

**UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

In re:)	Chapter 11
)	
Sentinel Management Group, Inc.,)	Case No. 07-14987
)	
Debtor.)	Hon. John H. Squires
)	

**THE BANK OF NEW YORK MELLON’S REPLY IN SUPPORT OF ITS
MOTION FOR AN ORDER PURSUANT TO §362 OF THE BANKRUPTCY CODE
GRANTING RELIEF FROM THE AUTOMATIC STAY TO FORECLOSE UPON ITS
COLLATERAL, OR IN THE ALTERNATIVE, TO EXERCISE ITS SETOFF RIGHTS**

The Bank of New York Mellon (“*BNY*”), by and through its undersigned counsel, hereby replies to the “Objection to Bank of New York’s Motion for an Order Pursuant to Section 362 of the Bankruptcy Code Granting Relief from the Automatic Stay to Allow The Bank of New York Mellon to Foreclose Upon Its Collateral, Or In the Alternative, to Exercise Its Setoff Rights” (the “*Objection*”) filed by the chapter 11 trustee (the “*Trustee*”) as follows:

PRELIMINARY STATEMENT

The Motion¹ should be granted. First, relief from the stay is warranted under Section 362(d)(2) of the Bankruptcy Code because the estate has no equity in the cash collateral comprising the BNY Accrued Payoff Amount and such collateral is not necessary for any reorganization or liquidation of the estate. Instead, under the circumstances presented here, as the Trustee has acknowledged, the estate effectively has negative equity in BNY Accrued Payoff Amount, as there will be continuing accrual of interest (which an immediate setoff would forestall) and BNY will require increasing amounts of collateral for protection of its secured

¹ Capitalized terms used but not defined herein shall have the meanings ascribed thereto in the “Motion For An Order Pursuant to Section 362 of the Bankruptcy Code Granting Relief From the Automatic Stay to Allow The Bank of New York Mellon to Foreclose Upon its Collateral, or in the Alternative, to Exercise its Setoff Rights” (Docket No. 974) (the “*Motion*”).

claim. Instead, the Objection makes plain what has been apparent all along: the Trustee and the unsecured creditors junior to BNY concede that the BNY collateral cushion will continue to diminish under any scenario, but they wish to hold BNY's collateral hostage to gain a tactical advantage in the Trustee Action. While those parties may have made such a decision with "eyes wide open," the Bankruptcy Code does not give them unfettered discretion to retain collateral; instead, unless the estate has equity in the cash collateral (which it does not) and needs such collateral to reorganize or effectively liquidate (which it does not), BNY is entitled to stay relief to foreclose on such collateral.

Second, under section 362(d)(1) of the Bankruptcy Code, cause for relief from the automatic stay exists, both because BNY will not be adequately protected and more generally in light of the improper tactical purpose for which the Trustee seeks to hold BNY's collateral reserve. On the former point, the Trustee's ever-changing proposed reserve amount has been and remains insufficient, and the Trustee has not demonstrated that BNY will be adequately protected if the Trustee continues to press forward with his plan of liquidation or cash collateral motion. Perhaps in recognition of this, the Trustee seeks to shift the burden to this Court and to BNY to determine at what reserve amount BNY will in fact be adequately protected, but that does not comport with the requirements of Section 362(d)(1). Instead, this Court should allow BNY relief from the automatic stay to offset current amounts owing against the collateral (with the estate of course retaining a full right to seek disgorgement if it were to obtain a final, non-appealable order in the Trustee Action in its favor) and should establish a proper legal fee reserve with an adequate cushion.

ARGUMENT

I. The Estate Lacks Equity in the Cash Collateral Up to the BNY Accrued Payoff Amount and Has No Need for Such Collateral to Reorganize or Liquidate.

BNY is entitled to relief from the automatic stay under Section 362(d)(2) of the Bankruptcy Code with respect to the BNY Accrued Payoff Amount because the Trustee has articulated no need for such cash collateral for any effective reorganization or liquidation and the estate does not have equity in the such amount. The difference between the cash value of the BNY Accrued Payoff Amount and BNY's lien on the BNY Accrued Payoff Amount is zero, and because the cash account is yielding amounts less than BNY's current interest and fees, all parties recognize that the estate's equity in that portion of the cash collateral up to the BNY Accrued Payoff Amount will always be negative.

The cases cited by the Trustee are distinguishable because none involve relief from the stay with respect to an oversecured creditor's cash collateral where such creditor's loan is continuing to accrue interest at a greater rate than the rate of return on any invested collateral. For instance, the Trustee's chief authority, *In re Opelika Mfg. Corp.*, 66 B.R. 444, 446 (Bankr. N.D. Ill. 1986), is clearly distinguishable because the collateral package there included an assortment of non-cash items, including pledged stock, the debtor's equipment, account receivables, and substantially all of the assets of the debtor's subsidiary. The facts in *Colonial Center, Inc.*, 156 B.R. 452 (Bankr. E.D. Pa. 1993) are distinguishable for the same reason; there, the creditor's collateral consisted of several properties and the rental income from the properties. While the debtors in the cases cited by the Trustee apparently had equity in the collateral package generally, the analysis is far simpler here; the only question for the Court is whether, if BNY prevails in the Trustee Action, the cash collateral consisting of the BNY Accrued Payoff Amount could generate a greater return for the estate than payment of its claim today. Because

the answer is unequivocally “no”, the estate has no equity in that collateral, and stay relief should be granted.

In his Objection, the Trustee has failed to identify any cases permitting the use or retention of cash collateral by a debtor or trustee in any similar circumstance. The reason for this is obvious; from a purely economic perspective, it makes no sense for a debtor to continue to accrue interest to a secured creditor at a rate greater than its investments can earn, rather than simply pay off the loan. What is different here, of course, is the overlay of the BNY litigation; the Trustee and the junior creditors in this case obviously believe that they will obtain a tactical advantage in the BNY litigation by withholding the collateral and setting an artificially low reserve amount. However, nothing in the Bankruptcy Code suggests that the estate, having no equity in a portion of a secured creditor’s collateral and no need for such collateral to reorganize, can “fence it off” for tactical purposes in related litigation.

II. Cause Exists for Stay Relief Because BNY Will Not Be Adequately Protected Under the Trustee’s Proposed Reserve and Because The Trustee Is Improperly Seeking to Tie Up BNY’s Collateral for Litigation Purposes

Section 362(d)(1) of the Bankruptcy Code provides that “the court shall grant relief from the stay ... (1) for cause, *including* the lack of adequate protection of an interest in property of such party in interest.” 11 U.S.C. §362(d)(1) (emphasis added). Here, in addition to the clear mandate for stay relief under Section 362(d)(2), cause exists to lift the automatic stay because BNY will not be adequately protected under the provisions of the Plan or under the Trustee’s proposed reserve. The Trustee has the burden under Sections 362(g) and 363(p) of the Bankruptcy Code to demonstrate that BNY will be adequately protected in order to retain and

use BNY's cash collateral rather than permitting a setoff.² However, instead of attempting to meet that burden, the Trustee has danced around it by proposing a Plan (and alternatively seeking use of cash collateral) that provides that cash will be set aside to establish the BNY Reserve "in the amount proposed by the Plan Proponents (or such greater amount set by the Bankruptcy Court) and determined by the Bankruptcy Court as constituting an amount adequate to provide payment in full" of BNY's claims. Plan §7.12.

As set forth in BNY's objection to the Plan and at the confirmation hearing, the current proposed amount for the BNY Reserve of approximately \$342 million (the "*Proposed Reserve Amount*") is grossly inadequate, as such amount fails to properly take into account the continuing interest accrual for the likely time period to conclude the Trustee Action as well as the substantial indemnifiable fees and expenses that BNY will incur in the Trustee Action and otherwise. In particular, the only evidence that the Proponents provided at the Confirmation Hearing in support of the calculation of the Proposed Reserve Amount was the testimony of the Trustee, who has no prior experience with complex commercial litigation, has never served previously as a Chapter 11 trustee or receiver, and has never been a general counsel with responsibility for supervising outside counsel in litigation. The Trustee's testimony revealed several serious flaws in his calculation, which together make clear the substantial likelihood that if the BNY Reserve were established only in the Proposed Reserve Amount, it ultimately would be insufficient to satisfy BNY's claim in full.³

² Section 362(g) provides that in connection with a hearing concerning relief from the automatic stay, the party opposing relief has the burden of proof on all issues, except on the issue of the debtor's equity in property. 11 U.S.C. §362(g)(2).

³ Among other obvious flaws, the Trustee improperly: (i) assumed an overly optimistic timeline for conclusion of the Trustee Action by December 2009, notably omitting any time for an appeal of the trial court's ruling in the Trustee Action or any remand thereof; (ii) provided only a \$10 million reserve for BNY's indemnifiable fees and expenses, despite the fact that, based on the uncontroverted testimony of Robert Bailey, BNY's Senior Managing Counsel, BNY already has incurred nearly that amount in fees

Perhaps recognizing this, the Trustee, instead of upwardly adjusting his number, seeks to shift responsibility to the Court to determine at what amount the BNY Reserve should be established. This is procedurally improper and incongruous with §362(g) of the Bankruptcy Code; instead, BNY submits that to the extent that the Court is inclined to confirm the Plan or to grant the Trustee's motion seeking BNY's use of cash collateral, cause exists for relief from the stay, as it is not clear whether BNY can or will be adequately protected going forward.

Moreover, as is plain from the language of Section 362(d)(1), lack of adequate protection is not the only "cause" for relief from the stay. Indeed, the Bankruptcy Code does not define the phrase "for cause" and the legislative history of section 362(d)(1) provides only general guidance; as a result, the "facts of each request will determine whether relief is appropriate under the circumstances." *In re Mazzeo*, 167 F.3d 139, 142 (2d Cir. 1999) (internal quotations omitted) (quoting H.R. Rep. No. 95-595, at 343-344 (1977)). Thus, cause for relief from the automatic stay may be based on factors not enumerated in the statute and may encompass many different situations. *See In re Pro Football Weekly, Inc.*, 60 B.R. 824 (N.D. Ill. 1986). Here, the Trustee's decision to waste estate assets by establishing the BNY Reserve, rather than provisionally paying BNY's claim on the effective date of the Plan, will cost millions of dollars and is sufficient cause, in and of itself, to lift the automatic stay. As noted above, the Trustee's only real justification for this is that he believes he will gain a tactical advantage in the Trustee Action. However, the automatic stay is a shield, not a sword, and this Court should not countenance such tactics.

and expenses and expects to incur another approximately \$17 to \$22 million in indemnifiable fees and expenses going forward; and (iii) failed to account for the higher rate of post-confirmation interest (*i.e.*, at least the national prime rate) that BNY is entitled to as dictated by the United States Supreme Court's decision in *Till v. SCS Credit Corp.*, 541 U.S. 465, 474 (2004).

CONCLUSION

For all of the foregoing reasons, as well as those detailed in the Motion itself, the Court should grant the Motion.

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Respectfully Submitted,

THE BANK OF NEW YORK MELLON

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