sale Order) at 2 (Signing Date); TR21541 (2010 NNC 10-K) at 26 (Purchase Price); TR50139 (U.S. D.I. 2065 GSM/GSM-R Sale Order), TR50032 (Dec. 2, 2009 GSM/GSM-R Approving and Vesting Order) (Sale Approval)

**CVAS**: See TR50149 (U.S. D.I. 2632 CVAS Sale Order) at 2 (Hearing Date); TR50171 (NNI Proposed Disclosure Statement) at 43 (Closing Date); TR50141 (U.S. Motion to Approve the CVAS Sale) at 2 (Signing Date); TR21541 (2010 NNC 10-K) at 26 (Purchase Price); TR50055 (Mar. 3, 2010 CVAS Approval and Vesting Order), TR50149 (U.S. D.I. 2632 CVAS Sale Order) (Sale Approval).

The initial purchase price was for $282 million subject to balance sheet and other adjustments of approximately $100 million resulting in a final purchase price at closing of $182 million. Subsequently a dispute arose between the parties over a defined term in the asset sale agreement which would impact the final purchase price. To resolve the dispute the parties engaged in settlement discussions resulting in the final purchase price of $157 million. The settlement was approved by the U.S. Court and Canadian Court on August 23, 2011. *See* TR40190 (2011 NNC 10K) at 25.

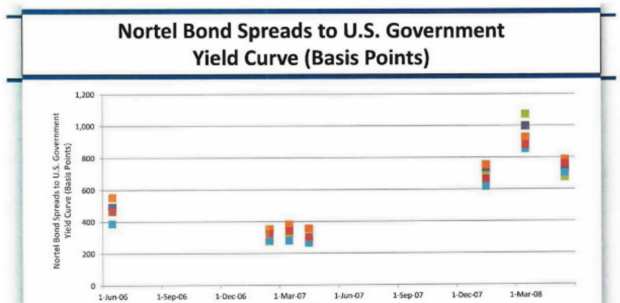
**GSM Retained Contracts**: See TR50271 (Transcript of Proceedings, In re: Nortel Networks, Inc., et al., Hearing re: GSM Retained Contracts Sale) (Hearing Date); TR50171 NNI Proposed Disclosure Statement) at 42 ( (Closing Date); TR50157 (U.S. Motion to Approve the Sale of Certain Assets of the GSM/GSM R Business) at 2, 9 (Signing Date and Purchase Price); TR47776 (Canadian Approval and Vesting Order, GSM/GSM-R Remaining Contracts), TR50159 (D.I 3048, U.S. Order Approving the Sale of Certain Assets of the GSM/GSM-R Business) (Sale Approval).

**Multi Service Switch (MSS)**: See TR50172 (U.S. D.I. 4054 MSS Sale Order) at 2 (Hearing Date); TR40190 (2011 NNC 10-K) at 25 (Closing Date); TR40633 (Canadian Motion Record, Approval and Vesting Order, MSS Business) at 4 (Signing Date); TR21541 (2010 NNC 10-K) at 27 (Purchase Price); TR50172 (U.S. D.I. 4054 MSS Sale Order), TR50056 (Sept. 30, 2010 Approval and Vesting Order MSS Business) (Sale Approval).

Total value. There were separate sales for the North America; Caribbean & Latin America (CALA); and Europe, Middle East & Africa (EMEA) regions.

## *571 APPENDIX C

### Nortel Bonds Spreads to U.S. Government Yield Curve (Basic Points) Chart




| | Issue Amount | Issuer/Guarantor(s) | Jun 29, 2006 | Feb 22, 2007 | Mar 22, 2007 | Apr 20, 2007 | Jan 31, 2008 | Mar 31, 2008 | May 21, 2008 |
|---|---|---|---|---|---|---|---|---|---|
| 5-year L+425 due Jul 2011 | 1 Billion | NNL/NNI & NNC | | 276 bps | 326 bps | 277 bps | 718 bps | 1,072 bps | 675 bps |
| 7-year 10.125% due Jul 2013 | 550 Million | NNL/NNI & NNC | 492 bps | | | | 737 bps | 997 bps | 731 bps |
| 10-year 10.75% due Jul 2016 | 450 Million (650 add-on in May 08) | NNL/NNI & NNC | 553 bps | 351 bps | 380 bps | 354 bps | 753 bps | 926 bps | 785 bps |
| 6.875% due Sep 2023 | 200 Million | NNL/ No Guarantee | 387 bps | 281 bps | 279 bps | 265 bps | 617 bps | 852 bps | 702 bps |
| 7.875% due Jun 2026 | 150 Million | NNCC/NNL | 464 bps | 323 bps | 339 bps | 301 bps | 666 bps | 879 bps | 760 bps |

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## All Citations

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Footnotes

1 The Court uses many defined terms in the opinion and has prepared a glossary of important terms which is attached as Appendix A.

2 The Court expresses its profound appreciation and respect for Justice Geoffrey Morawetz and Justice Frank J.C. Newbould who were able and congenial colleagues in this endeavor. Justice is alive and well in Canada.

3 The Court's authority to decide the allocation issues is discussed in *In re Nortel Networks, Inc.,* 737 F.3d 265 (3d Cir.2013). There, the Third Circuit Court of Appeals affirmed the Court's ruling that arbitration was not compulsory.

4 The U.S. Debtors in these chapter 11 cases, are: Nortel Networks Inc., Nortel Networks Capital Corporation, Nortel Altsystems Inc., Nortel Altsystems International Inc., Xros, Inc., Sonoma Systems, Qtera Corporation, CoreTek, Inc., Nortel Networks Applications Management Solutions Inc., Nortel Networks Optical Components Inc., Nortel Networks HPOCS Inc., Architei Systems (U.S.) Corporation, Nortel Networks International Inc., Northern Telecom International Inc., Nortel Networks Cable Solutions Inc. and Nortel Networks (CALA) Inc.

5 Nortel Networks (CALA) Inc. filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code on July 14, 2009, which was consolidated and is being jointly administered with the other Debtors' chapter 11 cases for procedural purposes [D.I. 1098].

6 TR43999 (Nortel Networks Corporation Form 10–K for fiscal year ended December 31, 2008) p. 1, Exhibit 21. A corporate chart showing the relevant corporate entities and the Debtor Estate to which each belongs is attached as Appendix "A".

7 TR00002 (Exh. 2, Affidavit of Clive Allen, April 11, 2014) para. 12

8 TR43999 (Nortel Networks Corporation Form 10–K for fiscal year ended December 31, 2008) p. 1; TR00001 (Exh. 1, Affidavit of Peter Currie, April 11, 2014) paras. 32, 36

9 TR11055B (Economic Analysis of Nortel Networks' Intercompany Transactions by Horst Frisch, March 14, 2002) p. 1–3; TR21003 (MRDA and addenda)

10 TR11055B (Economic Analysis of Nortel Networks' Intercompany Transactions by Horst Frisch, March 14, 2002) p. 1–3.

11 TR40150 (2001 Distribution Agreement between NNL and NN Austria, effective January 1, 2001); TR40151 (2001 Distribution Agreement between NNL and NN Portugal, effective January 1, 2001); TR40155 (2001 Distribution Agreement between NNL and NN Spain, effective January 1, 2001); TR40122 (2001 Distribution Agreement between NNL and NN Asia, effective January 1, 2001)

12 The Canadian Debtors include the following entities: NNC, NNL, Nortel Networks Technology Corporation, Nortel Networks Global Corporation and Nortel Networks International Corporation.

13 The EMEA Debtors include the following entities: Nortel Networks UK Limited ("*NNUK*"), Nortel Networks S.A. ("*NNSA*"), Nortel Networks (Ireland) Limited ("*NNIR*"), Nortel GmbH, Nortel Networks France S.A.S., Nortel Networks Oy, Nortel Networks Romania SRL, Nortel Networks AB, Nortel Networks N.V., Nortel Networks S.p.A., Nortel Networks B.V., Nortel Networks Polska Sp. z.o.o., Nortel Networks Hispania, S.A., Nortel Networks (Austria) GmbH, Nortel Networks, s.r.o., Nortel Networks Engineering Service Kft, Nortel Networks Portugal S.A., Nortel Networks Slovensko, s.r.o. and Nortel Networks International Finance & Holding B.V.

14 TR44220 (Rockstar Transaction ASA, June 23, 2011).

15 TR00001 (Exh. 1, Affidavit of Peter Currie, April 11, 2014) paras. 22–28; TR00004 (Exh. 4, Affidavit of Brian McFadden, April 10, 2014) paras. 31–38

16 TR00001 (Exh. 1, Affidavit of Peter Currie, April 11, 2014) paras. 22–28; TR00004 (Exh. 4, Affidavit of Brian McFadden, April 10, 2014) paras. 45–52

17 TR00009A (Exh. 9, Affidavit of Sharon Hamilton, April 11, 2014) paras. 9–13 (*but note*, at para. 9, that "[a] fourth business segment, Global Services (essentially Nortel's support and services arm), was a separate reportable segment until December 31, 2008, before being integrated into the other LOBs.")

18 TR00042 (Exh. 42, Expert Report of Philip Green, Reissued February 28, 2014) Appendices A–E Carve-out statements

19 TR00014 (Exh. 14, Affidavit of Paviter Binning, April 10, 2014) paras. 21, 47; TR46789 (Verizon Press Release regarding Global LTE Ecosystem, February 17, 2009); TR43999 (Nortel Networks Corporation Form 10–K for fiscal year ended December 31, 2008)

20 TR00004 (Exh. 4, Affidavit of Brian McFadden, April 10, 2014) para. 28, citing TR44900 (Email regarding Competitor Comparisons, February 19, 2004)

21 Gregory Mumford Deposition, October 24, 2013, p. 202:19–204:15, regarding TR21226 (Email discussing Harlow Input, October 28, 2003)

22 TR00004 (Exh. 4, Affidavit of Brian McFadden, April 10, 2014) para. 16

23 TR40259 (Nortel Networks Corporation Form 10–K for fiscal year ended December 31, 2000) p. F14–F16

24 TR00002 (Exh. 2, Affidavit of Clive Allen, April 11, 2014) paras. 38–39

25 TR00004 (Exh. 4, Affidavit of Brian McFadden, April 10, 2014) paras. 19–21; TR00023 (Exh. 23, Affidavit of Simon Brueckheimer, April 9, 2014) para. 10

26 TR00004 (Exh. 4, Affidavit of Brian McFadden, April 10, 2014) paras. 12, 17, 20, 22–23; Simon Brueckheimer Deposition, October 1, 2013, p. 165:6–166:19; Peter Newcombe Trial Testimony, Day 7, May 22, 2014, p. 1608:10–22

27 TR00004 (Exh. 4, Affidavit of Brian McFadden, April 10, 2014) para. 22

28 TR11084 (2004 Functional Analysis, November 30, 2004) p. 23

29 Michael Orlando Trial Testimony, Day 6, May 21, 2014, p. 1315:21–1316:1; TR11084 (2004 Functional Analysis, November 30, 2004) p. 28–29; TR22078 (Joint Request for US–Canada BAPA 2007–2011 (with rollback to 2006), October 31, 2008) p. 50, Appendix B

30 TR00006 (Exh. 6, Affidavit of Angela de Wilton, April 11, 2014) para. 12, citing TR47338 (Patent Excel File, January 7, 2009); *see also* TR11151 (Nortel's IP Team and Patent Portfolio PowerPoint, August 2010) Slide 11 (p. 11)

31 TR00006 (Exh. 6, Affidavit of Angela de Wilton, April 11, 2014) paras. 8–12; Timothy Collins Deposition, November 15, 2013, p. 40:10–41:20

32 TR00006 (Exh. 6, Affidavit of Angela de Wilton, April 11, 2014) paras. 8–12; TR40197 (List of Transferred Patents in Rockstar Transaction); TR47338 (Patent Excel File, January 7, 2009)

33 TR00062 (Eden Report) ¶ 20; TR00035 (Cooper Report) ¶ 3.1

34 TR00049 (Reichert Report) at 13

35 TR00062 (Eden Report); TR00049 (Reichert Report) at 14; Trial Tr. 2632:4–3632:14 (Cooper); TR00016 (Henderson Decl.) ¶ 8.

36 TR00062 (Eden Report) ¶ 24; TR00049 (Reichert Report) at 16; TR00035 (Cooper Report) ¶ 3.1

37 TR00049 (Exh. 49, Expert Report of Dr. Timothy Reichert, January 24, 2014) p. 16; TR21389 (Email attaching Memo regarding Nortel's Transfer Pricing Policy, March 18, 2003) p. 1

38 TR00014 (Binning Aff.) ¶ 9; TR00007A–B (McCorkle Aff.) ¶¶ 16, 17; Doolittle Dep. 258:15–259:3; Trial Tr. 815:11–816:8 (McCorkle); TR21322 (Corporate Procedure 303.37 discussing Regional/Global Cash Pooling); Freemantle Dep. 204:6–204:15; Rolston Dep. 34:6–35:2.

39 TR00001 (Currie Aff.) ¶ 39; Binning Dep. 148:13–23; Freemantle Dep. 416:7–17; *see also* TR40269 (NNC 2008 Form 10–K) at 54–59, 197–206, 281.

40 Trial Tr. 543:21–546:12 (Currie); *id.* 1069:14–1070:20 (Binning); TR00001 (Currie Aff.) ¶ 39; TR00014 (Binning Aff.) ¶ 9; TR00020 (Ray Decl.) ¶¶ 16, 30; TR00013 (G. Davies Aff.) ¶¶ 14, 18; Rolston Dep. 159:22–160:13.

41 TR00062 (Eden Report) ¶ 77; TR00049 (Reichert Report) at C–13 to C–15; TR00016 (Henderson Decl.) ¶ 9.

42 TR00049 (Reichert Report) at C–13 to C–15; TR00016 (Henderson Decl.) ¶¶ 10, 12.

43 TR46882 (1978 NNL–NNI R & D CSA); TR45048 (1983 NNL–NNI R & D CSA); TR45741 (1985 NNL–NNI R & D CSA); TR45740 (1985 NNL–NNUK R & D CSA); TR45739 (1985 NNL–NN Ireland R & D CSA); TR21002 (1992 NNL–NNI R & D CSA); TR33067 (1995 NNL–NNUK R & D CSA); TR46945 (2000 NNL–NNSA R & D CSA); TR11055 (Horst Frisch Report) at 1–2; TR00016 (Henderson Decl.) ¶ 14.

44 TR11055 (Horst Frisch Report) at 1, 10–12.

45 TR11058 (Dec. 2, 2001 Email from W. Henderson attaching "Overview of Objectives of December 12, 2001 Presentation") attachment at 1.

46 TR11103 (2001 Termination of Amended NNL–NNI R & D CSA); TR31016 (2001 Termination of Amended NNL–NNUK R & D CSA); TR 45043 (2001 Termination of Amended NNL–NN Ireland R & D CSA); TR32240 (2001 Termination of NNL–NNSA R & D CSA).

47 TR00016 (Henderson Decl.) ¶ 32.

48 TR22122 (attaching letters submitting 2002 APA applications to IRS, CRA and Inland Revenue); TR00016 (Henderson Decl.) ¶ 33.

49 TR11055 (Horst Frisch Report); TR22122 (Letters submitting 2002 APA Application to IRS, CRA and Inland Revenue) at EY–NRTL–001402 ("[t]he specific details of the proposed RPS methodology are provided in the economic analysis prepared by Horst Frisch Inc., which is attached as *Appendix 1* to this APA Request"); *id.* at EY–NRTL–001406; *id.* at EY–NRTL–001413; TR00016 (Henderson Decl.) ¶ 33.

50 TR11055 (Horst Frisch Report) at 30; TR00016 (Henderson Decl.) ¶ 35.

51 TR11055 (Horst Frisch Report) at 34; TR00016 (Henderson Decl.) ¶ 35.

52 TR11055 (Horst Frisch Report) at 37–40; TR00016 (Henderson Decl.) ¶ 37; TR21003 (MRDA) at 18–19 (Sched. A).

53 TR11055 (Horst Frisch Report) at 34–35, 40, 55; TR21003 (MRDA) at 18–19 (Sched. A).

54 TR11058 (Dec. 2, 2001 Email from W. Henderson attaching "Overview of Objectives of December 12, 2001 Presentation") attachment at 1; TR11053 (Dec. 11, 2001 PowerPoint Presentation titled "Overview of Transfer Pricing APA and Recommendations") at 15; *see also id.* at 16–18; TR11068 (Mar. 17, 2002 Email from W. Henderson titled "Mission Accomplished!") at NNI_01503492; TR22121 (July 5, 2002 Email from R. Prgomet attaching July 11, 2002 PowerPoint Presentation titled "Global Tax Practice") attachment at 13; TR11341 (Dec. 17, 2003 Call Notes); TR21525 (Nov. 23, 2005 Email from J. Doolittle to K. Stevenson and M. McCorkle); TR21169 (Dec. 18, 2005 Email from M. Weisz to M. Orlando) at 1; *see also* TR00028 (Weisz Decl.) ¶¶ 3–4; TR21170 (Dec. 5, 2007 Presentation titled "Global Tax Town Hall") at 7, 17; TR21164 (Oct. 22, 2007 Email from R. Culina to P. Carbone) at EMEAPRIV0089376 ; *see also id.* attachment at 1; TR45137 (May 6, 2008 Presentation titled "Tax Matters Update Audit Committee Meeting") at 3.

55 Trial Tr. 552–53 (Currie); TR00001 (Currie Decl.) ¶ 73.

56 See Orlando Decl. at 14, Figure 2 (citing TR49192 at "Rona" tab, 2001 Transfer Pricing Worksheet; TR49187 at "Rona" tab, 2002 Transfer Pricing Worksheet; TR49188 at "Rona" tab, 2003 Transfer Pricing Worksheet; TR49194 at "Profit split profit tab, 2004 Transfer Pricing Worksheet; TR49190 at "Profit split profit" tab, 2005 Transfer Pricing Worksheet; TR49191 at "RPS Calculation" tab, 2006 Transfer Pricing Worksheet; TR49193 at "RPS Calculation" tab, 2007 Transfer Pricing Worksheet; TR49189 at "FY RPS Calculation" tab, 2008 Transfer Pricing Worksheet.)

57 Trial Tr. 822:13–823:10 (McCorkle)

58 TR11239 (2010 NNI–IRS APA) App. A; TR48800 (2010 NNL–CRA APA) at 9.

59 Trial Tr. 1140:5–23 (Henderson); *id.* 1716:3–1717:21 (Stephens); Stephens Dep.34:15–35:6; Trial Tr. 1848:3–11; Lebrun Dep. 213:18–214:6.

60 TR11246 (Dec. 22, 2004 Email from Mark Weisz enclosing the Final Master R & D Agreement) at 5; TR21003 (MRDA) at 13–17 (Signature Blocks).

61 TR21003 (MRDA) at 6 (Art. 4(a))

62 Trial Tr. 1848:3–20 (Weisz)

63 Trial Tr. 1275:6–7; 1725:19–25; TR00028

64 TR21003 (MRDA) at 2 (final recital); TR21003 (MRDA) at 5 (Art. 3(c)); TR21003 (MRDA) at 19 n.2 (Schedule A); TR21003(MRDA) at 29 (Addendum to MRDA replacing, *inter alia,* Art. 11(d)).

65 TR21003 (MRDA) at 12 (Art. 13); TR00062 (Eden Report) ¶¶ 24–126

66 TR50194; TR50003

67 TR12032 (IFSA) at 2

68 TR12032 (IFSA).

69 TR12032 (IFSA) § 1; TR45561 (Apr. 24, 2009 Report of the Monitor) ¶¶ 50–51.

70 TR12032 (IFSA) § 12(c), (d).

71 *Id.* § 12(e).

72 *Id.* § 12(g).

73 *Id.* ¶¶ 11(a).

74 *Id.* § 11(d); *see also* TR44149 (CDMA–LTE License Termination Agreement) at 2; *id.* at Art. 2.08

75 TR12032 (IFSA) § 11(a); *see also id.* § 11(d).

76 *Id.* § 20.

77 TR40824 (Motion (A) Approving the IFSA and (B) Granting Related Relief); TR50057 (Canadian Order Approving the IFSA).

78 TR46910 (FCFSA) at 2.

79 TR46910 (FCFSA); TR11239 (Feb. 18 2010 NNI and IRS APA).

80 TR46910 (FCFSA) § 1; *See id.* § 9; *See id.* § 10; *See id.* § 28

81 TR48613

82 TR46910 (FCFSA) § 1;

83 TR40271 (2011 NNC Form 10–K) at 32; TR50431 (Jan. 21, 2010 Canadian Order Approving FCFSA); TR50146 (US D.I. 2347 Order Approving FCFSA).

84 TR00009A–C (Hamilton Aff.) ¶ 37; Trial Tr. 3208:7–19 (Green); Trial Tr. 4172:2–5 (Kinrich).

85 TR44149 (CDMA/LTE LTA); TR44186 (MEN LTA); TR12032 (IFSA) § 11(a).

86 TR44149 (CDMA/LTE LTA); TR44186 (MEN LTA).

87 TR11151 (Nortel's IP Team and Patent Portfolio PowerPoint, August 2010) Slide 11 (p. 11)

88 TR00009A (Exh. 9, Affidavit of Sharon Hamilton, April 11, 2014) para. 65

89 TR00009A (Exh. 9, Affidavit of Sharon Hamilton, April 11, 2014) para. 52(f)

90 Trial Tr. 2120:13–2120:20 (Huffard); Trial Tr. 3420:25–3421:7 (Britven); Trial Tr. 3220:23–3221:5 (Green); Trial Tr. 4104:1–4104:12 (Kinrich);

91 TR00009A (Exh. 9, Affidavit of Sharon Hamilton, April 11, 2014) paras. 59–60; John Veschi Deposition, November 7, 2013, p. 128:11–25

92 McColgan Dep. 123:14–22; Veschi Dep. 125:6–126:8

93 Veschi Dep. 124:10–20.

94 Veschi Dep. 124:10–20; *id.* at 146:7–17; TR48932 (Presentation titled "Overview") at 8; TR43641.03 (Presentation titled "Project Iceberg") at 1–3.

95 TR50843

96 TR40710

97 Trial Tr. 668:25–69:25 (McFadden); Trial Tr. 1595:13–1596:2 (Brueckheimer); Trial Tr. 2868:10–2869:1 (Felgran); Trial Tr. 2270:20–25 (Malackowski); Trial Tr. 2457:22–2458:5; TR31355 (Nortel Networks Functional Analysis for the years ended December 31) at 29; TR44077 (Presentation, Nortel Pre-Filing Conference with CRA) at 5; Tr. 4678:9–22 (Tucker).

98 Trial Tr. 628:2–6 (Allen); Trial Tr. 2662:19–2663:2 (Cooper); TR48711.02

  

99 TR00033; TR41471; TR48835; Trial Tr. 2281:2–12; Trial Tr. 2287:1–20; TR00035; Trial Tr. 2814:5–13; Trial Tr. 2051:5–11; TR21011; TR21013;

100 Trial Tr. 2266:22–2267:9; Trial Tr. 2276:16–2278; Trial Tr. 4679:1

101 Trial Tr. 2281:2–12 (Malackowski); TR00034 (Malackowski Rebuttal) at 31.

102 Trial Tr. 4511:15–4512:22

103 Trial Tr. 1075:2–1076:2 (Binning); Trial Tr. 933:6–12 (Hamilton)

104 TR00009A–C (Hamilton Aff.) ¶ 73.

105 Trial Tr. 1073:2–22 (Binning); Veschi Dep. 45:4–7, 47:13–25.

106 Veschi Dep. 42:5–42:23; ."); *id.* at 39:11–40:6; 232:21–233:12; TR 44998 (Appointment Notice for John Veschi).

107 Veschi Dep. 38:6–38:23.

108 Veschi Dep. 148:18–153:9; TR22102 (Dec. 4, 2008 Email from J. Veschi titled "FW: IP Org Update").

109 TR50711 (Nov. 6, 2008 Email from J. Veschi; Veschi Dep. 156:6–157:3; TR11150 (July 8, 2009 PowerPoint Presentation titled "IP Aspects of Residual Co") at 7.

110 Veschi Dep. 70:18–71:12, 94:2–13 (discussing TR22097), 69:18–71:12; ; TR22106 (Aug. 12, 2009 PowerPoint Presentation titled "Strategic Alternatives for IP") at 2; TR22097 (Dec. 16, 2009 PowerPoint Presentation titled "Patent Portfolio Analysis Phase One—Ottawa Presentation").

111 Trial Tr. 1075:2–1076:2 (Binning).

112 Veschi Dep. 73:25–77:4.

113 TR48716 (Oct. 15, 2009, Master Consulting Agreement ("*MCA*")) at Annex A to Exhibit A, at 15.

114 TR48716 (MCA) at 15.

115 TR50182 (US D.I. 507 Order Authorizing Retention and Employment of Lazard Freres); TR00001 (Currie Aff.) ¶ 85; US D.1. 2561 Order Approving An Amendment to the Terms of Compensation of Lazard Frères.

116 Trial Tr. 907:24–908:5 (Hamilton); Trial Tr. 1363:6–11 (Ray); Ray Decl. ¶ 54.

117 TR22097 (Dec. 16, 2009 PowerPoint Presentation titled "Patent Portfolio Analysis Phase One") at 11–12.

118 Veschi Dep. 92:6–15

119 TR50754 (Dec. 11, 2009 Email RE: "December 16 Logistics")

120 TR43655 (Jan. 29, 2010 PowerPoint Presentation titled "Patent Portfolio Analysis Phase One: Board of Directors Presentation").

121 TR50634.02 (Jan. 22, 2010 Draft PowerPoint Presentation) at 2; TR00020 (Ray Decl.) ¶¶ 51–52; Riedel Dep. 117:20–118:4, 118:6–13.

122 McDonald Dep. 165:19–166:10

123 TR50656 (Sept. 30, 2010 Email from S. Hamilton titled "Nortel IP Valuation Protocol"); Trial Tr. 933:6–12 (Hamilton)

124 TR21541 (2010 NNC 10–K) at 22.

125 TR50783 (Oct. 4, 2010 Email from G. Riedel to J. Veschi titled "Speaker Invitation—The IP Summit 2010: The Power of IP for Business Success"); TR47264 (Jan. 24, 2011 Email from G. McColgan to H. Chambers titled "FW: Nortel IP Follow-Up Information Request"); TR50797 (Jan. 10, 2011 Email from M. Spragg titled "RE: Nortel IP"); TR00009A–C (Hamilton Aff.) ¶ 69.

126 TR00009A–C (Hamilton Aff.) ¶ 74; *see also* TR00020 (Ray Decl.) ¶ 58; Trial Tr. 1359:25–1360:6 (Ray).

127 *See* TR22098 (Mar. 17, 2010 PowerPoint titled "Nortel IP Update to Creditor Committees") (reflecting first version of the model); TR50825 (Apr. 28, 2010 PowerPoint Presentation titled "IP Co. Update to Credit Advisor Working Group") (version 2.0); TR43658 (May 5, 2010 PowerPoint Presentation titled "IPCO. Model 2.2 Update") (version 2.2); TR50823 (May 3, 2010 Email from J. Veschi titled "IP Co. Presentation Materials for Creditor Fas") (explaining the evolution from version 2.0 to 2.2); TR43715 (PowerPoint Presentation titled "Model 3.0 Preliminary Valuations") (version 3.0); TR22108 (Oct. 25, 2010 PowerPoint Presentation titled "Project Copperhead IPR Model") (version 3.1); *see also* TR00020 (Ray Decl.) ¶ 9. There were also IPCo Updates for Leadership Teams/Boards. *See, e.g.,* TR50804 (Feb. 23, 2010); TR50817.02 (Mar. 10, 2010); TR50814.04 (Mar. 26, 2010); TR43861 (Apr. 27, 2010). Lazard provided IPCo Financial Projections as well. *See, e.g.,* TR43654 (Apr. 19, 2010); TR47157 (May 12, 2010); TR40022 (June 30, 2010); TR22108 (Oct. 25, 2010); TR48697.02 (Nov. 18, 2010). Mercer also provided an IPCo Management Compensation Analysis. TR50780.02 (Oct. 2010); *see also* TR00011 (US Interests Hamilton IPCo Demonstrative) at 1.

128 TR49827.01 (Email from Lazard to several recipients attaching IP Co. Model 3.1); TR49827.02 (IP Co. Model 3.1) at tabs "Global Revenue", "Franchise Bucket", "Enterprise Licensee Adress Rev.", "Voice Licensee Adress Rev.", "PC Licensee

  

Adress Rev.", "Internet Licensee Adress Rev.", "Data Net. Licensee Adress Rev.", "Optical Licensee Adress Rev.", "Infra. Adress Rev." and "Handset Licensee Adress Rev."

129 Trial Tr. 4124:12–4125:24 (Kinrich)

130 TR00051 (Kinrich Report) at Ex. 31; Trial Tr. 4138:19–24 (Kinrich).

131 Trial Tr. 2208:16–19 (Anderson); Trial Tr. 4114:21–4115:12 (Kinrich); TR50857 (United States Patent and Trademark Office Screen Shot) at 1; TR50849 (Canadian Intellectual Property Office—A Guide to Patents) at 9, 11; TR50975 (UK Intellectual Property Office—"What is a patent?").

132 Trial Tr. 4121:15–4123:5 (Kinrich); TR00051 (Kinrich Report) ¶ 79.

133 DEM00019 at 14, US Interests Kinrich Demonstrative, citing TR00051 (Kinrich Report) Exs. 21–22.

134 *Id.*

135 Trial Tr. 4123:23–4124:8 (Kinrich).

136 *Id.*

137 Trial Tr. 897:16–898:1, 900:10–17 (Hamilton).

138 Trial Tr. 905:8–14 (Hamilton); TR49824 (Twenty–Fifth Report of the Monitor) at ¶ 79; TR48716 (MCA) at 1.

139 TR48716 (MCA) ¶ 6(a).

140 TR00009A (Exh. 9, Affidavit of Sharon Hamilton, April 11, 2014) paras. 56, 67

141 Gillian McColgan Deposition, November 8, 2013, p. 141:12–24; TR00009A (Exh. 9, Affidavit of Sharon Hamilton, April 11, 2014) paras. 65–67; TR11151 (Nortel's IP Team and Patent Portfolio PowerPoint, August 2010) Slide 11 (p. 11) ( "~6,100 patent assets remain, covering wide variety of technologies [...] Strict limits on licenses granted (narrow fields of use/product-line limitations")

142 TR00009A (Exh. 9, Affidavit of Sharon Hamilton, April 11, 2014) paras. 79–80; John Ray Trial Testimony, Day 6, May 21, 2014, p. 1416:19–1420:12

143 TR00009A (Exh. 9, Affidavit of Sharon Hamilton, April 11, 2014) paras. 78–80

144 TR00009A (Exh. 9, Affidavit of Sharon Hamilton, April 11, 2014) para. 80

145 TR00021 (Ray Reply Decl.) ¶¶ 8,18.

146 TR12013 (Feb. 25, 2011 Email from K. Cunningham titled "Fw: Iceberg: Asset Sale Agreement Issues" attaching Bidder 1 Issues List).

147 TR00009A–C (Hamilton Aff.) ¶ 81.

148 TR00009A–C (Hamilton Aff.)

149 TR50184 (US D.I. 5202 Motion for Orders Authorizing Stalking Horse Asset Sale Agreement) at Ex. A § 5.13(b); TR00021 (Ray Reply Decl.) ¶ 19.

150 Riedel Dep. 138:9–139:5; Veschi Dep. 53:13–54:6; TR00009A–C (Hamilton Aff.) ¶¶ 98–100; Cianciolo Dep. 193:7–194:9; TR12013.

151 TR43640.01 (Apr. 4, 2011 ASA between Nortel Entities and Ranger Inc.); TR00009A–C (Hamilton Aff.) ¶ 85.

152 TR40725 (US D.I. 5202 Motion for Orders Authorizing Stalking Horse Asset Sale Agreement); TR49974 (Apr. 7 2011 Motion Record for Canadian Sales Process Order regarding Certain Patents and other Assets).

153 TR21281 (Sixty–Third Report of the Monitor).

154 TR50187 (US D.I. 5368 May 2, 2011 Hearing Transcript).

155 TR50196 (US D.I. 5935 Order Authorizing and Approving Sale); TR50428 (May 2, 2011 Canadian Order re Certain Patents); TR50184 (U.S. D.I. 5202 Motion for Orders Authorizing Stalking Horse Asset Sale Agreement) § 2.2.1; TR40725 (US D.I. 5202 Motion for Orders Authorizing Stalking Horse Asset Sale Agreement) ¶ 11; TR50187 (U.S. D.I. 5368 May 2, 2011 Hearing Transcript) 6:24–7:5.

156 TR21509 (July 11, 2011 Hearing Transcript) 40:24–25; TR21282 (Seventy–First Report of the Monitor).

157 TR00009A–C (Hamilton Aff.) ¶ 95.

158 TR00009A–C (Hamilton Aff.) ¶¶ 85, 93, 95; TR22085 (June 30, 2011 ASA between Nortel Entities and Rockstar Bidco, LP).

159 TR21508 (Rockstar License Termination Agreement) Arts. 2.01–2.04; TR43794 (IFSA) § 11(a).

160 TR21508 (Rockstar License Termination Agreement); TR22085 (June 30, 2011 ASA between Nortel Entities and Rockstar Bidco, LP) § 5.13(b).

161 TR21509 (July 11, 2011 Hearing Transcript).

162 TR21509 (July 11, 2011 Hearing Transcript) 56:10–18, 101:1–5, 110:6–111:8.

  

163 TR50034 (July 11, 2011 Canadian Approval and Vesting Order (Certain Patents and Other Assets)); TR50196 (US D.I. 5935 Order Authorizing and Approving Sale).

164 TR21281 (Sixty–Third Report of the Monitor) ¶ 82.

165 The fair market value of a business or asset is the highest amount that a reasonably well-informed purchaser would pay in arm's length negotiations in an open and unrestricted market. *Cartwright,* 411 U.S. at 551, 93 S.Ct. 1713; *Henderson v. Minister of Nat'l Revenue,* [1973], C.T.C. 636, para. 21 (Can. Tax Ct.); *see also* *Slatky v. Amoco Oil Co.,* 830 F.2d 476, 484 (3d Cir.1987) ("[Fair market value], by definition, is the highest price a willing buyer would pay[.]"); *Phillips,* 1 W.L.R. at 154 ("The value of an asset that is being offered for sale is, prima facie, not less than the amount that a reasonably well informed purchaser is prepared, in arm's length negotiations, to pay for it.").

166 11 U.S.C. § 1129(b)(2)(B)(ii); Insolvency Act, 1986, c. 45, § 107 (U.K.); *Central Capital Corp.,* Re (1995), 29 C.B.R. (3d) 33, para. 36 (Can. Ont. C.J. (Gen. Div.—Commercial List)), *aff'd* (1996), 38 C.B.R. (3d) (Can. Ont. C.A.); TR50470 (Standing Senate Committee on Banking Trade and Commerce, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (2003)) at 158–59 ("[Holders of equity] should be afforded lower ranking than secured and unsecured creditors, and the law—in the interests of fairness and predictability—should reflect both this lower priority for holders of equity and the interests of fairness and predictability —should reflect both this lower priority for holders of equity and the notion that they will not participate in a restructuring or recover anything until all other creditors have been paid in full."); Roy Goode, *Principles of Corporate Insolvency Law* (4th ed. 2011), ¶ 1–04 ("[O]nly when creditors have been paid in full (which is rarely the case) do shareholders come in to participate in the surplus remaining.") (citation omitted). To ensure this absolute priority scheme is followed, bankruptcy focuses "on legal entities, not on corporate groups." *See* Douglas G. Baird & Anthony J. Casey, *No Exit? Withdrawal Rights and the Law of Corporate Reorganizations,* 113 Colum. L. Rev. 1, 4–5 (2013).

167 *See* Ibbotson SBBI 2010 Valuation Yearbook: Market Results for Stocks, Bonds, Bills, and Inflation 1926–2009, 19 (James P. Harrington ed., Morningstar 2010); Michael Pellegrino, *BVR's Guide to Intellectual Property Valuation* at 4–5 (2009 ed.).

168 Transfer Pricing Worksheets.

169 *Id.*

170 Kinrich Report ¶¶ 79–80 (citing, *inter alia,* TR43636).

171 *See id.* at 30 (Table 5).

172 *Id.*

173 "EMEA stands for "European, Middle Eastern and African" affiliates.

174 The Administrators for all of the EMEA Debtors other than Nortel Networks (Ireland) Limited are Alan Robert Bloom, Christopher John Wilkinson Hill, Alan Michael Hudson and Stephen John Harris. The Administrators for Nortel Networks (Ireland) Limited are: Alan Robert Bloom and David Martin Hughes.

175 TR50631 (Order of the Ontario Court of Justice, August 14, 2009)

176 TR50631 (Order of the Ontario Superior Court of Justice, August 14, 2009) para. 3

177 NNC–NNL11755843 (Eighty–Eighth Report of the Monitor, September 26, 2012) para. 36

178 Order (Monitor's Expansion of Power Order # 2) of the Ontario Superior Court of Justice, October 3, 2012, para. 3

179 Order (Monitor's Expansion of Power Order # 2) of the Ontario Superior Court of Justice, October 3, 2012, para. 3

180 Order Pursuant to 11 U.S.C. § 105(a) Approving Cross–Border Court-to-Court Protocol, dated January 15, 2009 (D.I. 54).

181 Trial Trans. Day 3, 630:25–631:20 (Allen).

182 Trial Trans. Day 5, 1143:19–1144:8 (Henderson).

183 Trial Trans. Day 6, 1324:19–1325:7 (Orlando).

184 Trial Trans. Day 9, 1877:18–1878:1.

185 TR21003(MRDA) pp. 39, 42–47, 49.

186 Trial Trans. Day 6, 1288:14–16; 1323:7–23 (Orlando).

187 Trial Trans. Day 6, 1323:7–23 (Orlando).

188 TR21003 (MRDA and addenda) Article 4(d)

189 TR21003 (MRDA and addenda) Article 6(a)

190 TR21003 (MRDA and addenda) Article 11(d)

191 As an initial matter, the MRDA was subject to continual amendment until December 31, 2008, *see* TR21003 (MRDA) at 59 (4th Addendum), such that the factual matrix throughout the pre-petition period must be considered.

  

192 *See* TR11412 (Eden Report) ¶ 26.

193 *See* Trial Tr. 2667:14–2669:1 (Cooper); 5042:9–5043:17 (Eden).

194 TR40713 (1997 OECD Guidelines) ¶ 8.3; TR11391 (2010 OECD Guidelines) ¶ 8.3.

195 TR40713 (1997 OECD Guidelines) ¶ 8.23; TR11391 (2010 OECD Guidelines) ¶ 8.23.

196 TR50295 (IC 87–2R) ¶ 121.

197 TR21002 (1992 NNL–NNI R & D CSA) at 7–8 (Arts. 4, 5); TR31309 (1995 NNL NNUK R & D CSA) at 7 (Arts. 4, 5); TR46945 (2000 NNL–NNSA R & D CSA) at 8 (Arts. 4, 5).

198 TR21002 (1992 NNL–NNI R & D CSA) at 1 (Whereas Clauses); TR31309 (1995 NNL–NNUK R & D CSA) at 1 (Whereas Clauses); TR46945 (2000 NNL–NNSA R & D CSA) at 1 (Whereas Clauses).

199 TR21002 (1992 NNL–NNI R & D CSA) at 9–10 (Art. 7); TR31309 (1995 NNL–NNUK R & D CSA) at 9 (Art. 7); TR46945 (2000 NNL–NNSA R & D CSA) at 10 (Art. 7).

200 TR21002 (1992 NNL–NNI R & D CSA) at 10 (Art. 10); TR 31309 (1995 NNL–NNUK R & D CSA) at 10 (Art. 10); TR46945 (2000 NNL–NNSA R & D CSA) at 11 (Art. 10). *See also* Trial Tr. 1165:17–22 (Henderson) ("[W]hen I read that language ... what I understood it to mean is that when you have a fully paid up perpetual exclusive license, you're effectively the economic owner. That's commonly understood in—certainly in transfer pricing and I think in general economics.").

201 TR1105 (Horst Frisch Report) at 10; TR 11343 (IRS Notice of Adjustment) attachment at 3.

202 TR31022; Barton Dep. 117:6–7 and 117:9–13

203 TR48969.03 (2003 Transfer Pricing Report) at 25.

204 TR11169 at 25.

205 TR11084, cover letter at 2.

206 TR22078 (2008 Joint APA Request); Trial Tr. 1280:20–23, 1281–24–1289:9

207 TR50593.01; TR21456; TR22084; TR40777; TR40788.

208 TR50518; TR50231 at 2–3.

209 TR50516 ¶¶ 7–9.

210 TR21080; T. Collins Dep.; 219:8–11, 219:25–220:10.

211 TR22080 at 3; TR22154 at 1.

212 Bereskin Rebuttal ¶¶ 38, 45.

213 Bereskin Rebuttal ¶¶ 38–39.

214 Bereskin Rebuttal at ¶ 35.

215 Bereskin Rebuttal ¶¶ 46, 48, 54

216 *See* TR21003 (MRDA) at 20 (Sched. B).

217 *See* TR21003 (MRDA) at 3 (Art. 1(f)).

218 *See* TR21003 (MRDA) at 6 (Art. 5(a)) (granting each Licensed Participant "an exclusive, royalty-free license, including," *inter alia,* "the right to sublicense").

219 *See* TR21003 (MRDA) at 6 (Art. 5(a)).

220 TR21003 (MRDA) at 6 (Art. 4(e)).

221 TR21003 (MRDA) at 9 (Art. 9(c)).

222 TR21003 (MRDA) at 2 (second recital).

223 *See* TR48944 (MOU) at 1 & ¶¶ 3, 6.

224 *See* TR00043 (Green Rebuttal) at 19 (Green indicating that Rockstar paid "additional amounts for the Residual IP portfolio *on some other basis* than cash flows" (emphasis added)).

225 Trial Tr. Day 9, 2010:4–9 (Huffard)

226 TR00051 (Exh. 51, Expert Report of Jeffrey Kinrich, January 24, 2014) paras. 89–90

227 TR00051 (Exh. 51, Expert Report of Jeffrey Kinrich, January 24, 2014) para. 27

228 *See e.g.,* Pre–Trial Brief of the U.S. Interests, May 2, 2014, p. 76

229 Jeffrey Kinrich Trial Testimony, Day 17, June 18, 2014, p. 4328:13–20

230 Jeffrey Kinrich Trial Testimony, Day 17, June 18, 2014, p. 4329:15–20

231 Jeffrey Kinrich Trial Testimony, Day 17, June 18, 2014, p. 4330:3–4331:2

232 TR00053 (Exh. 53, *Valuing Small Businesses and Professional Practices,* 3d ed., New York: McGraw–Hill, 1998) p. 340

 

233 TR00053 (Exh. 53, *Valuing Small Businesses and Professional Practices,* 3d ed., New York: McGraw–Hill, 1998) p. 341–342
234 TR22078 (2007–2011 APA) Appx. A pp. 9–10; Drinkwater Dep. 45:21–46:24.
235 TR00001 (Currie Aff.) ¶ 27; Bifield Dep. 257:5–24.
236 Trial Trans. Day 3, 539:20–540:11 (Currie).
237 Trial Trans. Days 11–12, 2647:17–2648:18, 2718:16–20, 2737:12–19 (Cooper) (debtors engaged in a common endeavor akin to a joint venture among related parties); Day 8, 1719:6–15, 1721:16–20, 1751:16–25 (Stephens) (MRDA participants appeared to engage in a form of a joint venture to maximize global revenues).
238 Briard Dep. 21:4–14 (discussing R & D allocation).
239 Beatty Dep. 22:3–11, 178:19–179:3.
240 Trial Trans. Day 3, 571:13–572:5 (Currie); Day18, 4599:7–15 (Ryan).
241 Drinkwater Dep. 21:23–11:10; Riedel Dep. 113:16–23; Dadyburjor Dep. 37:7–13; and Briard Dep. 17:4–18.
242 Trial Trans. Day 7, 1578:5–1579:22 (Brueckheimer)
243 Bifield Dep. 256:10–258:25.
244 Trial Trans. Day 3, 711:11–712:11 (McFadden).
245 Briard Dep. 76:10–19.
246 TR11352 (Letter, Apr. 6, 2006) at NNI_01534867.
247 TR21188 (Global R & D Investment Strategy) p. 4.
248 TR21188 (Global R & D Investment Strategy) pp. 5–8.
249 TR21188 (Global R & D Investment Strategy) pp. 9–10; Trial Trans. Day 3, 709:14–710:19 (McFadden).
250 TR00023 (Brueckheimer Aff.) ¶ 5.
251 Trial Trans. Day 3, 713:10–11 (McFadden).
252 Trial Trans. Day 7, 1573:4–12 (Brueckheimer).
253 Trial Trans. Day 7, 1573:13–16 (Brueckheimer).
254 Trial Trans. Day 7, 1573:22–25 (Brueckheimer).
255 TR00004 (McFadden Aff.) ¶ 20.
256 TR00004 (McFadden Aff.) ¶ 20.
257 TR00004 (McFadden Aff.) ¶ 21; TR21188 pp. 5–8.
258 TR31355 (2000–2004 Functional Analysis) p. 24.
259 *Owens Corning,* 419 F.3d 195, 205 (3d Cir.2005) (emphasis added) (citation omitted).
260 Trial Tr. 3054:13–3055:2; 3074:25–3076:1 (Bazelon); TR00041 (DEM00014) at 5.
261 Trial Tr. 3039:3–3044:21; 3055:3–3057:11; 3072:1–3073:20 (Bazelon); TR00041 (DEM00014) at 4.
262 *Id.*
263 Model Law on Cross–Border Insolvency of the United Nations Commission on International Trade Law, UN GAOR, 52nd Sess., annex, Agenda Item 148, UN Doc. A/RES/52/158 (1998).
264 *Id.* at 279.
265 *See* TR12036 (Moody's Rating Action, June 16, 2006) p. 2; TR12037 (DBRS Credit Rating Report, July 16, 2006) pp. 1–2; TR12038 (Moody's Rating Action, Mar. 22, 2007) p. 1; TR12039 (DBRS Rating Report, Nov. 9, 2007) pp. 1–2; TR12040 (Moody's Rating Action, May 21, 2008) p. 1; TR12041 (DBRS Report, July 14, 2008) p. 2; TR12042 (Moody's Rating Action, Dec. 15, 2008) p. 1; TR12045 (Moody's Credit Opinion, Dec. 16, 2009) p. 3; and TR12045 (Moody's Credit Opinion, Dec. 16, 2009) p. 3.
266 Kilimnik Dep. 18:12–19:14.
267 See June 29, 2006 Offering Memoranda for NNL NoteSenior Notes due 2011, 2013, and 2016 (TR40117) at pp. 29–30 (CCC0004630–CCC0004631). See also the May 21, 2008 Offering Memorandum for Nortel's Senior Notes due 2016 (TR48723.01) at 22 (NNI_01410294) which contains identical risk factors and warnings; Trial Trans. Day 5, 1112:3–1114:21 (Binning).
268 TR40117at p. 34.
269 Trial Trans. Day 4, 828:7–21 (McCorkle).
270 TR40117, TR40041 (Proof of Claim for 2006 Indenture and Indenture appended), TR40182 (Prospectus—Offers to Exchange Notes due 2011, 2013, 2016 dated Dec 21, 2007), TR44615, TR40042 (Proof of Claim for 2007 Indenture and Indenture appended), TR40180 (Prospectus for NNC Convertible Notes due 2012 and 2014 dated December 21, 2007).

271 As Alexander Hamilton recognized soon after the United States' founding:

> [t]he nature of the contract, in its origin, is that the public will pay the sum expressed in the security, to the first holder or his assignee. The intent in making the security assignable, is, that the proprietor may be able to make use of his property, by selling it for as much as it may be worth in the market, and that the buyer may be safe in the purchase. ***Every buyer, therefore, stands exactly in the place of the seller; has the same right with him to the identical sum expressed in the security; and, having acquired that right, by fair purchase, and in conformity to the original agreement and intention of the Government, his claim cannot be disputed, without manifest injustice.***
>
> A. Hamilton, *First Report on Public Credit* (January 9, 1790) (emphasis added).

272 The Monitor and the Canadian Debtors expressed no position on a pro rata allocation.

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# TAB 14

**2015 ANNREVINSOLV 10**

**Annual Review of Insolvency Law**
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10 — Two Cheers for Universalism: Nortel's Nifty Novelty

**Two Cheers for Universalism: Nortel's Nifty Novelty**

*John A E Pottow* [*]

## I. — Introduction

Individuals in the cross-border bankruptcy community hiding under rocks may not have heard about the monumental decisions in the co-trials in the Canadian-United States Nortel bankruptcy proceedings, *In re Nortel Networks, Inc* and *Re Nortel Networks Corp.* [2] The decisions are thoughtful, innovative, practical, and important. They warrant a detailed case comment or two in their own right. This brief article, however, will not provide such worthy treatment. [3] Those hungering for in-depth reports of the cases and their holdings may stop reading now and devote their labours What this article *will* be is an appreciation of *Nortel*, explaining both why it is such an important opinion, or pair of opinions, for the cross-border bankruptcy world and why it should be seen as a triumph, albeit an incremental one, for the universalist school of transnational insolvency. [4]

## II. — The Nortel Cases

### 1. — The Nortel Enterprise

"Nortel", made up of Nortel Networks, Inc and Nortel Networks Corp, was an enormous telecommunications company of storied pedigree that foundered in the Great Recession. Although global in reach, one can fairly call it a "Canadian" company. Like many multinational business enterprises ("MBE"), it had, by definition, its tentacles well extended worldwide, but if anyone tried to assess the centre of main interests ("COMI") of the corporate group, it would likely have been Canada. As is often the case with such Canadian businesses, however, a considerable portion of its affairs were transacted in the United States ("US"), which produced the lion's share of its revenue. Most relevant for present purposes is that a significant component of Nortel's business was dependent upon intellectual property. The history and business model of Nortel, including its multiple product and service lines, is well recounted in both the Canadian and US bankruptcy court opinions; the curious reader is referred to either source for more detail. [5]

### 2. — The Nortel Proceedings

When Nortel first started to skid, reorganization was attempted, but the onslaught of the Great Recession hammered any lingering nails into its coffin. The company soon filed for bankruptcy protection. But it did not do so in the paradigmatic way anticipated by the dominant international instruments regulating cross-border insolvency proceedings, such as most notably, the UNICITRAL Model Law on Cross-Border Insolvency [6] implemented in Canadian law through the *Companies' Creditors Arrangement Act (CCAA)* [7] and US law through Chapter 15 of the US *Bankruptcy Code*. [8] That is, there was not a "main" proceeding filed in Nortel's COMI (Canada) and "ancillary" proceedings in the myriad other countries around the world where Nortel also had establishments. Rather, Nortel filed "parallel" proceedings in both Canada and the United States. [9] The filings were coordinated and simultaneous. To be specific, Nortel was not one mega-corporation that filed multiple parallel bankruptcy proceedings in different jurisdictions around the world; Nortel filed its various proceedings chiefly by affiliation. That is, the main parent and Canadian operating subsidiary filed in Canada, the US operating subsidiary filed in the United States, and so on. Some entities stayed out of formal court proceedings altogether. [10] Nortel, through multiple debtors in multiple proceedings, "went into bankruptcy".

As mentioned, the starts at reorganization ultimately sputtered. Not helping was inter-corporate squabbling over transfer payments, which are the tax-animated headaches that arise when one corporate affiliate pays another for intra-enterprise transactions, all designed to assuage tax watchdogs that tax evasion through income flight is not afoot. [11] The Canadian debtors also demanded financing from the US subsidiaries, contending that the financing was necessary to fund any sort of reorganization attempt. [12] But eventually, the writing revealed itself on the walls, and talk turned to liquidation.

In an enterprise the size of Nortel, liquidation can mean anything from depressing auctions of office chairs to highly integrated cross-border sales of intact business lines subsumed within larger corporate groups. The Nortel stakeholders hungered for the latter. In an omnibus resolution of some of the inter-corporate financing bickering, the various Nortel debtors entered into a protocol to cooperate in the sale of the firms' assets. [13] This protocol, significantly, recognized that trying to resolve the inter-corporate squabbles would delay and even jeopardize the value-maximizing sale of the corporate assets, and so the consensus was reached to sell all of the viable business lines collectively and put the proceeds into an evocatively labeled "lockbox". [14] Disbursing the lockbox's proceeds was left for a later day, after all the stakeholders had pulled together and beat the bushes for bidders. This protocol was successfully entered and survived appeal. [15]

The lockbox approach proved successful. After the major business lines were sold off, the debtors were even able to monetize their "rump" portfolio of around 7,000 patents. [16] So attractive were these IP assets that Nortel flirted with staying around as a sort of patent portfolio business, but ultimately decided to sell off those assets, too. [17] Google arrived as a stalking horse for \$900 million and served as a catalyst to jack up a final bid of \$3 billion by a syndicate known as "Rockstar". [18] All through, the sale of assets netted \$7 billion or so to the lockbox. [19]

So far, so good;everyone agreed to pull together to sell assets for their greatest value and make the pie as big as possible. But then, as in many matters commercial, when it came time to divide the pie, things went less well. Despite a provision of the protocol counseling mediation over how to divide the proceeds amongst the three bankruptcy estates Canada, US, and collectively, Europe, Middle East, and Africa ("EMEA"), consensual allocation proved fruitless, much to the dismay of the hapless mediators. [20] Judicial determination, the backstop resolution procedure under the protocol, then had to be invoked. [21]

## 3. — The Nortel Decisions

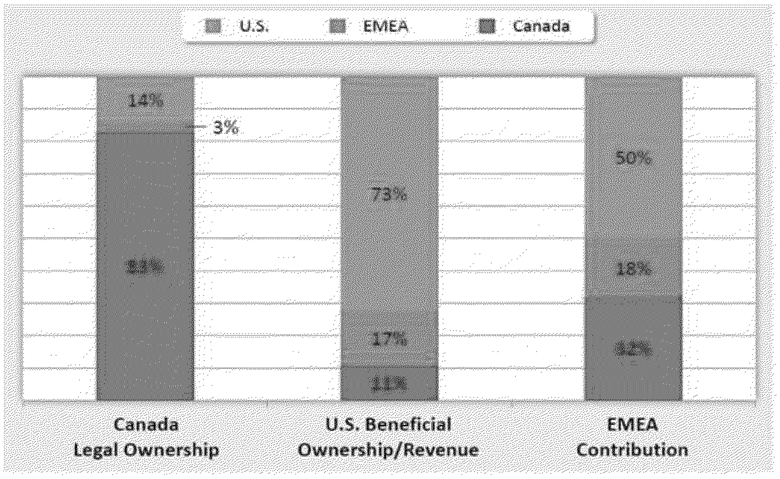
### *i. — Background*

The protocol provided for joint judicial resolution of the contested lockbox allocation. But joint judicial resolution is a strange beast, and there was no *ex ante* reason to expect orderly harmonization of those two judicial proceedings in Canada and the United States absent the protocol or the force of the Model Law. Neither was a main proceeding in the jurisdictional hierarchy anticipated by the typical main/ancillary format of the Model Law that would be presumptively entitled to cooperation from the other proceeding. Thus, the parties were venturing out into uncharted terrain. It could very well be that the Canadian court would render its own decision on the assets, which might conflict with the US court's determination. Indeed, the prospect of conflicting distributive determinations is not just a Nervous Nellie's nightmare; in the *In re Lernout & Hauspie Speech Prods* bankruptcy, the US and Belgian courts came to diametric interpretations on the priority rights of aggrieved investors who had fraud claims against the debtor, which but for eventual settlement would have been a jurisprudential disaster. [22]

The *Nortel* courts avoided disaster. They did so by invoking the procedures of the Model Law that facilitate cooperation as implemented through the protocol. [23] So, for example, the trial on how to allocate the lockbox proceeds was run in two different courtrooms in Toronto, Ontario and Wilmington, Delaware simultaneously, with the judges engaged in frank and frequent communications between themselves. [24] Witnesses were video-linked from one courtroom to the other, and litigants in each venue could see in live time what was afoot in the other. But as the respective courts made clear, each judge would arrive ultimately at his own determination on what the applicable bankruptcy law demanded for allocation of the lockbox proceeds across jurisdictional borders. [25]

***ii. — The parties' competing allocation proposals***

While coordinated and integrated, the proceedings were still woolly. The parties advanced sharply divergent approaches of how best to allocate the lockbox proceeds. Surprising perhaps no one, the parties' positions were, as one judge aptly characterized, "self-serving". [26] Proving the adage that a picture says a thousand words, the US Court graphically demonstrated how each constituency's approach to dividing the spoils just so happened to accord its members the largest share. [27]




Perhaps, in a way, the naked self-interest of the parties liberated the judges to blaze their own trail, which they did when rejecting all the party-advocated approaches in coming to their own allocation rule.

As mentioned, a considerable part of Nortel's global assets were tied up in patent portfolios, and so the question became how should the bankruptcy estates share in the proceeds realized upon the sale of those portfolios? Of course, the simplest solution would have been obtained were there only one bankruptcy estate, or perhaps even one main bankruptcy estate: all the money would go into that one pot. Unfortunately, the multi-jurisdictional parallel proceeding posture of *Nortel* made that simple outcome impossible. Each constituency made its own pitch, boiled down into three major positions as typified by the arguments of the Canadian, EMEA, and US debtors. [28]

The formalist position was advanced by the Canadians, who argued that all the intellectual property was owned by the Canadian entities, and so the sale of that property should naturally inure to the benefit of the Canadian estate. The EMEA stakeholders took a somewhat Lockean approach and argued that because the legal title to the intellectual property was parked in Canada for arbitrary (or more precisely, tax-related) reasons, allocating all the lockbox value based on that legal location would be unfair if not absurd, especially in light of Nortel's worldwide operations. Rather, they argued, the allocation should match the means of production, or perhaps factors of production if Research & Development ("R&D") expenditures is a proper proxy: because much of the worldwide R&D effort that occurred to generate those Canadian intellectual assets occurred in Europe and elsewhere, the proceeds from those assets' sales should be allocated in proportion to each jurisdiction's share of the R&D spending. [29]

Finally, the US interests partially joined the EMEA position in rejecting the Canadian debtor's "ownership" approach but veered off onto their own proposal, which might be called an "economic" approach. This tack was built upon the premise that the purpose of the intellectual property nominally owned by the Canadian entities was to generate money for a once-profitable worldwide business, and the US affiliates brought in the lion's share of that business. As such, the sale proceeds should be allocated in proportion to the respective affiliates' contribution to the global conglomerate's income. [30]

The courts' decision, independently reached but surely preceded by Model Law-sanctioned communication, was to reject all these approaches and adopt a novel alternative that they called a modified *pro rata* allocation. [31] The pot was divided in proportion to total creditors' claims.

***iii. — The modified pro rata allocation solution: pro rata***

Before explaining the courts' approach, it is first helpful to situate the outcome at the highest level of abstraction, and that is that the courts rejected the formalism of the Canadian approach and adopted a much more functional, even pragmatic lens toward Nortel's assets. That is, the "biggest picture" underpinning of the courts' opinions was to reject the idea that legal title of the intellectual property assets held in Canada entitled the Canadian estate to the proportionate proceeds of the lockbox, let alone the lockbox proceeds related to the business line sales. Rather, the courts accepted the principle of the other creditors, if not each calculation metric itself, that such an approach would shower a windfall upon the Canadian estate that did not reflect the economic substance of the R&D and other inter-connected operational aspects of this global firm. [32] This departure from focus on physical location in itself is a shattering repudiation of the doctrine of territorialism, a point to be explored below, but the main observation for present discussion is that the courts went beyond asset ownership in crafting an equitable solution to allocation.

Once that door had been opened, one can conjecture it became relatively simple to craft an allocation formula: sharing in the pot was not based on the debtors' budget or revenue as had been self-servingly proposed, but *equally by creditor*, invoking a "fundamental tenet" of bankruptcy law in the words of one court. [33] This is the meaning behind the courts' *pro rata* allocation decision. In other words, if the total value of the claims in the Canadian estate were \$1, and the total claims in the EMEA estate also \$1, and the total in the US estate were \$2, meaning that there would be \$4 of worldwide claims, the courts would order distribution of the lockbox 25% to Canada and EMEA each and 50% to the United States. [34] The result of this was to acknowledge everyone worldwide contributed to the value of Nortel as an MBE and that the conceit of trying to craft each constituency's precise, perfectly calibrated share was a fool's errand. It is interesting to speculate that if the non-Canadian estates had offered less self-serving counter-formulae, whether one might have taken root, but that is likely unanswerable. In the end, once recognizing that the Canadians could not take it all and opening the door to worldwide participation, the deep-seated bankruptcy baseline of *pro rata* equality was difficult to shake. Perhaps viewed another way, no party made a sufficiently compelling case why the distribution should *not* be *pro rata* in light of the courts' desires to share the allocation beyond Canada.

***iv. — The modified pro rata allocation solution: modification***

Without more, this approach could be described as "*pro rata*," period. But there was more, because this presumptively *pro rata* approach was purportedly "modified". And indeed, the courts went at times to awkward pains to protest that they were most definitely *not* engaging in *pro rata* or consolidated distribution of corporate assets. [35] The courts insisted this was not true *pro rata* allocation, but rather *modified pro rata* allocation, for two reasons, one accurate and one more confused. First, the courts explained this was not fully *pro rata* allocation because they were leaving some assets unallocated by the *pro rata* approach, in other words, just letting those assets lay where they be. Namely, cash on hand in each respective estate was left just where it was territorially. [36] Territorialism's random lottery of where cash happens to be parked on the day of filing was thereby vindicated, and each estate that happened to have cash or did not, enjoyed a respective windfall or disappointment. For illustration of the tempers this approach engenders, see generally *Lehman Brothers*. [37] No real attempt was made by either court to defend this outcome intellectually, so perhaps it might just be seen as a combination of (a) administrative ease, and/or (b) an easy, if arbitrary, way to rebut the "seemingly offensive" allegation that they were engaged in fully *pro rata* sharing by creditors. [38] Whatever the motivation, the distinct treatment of cash on hand was indeed a modification of the otherwise governing *pro rata* allocation formula.

As just partially presaged, the second reason the courts insisted this was not a fully *pro rata* allocation rests upon an apparent terror with being accused of effecting a substantive consolidation of the debtors' estates, which apparently was seen as a consequence of fully *pro rata* allocation. [39] The US Court was especially fearful of this allegation, the Canadian Court less so. In fact, the Canadian Court cheerfully launched into an alternative discussion saying that *even if pro rata* allocation was substantive consolidation, that remedy would be fully indicated under Canadian law on the facts of the case. [40] But the US Court would have none of it. Indeed, more broadly, the US Court was anxious to assure that it was not adopting "universalism", presumably an unwelcome cognate to substantive consolidation. [41]

The source of the Courts' concerns is hard to pin down, and these comments may not reflect one coherent argument so much as a collection of stray thoughts. The confusion stems in part from a conflation of *pro rata* allocation with substantive consolidation and/or both with universalism. [42] Because it is difficult to grasp fully the Courts' reasoning, or even direction, it might help simply to break the logical chain that universalism need equate to substantive consolidation. Whether *pro rata* allocation equates with substantive consolidation is a separate issue explored below. Recall that universalism in its pluralist form [43] advocates the disposition of a multinational debtor's assets in accordance with the substantive bankruptcy law of its COMI. [44] Universalism, or more precisely, its advocates, has not definitively figured out how to address interwoven corporate groups where multiple corporate debtors within a broader group have different COMI. Universalism thus has nothing conclusive to say on the doctrine of substantive consolidation of corporate debtors. [45] To be sure, squishing all the affiliates together into one giant "enterprise" and finding that *enterprise's* COMI, or "E-COMI", in the literature, [46] for purposes of choice of substantive bankruptcy law would be a form of universalism analogous to substantive consolidation. But that E-COMI approach to corporate groups is not compelled by universalism. [47] Indeed, while insisting upon an E-COMI approach has been recommended by some universalism advocates as the best approach to the corporate groups problem, it has not been advocated, for lack of a better term, universally. For example, a situation of discrete corporate subsidiaries incorporated throughout different jurisdictions without interwoven financial affairs could well yield a universalist outcome subsidiary-by-subsidiary for each entity's cross-border assets *without* requiring substantive consolidation at the E-COMI level. [48] In short, and contrary to the Courts' seeming concerns, universalism is agnostic to substantive consolidation.

There is not much point in getting bogged down in this aspect of the Courts' opinions, however. Little turns on it, other than revealing the Courts' respective disinclinations toward substantive consolidation and at least one Court's apparent contempt for universalism. [49] What matters more is the prior point that cash on hand was preserved by estate irrespective of proportionate creditor claims. That fact suffices to justify the label "modified" *pro rata* allocation, which the courts accurately used.

***v. — The allocation/distribution distinction***

Having jointly decided to take a modified *pro rata* approach to allocating the lockbox proceeds was not the end of the matter. The Courts' final step was to take the intriguing gesture of distinguishing *allocation* from *distribution*. [50] This distinction is relevant for the debate between universalism and territorialism for the straightforward reason that in true universalism, the COMI state "exports" its substantive distribution rules across national borders to govern local asset distribution. Modified universalism tempers this exportation with various carve-outs for exceptional treatment. [51] Territorialism, by contrast, allows each individual state to implement its own distributive rules to assets within its jurisdiction. [52] By underscoring the allocation/distribution distinction, the *Nortel* courts appeared to have been mollifying territorialists by assuring that local substantive bankruptcy rules would be alive and well to govern whatever share of the lockbox proceeds ended up being patriated to the respective jurisdictions under the modified *pro rata* allocation. In other words, Canadian bankruptcy law and priority rules would govern the ranking of claims and distribution of the modified *pro rata* share of the lockbox proceeds that went to Canada, US rules to the piece sent to the United States, and so forth. While this may seem like fine bologna to slice, the sovereignty-animated distinction was unlikely to have been lost on many. Territorialist concerns of local bankruptcy laws applying were expressly acknowledged and respected by clarifying that distribution would be locally governed as a distinct stage subsequent to allocation. [53] Whether this bifurcation was as territorialism-vindicating as might appear on first blush remains to be seen.

***vi. — Summary***

To summarize, the *Nortel* cross-border bankruptcy was resolved by a consensual, worldwide sale of the enterprise's valuable business lines and then its residual portfolio of patents and intellectual property in a highly coordinated and productive manner. Surely related to this congenial approach was an agreement by protocol to defer the thorny question of proceeds allocation until after the sales had all been completed, and even to try to mediate that question to further consensual resolution. When that mediation failed, the parties proceeded to litigate the matter, as provided by their protocol, before the Canadian and US bankruptcy courts. Those courts conducted a highly coordinated and cooperative joint trial, complete with simultaneous video feeds, containing dozens of witnesses and even more lawyers running around.

Eventually, the courts came to the same conclusion: reject all the parties' arguments and allocate the lockbox proceeds on a modified *pro rata* approach. *Pro rata* because the allocation would be in proportion to the amount of claiming creditors in each estate, counting inter-creditor claims in the pot, and *modified* because only the lockbox assets and not, *eg*, the cash on hand, would be allocated accordingly. The modified *pro rata* allocation approach, however, did not speak to ultimate distribution, which would be determined, *à la* territorialism, in accordance with the substantive bankruptcy laws of each respective jurisdiction receiving an allocation.

The ultimate resolution of the Nortel assets thus has a distinctly territorialist flair to it. Recognizing the separate estates and vindicating an implicit, and at times explicit, presumption that creditors in each estate were entitled to claim the assets within their physical jurisdiction, either *ab initio* or through allocation from the lockbox, seems to have reflected a territorialist mindset to the distribution question notwithstanding the happy coordination that occurred to get to that stage. And certainly the openly hostile digs at universalism made by at least one of the Courts augments the interpretation that the decisions were attempting to territorialism. But that assessment belies the full significance of the opinions. The *Nortel* case should be seen not as ultimately backsliding into territorialist conceptions of vested right but as actually moving the universalism ball forward, and considerably so.

**III. — Nortel's Universalism**

Properly viewed, *Nortel* should be seen as a significant step forward for universalism, notwithstanding its first-blush territorialist focus on estate-by-estate distribution. There are at least five ways in which it is accurate to characterize the decision as importantly, although far from completely, universalist.

**1. — Universalist Cooperation**

At the risk of stating the obvious, the courts worked very hard and very well together to synchronize their hearings and avoid the risk of inconsistent judgments that had plagued earlier cases like *Lernout&Hauspie*. Things were not all smooth sailing, of course. For example, at one stage in the case the Canadian bankruptcy court issued an order clarifying that prosecution of administrative proceedings for a so-called "financial support directive" in favour of UK pension claimants under section 96 of the *Pensions Act 2004* in the UK would constitute a violation of the Canadian automatic stay. [54] The UK pension authorities cheerfully ignored this order and went ahead to take the initial steps to determine potential pension liability anyway. [55] But all in all, the procedural integration of the co-trials, and not just the allocation trials, but indeed the whole proceedings, was commendable and a source of judicial statesmanship.

Fair enough: back-slapping all around. But is this a credit to universalism? After all, deeply sovereignty-conscious states can bask in territorialism yet nonetheless still be cordial and even cooperative with judicial colleagues in cross-border disputes without having to carry the banner of universalism. [56] Thus, to be strictly precise, one might celebrate the profound degree of cooperation in the case not so much as a victory for universalism *per se* but as a victory for the Model Law and similar instruments that strive for increased judicial dialogue, communication, and cooperation. [57] Captured by its protocol, the *Nortel* case unquestionably illustrates a highpoint of cross-border judicial cooperation.

One can take the next step, however, and claim that that cooperation in turn services the broader goals of universalism because it forces a necessary consideration of legal pluralism by counseling an otherwise autonomous judge to at least confer with an extra-territorial, indeed, extra-sovereign, peer. [58] Given that one of the conceptual cornerstones of universalism is the acceptance of outcome differences and given further that incrementalist universalists have predicted an acclimation process whereby increased interaction and immersion in foreign law will desensitize judges to any reflexive resistance to the application of foreign law that universalism requires, it is a fair conclusion that the working together of the two courts in the two countries highlights a cosmopolitan mindset that will advance, even if just conceptually or atmospherically, the universalist agenda. [59]

There is a further, inferential point regarding the importance of the procedural cooperation in this case and others, and that is the possibility that procedural integration increased the likelihood or perhaps otherwise played a causal role in the substantive determination on the allocation question. That is, although the judges insisted strongly they were coming to their own independent conclusions on the proper approach, surely the regular interaction between them allowed them some opportunity to exchange thoughts and ideas on a novel question of cross-border insolvency law. Who else, other than law clerks and the occasional professor, do judges get to bat ideas around with besides other judges? It should shock nobody that two judges working so closely together just so happened to come to the same solution on allocation, especially one that transcended the self-serving approaches of each respective national constituency. [60]

Importantly, it is not as if these two jurists were free from differences of legal opinion. Indeed, a bizarrely long portion of each judgment is devoted to interpretation of the tax-animated Master Research and Development Agreement ("MRDA"). It is bizarre because both courts ultimately held it largely irrelevant to the allocation decision, and the two courts diverged significantly in their analyses. [61] The focus on the MRDA interpretation could be professional path-dependency, *ie*, that so much argument was devoted to the interpretation of this agreement that the courts felt the need to respond to these arguments and offer their interpretations of the document. Or it could be that the courts, mindful of the novelty of their proposed *pro rata* allocation, where fleshing out alternative conclusions of law in anticipation of the inevitable onslaught of appeals. [62] Whatever the reason, each court went out of its way to remark how it disagreed with the other court on the proper interpretation of the agreement. [63] The Canadian court put more emphasis on legal title of the licensed property, decrying "economic theory", whereas the US court put more emphasis on what it saw as the economic substance of the location of all meaningful legal rights to exploit a profit lying at the hands of the licensees. [64]

Perhaps the length of the discussion on this ultimately moot issue was simply a manifestation of two judges who had grown to respect each other trying to make their best case, forcefully but politely, for why the other was mistaken when they agreed on so much else. However, there is another, more strategic possibility that could be complementary to the foregoing explanation. It could be that the judges were showing the world that they were not just deciding everything in lockstep but that they could, and did, disagree on matters. Perhaps they wanted the bankruptcy world to know that the courts were not simply two like-minded jurists who lucked into co-assignment but two judges working together who felt no reservation about expressing differences of opinion when necessary. But when the ultimate question had to be resolved, however, they came together and reached the same result. Given some of the scolding regarding the protracted state of the litigation, [65] it could well be that they aligned as a united front to make clear that this matter had to end, once and for all, and to send a strong signal that they were willing to do so even as judges who could disagree on other matters. In that regard, it is eminently fair to surmise that that convergence of outcome may well have been facilitated by the universalism-fostering cooperation and coordination of judicial proceedings that led to the mutual acceptance of a goal to end this nightmare and try to blunt the appetite for appeals by uniting with the same substantive decision. Procedural coordination may thus have affected substantive convergence.

**2. — Universal Allocation Offsetting Territorial Distribution**

In earlier academic work, I have discussed the role of, and distinction between, two vectors of territorialism, somewhat provocatively labeled "greed" and "pride". [66] These refer to the two concerns that territorialists have regarding universalism's encroachment on so-called "local interests". "Pride" is likely the more intractable and pertains to the sovereignty-conscious desire to see a nation's normatively rich bankruptcy laws apply to assets within that jurisdiction's borders. Thus, if a given country has a high priority ranking for labour claims, it is a hard swallow for many to send locally situated assets to a foreign main bankruptcy proceeding a foot in an MBE's COMI, where that priority will not be recognized, all while local workers sit in the courtroom and look forlornly at the local judge. [67] The "exportation" of the COMI's bankruptcy laws upon the assets in the local jurisdiction affronts sovereignty or, more cynically, upsets the rent-seeking divisions painstakingly inserted into local bankruptcy law. [68]

"Greed", by contrast, refers to good, old-fashioned local favouritism and depends on the asset coverage ratio of locally situated assets to cover local claims. Following the example above, local unsecured creditors with no priority couldn't care less about sovereignty and would be happy with a universalist outcome that destroyed the priority of their employee-creditor rivals under local law. Indeed, this is what happened in *Lernout & Hauspie*. [69] All these creditors care about is sharing the greatest amount of assets with the fewest number of creditors. So "greed" refers to the desire of creditors with a high ratio of local assets covering local claims not to share on a worldwide basis when to do so would dilute their dividend, irrespective of governing bankruptcy law. The reason greed is a less stable territorialist vector than pride is because it is generally only ascertainable *ex post*. No country can generally know *ex ante* how creditors in its jurisdiction will shake out in the asset scramble until there is an actual bankruptcy. Policymakers might hope that creditors within their jurisdictions will routinely be in "surplus" situations, in which the ratio of local assets to local claims beats the worldwide average, such that territorialism is attractive. Yet there is just as much chance that their creditors will find themselves in a "deficit" situation, in which case the local creditors will welcome universalism's worldwide sharing. [70]

Viewing *Nortel* through this lens, it is clear that sovereignty was alive and well: pride, though checked by cooperation, was prevalent. This conclusion is supported by the courts' pointed insistence on distinguishing between allocation and distribution, with the latter being expressly reserved for the respective sovereign jurisdictions to vindicate their policy-laden distribution rules and thus assuage their pride. As mentioned above, this puts a territorialist gloss on the *Nortel* proceedings. [71]

On the other hand, greed was roundly, if not explicitly, quashed, striking a universalist blow against the insistence, *ex post*, of course, that creditors with a winning asset coverage ratio within a domestic territory have a "right" to collection from assets within their local jurisdiction. Consider the counterfactual of what a "greedy" territorialist allocation would have looked like: each group of domestic creditors would have insisted on its rights to have each asset situated within a specific jurisdiction seized and distributed according to local law, not sent off to global sharing under universalism. If *Nortel* were following traditional territorialism, the litigation would have been simple: nothing more than a fight about *where*, *ie*, in which territory, the intellectual property assets were located, not, as it actually was, *how* to distribute the intellectual property sales proceeds most equitably. [72]

To be sure, there is some conceptual overlap, because the outcome in *Nortel* might conceivably be explained by concluding that the courts tried at first to answer the "where" question, found it unanswerable, and then just settled for the hands-throwing-up answer "everywhere", a territorialist methodology that yielded a universalist-seeming result. But that analysis is too quick, because if the courts were truly hell-bent on a territorialist asset-situation fight and nothing more, they would have winnowed down the patent location shortlist to Canada vs. the United States. Either the intellectual property assets were in Canada, where they were nominally owned, as one predicts would have been the strong presumptive territorialist argument, or at best they could have been said to be in the United States, on a pragmatic, economic functionalism argument that much of the profitable substance of the assets occurred through the exploitation of the licenses located there. [73]

Yet that is not what happened, far from it. Either recognizing the deleterious effects of incentivizing the territorialism lottery or simply acknowledging the inequity of such a result when applied to a truly integrated MBE like Nortel, both courts moved quickly beyond trying to figure out where the underlying assets "were" in allocating the proceeds of their sale. Rather, they appreciated what universalism advocates have maintained all along, that centralized administration and sharing of an insolvent multinational's assets ultimately is the most efficient and fair way to process a bankruptcy regardless of assets' territorial location. [74] If territorialism were to rule the day, the EMEA arguments would have been blown out of the water; the fact that there was international R&D contribution to the generation of the value-capturing intellectual property assets would have been interesting from a Marxist perspective but legally irrelevant. In fact, as soon as the Canadian formalist approach was rejected, it was clear the courts were moving beyond territorialism, which necessarily means, toward universalism. [75]

The final nail in the coffin of territorialist explanations of the asset allocation comes in the courts' rejection of the intriguing reliance arguments made by the guaranteed bondholders. Some bondholders holding inter-corporate guarantees essentially claimed that they were entitled to supra-*pro-rata* recovery because they purchased their bonds in reliance on accessing multiple potential bankruptcy estates through the guarantees should the bonds default, *ie*, *pro rata* in one estate for their primary bond claims and then *pro rata* again in another for their inter-corporate guarantees. [76]

This purported reliance led to a barrage of yield-spread graphs pored over by the courts and even more interesting expert testimony concerning whether there is actually any appreciable difference in bond yields for inter-corporate guaranteed versus non-guaranteed debt. [77] Without jumping into the dispute, it is worth noting the courts' ultimate rejection of the suggestion that settled expectations would somehow be undermined by sticking with the *pro rata* allocation formula given the demonstrated non-reliance of the parties. Even more remarkable is the courts' ultimate questioning whether there is *ever* actual reliance on inter-corporate guarantees, for there was serious discussion in both courts of the insolvency-state *irrelevance* of inter-corporate guarantees! [78]

The case should not be overstated, of course, because although ignored for *pro rata* allocation purposes, the guarantees were nonetheless preserved to buttress multiple possible claims at the distribution stage. Still, the foundation of territorialism's vested rights argument, namely, hypothetical *presumed* reliance, suffered serious and overdue destabilization in looking at the *actual* reliance on the guarantee by the parties in this case. [79]

**3. — Nortel's Specific Application: Near-Universalism**

While perhaps not as significant as the prior two aspects of *Nortel*'s universalist leanings, the specific application of the courts' holdings to mimic what a universalist result would look like is still important. That is because even though the courts' insistence on distribution by estate invoked the pride component of territorial concern over local interests, the actual application of that distribution in this case suggests that that pride will be minimally disruptive, almost trivial. In the facts of this particular case, there were no secured creditors claiming the lockbox proceeds, and the biggest potential candidate for an unsecured priority claim, the UK pension claimants, had been adjudicated not to have priority but general unsecured status (those claims to be fixed by UK proceedings). [80] If priority, especially the nettlesome priority of security, is stripped out of a case, then *pro rata* allocation by estate merges into universalism.

Running some numbers might help substantiate this assertion. Sticking with the earlier hypothetical, [81] consider the situation in which $1 of claims in Canada and $1 in EMEA each compete with $2 of claims in the US. Under *pro rata* allocation, the lockbox proceeds would be disbursed 25%, 25%, 50% to Canada, EMEA, and the US. It does not matter what the underlying assets are; they could be valued at X. Now appreciate what would happen under territorialism, and to do so easily, assume that all the assets are located in Canada. Under a territorialist regime where creditors can only file in one estate, which is not necessarily the case with sophisticated creditors but is the approach implicitly assumed in the *Nortel* courts' disposition, [82] the outcome would entail all the money going to the Canadian creditors, with the rest getting zero. On a purely universalist regime, however, everyone would file in Canada, or at least file in ancillary proceedings that defer to Canada, [83] and all the assets would be sent there for distribution, under Canadian law, although under this hypothetical they are already there. Under this universalist outcome, the Canadians would take 25% of X, EMEA 25% of X, and the US 50% of X, exactly matching the *pro rata* allocation approach.

The universalist outcome is not necessarily congruent with the *pro rata* allocation approach, however, because of *redistributive bankruptcy priorities*. Under the *pro rata* allocation approach, assets are sent to the respective jurisdictions to be distributed under each local jurisdiction's bankruptcy laws, whereas under universalism, the distribution would be effected by a Canadian court under Canadian bankruptcy laws. But the principal relevance of distribution laws is whether they confer different priorities and rankings for creditors that would make the choice of distribution law relevant, *ie*, creating some winners and some losers depending on whose laws applied. In this specific case, however, with no secured claims and the UK pension claimants being non-priority, that potential "distortion" of choice of distribution law is muted if not eliminated. For in the absence of any priority creditors, and *a fortiori* the absence of any relevance of differences in substantive bankruptcy distribution laws, the *pro rata* allocation approach will indeed merge fully into universalism. The application of Canadian "vs." US laws for distribution will be of no moment, and so the bifurcation of allocation and distribution will be irrelevant. Thus, protestations notwithstanding, the courts in *Nortel* have almost ordered what universalism would look like in this actual case, and the world has not stopped spinning. [84] To be sure, they were not at full universalism — recall the "modified" approach left cash on hand territorially in the local estates — but they got pretty close.

**4. — Universalism's "Uniqueness" Not So One-Off as Protested**

In ordering the modified *pro rata* allocation of the *Nortel* assets, the courts intermittently circled back to words like "extraordinary" or "unique" to describe both Nortel and their novel solution. [85] And in one sense, they were surely correct: *Nortel* is unique in its worldwide cooperation of an asset sale of billions of dollars, as it might also be unique in its magnitude of squabbling over the distribution of those proceeds. [86] It's a big, heady, headline-grabbing case, and thus unique in many respects. But the courts' factual analyses of the workings of a seething, cross-border behemoth reveal a business model that is not nearly so one-off as characterizations such as extraordinary and unique might imply. Quite the contrary, many of the financial and human resource integration practices explained by the courts seem like they could apply as descriptions of countless other MBE. As the Canadian court summed up: "[Nortel] was not one corporation and one set of employees inventing IP that led to patents. Nortel was a highly integrated multinational enterprise." [87] So, too, did the US court find functional integration.

> [Principals] did not run the business with any real knowledge of the statutory entities at all. ... Decisions to allocate resources and performances were not based on legal entity lines, but by lines of business. Nortel reported its finances on a consolidated basis without regard for its different legal entities...
>
> Although employed by a particular legal entity, employee work responsibilities were directed to the entire Nortel...
>
> ...
>
> To the outside world, including Nortel's customers, suppliers, and the rest of the world, the [corporate] logo referred to all of Nortel, and not to any one geographic entity. [88]

Whether Nortel was an exemplar or outlier in how it ran its operations is of course an empirical question, but there is good reason to suspect that Nortel's practices may be widespread. And if Nortel was indeed something close to a typical MBE in terms of its corporate interweaving of operations, then the case for universalist allocation of sales proceeds may be less unique than suggested. *Nortel* may thus serve as a focal point of salience for many future cross-border proceedings, further advancing universalism with its asset-sharing approach.

**5. — The Primordial Allure of Universalism**

The final way in which *Nortel* foments universalism is by under scoring the simple point that sharing *pari passu* is a deeply ingrained construct in many insolvency systems around the world. [89] It should thus startle few that when the courts threw out the self-serving allocation proposals offered by the parties and looked at the reality of the operational integration of the Nortel empire, they decided to revert to first principles of equality as equity. [90] It further shows the allure of universalism, because wholly apart from its efficiency arguments, which are normatively compelling, universalism fights back at what has been referred to as the lottery aspect of territorialism. [91] Given the ease with which some assets can move across borders, it makes no sense to privilege asset location in spreading losses of financially insolvent MBE debtors across creditors. [92] And, indeed, the bond spread analysis of *Nortel* shows how weak the "vested rights" arguments truly are that get trotted out to defend the charged unfairness of the lottery. [93] While it is ironic at some level that the assets most territorially privileged in the modified *pro rata* allocation approach in this case are the ones most susceptible to cross-border territory shopping, namely, cash, [94] the broader point remains that the unfairness of pinning the creditors' dividend to the sometimes random location of assets on bankruptcy day — the conceptual lynchpin of territorialism — clearly weighed upon the judges in the case of an integrated MBE when they crafted the *pro rata* approach. Recall that the situation of the intellectual property in Canada alone was for tax convenience. [95] As such, whether the courts recognized they were being guided by universalist impulses or not, the equality norm of bankruptcy law, and its implementation through a universalist approach to cross-border proceedings, was strongly on display in Nortel.

**IV. — Conclusion**

*Nortel* was a remarkable display of judicial cooperation and innovation, designing the nuanced and novel approach of modified *pro rata* allocation of the proceeds of a globally integrated insolvency sales procedure. Although the focus on estate-by-estate distribution of this pro-rated allocation might at first blush seem territorialist, properly viewed in context, *Nortel* is actually a considerable illustration and advancement of universalism. *Nortel* is far from a full-throated clarion cry for universalism, however, so at most two cheers can be mustered and not a full three. [96] But universalism is likely only to be reached along an incrementalist path anyway, [97] and *Nortel* has moved the ball forward. In their own way, perhaps covertly, perhaps subconsciously, perhaps unintentionally, or perhaps simply judiciously, the Nortel judges in their two different jurisdictions with their two coordinated and harmonious opinions have shown how universalism can work and how its allure remains strong.

> In so far as the IP is concerned, while the patents were registered in the name of NNL, I would not for that reason hold that NNL is entitled to the proceeds of the IP sales. The patents and application rights to apply for patents were held in the name of IP for administrative purposes. It was best practices in a multi-national enterprise to have all patents assigned to one company, in this case to NNL, as explained by Ms. Anderson and Ms. De Walton, and made management of the portfolio much easier. While these witnesses expressed subjective views that it was NNL who owned the patents, these views are not determinative, as acknowledged in the Monitor's reply brief at paras 65-66. This was not one corporation and one set of employees inventing IP that led to patents. Nortel was a highly integrated multi-national enterprise with all RPEs doing R&D that led to patents being granted. It was R&D that drove Nortel's business. R&D and the intellectual property created from it was the primary driver of Nortel's value and profits. All parties agree on that. *It would unjustly enrich NNL to deprive all of the other RPEs of the work that they did in creating the IP just because the patents were registered in NNL's name*. (Emphasis added).

*In re Nortel Networks, Inc*, 532 BR at 556.

Pottow, "Incrementalism", *supra* note 3 at 948.

*In re Nortel Networks, Inc*, 532 BR at 550.

Pottow, "Incrementalism", *supra* note 3 at 951.

*Re Nortel Networks Corp*, 2015 CarswellOnt 7072, para 197.

Footnotes

* John A E Pottow, John Philip Dawson Collegiate Professor of Law, University of Michigan Law School. James Robinson, Michigan JD Class of 2016, provided research assistance, and the referees provided comments. All are appreciated.

2 *In re Nortel Networks, Inc*, 532 BR 494 (Bankr D Del 2015); *Re Nortel Networks Corp*, 2015 ONSC 2987 (Ont SCJ [Commercial List]).

3 Others have taken up the charge. See, *eg*, Robert Harlang & Mitch Vininsky, "Nortel Networks: A New Twist on Substantive Consolidation?" (2015), 34 *Am Bankr Inst J* 18, 66 ("The *Nortel* allocation case was unique in many respects and resulted in decisions that demonstrated the respective judges' understanding of the business world and their creativity.").

4 The reader is presumed to know the well-rehearsed international bankruptcy debates between the competing theories of "territorialism" and "universalism" as the preferred normative models for resolving multinational failures. While territorialism

counsels following strict sovereign borders in allocating regulatory jurisdiction among nations over globally dispersed assets, universalism embraces a one-law approach: the application of one "exporting" country's bankruptcy law extraterritorially to other "receiving" jurisdictions. John A E Pottow, "Procedural Incrementalism: A Model for International Bankruptcy" (2005), 45 *Va. J Int'l* 935, 937 [Pottow, "Incrementalism"].

5 See *supra* note 1. For flavour: as of January 2009, Nortel's lines of business were "carrier networks", wireless networking solutions for providers of mobile voice, data and multimedia communications services over technologies; "enterprise solutions", enterprise communications solutions addressing the headquarters, branch and homes office needs of large and small businesses; and "metro ethernet networks", optical networking and carrier grade ethernet data networking solutions. *In re Nortel Networks, Inc*, 532 BR at 503.

6 UNCITRAL, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment and Interpretation* (New York: UN, 2014) [Model Law].

7 *Companies' Creditors Arrangement Act*, RSC 1985, c C-36, as amended to 26 February 2015 [*CCAA*].

8 US *Bankruptcy Code*, 11 USC §1501 *et seq* [US *Bankruptcy Code*].

9 While they are not the paradigmatic format, the Model Law anticipates parallel procedures. See Model Law, *supra* note 5, Part Two (A)(2); see also US *Bankruptcy Code*, *supra* note 7, §1528 (providing for parallel proceedings). Nortel also filed parallel proceedings in the United Kingdom ("UK"), Israel, and France. See *Management's Discussion and Analysis of Financial Condition and Results of Operations for the Year Ended December 31, 2011*, Nortel Networks (22 March 2012), online: <http://www.nortelcanada.com/wp-content/uploads/2011/11/NNL-2011-Annual-Report-MDA.pdf>.

10 One example is Nortel Networks SA, a French company.

11 From the late 1970s to 31 December 2000, Nortel operated under a series of Cost Sharing Agreements ("CSA"), which were bilateral agreements between the Canadian parent, Nortel Networks Limited ("NNL"), and each of the other R&D-performing Nortel entities. The purpose of these CSA was effectively to implement transfer pricing by allocating costs to respective corporate affiliates across the globe (and hence dictate the net taxable income for each such affiliate). It was never a smooth process at Nortel. For example, the last R&D CSA between NNL and the main US subsidiary, Nortel Networks, Inc ("NNI"), was drafted in 1996 and made effective from 1 January 1992, to reflect the terms of a 1996 advanced pricing agreement ("APA") between NNL, NNI, the Canadian Revenue Agency ("CRA"), the taxing authority and the Internal Revenue Service ("IRS"), the US tax authority. At the end of 1999, however, each of the three CSA APA in effect between NNL and each of the other then-cost sharing participants ("CSP") (namely, those governing R&D, tangible property, and headquarters cost sharing) had expired or was nearing expiration. In December 2001, Nortel's R&D CSA was terminated. Accordingly, from December 2001 through March 2002, the Nortel tax group worked with external advisors to craft the specific mechanics of a residual profit sharing method ("RPSM") for Nortel that could be submitted simultaneously to the CRA, IRS and Inland Revenue, the UK taxing authority, as the basis for proposed APA for the 2000 to 2004 period. It culminated in the Master Research and Development Agreement ("MRDA") that later came to be so litigated in the *Nortel* bankruptcy. Indeed, over the course of eight years (2001-08), as APA negotiations with the tax authorities dragged on regarding Nortel's RPSM, the individual entities ("IE") made or received billions of dollars in transfer pricing payments under that system. In 2009, following Nortel's insolvency and more than seven years after the 2002 APA applications, the IRS and CRA finally directed an income adjustment of US$2 billion from NNL to NNI as a condition for resolving the APA for those years. *In re Nortel Networks, Inc*, 532 BR 494, 507-9 (Bankr DDel 12 May 2015).

12 *In re Nortel Networks, Inc*, 532 BR at 502; *Re Nortel Networks Corp*, 2015 CarswellOnt 7072 (Ont SCJ [Commercial List]), paras 29-30.

13 "Interim Funding and Settlement Agreement" (visited 20 September 2015), online: <http://bankrupt.com/misc/NortelInterimFundingAgreement.pdf> [IFSA]. The IFSA settled the inter-corporate tax claim at US$2 billion. See *supra* note 10. The IFSA was later finalized into the Final Canadian Funding and Settlement Agreement. *In re Nortel Networks, Inc*, 532 BR at 511-12; *Re Nortel Networks Corp*, 2015 CarswellOnt 7072 at para 33.

14 *Ibid* at 11: "[T]he entire amount of the Sale Proceeds ... shall be deposited in an escrow account pursuant to an escrow agreement, the terms of which shall be negotiated and agreed by all Selling Debtors, in each case acting reasonably."

15 *In re Nortel Networks, Inc*, 737 F 3d 265 (3d Cir 2013).

16 *In re Nortel Networks, Inc*, 532 BR at 518; *Re Nortel Networks Corp*, 2015 CarswellOnt 7072 para 39.

17 *In re Nortel Networks, Inc*, 532 BR at 514-15; *Re Nortel Networks Corp*, 2015 CarswellOnt 7072 para 105.

18 Rockstar is a consortium comprising Apple, Ericsson, Microsoft, Blackberry, EMC, and Sony. *In re Nortel Networks, Inc*, 532 BR at 502.

19 $7.3 billion, to be precise. *Ibid* at 525.

20 "In no case shall there be any distribution from the Escrow Account in advance of either (i) agreement of all of the Selling Debtors or (ii) in the case where the Selling Debtors fail to reach agreement, determination by the relevant dispute resolver(s) ...." IFSA at 11.

21 [E]ach Party ... agrees to submit to the non-exclusive jurisdiction of the US and Canadian Courts (in a joint hearing conducted under the Cross-Boarder Protocol adopted by such Court, as it may be in effect from time to time), for purposes of all legal proceedings to the extent relating to the matters agreed in [the IFSA]. *Ibid* at 15.

22 See John A E Pottow, "Greed and Pride in International Bankruptcy: The Problems of and Proposed Solutions to "Local Interests" (2006) 104 *Mich L Rev* 1899, discussing the *Lernout & Hauspie* bankruptcy [Pottow, "Greed and Pride"]; see also *In re Lernout & Hauspie Speech Prods, NV*, 301 BR 651, 655 (Bankr D Del 2003) ("providing longer explication of the facts").

23 Model Law, *supra* note 5, arts 25-27; US *Bankruptcy Code*, *supra* note 7, §§1525-27; *CCAA*, *supra* note 6, ss 52; cf Bob Wessels & Miguel Virgós, *European Communication and Cooperation Guidelines for Cross-border Insolvency* (July 2007), online: <http://www.insol.org/INSOLfaculty/pdfs/BasicReading/Session%205/European%20Communication%20and%20Cooperation%20Guidelines%20for%20Cross-border%20Insolvency%20.pdf> [CoCo Guidelines] (elaborating recommendations for cross-border insolvency cases).

24 "The Courts have had discussions following the trial of the allocation dispute in an effort to avoid the travesty of reaching contrary results which would lead to further and potentially greater uncertainty and delay." *In re Nortel Networks, Inc*, 532 BR at 532.

25 *Ibid* at 556 ("[T]he US Court and the Canadian Court independently arrived at the same conclusion."); *Re Nortel Networks Corp*, 2015 CarswellOnt 7072 (Ont SCJ [Commercial List]), para 10 ("We have come to this conclusion in the exercise of our independent and exclusive jurisdiction in each of our jurisdictions.").

26 "[T]he self-serving allocation positions of the Canadian Interests, the US Interests and the EMEA Debtors are not determinative or helpful." *In re Nortel Networks, Inc*, 532 BR at 532.

27 *Ibid* at 522; "The Court compares the Allocation Dispute to three people trying to reach the top of a mountain by pulling the others down. In other words, no one gets to the top." *Ibid* at 556.

28 The only parties who made a full-hearted *pro rata* pitch were the UK pension claimants. Wilmington Trust advocated a *pro rata* approach, but only as an alternate theory to its primary argument. *Ibid* at 530.

29 *Ibid* at 547-48; *Re Nortel Networks Corp*, 2015 CarswellOnt 7072, paras 64-66. The EMEA alternatively argued (in an argument that went nowhere) that the residual profit entities ("RPE") should have ownership of the IP under common law principles "by reason of the IP belonging to the RPE that employed the inventors". *Re Nortel Networks Corp*, 2015 CarswellOnt 7072, para 186. Under the MDRA, each Licensed Participant vested legal titled in NNL to the IP it created in exchange for which NNL granted an exclusive license back to each Licensed Participant. *In In re Nortel Networks, Inc*, 532 BR at 510.

30 *In re Nortel Networks, Inc*, 532 BR at 548-49; *Re Nortel Networks Corp*, 2015 CarswellOnt 7072, para 65.

31 *In re Nortel Networks, Inc*, 532 BR at 549-60; *Re Nortel Networks Corp*, 2015 CarswellOnt 7072, paras 193-249.

32 *In re Nortel Networks, Inc*, 532 BR at 533: "The Canadian Debtors are nothing short of narcissistic in allocating the bulk of the Sales Proceeds to themselves and in their failure to recognize the contributions of the other Nortel companies and the realities of the manner in which the Nortel enterprise operated on a day-to-day basis." *Re Nortel Networks Corp*, 2015 CarswellOnt 7072, paras 196-97:

33 "It is a fundamental tenet of insolvency law that all debts shall be paid *pari passu* and all unsecured creditors receive equal treatment." *Re Nortel Networks Corp*, 2015 CarswellOnt 7072, para 209.

34 "The allocation each Debtor Estate will be entitled to receive from the lockbox funds is the percentage that all accepted claims against that Estate bear to the total claims against all Debtor Estates." *Ibid* at para 250.

35 "[Both courts] agree that their methodology does not constitute global substantive consolidation." *In re Nortel Networks, Inc*, 532 BR at 551.

36 *Ibid.*

37 *In re Lehman Bros Special Fin Inc v BNY Corporate Tr Servs Ltd (In re Lehman Bros Holdings Inc)*, 422 BR 407 (Bankr SDNY 2010).

38 The discussion of *pro rata* allocation requires a discussion of substantive consolidation and, more importantly, why the Court's approach is not that seemingly offensive outcome ... The Court, for one, is not ordering payments to the "most deserving" creditors as the Bondholders fear. The Court is not ordering a distribution scheme. Instead, the Court is directing an allocation among the Estates for the Estates to distribute in an appropriate manner. It is a distinction with a difference.

39 See *ibid.*

40 "Even if it could be said that a *pro rata* allocation involved substantive consolidation, which it cannot, I do not see case law precluding it in the unique circumstances of this international case. Even in domestic cases, CCAA plans involving substantive consolidation are not unknown." *Re Nortel Networks Corp*, 2015 CarswellOnt 7072, at para 214.

41 "To be clear, the Court's *pro rata* allocation is not the 'new order' which the *pro rata* proponents urge with terms such as 'universalism'". *In re Nortel Networks, Inc*, 532 BR at 558.

42 For example, the courts note that they were recognizing inter-corporate debt, *In re Nortel Networks, Inc*, 532 BR at 532; *Re Nortel Networks Corp*, 2015 CarswellOnt 7072 para 214, which indeed would be ignored in applying the doctrine of substantive consolidation, *In re Nortel Networks, Inc*, 532 BR at 532; *Re Nortel Networks Corp*, 2015 CarswellOnt 7072 para 214. But that simply speaks to whether *pro rata* allocation is tantamount to substantive consolidation (suggesting that it might be). It has nothing to do with universalism, which is indifferent to inter-corporate debt.

43 In its purest conceptual form, universalism aspires to the harmonization of one worldwide, substantive law of bankruptcy. The most common model of universalism, however, follows a pluralist route. Sidestepping the issue of which substantive provisions the ideal bankruptcy law would possess, it simply selects from one of the preexisting bankruptcy regimes *ex post*. To the extent that other courts are needed (to give legal force to the orders of the courts of the governing jurisdiction), such courts could convene ancillary proceedings designed to effectuate the controlling court's orders. The current universalist paradigm thus concedes the divergence of present domestic bankruptcy laws and advocates only a pluralist system of choice-of-law; its theory does not envision (or rely upon) substantive harmonization of those bankruptcy laws.

44 *Ibid* at 949.

45 See UNCITRAL, *Legislative Guide on Insolvency Law, part three: Treatment of enterprise groups in insolvency*, 38 th Sess, UN Doc A/CN.9/WG.V/WP.92, 2010 [Legislative Guide].

46 See Irit Mevorach, "Towards a Consensus on the Treatment of Multinational Enterprise Groups in Insolvency" (2010), 18 *Cardozo J Int'l & Comp L* 359.

47 The most that could be said is that substantive consolidation is "harmonious" with a robust form universalism applied to corporate groups.

48 See Legislative Guide, *supra* note 44.

49 "To be clear, the Court's *pro rata* allocation is not the "new order" which the *pro rata* proponents urge with terms such as "universalism". *In re Nortel Networks, Inc*, 532 BR 494, 558 (Bankr D Del 12 May 2015). The court's apparent dislike for universalism appears premised on a misunderstanding that Chapter 15 of the US *Bankruptcy Code* is not the enactment of the Model Law (which of course, it is). Awkwardly, Judge Gross insisted: "These cases are not proceeding under the purview of the Model Law, which is purely a proposal at this time. These cases *are* proceeding under the dictates of Chapters 11 and 15 of the US *Bankruptcy Code*." Ibid at 559 (emphasis added). Thus, one might charitably chalk the court's disdain up to confusion.

50 "The Court is not ordering a distribution scheme. Instead, the Court is directing an allocation among the Estates for the Estates to distribute in an appropriate manner. It is a distinction with a difference. The difference is that intercompany claims, settlements, cash-on-hand will all be honored in the allocation." *Ibid* at 555.

51 EC, *Council Regulation(EC) 1346/2000 of 29 May 2000 on insolvency proceedings*, [2000] OJ L 160 at art 12.

52 Lynn M LoPucki, "The Case for Cooperative Territoriality in International Bankruptcy" (2000) 98 *Mich L Rev* 2216 [LoPucki].

53 *In re Nortel Networks, Inc*, 532 BR at 554: "All claims against each Nortel Debtor, including intercompany claims and court approved settlements, will receive distributions from the separate Debtor Estates."; *Re Nortel Networks Corp*, 2015 CarswellOnt 7072 (Ont SCJ [Commercial List]), paras 250-51.

54 *Re Nortel Networks Corp*, 2010 ONSC 1304 (Ont SCJ [Commercial List]).

55 *Re Nortel Networks Corp*, 2015 ONSC 4170 (Ont SCJ [Commercial List]) at para 53.

56 See for example, LoPucki, *supra* note 51, arguing for "cooperative" territorialism.

57 Model Law, *supra* note 5, arts 25-27; CoCo Guidelines, *supra* note 22.

58 See for example, US *Bankruptcy Code*, *supra* note 7, §1508: "In interpreting this chapter, the court shall consider its international origin, and the need to promote an application of this chapter that is consistent with the application of similar statutes adopted by foreign jurisdictions."

59 Jay L Westbrook, "Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum" (1991), 65 *Am Bankr L J* 457; Pottow, "Incrementalism", *supra* note 3 at 988-92.

60 See for example, Elizabeth Warren *et al*, *The Law of Debtors & Creditors: Text, Cases and Problems 914*, 7th ed (Aspen Publishers, 2014), discussing this aspect of the famous *Maxwell Communications* case.

61 Over 13 pages, Judge Gross rejected the Canadian debtors' argument that the MRDA gave them ownership of the IP and subsequent IP sales proceeds. *In re Nortel Networks, Inc*, 532 BR 494, 538 (Bankr D Del 12 May 2015). Rather, the US court looked to Nortel's representations to tax authorities and its enforcement and sublicensing practices to find that the MRDA gave the US debtors and the EMEA debtors economic and beneficial ownership, and thus shared ownership, of the IP. *Ibid* at 540-47. Across the border and over 23 pages, the Canadian court found that while under the MRDA, the Canadian debtors had complete ownership of the IP subject to exceptions, it joined the US court in ultimately concluding that the MRDA itself was not controlling on the question of allocation of the IP sales proceeds, *Re Nortel Networks Corp*, 2015 CarswellOnt 7072 (Ont SCJ [Commercial List]), paras 169, 171, because "[t]he MRDA was an operating agreement and was not intended to, nor did it, deal with the disposal of all Nortel's assets in a situation in which no revenue was being earned and no profit or losses were occurring." *Ibid* at para 172.

62 See for example, US Debtors' Motion for Clarification and/or Reconsideration of the 12 May 2015 Allocation Trail Opinion and Order, *In re Nortel Networks, Inc*, 532 BR 494 (Bankr D Del 12 May 2015) (No 09-10138) (Dkt No 15611).

63 As the US Court candidly conceded, "The Courts have different interpretations of the MDRA." *In re Nortel Networks, Inc*, 532 BR at 532.

64 See *supra* note 60.

65 The parties' complex arguments for their positions and against others [*sic*] supported by the enormous volume of supporting papers go around and around without end and without a definitive correct answer. It is fair to find that there is validity and error in all of the arguments, largely because the arguments are not rooted in an agreement which applies to the facts.

66 Pottow, "Greed and Pride", *supra* note 21; see also Sohsuke Takahashi, "The Reality of the Japanese Legal System for Cross-Border Insolvency — Driven by Fear of Universalism" (14 March 2011) [unpublished, on file with the International Insolvency Institute], at 67-72, discussing the cognate concept of "fear".

67 It is very difficult for a court in Country B to tell a group of Country B employees who have worked in a branch office in Country B for years that they will not enjoy the special priority distribution rule accorded to workers under Country B's bankruptcy laws, even though there are plentiful assets in Country B to cover such a payout, because their employer's bankruptcy will be governed under the laws of Country A, which grants no such priority.

68 See Frederick Tung, "Fear of Commitment in International Bankruptcy" (2001), 33 *Geo Wash Int'l L Rev* 555, 566 n44.

69 *In re Lernout & Hauspie Speech Prods, NV*, 301 BR 651, 655 (Bankr D Del 2003).

70 See Pottow, "Greed and Pride", *supra* note 21 at 1912-15.

71 See *supra* note 49.

72 "[T]he Court is attempting to apply an equitable result where parties could not agree upon one and did not prove the validity of any one of the conflicting views." *In re Nortel Networks, Inc*, 532 BR 494, 556 (Bankr D Del 12 May 2015); "It would unjustly enrich NNL to deprive all of the other RPEs of the work that they did in creating the IP just because the patents were registered in NNL's name." *Re Nortel Networks Corp*, 2015 CarswellOnt 7072 (Ont SCJ [Commercial List]), para 197.

73 See for example *In re Nortel Networks, Inc*, 532 BR at 555, preferring economic approach.

74 It was not one corporation and one set of employees inventing IP that led to patents. Nortel was a highly integrated multi-national enterprise with all RPEs doing R&D that led to patents being granted. It was R&D that drove Nortel's business. R&D and the intellectual property created from it was the primary driver of Nortel's value and profits. All parties agree on that. It would unjustly enrich NNL to deprive all of the other RPEs of the work that they did in creating the IP just because the patents were registered in NNL's name.

75 "Territorial wrangling significantly diminishes value for stakeholders in a global insolvency involving a highly-integrated multi-national enterprise whose assets are entangled, and ought not to be condoned or rewarded." *In re Nortel Networks, Inc*, 532 BR at 531.

76 *Ibid* at 559; *Re Nortel Networks Corp*, 2015 CarswellOnt 7072, para 229.

77 *In re Nortel Networks, Inc*, 532 BR at 559; *Re Nortel Networks Corp*, 2015 CarswellOnt 7072 at para 239.

78 "The guarantees did not restrict NNC or its subsidiaries from lending cash to, or making investments in, affiliates, or from incurring substantial amounts of additional indebtedness investors were warned of the possibility of consolidation, and that under applicable law principal and interest might not be paid. Thus, the Bondholders' allegations of reliance on the outcome they now advocate are unfounded [*sic*]." *In re Nortel Networks, Inc*, 532 BR at 559.

79 See John A E Pottow, "Beyond Carve-Outs and Toward Reliance: A Normative Framework for Cross-Border Insolvency Choice of Law" (2014), 9 *Brook J Corp Fin & Com L* 197, arguing that only actual reliance rather than presumed reliance based on conjectured expectations should generally justify departure from COMI bankruptcy rules.

80 *Re Nortel Networks Corp*, 2015 ONSC 4170 (Ont SCJ [Commercial List]) at para 54.

81 See *supra* note 33.

82 "In determining what the claims against a Debtor Estates [*sic*] are, a claim that can be made against more than one Debtor Estate can only be calculated and recognized once." *Re Nortel Networks Corp*, 2015 CarswellOnt 7072, para 251; see also Jay Lawrence Westbrook, "Universal Participation in Transnational Bankruptcies", in Ross Cranston, ed, *Making Commercial Law: Essays in Honour of Ray Goode* (Oxford: Clarendon Press, 1997) 419, 436-37 (discussing "universal cross-filing").

83 See Pottow, "Incrementalism", *supra* note 3 at 947.

84 Most of the parties — save the plucky US interests — have not appealed the allocation decision, although they have filed contingent cross-appeals if the US appeals are granted. The appellate courts have rebuffed invitations to expedite these appeals. Gina Passarella, "Nortel Bankruptcy Appeals Denied Fast Track to Third Circuit", *Delaware Law Weekly* (5 August 2015), online: <http://www.delawarelawweekly.com/id=1202733834964/Nortel-Bankruptcy-Appeals-Denied-Fast-Track-to-Third-Circuit?slreturn=20150905125146>.

85 "*Pro rata* is, to say the least, an extraordinary result." *In re Nortel Networks, Inc*, 532 BR 494, 560 (Bankr D Del 12 May 2015). "[D]oing what is just in the unique circumstances of this case should govern the allocation." Re Nortel Networks Corp, 2015 CarswellOnt 7072, para 204.

86 "The Court can only speculate why the parties, all represented by the ablest of lawyers and sparing no expense, were unable to reach a settlement on allocation." *In re Nortel Networks, Inc*, 532 BR at 500.

87 *Re Nortel Networks Corp*, 2015 CarswellOnt 7072 (Ont SCJ [Commercial List]), para 197; *ibid* at para 218 (noting "significant intertwining of the debtor companies, including multiple instances of inter-company debts, cross-default provisions and guarantees and the existence and operation of a centralized cash-management system").

88 *In re Nortel Networks, Inc*, 532 BR at 551-52.

89 See Legislative Guide, *supra* note 44.

90 Modified by the cash on hand, to be sure, but still *pro rata* in the main.

91 As Lord Hoffmann for the Privy Council puts it best: "[F]airness between creditors requires that, ideally, bankruptcy proceedings should have universal application. There should be a single bankruptcy in which all creditors are entitled and required to prove. No one should have an advantage because he happens to live in a jurisdiction where more of the assets or fewer of the creditors are situated." *Cambridge Gas Transportation Corp v Official Committee of Unsecured Creditors of Navigator Holdings plc*, [2006] 3 All ER 829, [2006] UKPC 26 (PC) at paras 13-15.

92 See for example, John A E Pottow, "The Myth (and Realities) of Forum Shopping in Transnational Insolvency" (2006), 32 *Brook J Int'l L* 785, discussing territorialism's facilitation of forum shopping through asset flight [Pottow, "Myth (and Realities)"].

93 Jay Lawrence Westbrook, "A Global Solution to Multinational Default" (2000), 98 *Mich L Rev* 2276.

94 See Pottow, "Myth (and Realities)", *supra* note 90.

95 See *supra* note 60.

96 This territorial backslide can be seen, for example, by the modification to the *pro rata* approach, the vocal protestations that it was neither substantive consolidation nor universalism, and the aforementioned fixation on territorial estates. *In re Nortel Networks, Inc*, 532 BR at 550, 558, 538; *Re Nortel Networks Corp*, 2015 CarswellOnt 7072 (Ont SCJ [Commercial List]) at paras 88, 212.

97 Pottow, "Incrementalism", *supra* note 3.

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# TAB 15

Court File No. CV-15-000011169-00CL

***ONTARIO***
**SUPERIOR COURT OF JUSTICE**
**COMMERCIAL LIST**

| | | |
|---|---|---|
| THE HONOURABLE MR. | ) | FRIDAY, THE 21st |
| | ) | |
| JUSTICE HAINEY | ) | DAY OF SEPTEMBER, 2018 |

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF ESSAR STEEL ALGOMA INC., ESSAR TECH ALGOMA INC., ALGOMA HOLDINGS B.V., ESSAR STEEL ALGOMA (ALBERTA) ULC, CANNELTON IRON ORE COMPANY AND ESSAR STEEL ALGOMA INC. USA

**(Applicants)**

**APPROVAL AND VESTING ORDER**

**THIS MOTION**, made by Essar Steel Algoma Inc. ("**Algoma**"), Essar Steel Algoma Inc. USA ("**Algoma USA**"), Essar Tech Algoma Inc., Algoma Holdings B.V., Essar Steel Algoma (Alberta) ULC, and Cannelton Iron Ore Company (collectively, the "**Applicants**"), for an order, *inter alia*: (a) approving the sale transaction (the "**Sale Transaction**") contemplated by the asset purchase agreement (the "**APA**") between Algoma and Algoma USA, as "**Sellers**", and Algoma Steel Inc. (f/k/a 1076318 B.C. Ltd.), as "**Buyer**" and appended to the Affidavit of John Strek sworn September 17, 2018, and (b) vesting in the Buyer the Sellers' right, title and interest in and to the Purchased Assets (as defined in the APA), and vesting in the Buyer Parent (as defined in the APA) Algoma's right, title and interest in and to the Buyer Preferred Shares (as defined in the APA), was heard this day at 330 University Avenue, Toronto, Ontario.

**ON READING** the Notice of Motion of the Applicants, the Affidavit of John Strek sworn July 23, 2018 and the Exhibits attached thereto, the Affidavit of John Strek sworn

September 17, 2018, the Forty Fifth Report of Ernst & Young Inc., in its capacity as Monitor of the Applicants (the "**Monitor**"), dated July 31, 2018, the Forty Seventh Report of the Monitor dated September 19, 2018 and on being advised that those parties disclosed on the Service List attached to the Motion Record were given notice, and on hearing the submissions of counsel for the Applicants, the Monitor and the Buyer and the other parties appearing, no one appearing for any other person on the service list, although properly served as appears from the affidavit of Sanja Sopic, sworn July 27, 2018 and affidavit of Sanja Sopic, sworn September 17, 2018, filed:

**DEFINITIONS**

1. **THIS COURT ORDERS** that, unless otherwise indicated or defined herein, capitalized terms used in this Order shall have the meaning given to them in the APA.

**SALE TRANSACTION**

2. **THIS COURT ORDERS AND DECLARES** that the APA and the execution and delivery thereof by the Sellers, and the Sale Transaction, are hereby authorized and approved, with such minor amendments as the Sellers and the Buyer, with the approval of the Monitor, may agree upon. The Sellers are hereby authorized and directed, and the Monitor is authorized and empowered, to take such additional steps and execute such additional documents as may be necessary or desirable for the completion of the Sale Transaction and for the conveyance of the Purchased Assets to the Buyer, including without limitation the execution and delivery of the Share Transfer Agreement and the Senior Secured Notes Interest Agreement by Algoma and the seizure of the Buyer Preferred Shares by the Buyer Parent, and including amending the acquisition structure pursuant to and in accordance with section 7.17 of the APA.

3. **THIS COURT ORDERS AND DECLARES** that upon the delivery of a Monitor's certificate to the Buyer substantially in the form attached as Schedule "A" hereto (the "**Monitor's Sale Certificate**"), all of the Sellers' right, title and interest in and to the Purchased Assets shall vest absolutely in the Buyer, free and clear of and from any and all ownership claims, security interests (whether contractual, statutory, or otherwise), hypothecs, mortgages, pledges, trusts, constructive trusts or deemed trusts (whether contractual, statutory or otherwise and including, for greater certainty, any statutory trust under the *Pension Benefits Act* (Ontario)), liens, encumbrances, obligations, liabilities, claims, prior claims, demands,

guarantees, set-off , executions, levies, charges, or other financial or monetary claims, adverse claims, restrictions, development or similar agreements, title defects, or rights of use, puts or forced sale provisions exercisable as a consequence of or arising from closing of the Sale Transaction whether arising prior to or subsequent to the commencement of the CCAA Proceedings, whether or not they have attached or been perfected, registered or filed and whether secured, unsecured, legal, equitable, possessory or otherwise (collectively, the "**Claims**") including, without limiting the generality of the foregoing: (a) any encumbrances or charges created by the Initial CCAA Order, and any subsequent charges created by the Court; (b) all charges, security interests or claims evidenced by registrations pursuant to the *Personal Property Security Act* (Ontario) or any other personal property registry system; and (c) those Claims listed on Schedule "C" hereto (all of which are collectively referred to as the "**Encumbrances**"), provided that, (x) the Claims and Encumbrances referred to herein shall not include the Permitted Encumbrances; and (y) the vesting of the Purchased Assets in the Buyer, free and clear of and from any Encumbrances in respect of a Priority Claim (as defined below) shall not occur prior to the delivery of a Priority Claims Certificate (as defined in Schedule "C" hereto). For greater certainty, this Court orders that all of the Encumbrances affecting or relating to the Purchased Assets are hereby expunged, vacated and discharged as against the Purchased Assets except for Permitted Encumbrances.

4. **THIS COURT ORDERS AND DECLARES**, in furtherance of the Buyer Parent's seizure of the Buyer Preferred Shares with the consent of Algoma as contemplated by the APA and the Share Transfer Agreement, that upon the delivery of a Monitor's certificate to the Buyer and the Buyer Parent substantially in the form attached as Schedule "B" hereto (the "**Monitor's Shares Certificate**" and together with the Monitor's Sale Certificate, the "**Monitor's Certificates**"), all of Algoma's right, title and interest in and to the Buyer Preferred Shares shall vest absolutely in the Buyer Parent, free and clear of and from any and all Claims and Encumbrances. For greater certainty, this Court orders that all of the Encumbrances affecting or relating to the Buyer Preferred Shares are hereby expunged and discharged as against the Buyer Preferred Shares.

5. **THIS COURT ORDERS** that upon (a) the registration in the applicable Land Registry Office of a Document General attaching a copy of this Order in the form prescribed by the *Land Registration Reform Act* or an Application for Vesting Order in the form prescribed by the *Land Registration Reform Act* and/or the *Land Titles Act* and/or the *Registry Act*, as applicable, or,

alternatively, (b) upon presentation of a copy of this Order and the Monitor's Sale Certificate to the applicable Land Registry Office, the applicable Land Registrar is hereby directed to enter the Purchaser as the owner of the subject real property identified in Schedule "D" hereto (the "**Sault Ste. Marie Property**") in fee simple, and is hereby directed to delete and expunge from title to the Sault Ste. Marie Property all of the Encumbrances listed on Schedule "C" hereto relating to the applicable parcel of the Sault Ste. Marie Property.

6. **THIS COURT ORDERS** that the Sellers, the Buyer, the Buyer Parent or the Monitor shall be authorized to take all steps as may be necessary to effect the discharge of the Claims and Encumbrances with respect to the Purchased Assets and the Buyer Preferred Shares after completion of the Sale Transaction.

7. **THIS COURT ORDERS** that, if the Sellers file a plan of compromise or arrangement then, provided the APA has not been terminated, the plan shall not derogate or otherwise affect any right or obligation of the Sellers, the Buyer or the Buyer Parent under the APA unless otherwise agreed by the Sellers, the Buyer and the Buyer Parent.

8. **THIS COURT ORDERS** that, notwithstanding:

(a) The pendency of these proceedings;

(b) Any applications for a bankruptcy order or receivership order now or hereafter issued pursuant to the *Bankruptcy and Insolvency Act* (Canada) in respect of the Sellers and any bankruptcy order or receivership order issued pursuant to any such applications; and

(c) Any assignment in bankruptcy made in respect of one or more of the Sellers;

the vesting of the Purchased Assets in the Buyer, the vesting of the Buyer Preferred Shares in the Buyer Parent and the payments, distributions, and disbursements made pursuant to the APA, the Share Transfer Agreement and this Order shall be binding on any trustee in bankruptcy or receiver that may be appointed in respect of the Sellers and shall not be void or voidable by creditors of the Sellers, nor shall it constitute nor be deemed to be a fraudulent preference, assignment, fraudulent conveyance, transfer at undervalue, or other reviewable transaction under the *Bankruptcy and Insolvency Act* (Canada) or any other applicable federal or provincial legislation, nor shall it constitute oppressive or unfairly prejudicial conduct pursuant to any applicable federal or provincial legislation.

9. **THIS COURT ORDERS** that (a) on or after the Closing Time, the Sellers are hereby permitted to execute and file articles of amendment or such other documents or instruments as may be required to change their respective legal names in accordance with section 7.16 of the APA, and such articles, documents or other instruments shall be deemed to be duly authorized, valid and effective and shall be accepted by the Director (as defined in the *Canada Business Corporations Act*) and the Delaware Secretary of State without the requirement (if any) of obtaining director, partner or shareholder approval pursuant to any federal, provincial or state legislation; and (b) upon the official change to the legal names of the Sellers that is to occur in accordance with section 7.16 of the APA, the names of the Sellers in the within title of proceedings shall be deleted and replaced with the new legal names of the Sellers, and any document filed thereafter in these proceedings (other than the Monitor's Certificate) shall be filed using such revised title of proceedings.

10. **THIS COURT ORDERS** that the Agent is authorized and directed to take all such actions (including through a designated agent or representative of the Agent), solely to the extent within the Agent's control, as may be necessary or desirable to facilitate and effectuate the completion of the Sale Transaction, including the taking of the actions specified in section 5.6 of the APA (as it may be amended, supplemented or otherwise modified from time to time in accordance with the RSA), subject to receiving the Lender Direction Letter, in form and substance acceptable to the Agent, acting reasonably, from the Required Lenders (as defined in the Term Loan Agreement) to take such actions. The authorizations and directions contained herein are ordered notwithstanding any term or condition of the Term Loan Agreement or any provision of applicable law. The Agent shall not be liable for, and is hereby released and exculpated from, any liability, loss, damage, claim, cost or expense related to or arising as a result of carrying out the provisions of this Order or undertaking the actions contemplated pursuant to the APA (including through a designated agent or representative of the Agent), including the execution, delivery and performance of the Lender Credit Bid Documents, including any claims or causes of action asserted or that could be asserted by any party in interest (including any Lender or agent for such Lender), and the Agent shall be fully

indemnified by the Buyer and the Buyer Parent for any such liability, loss, damage, claim, cost or expense.

11. **THIS COURT ORDERS** that the Indenture Trustee, in in its capacity as trustee and/or collateral agent, is authorized and directed to take all such actions (including through a designated agent or representative of the Indenture Trustee), in each case solely to the extent within the Indenture Trustee's control, as may be necessary or desirable, and to cooperate with the Depository Trust Company ("**DTC**"), subject to applicable DTC procedures, to facilitate and effectuate the completion of the Sale Transaction, including the transfer of the Senior Secured Notes and the taking of the actions specified in section 5.7 of the APA (as it may be amended, supplemented or otherwise modified from time to time in accordance with the RSA), subject to receiving the Noteholder Direction Letter, in form and substance acceptable to the Indenture Trustee, acting reasonably, from Senior Secured Noteholders holding, in the aggregate, at least 66 2/3% in principal amount outstanding of the Senior Secured Notes to take such actions. The authorizations and directions contained herein are ordered notwithstanding any term or condition of the Senior Secured Notes Indenture or any provision of applicable law. The Indenture Trustee shall not be liable for, and is hereby released and exculpated from, any liability, loss, damage, claim, cost or expense related to or arising as a result of carrying out the provisions of this Order or undertaking the actions contemplated pursuant to the APA (including through a designated agent or representative of the Indenture Trustee), including the execution, delivery and performance of the Noteholder Credit Bid Documents, including any claims or causes of action asserted or that could be asserted by any party in interest (including any Senior Secured Noteholder or agent for such Senior Secured Noteholder), and the Indenture Trustee shall be fully indemnified by the Buyer and the Buyer Parent for any such liability, loss, damage, claim, cost or expense.

12. **THIS COURT ORDERS AND DIRECTS** the Monitor to file with the Court a copy of the Monitor's Certificates, forthwith after delivery thereof.

13. **THIS COURT ORDERS** that the Monitor may rely on (i) written notice from the Sellers and the Buyer regarding fulfillment of conditions to closing under the APA, and (ii) written notice from Algoma, the Buyer and the Buyer Parent regarding fulfillment of conditions to closing under the Share Transfer Agreement, and shall incur no liability with respect to the delivery of the Monitor's Certificates.

14. **THIS COURT ORDERS** that, pursuant to clause 7(3)(c) of the *Personal Information Protection and Electronic Documents Act* (Canada), the Sellers and the Monitor are authorized and permitted to disclose and transfer to the Buyer all human resources and payroll information in the Sellers' records pertaining to the Sellers' past and current employees. The Buyer shall maintain and protect the privacy of such information and shall be entitled to use the personal information provided to it in a manner which is in all material respects identical to the prior use of such information by the Sellers.

15. **THIS COURT ORDERS** that notwithstanding any other provision of this Order and the APA, upon Closing of the Sale Transaction, the Pellet Sale and Purchase Agreement dated January 31, 2002 as amended, the Amendment to 2002 Pellet Sale and Purchase Agreement and 2013 Term Sheet dated as of September 18, 2017, the Pellet Sale and Purchase Agreement dated October 6, 2017 and effective as of January 1, 2017, and the Pellet Supply Term Sheet – Incremental Tons dated September 30, 2017 (collectively, the "**Cliffs Contracts**") each between Algoma and Cliffs Mining Company or its affiliates (collectively, "**Cliffs**") shall, without further formality or documentation, be binding on and enure to the benefit of the Buyer and Cliffs and shall be deemed assigned to and assumed by the Buyer. For greater certainty, this Order shall not affect the rights and obligations of Algoma, Cliffs and the Buyer, under the Cliffs Reinstatement Agreement Approval Order of Justice Newbould dated May 27, 2016, the Order of Justice Newbould dated December 29, 2016, the Order of Justice Hainey dated December 5, 2017 and the Cliffs Contracts except to the extent that upon Closing the Buyer will replace Algoma.

**DISTRIBUTIONS**

16. **THIS COURT ORDERS** that, following the delivery of the Monitor's Certificates, the Sellers, in consultation with the Monitor, are hereby authorized and directed, without further order of this Court, to repay in full from the Cash Purchase Price:

(a) All indebtedness and obligations outstanding, as of the Closing Date, under the DIP Facility; and

(b) All indebtedness and obligations outstanding, as of the Closing Date, under the ABL Facility;

in each case, such repayments being made free and clear of all Claims and Encumbrances, including, for greater certainty, any encumbrances or charges created by the Initial CCAA Order, and any subsequent charges created by the Court.

**CHARGES**

17. **THIS COURT ORDERS** that upon the repayment in full in cash of all indebtedness outstanding under the DIP Facility as of the Closing Date, the DIP Lenders' Charge (as defined in the Initial CCAA Order) shall be hereby terminated, released and discharged.

18. **THIS COURT ORDERS** that upon Closing, the D&O Charge (as defined in the Initial CCAA Order) and the KERP Charge (as defined in the Order (re KERP Approval) dated December 7, 2015) shall be terminated, released and discharged.

**PRIORITY CLAIMS PROCESS**

19. **THIS COURT ORDERS** that any liability, obligation or claim that (a) the Sellers and the Buyer agree ranks in priority to the Term Loan Secured Debt and the Senior Secured Debt that is not otherwise satisfied pursuant to the APA, including by way of assumption by the Buyer as an Assumed Liability, or otherwise under this Order or the Administrative Reserve Order (a "**Priority Claim**"); or (b) is determined to be a Priority Claim in accordance with a process to be determined by further Order of the Court (the "**Priority Claims Order**"), shall be paid by the Buyer following such agreement or determination and the expiry of all applicable appeal periods or the final determination of any appeals.

**BANK ACCOUNTS**

20. **THIS COURT ORDERS** the Sellers are hereby authorized and directed to transfer their bank accounts to the Buyer effective upon Closing in accordance with the APA, and this Order shall be accepted by any person as valid authorization and approval for completing such transfer without any further requirement for approval by the boards of directors of the Sellers.

**SPECIAL PAYMENTS**

21. **THIS COURT ORDERS** that the Buyer shall have no liability for any Special Payments (as defined in the Order of the Court dated January 13, 2016 (the "**Special Payments**

**Suspension Order"**)) owing to the Essar Steel Algoma Inc. Pension Plan for Hourly Employees, the Essar Steel Algoma Inc. Pension Plan for Salaried Employees, or the Essar Steel Algoma Inc. Wrap Pension Plan that were suspended for the duration of the Applicants' CCAA proceedings pursuant to the Special Payments Suspension Order.

**SEALING**

22. **THIS COURT ORDERS** that the Compendium of Cross Examination Transcripts, and Undertakings, Under Advisements, and Refusals dated August 20, 2018 and the Compendium of Exhibits from Cross-Examinations dated August 20, 2018, shall be sealed, kept confidential and not form part of the public record, until otherwise ordered by this Court.

**GENERAL**

23. **THIS COURT HEREBY REQUESTS** the aid and recognition of any court, tribunal, regulatory or administrative body having jurisdiction in Canada or in the United States or any other jurisdiction to give effect to this Order and to assist the Applicants, the Monitor and their respective agents in carrying out the terms of this Order, including the U.S. Bankruptcy Court. All courts, tribunals, regulatory and administrative bodies are hereby respectfully requested to make such orders and to provide such assistance to the Applicants and the Monitor, as an officer of this Court, as may be necessary or desirable to give effect to this Order or to assist the Applicants and the Monitor and their respective agents in carrying out the terms of this Order.

Hainey J.

**Schedule A – Form of Monitor's Sale Certificate**

Court File No. CV-15-000011169-00CL

*ONTARIO*
**SUPERIOR COURT OF JUSTICE**
**COMMERCIAL LIST**

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT,* R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF ESSAR STEEL ALGOMA INC., ESSAR TECH ALGOMA INC., ALGOMA HOLDINGS B.V., ESSAR STEEL ALGOMA (ALBERTA) ULC, CANNELTON IRON ORE COMPANY AND ESSAR STEEL ALGOMA INC. USA

(Applicants)

**MONITOR'S SALE CERTIFICATE**

**RECITALS**

A. Pursuant to an Order of the Ontario Superior Court of Justice (the "**Court**") dated November 9, 2015 (as amended, restated, supplemented or modified from time to time), Ernst & Young Inc. was appointed as the monitor (the **"Monitor")** of Essar Steel Algoma Inc. ("**Algoma**"), Essar Tech Algoma Inc., Algoma Holdings B.V., Essar Steel Algoma (Alberta) ULC, Cannelton Iron Ore Company and Essar Steel Algoma Inc. USA ("**Algoma USA**" and collectively the "**Applicants**"), in respect of these CCAA Proceedings.

B. Pursuant to an Order of the Court dated September ●, 2018 (the "**Approval and Vesting Order**"), the Court approved the sale transaction contemplated by the asset purchase agreement (the "**APA**") between Algoma and Algoma USA, as "**Sellers**", and Algoma Steel Inc. (f/k/a 1076318 B.C. Ltd.), as "**Buyer**", and provided for, among other things, the vesting in the Buyer of the Sellers' right, title and interest in and to the Purchased Assets, which vesting is to be effective with respect to the Purchased Assets upon the delivery by the Monitor to the Buyer of a certificate confirming that the conditions to closing under the APA have been satisfied or waived by the Sellers and the Buyer (as applicable).

C. Pursuant to the Approval and Vesting Order, the Monitor may rely on written notice from the Sellers and the Buyer regarding fulfillment of conditions to closing under the APA.

D. Unless otherwise indicated herein, terms with initial capitals have the meanings set out in the APA.

**THE MONITOR CERTIFIES** the following:

1. The Sellers and the Buyer have each delivered written notice to the Monitor that all applicable conditions under the APA have been satisfied and/or waived, as applicable;

2. The conditions to Closing as set out in sections 6.1, 6.2 and 6.3 of the APA have been satisfied or waived by the Sellers and the Buyer (as applicable); and

3. The transaction contemplated by the APA has been completed to the satisfaction of the Monitor; and

4. The D&O Charge and KERP Charge (each as defined in the Approval and Vesting Order) have been terminated, released and discharged in accordance with the Approval and Vesting Order.

This Certificate was delivered by the Monitor at ________ [TIME] on _______, 2018.

**Ernst & Young Inc., in its capacity as Monitor of the Sellers, and not in its personal or corporate capacity**

Per: ______________________________

Name:

Title:

**Schedule B – Form of Monitor's Shares Certificate**

Court File No. CV-15-000011169-00CL

*ONTARIO*
**SUPERIOR COURT OF JUSTICE**
**COMMERCIAL LIST**

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT,* R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF ESSAR STEEL ALGOMA INC., ESSAR TECH ALGOMA INC., ALGOMA HOLDINGS B.V., ESSAR STEEL ALGOMA (ALBERTA) ULC, CANNELTON IRON ORE COMPANY AND ESSAR STEEL ALGOMA INC. USA

(Applicants)

**MONITOR'S SHARES CERTIFICATE**

**RECITALS**

A. Pursuant to an Order of the Ontario Superior Court of Justice (the "**Court**") dated November 9, 2015 (as amended, restated, supplemented or modified from time to time), Ernst & Young Inc. was appointed as the monitor (the "**Monitor**") of Essar Steel Algoma Inc. ("**Algoma**"), Essar Tech Algoma Inc., Algoma Holdings B.V., Essar Steel Algoma (Alberta) ULC, Cannelton Iron Ore Company and Essar Steel Algoma Inc. USA ("**Algoma USA**" and collectively the "**Applicants**"), in respect of these CCAA Proceedings.

B. Pursuant to an Order of the Court dated September ●, 2018 (the "**Approval and Vesting Order**"), the Court approved the sale transaction contemplated by the asset purchase agreement (the "**APA**") between Algoma and Algoma USA, as "**Sellers**", and Algoma Steel Inc. (f/k/a 1076318 B.C. Ltd.), as "**Buyer**", and provided for, among other things, pursuant to the Share Transfer Agreement (the "**Share Transfer Agreement**") between Algoma, the Buyer and the Buyer Parent (as defined in the APA) contemplated thereby, the vesting in the Buyer Parent of Algoma's right, title and interest in and to the Buyer Preferred Shares (as defined in the APA), which vesting is to be effective with respect to the Buyer Preferred Shares upon the delivery by the Monitor to the Buyer and the Buyer Parent of a certificate confirming that the conditions to closing under the Share Transfer Agreement have been satisfied or waived by Algoma, the Buyer and the Buyer Parent (as applicable).

C. Pursuant to the Approval and Vesting Order, the Monitor may rely on written notice from Algoma, the Buyer and the Buyer Parent regarding fulfillment of conditions to closing under the Share Transfer Agreement.

D. Unless otherwise indicated herein, terms with initial capitals have the meanings set out in the APA.

**THE MONITOR CERTIFIES** the following:

1. Algoma, the Buyer and the Buyer Parent have each delivered written notice to the Monitor that all applicable conditions under the Share Transfer Agreement have been satisfied and/or waived, as applicable;

2. The conditions to Closing as set out in the Share Transfer Agreement have been satisfied or waived by Algoma, the Buyer and the Buyer Parent (as applicable); and

3. The transaction contemplated by the Share Transfer Agreement has been completed to the satisfaction of the Monitor.

This Certificate was delivered by the Monitor at _______ [TIME] on _______, 2018.

**Ernst & Young Inc., in its capacity as Monitor of the Sellers, and not in its personal or corporate capacity**

Per: ______________________________

Name:

Title:

**Schedule "C" - Encumbrances to be Deleted/Expunged**

1. No. AL139270 being a charge registered on November 14, 2014 in favour of Wilmington Trust, National Association.

2. No. AL139271 being a charge registered on November 14, 2014 in favour of Deutsche Bank AG New York Branch.

3. No. AL139274 being a charge registered on November 14, 2014 in favour of Deutsche Bank AG.

4. No. AL139275 being a charge registered on November 14, 2014 in favour of Wilmington Trust, National Association.

5. No. T469244 being a charge registered on November 14, 2014 in favour of Wilmington Trust, National Association.

6. No. T469245 being a charge registered on November 14, 2014 in favour of Deutsche Bank AG New York Branch.

7. No. T469246 being a charge registered on November 14, 2014 in favour of Deutsche Bank AG.

8. No. T469247 being a charge registered on November 14, 2014 in favour of Wilmington Trust, National Association.

9. No. AL139337 being an application change name instrument registered on November 17, 2014.

10. No. AL139354 registered on November 17, 2014 being a notice to which is attached an Inter-Lender Agreement dated November 14, 2014.

11. No. AL154658 registered on December 9, 2015 being an Application to Register Court Order to which is attached an Amended and Restated Initial Order dated November 9, 2015.

12. No. T469366 registered on December 9, 2015 being an Amended and Restated Initial Order dated November 9, 2015.

13. No. T426931 being a Debenture registered on January 29, 2002 in favour of Bank of America National Association.

14. No. AL25043 being a charge registered on October 22, 2017 in favour of UBS AG, Stamford Branch

15. No. AL 25044 being a charge registered on October 22, 2017 in favour of Bank of America, N.A.

16. All Encumbrances in respect of outstanding realty and municipal taxes and arrears, fines, interest and penalties related thereto.

17. All Encumbrances listed in a certificate(s) of the Monitor (a "**Priority Claims Certificate**") to

be delivered in accordance with the Priority Claims Order.

**Schedule "D" – Sault Ste. Marie Property**

**[Attached]**

| NO. | PIN | LEGAL DESCRIPTION |
|---|---|---|
| **SAULT STE. MARIE PARCELS** | | |
| 1. | 31613-0015(LT) | PCL 3902 SEC AWS; PT WATER LT M IN ST.MARY'S RIVER AWENGE; PTWATER LT N IN ST.MARY'S RIVER AWENGE AS IN LT34916 (FIRSTLY & FOURTHLY) EXCEPT PT 1 1R2386; S/T LT200702, LT200703; SAULT STE. MARIE |
| 2. | 31613-0016 (LT) | PCL 3903 SEC AWS; PT UPPER WATER LT IN ST. MARY'S RIVER IN FRONT OF SEC 2 AWENGE AS IN LT34916 (SECONDLY); S/T PT 20, 22- 26 1R8648 AS IN LT200702; S/T PT 2-4 1R8648; S/T LT90359; SAULT STE. MARIE |
| 3. | 31613-0017(LT) | PCL 3904 SEC AWS; PT WATER LT L IN ST.MARY'S RIVER AWENGE AS IN LT34916 (THIRDLY); SAULT STE. MARIE |
| 4. | 31613-0018 (LT) | PCL 3905 SEC AWS; PT WATER LT L IN ST.MARY'S RIVER AWENGE AS IN LT34916 (FIFTHLY); SAULT STE. MARIE |
| 5. | 31613-0023 (LT) | PCL 5642 SEC AWS; PT SEC 4 AWENGE PT 1-F 1R1537 EXCEPT PT 15 TO21 1R8860; SAVING, EXCEPTING & RESERVING FOR THE BENEFIT & USE OF ALL PERSONS REQUIRING TO USE THE SAME, THE FREE USE & NAVIGATION OF ALL CREEKS & STREAMS RUNNING THROUGH OR UPON ANY PT OF THE SAID PCL OR TRACT OF LAND HEREBY GRANTED & NOT EMBRACED IN THE RESERVATION HEREINBEFORE CONTAINED FOR THE PURPOSE OF RUNNING & FLOATING DOWN SAW LOGS & OTHER TIMBER, LUMBER, RAFTS & CRAFTS, AT ALL TIMES & SEASONS & EXCEPTING & RESERVING ALSO FOR THE USE & BENEFIT OF ALL PERSONS REQUIRING TO USE THE SAME FOR THE PURPOSE OF RUNNING & FLOATING DOWN OR UPON ANY CREEK, STREAM OR NAVIGABLE WATERS UPON THE SAID PCL OR TRACT OF LAND, THE RIGHT TO ENTER IN & UPON THE SAID PARCELS OR TRACTS OF LAND & TO OCCUPY & USE SO MUCH OF THE SAID LANDS OF SAID CREEKS & STREAMS & THE SAID NAVIGABLE WATERS AS MAY BE NECESSARY FOR THE PURPOSES OF SUCH RUNNING & FLOATING & FOR THE FURTHER PURPOSE OF ERECTING CONSTRUCTING & REPAIRING SUCH DAMS, SLIDES & WORKS AS MAY BE REQUIRED FOR THE PURPOSE AFORESAID DOING NO UNNECESSARY DAMAGE THEREBY. & IT IS HEREBY DECLARED THAT THE GRANT AFORESAID BE MADE ON THE EXPRESS CONDITION THAT THE SAID GRANTEE FOR HIMSELF, HIS HEIRS & ASSIGNS CONSENTS & AGREES THAT ALL PERSONS DESIRING TO USE THE SAME SHALL HAVE THE RIGHT TO ENJOY THE EASEMENT HEREINBEFORE RESERVED; S/T LT89277; SAULT STE. MARIE |
| 6. | 31613-0026 (LT) | PCL 5645 SEC AWS; PT SEC 5 AWENGE PT 3, 4, 56 1R1537; S/T T110206; SAULT STE. MARIE |
| 7. | 31613-0033 (LT) | PCL 7413 SEC AWS; PT SEC 2 AWENGE PT 1-3, 19-21 1R2602; RESERVING FREE ACCESS TO THE SHORE OF THE RIVER STE. MARIE, FOR ALL VESSELS, BOATS & PERSONS; S/T TA426 TRANSFERRED BY TA429; S/T PARTS 20 & 21 1R2602 AS IN LT248296; S/T PARTS 8 TO 13 1R10717 AS IN LT248295; S/T LT200703, LT205668, LT231898, LT90359, T139665Y, T65292; SAULT STE. MARIE |
| 8. | 31613-0044 (LT) | PCL 11975 SEC AWS; PT WATER LT IN ST. MARY'S RIVER IN FRONT OF SEC 2 AWENGE AS IN T355353; SAULT STE. MARIE |
| 9. | 31613-0299 (LT) | PT SEC 5 AWENGE PT 5 1R1537; SAULT STE. MARIE |
| 10. | 31613-0300 (LT) | PT SEC 5 AWENGE PT 2 1R1537; SAULT STE. MARIE |
| 11. | 31613-0303 (LT) | PT SEC 4 AWENGE PT 6 & 7 1R1537; S/T T110206; SAULT STE. MARIE |

| NO. | PIN | LEGAL DESCRIPTION |
|---|---|---|
| 12. | 31613-0308 (LT) | PT SEC 2 AWENGE AS IN T367943 (THIRTY-SIXTHLY); PT SEC 3 AWENGE PT 17 & 30 1R1537; S/T T444867; S/T T444869; S/T T393141; SAULT STE. MARIE |
| 13. | 31613-0330 (LT) | PCL 1176 SEC ALG; PT LAND COVERED WITH WATER AT THE HEAD OF THE RAPIDS IN ST. MARY'S RIVER IN FRONT OF & ADJACENT TOTWP OF AWENGE PT 7 1R2602; S/T PT 5 1R8648 AS IN LT200703; S/TLT90359; SAULT STE. MARIE |
| 14. | 31613-0332 (LT) | PCL 344 SEC AWS; PT WATER LT N IN ST.MARY'S RIVER AWENGE AS IN LT79484 (THIRDLY) EXCEPT PT 2 1R2386; SAULT STE. MARIE |
| 15. | 31613-0333 (LT) | PCL 344 SEC AWS; PT WATER LT M IN ST.MARY'S RIVER AWENGE AS IN LT79484 (SECONDLY); SAULT STE. MARIE |
| 16. | 31613-0334 (LT) | PCL 344 SEC AWS; PT WATER LT M IN ST.MARY'S RIVER AWENGE AS IN LT79484 (FIRSTLY); S/T LT200703; SAULT STE. MARIE |
| 17. | 31613-0335 (LT) | PCL 7413 SEC AWS; PT SEC 1 AWENGE; PT SEC 2 AWENGE PT 4, 14-18 1R2602 EXCEPT PT 1-3 1R10515; RESERVING FREE ACCESS TO THE SHORE OF THE RIVER STE. MARIE, FOR ALL VESSELS, BOATS & PERSONS; S/T TA426 TRANSFERRED BY TA429; S/T LT200703, LT90359, T65292; SAULT STE. MARIE |
| 18. | 31613-0339 (LT) | PCL 5644 SEC AWS; PT SEC 4 AWENGE PT 8 & 9 1R1537; S/T T110206; SAULT STE. MARIE |
| 19. | 31613-0352 (LT) | PT NE 1/4 SEC 4 AWENGE, PT 1 1R11093, SAULT STE. MARIE S/T LT216273; PT NW 1/4 SEC 3 AWENGE, PT 2 1R11093, SAULT STE. MARIE<br>S/T LT216273 |
| 20. | 31613-0353 (LT) | FIRSTLY:PCL 5644 SEC AWS, PT SEC 4 AWENGE PT 1-G 1R1537 EXCEPT PT 13-14 1R8860 RESERVING FREE ACCESS TO THE SHORES OF RIVER ST. MARIE FOR ALL VESSELS, BOATS & PERSONS; S/T LT89277 SECONDLY PCL 11234 SEC AWS; PT WATER LT IN FRONT OF SEC 4 & 9 AWENGE; PT SEC 9 AWENGE PT 1-3 1R6699; S/T 1-3 1R6699 AS IN LT248293 SAVING, EXCEPTING & RESERVING FOR THE BENEFIT & USE OF ALL PERSONS REQUIRING TO USE THE SAME, THE FREE USE & NAVIGATION OF ALL CREEKS & STREAMS RUNNING THROUGH OR UPON ANY PT OF THE SAID PCL OR TRACT OF LAND HEREBY GRANTED & NOT EMBRACED IN THE RESERVATION HEREINBEFORE CONTAINED FOR THE PURPOSE OF RUNNING & FLOATING DOWN SAW LOGS & OTHER TIMBER, LUMBER, RAFTS & CRAFTS, AT ALL TIMES & SEASONS & EXCEPTING & RESERVING ALSO FOR THE USE & BENEFIT OF ALL PERSONS REQUIRING TO USE THE SAME FOR THE PURPOSE OF RUNNING & FLOATING DOWN OR UPON ANY CREEK, STREAM OR NAVIGABLE WATERS UPON THE SAID PCL OR TRACT OF LAND, THE RIGHT TO ENTER IN AND UPON THE SAID PARCELS OR TRACTS OF LAND & TO OCCUPY & USE SO MUCH OF THE SAID LANDS OF SAID CREEKS & STREAMS & THE SAID NAVIGABLE WATERS AS MAY BE NECESSARY FOR THE PURPOSES OF SUCH RUNNING & FLOATING & FOR THE FURTHER PURPOSE OF ERECTING CONSTRUCTING & REPAIRING SUCH DAMS, SLIDES & WORKS AS MAY BE REQUIRED FOR THE PURPOSE AFORESAID DOING NO UNNECESSAY DAMAGE THEREBY & IT IS HEREBY DECLARED THAT THE GRANT AFORESAID BE MADE ON THE EXPRESS CONDITION THAT THE SAID GRANTEE FOR HIMSELF, HIS HEIRS & ASSIGNS CONSENTS & AGREES THAT ALL PERSONS DESIRING TO USE THE SAME SHALL HAVE THE RIGHT TO ENJOY THE EASEMENT HEREINBEFORE RESERVED. THIRDLY; |

| NO. | PIN | LEGAL DESCRIPTION |
|---|---|---|
| | | PCL 344 SEC AWS; WATER LT H IN ST MARY'S RIVER AWENGE AS IN A-2172. FOURTHLY: PCL 849 SEC AWS; WATER LT IN ST. MARY'S RIVER IN FRONT OF SEC 3 AWENGE: WATER LT IN ST. MARY'S RIVER IN FRONT OF SEC 4 AWENGE; WATER LT IN ST.MARY'S RIVER IN FRONT OF SEC 9 AWENGE; WATER LT IN ST. MARY'S RIVER INFRONT OF SECTION 10 AWENGE EXCEPT PT 1 1R6699 & ISLAND #1 & ISLAND #2; S/T A2881; S/T PT 4 1R6699 AS IN LT248293. FIFTHLY PCL 5646 SEC AWS; ISLAND 1 IN THE ST. MARY'S RIVER AWENGE; SIXTHLY: PCL 5646 SEC AWS; ISLAND 2 IN THE ST. MARY'S RIVER AWENGE. SEVENTHLY: PCL 5672 AWS; PT BED OF THE ST. MARY'S RIVER IN FRONT OF BROKEN SECTION 3 AWENGE PT 1 1R1396. EIGHTLY: PCL 5644 SEC AWS; PT SEC 4 AWENGE PT 1-H 1R1537 EXCEPT PT 1 TO 12 1R8860 & PT 1 1R11093 S/T PT 7 & 8 1R6699 & PT 22 1R10688 AS IN LT248293 S/T LT127572, LT216273, LT89277. NINETHLY: PCL 5640 SEC AWS; PT SEC 3 AWENGE PT 1, 51, 52, 57 TO 59 1R1537 EXCEPT PT 2 1R11093 S/T PT 21 1R10688 AS IN LT248293, S/T LT216273. TENTHLY: PCL 5641 SEC AWS;S 1/2 OF SW 1/4 SEC 3 AWENGE; SEC 10 AWENGE. ELEVENTHLY: PCL 5643 SEC AWS; SEC 9 AWENGE; SE 1/4 SEC 4 AWENGE; S/T PT 5 & 6 1R6699 AS IN LT248293; SAVING AND EXCEPTING & RESERVING FOR THE BENEFIT & USE OF ALL PERSONS REQUIRING TO USE THE SAME, THE FREE USE & NAVIGATION OF ALL CREEKS & STREAMS RUNNING THROUGH OR UPON ANY PT OF THE SAID PCL OR TRACT OF LAND HEREBY GRANTED & NOT EMBRACED IN THE RESERVATION HEREINBEFORE CONTAINED FOR THE PURPOSE OF RUNNING & FLOATING DOWN SAW LOGS & OTHER TIMBER, LUMBER, RAFTS & CRAFTS, AT ALL TIMES & SEASONS & EXCEPTING & RESERVING ALSO FOR THE USE & BENEFIT OF ALL PERSONS REQUIRING TO USE THE SAME FOR THE PURPOSE OF RUNNING & FLOATING DOWN OR UPON ANY CREEK, STREAM OR NAVIGABLE WATERS UPON THE SAID PCL OR TRACT OF LAND, THE RIGHT TO ENTER IN & UPON THE SAID PARCELS OR TRACTSOF LAND AND TO OCCUPY & USE SO MUCH OF THE SAID LANDS OF SAID CREEKS & STREAMS & THE SAID NAVIGABLE WATERS AS MAY BE NECESSARY FOR THE PURPOSES OF SUCH RUNNING & FLOATING & FOR THE FURTHER PURPOSE OF ERECTING CONSTRUCTING & REPAIRING SUCH DAMS, SLIDES & WORKS AS MAY BE REQUIRED FOR THE PURPOSE AFORESAID DOING NO UNNECESSARY DAMAGE THEREBY & IT IS HEREBY DECLARED THAT THE GRANT AFORESAID BE MADE ON THE EXPRESS CONDITION THAT THE SAID GRANTEE FOR HIMSELF, HIS HEIRS & ASSIGNS CONSENTS & AGREES THAT ALL PERSONS DESIRING TO USE THE SAME SHALL HAVE THE RIGHT TO ENJOY THE EASEMENT HEREINBEFORE RESERVED; S/T LT89277; SAULT STE. MARIE |
| 21. | 31610-0001 (LT) | PCL 5648 SEC AWS; PT SEC 33 KORAH PT 20 1R1537 EXCEPT PT 1 TO 4 1R4146; S/T LT141820, LT147469, LT231895, LT88858, LT89277; SAULT STE. MARIE |
| 22. | 31610-0273 (LT) | PT SEC 4 AWENGE; PT SEC 33 KORAH PT 12, 13, 16 & 17, 1R8998; S/T T444704; SAULT STE. MARIE |
| 23. | 31610-0274 (LT) | PT SEC 33 KORAH PT 33, 1R1537 EXCEPT PT 25, 26 & 27, 1R10688; SAULT STE. MARIE |
| 24. | 31609-0001 (LT) | PCL 108 SEC AWS; E1/2 OF SW1/4 SEC 34 KORAH EXCEPT PT 1, 3 & 4 1R2362, PT 22, 1R1537, PT 1 & 2 1R8364, PT 3 & 24 1R10688, PT 1, 2, 3, 9, 16, 20 & 21 1R10744; S/T PT 1 1R9347 AS IN LT248294; S/T LT205669, LT216273, LT231895; SAULT STE. MARIE |

| NO. | PIN | LEGAL DESCRIPTION |
|---|---|---|
| 25. | 31609-0002 (LT) | PCL 108 SEC AWS; PT SEC 34 KORAH PT 22, 1R1537 EXCEPT PT 16 1R1910; SAULT STE. MARIE |
| 26. | 31609-0016 (LT) | PCL 4469 SEC AWS; LT 22 PL M56 KORAH; S/T LT89277; SAULT STE. MARIE |
| 27. | 31609-0017 (LT) | PCL 4560 SEC AWS; W 1/2 LT 21 PL M56 KORAH; S/T LT89277; SAULT STE. MARIE |
| 28. | 31609-0019 (LT) | PCL 1620 SEC AWS; LT 15-19 PL M56 KORAH; S/T LT89277; SAULT STE. MARIE |
| 29. | 31609-0034 (LT) | PCL 222 SEC AWS; SW1/4 OF SW1/4 SEC 34 KORAH EXCEPT PT 1 & 2 1R8246, PT 1 & 2 1R9991, PT 1-2, 7 & 23 1R10688, PT 19 1R1537; S/T PT 17, 18, 19 & 20 1R10688 AS IN LT248293; S/T LT205669, LT216273, LT231895, LT248225; SAULT STE. MARIE |
| 30. | 31609-0038 (LT) | PCL 5647 SEC AWS; PT SEC 34 KORAH PT 31 1R1537 EXCEPT PT 2 1R2362, PT 7 1R5829, PT 4-8, 10-14, 17-19 1R10744; S/T PT 1 1R9346 AS IN LT248294; S/T LT205669, LT216273, LT231895; SAULT STE. MARIE |
| 31. | 31609-0044 (LT) | PCL 5649 SEC AWS; LT 414 PL 1598 KORAH; LT 415 PL 1598 KORAH; LT 416 PL 1598 KORAH PT 23 1R1537; S/T PT 2 1R9346 AS IN LT248294; S/T LT205669, LT216273, LT231895; SAULT STE. MARIE |
| 32. | 31609-0045 (LT) | PCL 5649 SEC AWS; LT 411 PL 1598 KORAH; LT 412 PL 1598 KORAH; LT 413 PL 1598 KORAH S/T TO PT 3 1R9346 AS IN LT248294; S/T LT205669, LT216273, LT231895; SAULT STE. MARIE |
| 33. | 31609-0046 (LT) | PCL 5649 SEC AWS; LT 299 PL 1598 KORAH; LT 300 PL 1598 KORAH; LT 301 PL 1598 KORAH PT 25 1R1537; S/T PT 4 1R9346 AS IN LT248294; S/T LT205669, LT216273, LT231895; SAULT STE. MARIE |
| 34. | 31609-0047 (LT) | PCL 5649 SEC AWS; LT 296 PL 1598 KORAH; LT 297 PL 1598 KORAH; LT 298 PL 1598 KORAH PT 26 1R1537; S/T PT 5 1R9346 AS IN LT248294; S/T LT205669, LT216273, LT231895; SAULT STE. MARIE |
| 35. | 31609-0048 (LT) | PCL 5649 SEC AWS; LT 173 PL 1598 KORAH; LT 174 PL 1598 KORAH; LT 175 PL 1598 KORAH; LT 176 PL 1598 KORAH; LT 177 PL 1598 KORAH; LT 178 PL 1598 KORAH; LT 179 PL 1598 KORAH; LT 180 PL 1598 KORAH; LT 181 PL 1598 KORAH; LT 182 PL 1598 KORAH; LT 183 PL 1598 KORAH; LT 184 PL 1598 KORAH; LT 185 PL 1598 KORAH; LT 186 PL 1598 KORAH; LT 187 PL 1598 KORAH; LT 188 PL 1598 KORAH; LT 189 PL 1598 KORAH; PT LANE PL 1598 KORAH PT 27 1R1537; S/T PT 6 1R9346 AS IN LT248294; S/T LT109013, LT205669, LT216273, LT231895; SAULT STE. MARIE |
| 36. | 31609-0049 (LT) | PCL 5649 SEC AWS; LT 63 PL 1598 KORAH; LT 64 PL 1598 KORAH; LT 65 PL 1598 KORAH; LT 66 PL 1598 KORAH; LT 67 PL 1598 KORAH; LT 68 PL 1598 KORAH; PT LANE PL 1598 KORAH PT 28 1R1537; S/T PARTS 7 & 8 1R9346 AS IN LT248294; S/T PT 2 1R10717 AS IN LT248295; S/T LT205669, LT216273; SAULT STE. MARIE |
| 37. | 31609-0050 (LT) | PCL 222 SEC AWS; PT SEC 34 KORAH PT 19 1R1537 EXCEPT PT 4-6 1R10688; SAULT STE. MARIE |
| 38. | 31609-0104 (LT) | LT 61-62 PL 1598 KORAH; S/T T393141, T444868; SAULT STE. MARIE |
| 39. | 31609-0358 (LT) | PCL 5647 SEC AWS; PT SEC 34 KORAH PT 15 1R10744; SAULT STE. MARIE |
| 40. | 31592-0280 (LT) | LT 1-7, 571-579 BLK 1 PL 1751 KORAH; LANE BLK 1 PL 1751 KORAH CLOSED BY X371; LT 1-19 BLK 2 PL 1751 KORAH; LANE BLK 2 PL 1751 KORAH CLOSED BY X371; LT 1-19 BLK 3 PL 1751 KORAH; LANE BLK 3 PL 1751 KORAH CLOSED BY X371; LT 1-19 BLK 4 PL 1751 KORAH; LANE BLK 4 |

| NO. | PIN | LEGAL DESCRIPTION |
|---|---|---|
| | | PL 1751 KORAH CLOSED BY X371 & T9244; LT 1-8, 11-16 BLK 5 PL 1751 KORAH; LT 1-20 BLK 6 PL 1751 KORAH; LANE BLK 6 PL 1751 KORAH CLOSED BY X371 & T164629; LT 1-20 BLK 7 PL 1751 KORAH; LANE BLK 7 PL 1751 KORAH CLOSED BY X371; LT 1-20 BLK 8 PL 1751 KORAH; LANE BLK 8 PL 1751 KORAH CLOSED BY X371; LT 1-5, 9-20 BLK 9 PL 1751 KORAH; COLLINS ST PL 1751 KORAH CLOSED BY T164628, T9244 & X371; 66 FT RD INTERSECTION LOCATED AT THE SE CORNER OF THE INTERSECTION OF COLLINS & LETCHER STREETS PL 1751 KORAH CLOSED BY T9244 ; QUEEN ST W PL 1751 KORAH (AKA WILDE AV) CLOSED BY X209; BLK A PL H466 KORAH; PT LT 14-15 BLK 10 PL 1751 KORAH PT 1 & 2 1R9063; PT GOULAIS AV PL 1751 KORAH CLOSED BY T164628 AS IN T367943 (TWELFTHLY); PT LT 17-20 BLK 5 PL 1751 KORAH; PT LANE BLK 5 PL 1751 KORAH CLOSED BY T164629; PT LT 6-8 BLK 9 PL 1751 KORAH; PT LANE BLK 9 PL 1751 KORAH CLOSED BY X371 & T164629; PT LT 14-15 BLK 16 PL 1751 KORAH; PT 33 FT RDAL PL 1751 KORAH CLOSED BY X371; PT BONNEY ST PL 1751 KORAH (FORMERLY ALBERT ST) CLOSED BY X371 & T9244; PT LETCHER ST, CENTRAL ST PL 1751 KORAH CLOSED BY X371 & T164628, CLOSED BY X371, T9244 & T164628; PT GOETZ ST PL 1751 KORAH CLOSED BY X371; PT METZGER ST PL 1751 KORAH CLOSED BY X371 & T164628; PT SEC 35 KORAH; PT SEC 36 KORAH; PT LT 18-23 BLK 4 PL 402 KORAH; PT LANE PL 402 KORAH CLOSED BY T68576; PT RDAL BTN BLOCK 4 STEWART SURVEY OF KORAH BLOCKS & SEC 36 KORAH (AKA ST. PATRICK ST) CLOSED BY T68576, ALL BEING PT 1 1R8359 EXCEPT PT 1 & 4 1R10079; T/W T444897, T444898, T444899, T444900, T444901, T444902, T444903; S/T T134814, T134815, T134816 AMENDED BY T444866; S/T T444868, T444869, T444870, T444871, T444872, T444873, T444874, T444875; S/T T138296, T139665Y, T241681, T243802, T250272, T376077, T376078, T379483, T393141, T418354, T418367; S/T EASEMENT IN GROSS OVER PTS 1 TO 10 INCLUSIVE 1R11240 AS IN AL9664; S/T EASEMENT IN GROSS OVER PT LETCHER ST, CENTRAL ST PL 1751 KORAH CLOSED BY X371 & T164628 AS IN AL34084; SAULT STE. MARIE |
| 41. | 31536-0165 (LT) | PT SUMMIT AV PL 3206 ST. MARY'S CLOSED BY RY557; AS IN T367943 (THIRTY-SECONDLY); SAULT STE. MARIE |
| 42. | 31569-0271 (LT) | PT BLK 11 STEWART SURVEY OF KORAH BLOCKS KORAH PT 4 1R10936; SAULT STE. MARIE |
| 43. | 31576-0025 (LT) | PT LT 19 PORTAGE ST, 20 PORTAGE ST, 21 PORTAGE ST, 22 PORTAGE ST PL TOWN PLOT OF ST. MARY'S; PT PORTAGE ST PL TOWN PLOT OF ST. MARY'S CLOSED BY RY5684, PT 9, 10, 11 & 12, 1R4514; T/W T242063; S/T T241680; SAULT STE. MARIE |
| 44. | 31577-0045 (LT) | PCL 12208 SEC AWS; PT LAND & LAND COVERED WITH WATER SAULT STE. MARIE PT 37, 40-42 1R10515; SAULT STE. MARIE |
| 45. | 31536-0169 (LT) | PT LT 9 PL 3206 ST. MARY'S; PT ONTARIO AV PL 3206 ST. MARY'S CLOSED BY X406; PT 5 1R10591; SAULT STE. MARIE |
| 46. | 31577-0004 (LT) | PCL 1007 SEC ALG; PT LAND & LAND COVERED WITH WATER LYING BTN S PORTAGE ST & ST.MARY'S ISLAND ST. MARY'S AS IN A785 EXCEPT LT10720, LT10896, LT11134, LT11135, LT11988, LT12658, LT12946, PT 6 1R2602; NO DEALING MAY BE HAD WITHOUT A PLAN OF SURVEY SHOWING THE DIMENSIONS OF THE BOUNDARIES OF THE REMAINDER AND OF THE PORTIONS PREVIOUSLY SEVERED; SAULT STE. MARIE |
| 47. | 31613-0314 (LT) | PT SEC 2 AWENGE AS IN T1101 EXCEPT PT 3 1R2602; SAULT STE. MARIE |
| 48. | 31592-0282 (LT) | LT 8-9 BLK 1 PL 1751 KORAH; SAULT STE. MARIE |

| NO. | PIN | LEGAL DESCRIPTION |
|---|---|---|
| 49. | 31569-0268 (R) | PT BLK 11 STEWART SURVEY OF KORAH BLOCKS KORAH PT 2, AR1120; S/T RIGHT AS IN T157505; SAULT STE. MARIE |
| 50. | 31609-0176 (R) | LT 190-192, 289-295, 302-308, 405-410 PL 1598 KORAH; PT QUEEN ST W PL 1598 KORAH (AKA BASE LINE RD); LT 417-422 PL 1598 KORAH; PT GOULIAS AV PL 1598 KORAH (AKA GOULAIS AV); PT LANE PL 1598 KORAH; PT PITTSBURGH AV, DAYTON AV, GLASGOW AV, SPADINA AV PL 1598 KORAH CLOSED BY T167803, T167804, T164628, T164629, T220708 AS IN T367943; PT SEC 34 KORAH PT 40 1R1537; SAULT STE. MARIE |
| 51. | 31613-0006 (LT) | PCL 346 SEC AWS; WATER LT K AWENGE; PT WATER LT L AWENGE PT 9 & 10 1R2602; S/T LT205668; SAULT STE. MARIE |
| 52. | 31613-0005 (LT) | PCL 345 SEC AWS; WATER LT I AWENGE; WATER LT J AWENGE; SAULT STE. MARIE |
| 53. | 31538-0559 (LT) | LT 1-3 PL 2034 ST. MARY'S: SAULT STE. MARIE |

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT,* R.S.C. 1985, c. C-36, AS AMENDED

Court File No. CV-15-000011169-00CL

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF ESSAR STEEL ALGOMA INC., ET AL.

*ONTARIO*
**SUPERIOR COURT OF JUSTICE**
**(COMMERCIAL LIST)**

Proceeding commenced at Toronto

**APPROVAL AND VESTING ORDER**

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