

**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 PROPOSED  
FINDINGS OF FACT AND CONCLUSIONS OF LAW**

The Bank of New York Mellon (“BNY”)<sup>1</sup>, by and through its undersigned attorneys, hereby submits the following proposed findings of fact and conclusions of law regarding (a) the proposed confirmation of the Chapter 11 Plan of Liquidation (as amended, the “Plan”) jointly filed by Frederick J. Grede, as chapter 11 trustee (the “Trustee”) for Sentinel Management Group, Inc. (“Sentinel”), and the Official Committee of Unsecured Creditors (the “Committee”) and, together with the Trustee, the “Proponents”) and (b) the Trustee’s Motion, Pursuant to Section 363 of the Bankruptcy Code, for Authority to Use Cash Collateral and Providing Adequate Protection Therefor [Docket No. 686] (the “Cash Collateral Motion”).

**PROPOSED FINDINGS OF FACT**

**A. Sentinel’s Bankruptcy**

1. On August 17, 2007 (the “Petition Date”), Sentinel filed a voluntary chapter 11 petition in this Court, and, on August 28, 2007, the Trustee was appointed.

2. Prior to the Petition Date, BNY provided Sentinel with loans and other extensions of credit on a daily basis as Sentinel’s clearing bank and secured lender, and Sentinel pledged

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<sup>1</sup> On July 1, 2008, The Bank of New York merged with Mellon Bank, N.A. to become The Bank of New York Mellon.

collateral to BNY to secure its debt, including, without limitation, any and all securities and other property held in the accounts maintained by BNY and any cash balances held in any cash account maintained by BNY in connection therewith. *See, e.g.*, Global Clearing and Custody Agreement, dated January 9, 2003 (the “Global Clearing Agreement”); Securities Clearing Agreement, dated October 21, 1997 (the “Securities Clearing Agreement”).<sup>2</sup>

3. Sentinel further agreed to indemnify BNY “against any and all Losses sustained or incurred by or asserted against [BNY] by reason of or as a result of any action or inaction, or arising out of [BNY’s] performance [of its contractual obligations to Sentinel], including reasonable fees and expenses of counsel incurred by [BNY] in a successful defense of claims by [Sentinel].” *See, e.g.*, Global Clearing Agreement, §6.01(c); Securities Clearing Agreement, §4.05(b).

4. Under its agreements with Sentinel, BNY was and remains permitted, following Sentinel’s default, to demand immediate repayment of all amounts due to BNY, to liquidate any of the collateral securing Sentinel’s obligation to BNY, and to debit any cash account held at BNY to satisfy any amounts due to BNY. *See, e.g.*, Global Clearing Agreement, §§ 5.2, 6.7 and 7.

## **B. The BNY Action**

5. On March 3, 2008, the Trustee filed an adversary proceeding against BNY (the “BNY Action”) seeking, among other things, recovery of allegedly fraudulent and preferential transfers and equitable subordination, disallowance and/or equitable disallowance of BNY’s secured claim and liens. Cmplt. ¶¶13, 202-229.

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<sup>2</sup> The Global Clearing Agreement and the Securities Clearing Agreement are attached as Exhibits 1 and 2, respectively, to The Bank Of New York Mellon’s Objection To The Chapter 11 Plan Of Liquidation, dated August 1, 2008 [Docket No. 943] (the “BNY Confirmation Objection”).

6. On May 2, 2008, BNY filed (a) a motion in this Court to dismiss the BNY Action (the “Motion to Dismiss”) and (b) a motion in the United States District Court for the Northern District of Illinois (the “District Court”) seeking to withdraw the reference of the BNY Action from this Court (the “Motion to Withdraw the Reference”). On June 10, 2008, this Court issued a ruling denying the Motion to Dismiss without prejudice. On June 20, 2008, the District Court granted the Motion to Withdraw the Reference. Accordingly, the BNY Action is now pending in the District Court. The District Court is in the process of reviewing the Motion to Dismiss *de novo*.

**C. BNY’s Secured Claim**

7. As of the Petition Date, the balance of BNY’s loan to Sentinel (including principal and prepetition fees) was \$312,252,000. *See* Trustee’s Exhibit No. 1; *see also* August 12, 2008, Hearing Transcript (“8/12 Tr.”), 56:3-4.<sup>3</sup> From the Petition Date through July 31, 2008, an additional \$12,498,060 in interest accrued on BNY’s loan. *See* Trustee’s Exhibit No. 1. In addition, Robert Bailey, Senior Managing Counsel for BNY, testified that BNY incurred approximately \$9.8 million in professional fees and expenses for which BNY is entitled to indemnification under its agreements with Sentinel through July 2008. 8/12 Tr. 12:19-20.<sup>4</sup> Accordingly, as of August 13, 2008, the second date of the hearing on the proposed confirmation of the Plan (the “Confirmation Hearing”), BNY’s total secured claim was approximately \$335 million (excluding interest accrued after July 31, 2008 and certain accrued and unpaid fees and expenses).

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<sup>3</sup> A copy of the August 12, 2008 Hearing Transcript is attached hereto as Exhibit A.

<sup>4</sup> Mr. Bailey further testified that the \$9.8 million spent by BNY is comprised of \$7.1 million in legal fees and expenses, and approximately \$2.7 million in vendor-related fees. 8/12 Tr. 19. Of the legal fees, Mr. Bailey testified that approximately \$2.3 million has been spent in connection with proceedings in Sentinel’s main chapter 11 case, approximately \$4.5 million has been spent in connection with the BNY Action and approximately \$350,000 has been spent in connection with a separate class action lawsuit initiated by one of Sentinel’s customers in the Southern District of New York. Tr. 19:13-20:2.

8. BNY's claim is currently secured by approximately \$520 million in cash collateral plus additional securities with a face value of approximately \$120 million. *See* 8/12 Tr. 89:9-19. As such, BNY is substantially oversecured, and no reasonable or colorable risk currently exists that BNY's claim would not be paid in full if BNY were currently allowed to set off against the collateral it is holding. *See* 8/12 Tr. 89:23-90:9.

**D. The Plan and Disclosure Statement**

9. In May 2008, the Trustee and the Committee filed their original Plan<sup>5</sup> and related disclosure statement (as amended, the "Disclosure Statement"). On June 19, 2008, this Court approved the Disclosure Statement and established August 1, 2008 as the deadline for objections to and voting on the Plan. On August 1, 2008, BNY (a) filed the BNY Confirmation Objection and (b) submitted a ballot rejecting the Plan [Docket No. 917]. As a result of BNY's vote, Class 2 has rejected the Plan.

10. As he testified at the Confirmation Hearing, the Trustee played only a limited role in formulating the Plan, essentially allowing creditors – specifically the Committee and counsel to the Committee – to control the process. *See* 8/12 Tr. 46:6-12,<sup>6</sup> 8/12 Tr. 83:14-21.<sup>7</sup> Among other things, the Trustee testified that he deferred to the creditors regarding the proposed

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<sup>5</sup> The Plan has since been amended several times. Most recently, on August 25, 2008, the Proponents filed their Second Amended Chapter 11 Plan of Liquidation. [Docket No. 1018] (the "Second Amended Plan").

<sup>6</sup> Q: And what can you tell us about your role in these discussions [with the Committee] about a plan of liquidation?

A: Well, to some extent I took a step back. I'm basically saying to the creditors we are in the process of liquidating securities. This is how much I anticipate we will have available to make a distribution. Tell me how you want me to distribute – make the distribution. . . .

<sup>7</sup> Q: Mr. Grede, it is true, is it not, that the content of the proposed plan was negotiated by the members of the creditors committee, correct?

A: Primarily, correct.

Q: And it is also true, that the primary authors of the plan were counsel to the creditors committee, correct?

A: That is correct.

treatment of BNY's claim under the Plan, and specifically regarding whether to pay BNY's claim in full on the effective date. 8/12 Tr. 85:17-21.<sup>8</sup>

**E. The Plan's Proposed Treatment of BNY's Secured Claim**

11. With respect to BNY's claim, the Plan provides that on the Effective Date, BNY's liens will be "deemed forever extinguished and discharged." DS at 55; Plan §10.13. In addition, the Plan does not provide for any immediate or scheduled payments or distributions to BNY on account of its secured claim. 8/12 Tr. 86:23-87:7. Instead, Section 7.12 of the Plan provides that a reserve will be established for payment of BNY's secured claim (the "BNY Reserve"). Plan § 7.12. Until the BNY Action is resolved, the Plan provides that BNY "shall have and retain a perfected, first-priority lien on all funds in the [BNY] Reserve..." *Id.* In addition, Section 7.12 of the Plan, as revised in the Second Amended Plan, provides that BNY will also have a lien (the "BNY Replacement Lien") against all of the assets of the Liquidation Trust (with the exception of certain funds held in reserve, including the funds in the BNY reserve) and provides that the Liquidation Trust will at all times maintain \$10,000,000 in cash that is encumbered solely by the BNY Replacement Lien. *Id.*

12. However, under the Plan, BNY has no ability to enforce its lien on the BNY Reserve or the BNY Replacement Lien or to apply such collateral to its claim until the BNY Action is finally resolved. *See* Plan § 7.2; 8/12 Tr. 86:8-11.<sup>9</sup> The Amended Plan continues to provide for no immediate payment of any portion of BNY's claim and no post-confirmation

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<sup>8</sup> Q: And it is correct that in your view the decision whether to pay the Bank of New York in full [on the Effective Date] is ultimately a decision for the creditors to make, correct?

A: I believe that's correct, yes.

<sup>9</sup> Q: But it is true, is it not, sir, that the plan does not permit the bank to exercise its rights against the collateral securing its claim, correct?

A: Not without court approval.

amortization of principal or payment of postpetition or post-confirmation interest or fees until the resolution of the BNY Action at some indeterminate point in the future.

13. Notwithstanding the treatment proposed in the Plan, the Proponents asserted in the Disclosure Statement and the Plan that BNY's secured claim was unimpaired. *See* Plan § 4.3; DS at 7.<sup>10</sup>

14. The Plan provides that the amount of the BNY Reserve will be “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 (including all principal, accrued interest and any other indemnifiable amounts as provided for in the operative [BNY] agreement or related documents and allowable under applicable law).” Plan § 7.12.

15. Section 7.12 of the Plan provides that either BNY or the Trustee may seek authority from the Bankruptcy Court, after notice and hearing, to modify the terms of the BNY Reserve, including seeking authority to make a provisional distribution of funds in the BNY Reserve or other funds held by the Liquidation Trust to BNY. *Id.* However, the Plan does not provide BNY with any recourse in the event that, at the time when such provisional distribution is sought, there are not funds in the BNY Reserve or subject to the BNY Replacement Lien sufficient to satisfy BNY's claim in full. *See* 8/12 Tr. 97:21-25. Further, the Trustee testified that

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<sup>10</sup> The Proponents appear to have since abandoned this position. In their Memorandum of Law in Support of Confirmation of the Amended Chapter 11 Plan of Liquidation and in Response to Objections to Confirmation [Docket No. 981] (the “Confirmation Memo”) and again at the Confirmation Hearing, the Proponents stated that they have decided to count the “provisional” ballot cast by BNY and, as a result, the Court does not need to address whether BNY's claim is unimpaired. *See* Confirmation Memo, 2; 8/13 Tr. 115:13-17 (MR. LAZAR: “...we're prepared to go to cram down on Bank of New York. We gave them a provisional ballot. They voted no. And, therefore, for purposes of confirmation, we're prepared to go forward as if that's a rejecting class as well.”)

he did not investigate whether there was any insurance or other similar bonding mechanism that could be used to cover any shortfall in the reserve. *See* 8/12 Tr. 98:1-5.

**F. The Proponents' Proposed Reserve Amount**

16. On July 15, 2008, the Trustee filed the Cash Collateral Motion seeking authority, pursuant to Section 363 of the Bankruptcy Code, to use BNY's cash collateral "for any purposes authorized by the Bankruptcy Code or any order of the Bankruptcy Court" including "making distributions under the Plan."<sup>11</sup> *See* Cash Collateral Motion at 9. As adequate protection for BNY's interest in its cash collateral, the Trustee proposed to leave cash totaling \$331,090,486 on deposit in restricted accounts currently held at BNY pending resolution of the BNY Action. *Id.* at 1, 9. According to the Cash Collateral Motion, it was the Trustee's intention that the reserve proposed in the Cash Collateral Motion would eventually become the BNY Reserve contemplated by Section 7.12 of the Plan. *Id.* at n. 1.

17. Just prior to the Confirmation Hearing, the Proponents revised their proposal, increasing the proposed amount of the BNY Reserve to \$340,658,912 (the "Proposed Reserve Amount").<sup>12</sup> *See* Trustee Exhibit 1. At the Confirmation Hearing, the Proponents agreed to further increase the Proposed Reserve Amount to \$342,760,000.<sup>13</sup>

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<sup>11</sup> Although the Trustee asserted in the Cash Collateral Motion that access to BNY's collateral was also necessary to pay administrative expenses, the Trustee's testimony belies this assertion. The Trustee testified that the estate currently has approximately \$15 million to \$20 million in unrestricted cash in what is termed the "Trustee Operating Fund" and that estate professionals are being paid from that fund on current basis. 8/12 Tr. 90:14-21.

<sup>12</sup> The difference between the Trustee's initial proposal and the proposal put forth at the Confirmation Hearing appears to be based on the Proponents' decisions (a) to increase their calculation regarding the spread between the interest rate on the BNY loan and the rate of return on the funds in the BNY Reserve and (b) to increase the amount of the reserve related to BNY's claim for indemnifiable fees and expenses from \$5 million to \$10 million. *Compare* Cash Collateral Motion pp. 6, 10 and 8/12 Tr. 73, 74:13-15.

<sup>13</sup> At the Confirmation Hearing, the Proponents agreed in response to the proffered testimony of BNY's expert witness, David A. Chapman, to increase the proposed amount of their reserve (net of legal fees) by approximately \$2 million to \$332,760,000, increasing the Proponents' total Proposed Reserve

18. The Proposed Reserve Amount is based on the Trustee's assumption that the BNY Action will be resolved by December 31, 2009 and is comprised of the following:

- (a) the prepetition loan balance of \$312,252,000;
- (b) postpetition interest from the Petition Date through July 31, 2008 totaling \$12,498,060;
- (c) postpetition interest from July 31, 2008 through December 31, 2009 totaling \$14,714,225;
- (d) postpetition professional fees totaling \$10,000,000; and
- (e) a credit of \$8,805,373 for interest earned on the reserve from August 1, 2008 through December 31, 2009.

*See* Trustee Exhibit 1.

**G. Flaws in the Proponents' Calculation of the Proposed Reserve Amount**

19. The only evidence that the Proponents provided at the Confirmation Hearing in support of the Proposed Reserve Amount was the testimony of the Trustee, who has no prior experience with complex commercial litigation, has never previously served as a Chapter 11 trustee or receiver, and has never been a general counsel with responsibility for supervising outside counsel in litigation. *See* 8/12 Tr. 98:11-14, 151:21-152:4. The Trustee's testimony revealed several serious flaws in his determination of the Proposed Reserve Amount, which 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.

**i. The timeline used to calculate the Proposed Reserve Amount**

20. The Trustee testified that the Proposed Reserve Amount was calculated assuming a final order in the BNY Action by December 31, 2009. Tr. 56:23-57:1. However, this Court has no basis to find, based on the limited evidentiary record before it, that such assumption is reasonable or that the BNY Action is likely to be concluded by such date. In support of his assumption that the BNY Action will be resolved by the end of 2009, the Trustee relied on only

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Amount to \$342,760,000. *See* August 13, 2008 Hearing Transcript ("8/13 Tr."), 47-50. A copy of the 2008 Hearing Transcript is attached hereto as Exhibit B.

two things: (a) the self-interested advice of his own professionals and (b) a qualified statement made by Judge Zagel at an August 5, 2008 status conference<sup>14</sup> indicating the *possibility* that he may set a trial date in the BNY Action in early 2009. 8/12 Tr. 57, 98:24-99:3. On the other hand, several facts suggest that a trial in the BNY Action is not likely to be concluded prior to the end of 2009.

21. As an initial matter, although Judge Zagel's comment indicated the possibility of setting a trial date in 2009, he has not yet set any trial date in the BNY Action. Further, Judge Zagel has not set a cutoff for discovery in the BNY Action and is still considering BNY's Motion to Dismiss. 8/12 Tr. 99:23-100:1. At the same hearing noted above, Judge Zagel suggested that he in fact might need further briefing on the Motion to Dismiss.

22. Moreover, the most recent objective indicia of trial timelines from the Northern District of Illinois – historical data collected by the Administrative Office of the U.S. Courts based on recently concluded civil cases – indicates the *median* time from the filing of a civil case *to conclusion of trial* for the year 2007 was approximately 28 months. *See* Admin. Office of the U.S. Courts, Judicial Business of the U.S. Courts, 2007 Annual Report of the Director, Table C-10, at 192 (2007).<sup>15</sup> If this case were to follow the median timeline, a trial in the BNY Action would not be concluded until July 2010.

23. The Trustee's assumptions regarding the necessary time horizon for the reserve is also patently flawed in that the Trustee's timeline does not include any time for an appeal of the

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<sup>14</sup> *See also* August 5, 2008 District Court Hearing Transcript at 5:9-15. (“What I’m **likely** to do is set a trial date, **I think**, for early next year. In theory, we could give you a trial date this year, but I’m quite sure that if I gave you a trial date this year, in fact both sides might be coming back here telling me how difficult it would be to do that.”) (emphasis added).

<sup>15</sup> Table C-10 is attached as Exhibit 4 to the BNY Confirmation Objection.

trial court's ruling in the BNY Action.<sup>16</sup> See 8/12 Tr. 58:14-21, 98:19-23. In attempting to explain why he believed it was appropriate to exclude any time period for appeal in the calculation of the Proposed Reserve Amount, the Trustee offered several unconvincing explanations.

24. The Trustee first testified that there was an "adequate cushion" in the Proposed Reserve Amount to cover the possibility of an appeal. 8/12 Tr. 58:14-21. However, the Trustee could provide no detail about the extent or likely adequacy of this supposed cushion to cover any unforeseen changes in timeline. The only cushion that the Trustee's calculations appear to have contemplated is a slightly greater "spread" between the projected rate at which interest will accrue on the BNY loan and the rate at which interest will be earned on the funds in the BNY Reserve as compared to the average historical spread for those two rates. 8/12 Tr. 66-67, 101:8-18. According to the Trustee, the average historical spread between the interest rate on the BNY loan and the interest earned Dreyfus Treasury Fund (the fund in which the Proponents propose to invest the funds in the BNY Reserve) was approximately 121 basis points for the 8 years of the Dreyfus Treasury Fund's existence. 8/12 Tr. 66.<sup>17</sup> The Trustee testified that the Proposed Reserve Amount was calculated using an assumed spread of 150 basis points rather than the historical spread of 121 basis points, 8/12 Tr. 67, and that this 29 basis point "cushion" would be sufficient to protect BNY against any timeline risk. The Trustee did not, however,

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<sup>16</sup> According to the most recent statistics from the United States Seventh Circuit Court of Appeals, the *median* time for an appeal alone in the Seventh Circuit was 10.9 months. See Admin. Office of the U.S. Courts, Judicial Business of the U.S. Courts, 2007 Annual Report of the Director, Table B-4A, at 108 (2007). A copy of Table B-4A is attached as Exhibit 5 to the BNY Confirmation Objection. Accordingly, adding the median timeline for an appeal to the median timeline to conclusion of a trial in the BNY Action would extend the estimated timeline for final resolution of the BNY Action to March 2011 (excluding any time for remand following appeal), approximately 18 months longer than the Trustee's assumed timeline.

<sup>17</sup> This figure was contradicted by the proffered testimony of BNY's expert witness David A. Chapman. Dr. Chapman found that the average historical spread between the interest rate on the BNY loan and the Dreyfus Treasury Fund was 126 basis points. See 8/13 Tr. 46:13-16.

provide any basis for the decision to use an assumed spread of 150 basis points other than his view that the amount seemed “reasonable.”<sup>18</sup> In particular, the Trustee offered no evidence as to whether it is likely or possible that the spread could exceed 150 basis points for the assumed timeline, and he indicated that he and his advisors in fact did no such statistical analysis. 8/12 Tr. 103:8-104:4.<sup>19</sup> The Trustee also testified that he (a) had no idea how long the “cushion” in the interest spread calculation would cover the interest accrual on the BNY loan after December 31, 2009 (assuming the spread were to stay at the historical average through December 2009) and (b) also had not directed anyone to make that calculation for him. 8/12 Tr. 102:1-10.

25. In addition, the Trustee testified that his sole basis for not including any additional time for appeal was because if BNY prevails at the trial level, the Trustee will pay off the BNY loan. 8/12 Tr. 58:22-59:6.<sup>20</sup> Of course, paying off the outstanding amount of the BNY loan only addresses the accrual of interest. It does not address BNY’s indemnifiable fees that would

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<sup>18</sup> According to Dr. Chapman’s proffered testimony the statistical distribution regarding the historical spreads between the interest rate on the BNY loan followed a normal distribution which allowed for certain assumptions regarding the distribution of likely spreads in the future. *See* 8/13 Tr. 46:17-18. Specifically, according to Dr. Chapman’s proffered testimony, the mean plus two standard deviations is likely to result in outcomes that are within 95 percent of expected outcomes and with respect to the spread between the BNY loan rate and the return on the Dreyfus Treasury Fund, the mean plus two standard deviations would be 162 basis points, 12 basis points higher than the Trustee’s proposal.

<sup>19</sup> Q: Those 29 basis points, who determined that figure, 29 basis points?

A: We did, with consultation with counsel.

Q: When you say “we,” you mean yourself and counsel?

A: Yes, that’s correct.

Q: And how was that 29 basis points derived?

A: We added a 25 percent cushion on top of that.

Q: And the 25 percent figure, how was that derived?

A: It seems reasonable to me.

Q: Any other basis other than it seemed reasonable to you?

A: No. We go through a number of scientific and statistical determinations, but as I say, that seems more than reasonable to me as far as a cushion is concerned.

Q: Did you go through any form of scientific analysis, as you just referred to, in reaching that 25 percent figure?

A: No.

<sup>20</sup> Section 4.3, as revised in the Second Amended Plan, now requires the Trustee to pay BNY’s claim in the event BNY prevails in the BNY Action at the trial level.

continue to accrue in the event that the Trustee appeals the trial court's ruling in favor of BNY. It also fails to address what happens if BNY loses at the trial level but later wins on appeal or subsequent remand.

26. In apparent recognition of the shortcomings of his approach, the Trustee testified that in the event of such appeals, there might be additional funds coming into the estate from tax refunds or other litigation that could be used to satisfy BNY's claim. 8/12 Tr. 59:7-60:2. However, the Trustee stated that he currently has no intention of depositing additional funds in the BNY Reserve and that nothing in the Plan requires him to do so. 8/12 Tr. 95:8-13, 96:15-18. Instead, any additional funds recovered or received by the Trustee would be available for distribution to other creditors and could be immediately distributed upon receipt. 8/12 Tr. 94:14-17.

**ii. The reserve for BNY's indemnifiable fees**

27. The Proposed Reserve Amount includes \$10 million for BNY's indemnifiable fees and expenses. *See* Trustee's Exhibit 1. As Mr. Bailey testified in his capacity as Senior Managing Counsel and the attorney primarily responsible for oversight of this case for BNY, BNY has already incurred nearly that amount in indemnifiable fees and expenses in connection with the BNY Action and other Sentinel-related proceedings involving BNY. 8/12 Tr. 12:19-20. Further, Mr. Bailey testified that BNY anticipates incurring another approximately \$17 million to \$22 million in indemnifiable fees and expenses going forward, bringing the estimate of BNY's total indemnifiable fees and expenses to a range of \$27 million to \$32 million. 8/12 Tr. 29:15-30:2.

28. The Proponents offered no evidence to refute Mr. Bailey's testimony regarding the indemnifiable fees and expenses incurred by BNY to date, nor did they provide any evidence to refute Mr. Bailey's estimate of the fees and expenses that BNY will incur going forward. The

Trustee acknowledged that he had not reviewed any of BNY's legal bills. 8/12 Tr. 74:16-18. Instead, the Trustee testified that his \$10 million estimate of BNY's indemnifiable fees and expenses was based solely on estimates that he received from his own professionals regarding the fees and expenses that they had incurred or expected to incur in connection with the BNY Action. 8/12 Tr. 109:10-16. Specifically, the Trustee testified that the estate's professionals had incurred approximately \$3.2 million in connection with the BNY Action and that they projected additional expenditures of approximately \$10 million for a total of \$13.2 million in legal fees. 8/12 Tr. 74:22-75:5.

29. This Court affords little weight to such estimate, as the \$10 million projection for the Trustee's fees going forward in the BNY Action is not in any way subject to a cap or other limitation. In particular, the Trustee testified that while he would be reserving a total of \$28 million for post-confirmation professional fees, 8/12 Tr. 106:15-18, such reserve will not be earmarked for specific litigation. Moreover, in the event that the Trustee's projections regarding his future legal fees in the BNY Action prove inaccurate, the Trustee will be permitted to use other funds in the professional fee reserve to cover any additional costs. *See* 8/12 Tr. 108:3-10. Moreover, if the Trustee recovers additional funds, he testified that those additional amounts could be used to cover his legal fees. *See* 8/12 Tr. 19-23. Based on this, the Court finds the \$10 million figure extremely speculative and without sufficient evidentiary basis to be a reliable prediction of BNY's future indemnifiable fees and expenses.

30. In addition, the Trustee testified that the \$10 million proposed reserve amount for BNY's indemnifiable fees and expenses did not include any costs associated with any possible appeal that BNY or the Trustee might take of the BNY Action or any costs associated with any remand following appeal. 8/12 Tr. 111:18-112:13.

## **H. Post-Confirmation Interest Rate**

31. The Trustee testified that his professionals calculated interest on BNY's claim after the confirmation date at the projected contract rate of interest. 8/12 Tr. 105:12-17. The Trustee did not consider using any other rate of interest and did not make calculations or direct anyone to make calculations regarding the reserve amount necessary using the national prime rate of interest to calculate interest on BNY's claim post-confirmation. 8/12 Tr. 105:18-106:5.

## **PROPOSED CONCLUSIONS OF LAW**

### **A. Burden of Proof**

32. The Proponents have the burden of proving by at least a preponderance of the evidence that the Plan satisfies all of the requirements of Section 1129 of the Bankruptcy Code. *In re Rusty Jones, Inc.*, 110 B.R. 362, 373 (Bankr. N.D. Ill. 1990). The Proponents have failed to meet their burden because the Plan fails to comply with certain requirements of Section 1129(a) as well as the requirements of Section 1129(b).

### **B. BNY's Claim Is Impaired Under the Plan**

33. Section 1124(1) of the Bankruptcy Code provides that a claim "is impaired under a plan unless ... the plan – leaves unaltered the legal, equitable, and contractual rights to which such claim ... entitles ... the holder of such claim." 11 U.S.C. § 1124(1). Here, the Plan clearly alters BNY's legal, equitable, and contractual rights. The Plan eliminates BNY's contractual right to demand immediate payment of the amounts due under the BNY loan and to liquidate the collateral it holds and to offset the proceeds against its claim against Sentinel. In addition, the Plan proposes to strip away a significant portion of BNY's collateral in order to make distributions to other creditors, thereby placing BNY's ultimate recovery on its currently substantially oversecured claim in jeopardy. Such "[u]nfettered use of a secured creditor's restricted cash is clearly impairment of that creditor's rights." *In re Global Ocean Carriers Ltd.*,

251 B.R. 31, 40 (Bankr. D. Del. 2000). As a result, this Court concludes that BNY's secured claim is impaired within the meaning of Section 1124 of the Bankruptcy Code.

34. Because BNY's claim is impaired, BNY was entitled to vote on the Plan as the holder of a Class 2 Secured Claim. Because BNY has submitted a vote rejecting the Plan, Class 2 has rejected the Plan. Accordingly, the Plan can only be confirmed if it meets the cram-down requirements of Section 1129(b) and the "best interests of creditors" standard of Section 1129(a)(7). The Plan, however, plainly fails to meet the requirements of either section.

**C. The Plan Does Not Meet the Requirements of Section 1129(b)**

35. Pursuant to Section 1129(b), a plan can only be confirmed "if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims that is impaired under, and has not accepted, the plan." 11 U.S.C. § 1129(b). Section 1129(b)(A) further provides that a plan is "fair and equitable" with respect to a class of secured claims if the plan provides:

(i) (I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and (II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;

(ii) for the sale, subject to Section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or

(iii) for the realization by such holders of the indubitable equivalent of such claims.

11 U.S.C. § 1129(b)(2)(A). The Plan's proposed treatment of BNY's claim (the only secured claim in Class 2) meets none of the requirements set forth in Section 1129(b)(A).

36. As the Proponents and BNY agree, Section 1129(b)(2)(A)(ii) is inapplicable on its face because the Plan does not contemplate a sale of any of BNY's collateral at which sale BNY would have an opportunity to credit *bid*.

37. In addition, the Plan's treatment of BNY's claim does not meet the requirements of Section 1129(b)(2)(A)(i) because it does not allow BNY to retain its lien on its existing collateral in at least an amount equal to the possible allowed amount of BNY's secured claim and does not provide for any scheduled payments to BNY with a present value equal to such amount. Instead, the Plan proposes to extinguish BNY's lien on its existing collateral and to replace it with a silent lien on a reserve in an amount that is substantially less than the value of BNY's existing collateral and that may be less than the amount necessary to provide BNY with the present value of its claim. *See* Plan §§ 7.12, 10.13. Moreover, the Plan does not provide for any deferred cash payments to BNY that are susceptible to any present value calculation or determination.

38. In addition, the Plan does not meet the requirements of Section 1129(b)(2)(A)(i) because the Plan inappropriately calculates post-confirmation interest on BNY's claim at the contract rate, which the Proponents have acknowledged and this Court has previously judicially noticed is less than the national prime rate. In order to provide BNY with the present value of its claim, the post-confirmation interest rate on BNY's claim must be at least the national prime rate of interest. *See Till v. SCS Credit Corp.*, 541 U.S. 465, 478-79 (2004). An improperly low rate of interest accrual on BNY's secured claim will ensure that if the BNY Action concludes after the effective date of the Plan – an all but certain conclusion if the Plan were confirmed – BNY will receive a payment at the conclusion of the litigation that is less than the allowed amount of

its secured claim, accounting for the time-value of money. This Court concludes that such treatment does not comport with Section 1129(b)(2)(A)(i).

39. Secondly, the Plan does not meet the requirements of Section 1129(B)(2)(A)(iii) because the Plan does not provide BNY with the “indubitable equivalent” of its claim. The proposed treatment of BNY’s claim fails to provide BNY with the indubitable equivalent of its claim because the flaws in the Proponents’ calculation of the Proposed Reserve Amount create a substantial likelihood that there will be insufficient funds in the BNY Reserve to satisfy BNY’s claim in full upon final resolution of the BNY Action.

40. Among other things, the Proposed Reserve Amount is based on an unrealistic estimate regarding the timeline for the BNY Action. In particular, the assumed timeline underestimates the time period for resolution of the BNY Action at the trial level and includes no time for any appeal. As a result, the Proponents likely have underestimated the time period during which interest will continue to accrue on BNY’s claim and, thus, underestimated the total amount of post-confirmation interest that ultimately would be included in BNY’s allowed claim if it were to prevail in the BNY Action. That interest component of the reserve is also deficient because the Proposed Reserve Amount was calculated using the contract rate of interest post-confirmation as opposed to the national prime rate, which, as noted above, this Court finds to be the required post-confirmation rate under *Till* and its progeny. Finally, the Proponents have also underestimated the portion of the Proposed Reserve Amount attributable to BNY’s indemnifiable fees, as such amount is only one-third, approximately, of the total amount of indemnifiable fees and expenses that BNY’s in-house counsel testified that BNY will incur prior to final resolution of the BNY Action.

41. As this Court previously has held, to demonstrate that the Plan's treatment constitutes the indubitable equivalent of BNY's secured claim, the Proponents have the burden of showing that the treatment is "safe" and "completely compensatory" and that the risk to BNY will "not be increased by reason of the change in its collateral." *In re Sparks*, 171 B.R. 860, 866 (Bankr. N.D. Ill. 1994). Based on this Court's review of the record before it and the factual findings set forth above, this Court cannot conclude that the Plan treatment meets these criteria, and consequently the Proponents have failed to show that the treatment meets the indubitable equivalence standard of Section 1129(b)(2)(a)(iii) of the Bankruptcy Code.

**D. The Plan Violates the Absolute Priority Rule**

42. In light of, and as a corollary to, the foregoing findings and conclusions, this Court also concludes that the Plan cannot be confirmed because it violates the absolute priority rule, which forbids confirmation of a chapter 11 plan over the objection of an impaired class of creditors who will not receive payment in full unless junior creditors will not receive or retain under the plan *any property* on account of their junior claims. *See Wilkow v. Forbes, Inc.* 241 F.3d 552, 554 (7th Cir. 2001). Here, because BNY is not certain to receive payments on or after the Effective Date of the Plan equal to the allowed amount of BNY's claim or otherwise receive the indubitable equivalent of its claim, the absolute priority rule mandates that no junior class of creditors is permitted to receive any distribution under the Plan on account of their claims. To the contrary, the Plan contemplates distribution to unsecured and other junior creditors on the Effective Date from the proceeds of BNY's own collateral before BNY receives anything. As such, the Plan cannot be confirmed. *See, e.g. In re Woodbrook Associates*, 19 F.3d 312, 320 (7th Cir. 1994); *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1359 (7th Cir. 1990).

**E. The Plan Does Not Meet the Requirements of Section 1129(a)(7)**

43. Pursuant to Section 1129(a)(7) of the Bankruptcy Code, the Plan cannot be confirmed unless an impaired class of creditors either accepts the Plan or will “receive or retain under the [P]lan on account of such claim ... property of a value ... that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of [the Bankruptcy Code].” *See* 11 U.S.C. § 1129(a)(7). The Plan fails to meet the requirements of Section 1129(a)(7) with respect to the Class 2 Secured Claims because a more than reasonable likelihood exists that BNY would receive more if Sentinel were liquidated under chapter 7 than BNY would receive under the Plan.

44. In their briefs, the Proponents have argued that BNY’s claim would not be treated better in a chapter 7 liquidation because a chapter 7 trustee would be permitted to make interim distributions out of BNY’s collateral to other creditors prior to resolution of the BNY Action. The Proponents have offered no support for this proposition other than a conclusory reference to Section 363 of the Bankruptcy Code. However, Section 363 permits a trustee or debtor to “use, sell, or lease, other than in the ordinary course of business, property of the estate”; it does not, by its terms, permit distributions of property of the estate subject to liens of senior creditors to be made to junior creditors in satisfaction of their claim. *See* 11 U.S.C. § 363(b).

45. Other than citing the provisions of Section 363, the Proponents have cited no other authority – and this Court is aware of none – that would permit a chapter 7 trustee to make distributions to junior creditors from BNY’s collateral until after the BNY Action is finally resolved. Absent such authority, as noted above, BNY would remain substantially oversecured and face no reasonable or colorable risk of non-payment; this Court cannot conceive of a situation where such chapter 7 trustee’s administrative expenses would result in a substantial diminution of BNY’s equity cushion. On the other hand, the Plan strips BNY of its existing

collateral position and replaces it with a reserve in an insufficient amount and creates significant risk that BNY's claim will not be paid in full, while such prior collateral is to be distributed to potentially junior creditors with no effective recourse for BNY. This Court rejects the Proponents' argument that a chapter 7 trustee would have the authority or discretion to make any interim distributions under the circumstances set forth here, and based on the foregoing, the Court concludes that the Proponents have failed to demonstrate that the "best interests of creditors" test of Section 1129(a)(7) of the Bankruptcy Code is satisfied with respect to BNY. As such, the Plan cannot be confirmed.

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Respectfully submitted,

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