**IN THE UNITED STATES BANKRUPTCY COURT**
**FOR THE DISTRICT OF DELAWARE**

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| In re: | ) | Chapter 11 |
| | ) | |
| SEA CONTAINERS LTD., *et al.*,[1] | ) | Case No. 06-11156 (KJC) |
| | ) | (Jointly Administered) |
| | ) | |
| Debtors. | ) | |
| | ) | |

**DEBTORS' REPLY BRIEF IN FURTHER SUPPORT OF THEIR MOTION FOR ORDER APPROVING SETTLEMENT REGARDING PENSION CLAIMS**

1 The Debtors in these chapter 11 cases are Sea Containers Caribbean Inc. ("SCC"), Sea Containers Ltd. ("SCL") and Sea Containers Services Ltd ("SCSL").

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# INTRODUCTION

On February 18, 2008, the Debtors filed their motion (the "Motion") to approve the Settlement regarding the Trustees' Scheme-related claims.[1] (Docket No. 1458) The Settlement is a major milestone in the restructuring. As the Debtors continually have stated during these cases, without a settlement of the pension claims, a confirmable chapter 11 plan is extraordinarily challenging at best, and more likely unachievable. This is particularly true because, unlike typical situations involving a domestic debtor, any plan in this case must comport with and be capable of implementation under the laws of foreign jurisdictions. Nowhere in the 74-page objection to the Settlement filed by the SCL Committee (the "Objection") does the SCL Committee take issue with -- or even address -- that reality. Instead, the bondholders and the SCL Committee advance a number of theories which demonstrate that they simply have not come to terms with the magnitude of the Debtors' pension liabilities. Thus, rather than addressing the standards for review of a settlement in this Circuit, the SCL Committee advances arguments which, while at best novel, are off point and often based on wild conspiracy theories and half truths. In doing so, the SCL Committee fails to consider the Settlement in its proper historical context, intentionally omits certain cold, hard facts, and fails to even mention the consequences of the Settlement failing, all of which confirm the reasonableness of entering into the Settlement as an exercise of the Debtors' business judgment.

To understand the Settlement, it is important to consider why the Debtors filed these chapter 11 cases in the U.S. As summarized in the Motion (¶¶ 69 and 70), the Debtors are Bermudan and British companies with the core of their operations and assets outside the U.S. Most of the subsidiaries in the group have not filed for relief under the Bankruptcy Code and

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1 Capitalized terms not defined herein shall have the meanings ascribed to them in the Motion.

continue to operate outside bankruptcy and in the ordinary course. In mid-2006, prior to the bankruptcy filing, the Trustees and the Pensions Regulator initiated discussions with the Debtors and, in the Fall of 2006, sent notifications that ultimately led to regulatory and other actions in the U.K.

Nonetheless, the Debtors filed for chapter 11 protection in the U.S. primarily to protect their GE SeaCo interests from a potential GE buy-out right if the appointment of a liquidator or administrator in the U.K. or Bermuda was found to be a "change of control."[2] Since the filing, however, the Debtors have continued to face the specter of insolvency proceedings in the U.K. (which the automatic stay likely could not stop.) Although the Trustees agreed not to contest the Debtors' U.S. bankruptcy filing, the Trustees reserved the right to pursue U.K. and other non-U.S. remedies. *See* 12/4/06 Abbot Ltr. to Buchbinder at 4 & n.2 (Docket No. 1030, Ex. A.) Throughout the case, the SCSL Committee has continually reaffirmed the Trustees' "U.K. legal entitlements" and re-emphasized that the "U.K. Pension Schemes could be prompted to petition for a U.K. administration." *Response of the Official Committee of Unsecured Creditors of Sea Containers Services Ltd. to Debtors' Motion to Extend Their Exclusive Periods to File and Solicit Votes for Their Chapter 11 Cases* at ¶ 6 (Docket No. 1030.) The U.K. government, through its pension regulatory agency ("TPR") and Pension Protection Fund ("PPF"), also has a keen interest and concern regarding these matters, and has rights and duties that loom over these proceedings.

The Trustees have made clear to the Debtors and the SCL Committee that they would resort to U.K. remedies if they did not obtain (through these chapter 11 cases) claims comparable

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2 The "change of control" buy-out right arises under the GE SeaCo Members Agreement and Articles of Organization. See *Debtors' Motion for Order Authorizing SCL's Entity into Framework Agreement with GECC for Global Settlement of Pending Claims and Other Matters Regarding GE SeaCo* (Docket No. 1709 ¶19.)

to their entitlements under English law -- *i.e.*, Section 75 "buy-out" claims against SCL. As discussed below, even apart from these Chapter 11 proceedings, the Trustees have multiple levers for realizing value available to the Schemes in the U.K. and elsewhere. The TPR also is intent on fulfilling its mission of acting in the U.K. to protect U.K. pensioners' rights under U.K. pension schemes. Thus, the Debtors must view the Trustees' statements and TPR actions as a credible and legitimate threat to the Debtors' restructuring efforts in the United States.

For that reason, the Debtors and their advisors have expended considerable estate resources analyzing multiple recovery scenarios for the Schemes and for the unsecured creditors of SCL. This analysis takes into account the possibility that the Schemes and TPR effectively can attach non-debtor assets and directly assert claims against SCL and SCSL under English law notwithstanding the automatic stay, if even applicable, or any attempt to enforce it in the U.K. against the British government and other U.K. domiciled parties. It also takes into account the Services Agreement between SCL and SCSL, the web of intercompany claims within the SCL group, and the consequences and administrative costs of collection actions and insolvency proceedings in non-U.S. venues. In a nutshell, if the Schemes and TPR (or PPF) were to pursue all of their rights under U.K. law against Debtors and non-debtors, non-pension creditors would suffer greatly.

From this analysis, the Debtors have reached one inescapable conclusion: the optimal achievable outcome for the estates requires a pension settlement based on channeling all Scheme-related claims into a single claim against SCL based on section 75 of the U.K.'s Pensions Act 1995 ("Section 75"). Foregoing this settlement approach and rejecting a Section 75-based claim risks collapse of the SCL group and a severe impact on the recovery of estate creditors.

The Debtors have not hidden their analysis and conclusions from the SCL Committee. On the contrary, both the Debtors and the SCL Committee, together with their advisors, spent millions of dollars and endless hours pouring over data, reviewing documents, and researching and analyzing the relevant legal issues before and as the Settlement was being negotiated. And, throughout, the Debtors shared their analysis and conclusions with the SCL Committee. The SCL Committee also actively engaged in the negotiations until its abrupt and counter-productive withdrawal from the final stages of the negotiating process in December 2007. In fact, the SCL Committee even proposed a settlement based on a single Section 75-based claim against SCL, which, of course, is the structure it now so melodramatically complains about.

The SCL Committee's complaint that the Settlement should be rejected because the Trustees are supposed to have somehow violated the automatic stay in connection with the issuance of the FSD is also belied by their conduct. The SCL Committee actively collaborated with the Debtors in opposing the FSD as part of the Determinations Panel proceedings that resulted in issuance of the FSD. It also sent its legal advisors to observe the entire proceedings. Despite its involvement and the full knowledge it had, the SCL Committee chose not to ask this Court to stop the FSD proceedings that it now decries as void.

In short, as further discussed herein, the Settlement did not spring from nowhere on February 18. It is the product of intense analysis and negotiation among the Debtors, the Trustees, the SCSL Committee, *and* the SCL Committee, and it is an excellent result for the estates. Particularly in light of the alternatives, the Settlement falls well above the lowest point in the range of reasonable litigation outcomes and should be approved.

## BACKGROUND

### *Why The Debtors Sought A Pension Settlement*

As discussed in the Motion, there were several factors that triggered SCL's financial difficulties and the need to restructure. One of the most important was the Debtors' inability to fully fund their pension obligations. By the Fall of 2006, after months of discussions that took place *before* the Chapter 11, it was clear that in order to protect the Schemes, the Trustees and TPR might initiate actions against multiple entities in the SCL group under the U.K. statutory and regulatory framework. As the Debtors (in consultation with a pre-petition bondholders group represented by the same professionals that now represent the SCL Committee) considered a Chapter 11 filing to deal with the GE SeaCo change of control problems, the Schemes' underfunding, together with the interaction and conflicts between U.S. and English law, gave rise to many difficult issues. The cross-border jurisdictional overlay of U.S., U.K. and Bermuda courts and U.K. regulators further complicated the situation.[3] More troubling, it was evident from the beginning that the Trustees would have significant claims and potentially could block confirmation of a chapter 11 plan.

For these reasons, since even before the inception of these cases, the Debtors, with the assistance of their retained professionals, conducted extensive legal and financial due diligence to assess the Trustees' claims. The Debtors obtained legal advice on the potential pension claims and the Trustees' and TPR's remedies from U.S. and U.K. counsel at Sidley Austin LLP, Kirkland & Ellis LLP, PricewaterhouseCoopers ("PwC") Legal, and from English barristers' (including Queens Counsel's) chambers. The Debtors' financial advisor, PwC, created a model,

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3 As mentioned, while consenting to the chapter 11 filings, the Trustees continued to reserve their U.K. remedies. Furthermore, TPR has never appeared in these bankruptcy cases and did not endorse in any way the Debtors' filing for U.S. bankruptcy protection.

(a/k/a the "Entity Priority Model" or "EPM") taking into account the assets and liabilities of the Debtors and non-debtors in the SCL group, as well as the complicated network of intercompany claims between all of the companies, to simulate creditor recoveries under various scenarios with respect to pension-related claims.

Issues considered as part of the due diligence included: the quantum of the claims; whether U.S. or English law would apply; what other entities in the SCL group (including SCL itself) might be responsible for the obligations of SCSL and/or the other participating employers in the Schemes (via the Services Agreement, the Schemes' rules, application of English law, or otherwise); the potential rights and defenses to pension-related claims; actions the Trustees and TPR could take in the U.K. and elsewhere; implications relating to intercompany claims among the SCL group entities; and whether the automatic stay would enjoin the Trustees and TPR from pursuing remedies outside the U.S. In particular, to model creditor recoveries under the EPM, the Debtors analyzed the Trustees' and TPR's ability to recover value through direct actions against non-debtor subsidiaries and through intercompany claims. The Debtors also assessed the potential costs, risks and outcomes of litigation.

In addition, in the Spring of 2007 another pension issue arose that could also directly impact confirmation of a chapter 11 plan: equalization. As discussed in the Motion, there were significant questions as to whether the retirement ages for men and women participating in the 1983 Scheme and the 1990 Scheme were properly equalized in accordance with English law. The Debtors and their professional advisors analyzed the equalization issue in depth and shared this analysis with the SCL Committee under a common interest agreement. The Debtors concluded that any settlement had to address these matters, as the Trustees legitimately needed to address these matters in connection with their claims, and leaving the resolution of equalization issues unaddressed could create significant obstacles to confirming and implementing a chapter 11 plan.

With the benefit of all this due diligence and analysis, and the advice from their retained professionals, the Debtors narrowed the field to three principal options —but only one realistic choice: (1) settle the pension claims prior to filing a plan; (2) attempt to defer resolution and liquidation of the pension claims until post-confirmation while reserving for them in full; or (3) delay filing a plan and emerging from chapter 11 pending a litigated outcome. (Trial Ex. 49 at 16-19.) The Debtors reached the obvious conclusion that the settlement option served the best interests of the estates, while the other two presented unacceptable risks and costs. (*Id.*)

The other two options (*i.e.*, defer resolution until post-confirmation or a litigated outcome) did not work for a variety of reasons. Attempting to confirm a plan absent resolution of the pension claims surely would likely result in a hotly contested process with questionable confirmation prospects. Moreover, the Trustees and TPR likely would pursue U.K. remedies rather than awaiting the outcome of a contested confirmation. In addition, deferring on the pension issue likely would considerably delay resolution of the complex web of intercompany claims, even though their resolution may be a prerequisite for the endorsement of a scheme of arrangement by a Bermuda court.[4] (*Id.*) Likewise, a litigated outcome would be extremely detrimental to the estates, as it would result in enormous administrative costs and delays in distributions to creditors, and likely would involve competing proceedings in the U.S. and U.K. (*Id.*) Therefore, the Debtors believe it is a "significantly better outcome to achieve a settlement" of the pension claims, in order to preserve the value of the estates. (*Id.* at 19.)

4 The Debtors currently believe that implementation of a Chapter 11 plan in these cases will require a proceeding and endorsement in Bermuda.

***The Process Leading To The Pension Settlement***

After forming the view that a settlement constituted the preferred path and a critical step towards confirmation, the Debtors encouraged the parties to initiate direct negotiations. To this end, starting in March 2007, following the Debtors' presentation of the EPM to the SCL Committee, initial the Debtors initiated a "dispute resolution process" with the Committees. As part of this process, the SCL Committee advisors conducted interviews with the Debtors' employees, the Debtors shared legal advice and financial analyses and the Debtors shared the EPM model with the SCL Committee advisors and exchanged various potential settlement scenarios. Negotiations with the Committees started in earnest in June 2007 and continued until the Settlement in February 2008. (Trial Ex. 49 at 13-16.) The negotiation had two phases. (*Id.*)

In the first phase, the Debtors acted as facilitator and mediator in negotiations between the SCL Committee and the SCSL Committee. Among other things, the Debtors oversaw the process, responded to information requests from the Committees, and obtained their own legal and actuarial advice on the matters relevant to the negotiations. (*Id.*)

One of the key issues in this first phase related to the entities in the SCL group that could have pension-related liabilities. The evidence will show that by November 2007, a consensus among all parties -- including the SCL Committee -- started to form around a single Section 75-based claim against SCL as the foundation for any settlement. From as early as July 2007, the SCL Committee's senior advisors encouraged the Debtors to introduce the concept of a single Section 75 claim against SCL, which became known as the "trial balloon." (*See* Trial Ex. 21.) The "trial balloon" concept was refined in further rounds of negotiations through mid-December 2007. On November 14, 2007, the SCL Committee itself made a proposal based on the "trial balloon," and suggested that the pension claims be channeled into a single claim against SCL.

By December 2007, there remained differences between the parties although the gap was narrowing. By this time, the Debtors and the Committees had spent enormous resources in the U.K. and the U.S. on pension matters. In early December 2007, the Debtors requested an all-hands meeting in an effort to close the remaining gaps and reach a final settlement. The Debtors made clear to both Committees that, if they could not reach an accord, the Debtors would take a more active role in advising the parties as to the Debtors' views of a reasonable outcome. Both Committees acknowledged the need to conclude the negotiations and agreed to attend.

In mid-December 2007, on the eve of that critical meeting, the SCL Committee advised the Debtors and the SCSL Committee that a bondholder group had taken an interest in the case and that the SCL Committee needed "24-48 hours" to determine the bondholders group's desire to join the SCL Committee. As a result, the SCL Committee announced that it would not attend the meeting scheduled for December 12, 2007. The Debtors and SCSL Committee nonetheless met on December 12 to discuss open issues and reset the final negotiating session for December 19. On the eve of that rescheduled meeting, the SCL Committee informed the Debtors that the new bondholders would not join the SCL Committee but that, nonetheless, the SCL Committee was now unwilling to participate in further negotiations until January, and even then not until after the new group of bondholders who had refused to join the Committee were brought up to speed on the months of diligence and negotiations that had taken place.

With the SCL Committee's withdrawal, the second phase of the negotiations began. (Trial Ex. 49 at 14.) In this second phase, the Debtors shifted from serving as a facilitator and mediator to direct negotiations with the SCSL Committee and the Trustees. (*Id.*) Even so, the Debtors continued to advise the SCL Committee regarding the status of the ongoing negotiations.

Certain bondholders subsequently did engage counsel and were also kept abreast of settlement discussions by the Debtors and the SCL Committee.

The Debtors undertook arm's-length negotiations with the SCSL Committee and the Trustees regarding several aspects of the pension claims. Between December 7, 2007 and February 5, 2008, the Debtors and the SCSL Committee exchanged no less than 15 proposals and counter-proposals. (Trial Ex. 21.) Throughout, the Debtors received financial, actuarial and legal advice from K&E, PwC and other advisors. Ultimately, as explained by Laura Barlow (who is the Debtors' Chief Restructuring Officer and Chief Financial Officer), the Debtors reached a pension settlement that "is a fair compromise [and] is within the range of litigation outcomes that might have been achieved." (Trial Ex. 49 at 20.)

***The Key Aspects of The Settlement***

By entering into the pension settlement, the Debtors extracted five significant compromises from the SCSL Committee and the Trustees: (1) structural priority, (2) fixing and limiting the quantum of claim, (3) using a favorable foreign exchange rate, (4) reducing the volatility risk, and (5) limiting expense reimbursement. (Trial Ex. 49 at 29-33.)

*Structural priority*. Despite what the SCL Committee asserts in its Objection, absent the Settlement, the Schemes currently maintain a clear advantage in obtaining recoveries from the SCL group to the disadvantage of bondholders. While the bondholders and other SCL creditors could assert claims only against SCL, the Trustees and TPR can pursue contractual and statutory rights against SCL, SCSL, the non-debtor participating employers, and (indirectly through intercompany claims) all other non-debtor subsidiaries. (*Id.* at 29-30.) Many of these claims would be joint and several. Also, as discussed, it is unlikely that the automatic stay would enjoin actions in the U.K. As a result, the Schemes legally can effectively recover on joint and several claims potentially against many entities in the SCL group. Through the Settlement, the Schemes effectively relinquish this right by agreeing to channel all pension-related claims into a single Section 75-based claim against SCL. (*Id.*) In doing so, value will be released to other SCL creditors. In agreeing to share their recovery with other SCL creditors, the Trustees have sacrificed (not improved) their structural priority.

Therefore, the SCL Committee is flat wrong in its Objection in saying that the Trustees have achieved a "priority jump." The SCL Committee argues that the Settlement "avoid[s] valid set-off rights that SCL has against Services for inter-company claims." (Objection at 3) Insofar as the Trustees effectively waive any right to rely on the Services Agreement to assert their claims under the Settlement, this may technically be true, but it misses the point and misleads the Court. Based on the Debtors' analysis shared with both Committees, even assuming (i) no Settlement, (ii) the Services Agreement is valid (which the Debtors have no reason to doubt), (iii) SCL enjoys the full setoff rights trumpeted by the SCL Committee, and (iv) the Trustees maintain all the remedies against the SCL group already discussed, the Schemes likely could obtain a ***better*** recovery than they do through the Settlement even without the benefit of the FSD. Thus, while the Settlement moots any setoff rights SCL may have against SCSL under the Services Agreement, it achieves a better outcome for SCL creditors than maintaining setoff rights at the cost of losing the benefit of consolidating the Schemes' multi-level claims at SCL.

*Quantum of Claim*. Although the SCL Committee argues that the Trustees have not really compromised the quantum of their claims through the Settlement, its argument is wrong and misses the point. The Trustees' claims were estimated at $225 million or higher as of the petition date (October 2006), and rising scheme deficits could further increase that amount. In agreeing to effectively reduce their aggregate claims to $194 million by fixing the date for the section 75 valuation to take place, the Trustees made a significant concession[5] (Trial Ex. 49 at 30-31.) Moreover, as discussed above, the entire Settlement, including the Scheme claims, must be evaluated in a broader context. Since the Trustees from the inception of the case have reserved their right to abandon the chapter 11 process and pursue remedies in non-U.S. jurisdictions, the Trustees' claims must be considered in light of their recovery value were the Trustees to pursue claims outside the U.S. In fact, the Trustees have exchanged claims likely worth more on a percentage-recovery basis for "common currency" claims alongside other SCL creditors.

*Foreign Exchange Rate*. Through the Settlement, the Debtors locked-in a favorable foreign exchange rate to convert the Trustees' claims from Pounds Sterling to U.S. Dollars. (Trial Ex. 49 at 31-32 and 42-43.) It is undisputed that the petition-date exchange rate of $1.87/pound is more favorable than the prevailing rate as of the last date for calculation of the pension deficits, November 30, 2007 ($2.05/pound.) This results in a discount of approximately 8.6% on the Trustees' claims. (*Id.* at 43.) Although the SCL Committee tries to minimize this discount by citing the fact that as the Bankruptcy Code fixes exchange rate as of a petition date in any event, it would be difficult to expect the fixing of the exchange rate in any U.K. proceedings the Trustees or TPR would initiate absent the Settlement.

*Volatility Risk.* During the negotiations, the Debtors believed there was substantial danger that a further deterioration in the financial markets (as has in fact occurred) would cause the Schemes' deficits to rise. (*Id.* at 32.) The Settlement definitively fixes the quantum of the Trustees' claims at $194 million and, consequently, the Debtors no longer face the risk of growth in the Schemes' deficits, which is now borne by the Trustees. (*Id.*)

5 Under Section 75(2) of the 1995 Act, upon winding up, the trustees may elect the date on which the Section 75 debt would be certified, so as to maximize the Scheme's claims.

*Expenses*. As described more fully below, by the Settlement, the SCSL Committee and the Trustees agreed to limit reimbursement of their ordinary course expenses in maintaining the Schemes to $5 million. At the request of the Debtors and the SCL Committee, the Trustees agreed not to wind-up the Schemes for a limited time so as to allow for negotiation of the Settlement and an orderly restructuring process. (*Id.* at 32-33) In keeping the Schemes open, the Schemes estimate that significant legal and financial advisory expenses, actuarial costs, costs for the Trustees, and additional PPF levies could be incurred. By capping reimbursement of these expenses, the Debtors obtained another valuable compromise and the court need look no further than the Settlement itself for the benefit to the estate of the $5 million administrative claim.

***The Benefits Of The Pension Settlement For All Creditors***

After carefully considering the alternatives, and in light of the concessions achieved through the Settlement, it is clear that the Settlement greatly benefits the estates.

First, the Settlement avoids what otherwise surely would be costly and protracted litigation over complex and heavily contested issues with respect to the Trustees' claims. Resolving the Trustees' claims would require resolving novel U.S.- and English- law issues. It would require consideration of the potential conflict between U.S. and U.K. legal and regulatory institutions. The Settlement eliminates the possibility of competing foreign insolvency or collection proceedings that could jeopardize SCL creditor recoveries.[6] Without question, absent

[6] *See Response of the Official Committee of Unsecured Creditors of Sea Containers Services Ltd. to Debtors' Motion to Extend Their Exclusive Periods to File and Solicit Votes for Their Chapter 11 Cases* at ¶ 6 (Docket No. 1030) ("Prior to the Petition Date, the Debtors approached the U.K. Pension Schemes in connection with the Debtors' proposal to commence plenary bankruptcy cases in the United States as opposed to other potential jurisdiction, such as the U.K. Upon information and belief, in connection with their willingness not to oppose initially the Debtors' jurisdiction choice, it was the position of the U.K. Pensions Schemes (and it remains their position) that should the Debtors seek to use the jurisdiction in the U.S. in an inequitable manner in light of their U.K. legal entitlements, the U.K. Pension Schemes could be prompted to petition for a U.K. administration. Indeed, the U.K. Pension Schemes "expressly -- and continue to reserve -- any and all of their rights under the creditors' rights laws of the U.K. and other applicable jurisdictions (including the right to petition for administration thereunder.)")

the Settlement, the estates could incur tens of millions of dollars in additional administrative costs associated with proceedings before this Court, U.K. courts, and possibly elsewhere.

In particular, in light of SCL's complicated corporate structure, and the web of intercompany claims among the Debtors and their non-debtor subsidiaries and affiliates, enforcement actions outside of chapter 11 could result in a domino effect of non-U.S. insolvency and enforcement proceedings. The SCL Committee never explains how this risk could be eliminated, or substantially reduced, absent the Settlement. The SCL Committee also never challenges the Debtors' business judgment that such events could materially diminish creditor recoveries.

Second, creditors are likely to realize enhanced recoveries from the estates as a result of the Trustees obtaining a single claim against SCL. As already discussed, the Trustees agreed to receive a single claim against SCL in lieu of their multitude of other claims against SCL, SCSL and the non-debtors in the SCL group. As a result, significant value now can flow in the near term from the non-debtor subsidiaries to the Debtors and their creditors. On a net basis, the Debtors believe this could improve and accelerate creditor recoveries.

Third, in addition to these benefits, the Settlement is well above the lowest point in the range of reasonable litigation outcomes. The Schemes' proofs of claims together total over $295 million. The Court will hear expert testimony that under English law (the likely applicable law, particularly if proceedings are brought in the U.K.) the Section 75 buy-out method governs calculation of the funding deficit. (*See* Trial Ex. 16 at ¶¶ 33-37.) Therefore, the estimate advocated by the SCL Committee is unrealistically low. The Settlement represents a discount of the claimed funding deficits, with less than 3% receiving administrative priority. Further, the reserve for the equalization claim leaves open the possibility of a refund. If the SCL Committee is correct in its conclusion that the Debtors have no liability for equalization, then the estates stand to recover surplus distributions set aside in the reserve. The reduction in the amount of the Trustees' claims for funding deficits; the fixing of the claims and the foreign exchange rate as of, respectively, November 30, 2007, and the petition date; the improved recovery for SCL creditors; and the possibility of recovery from the reserve represent a fair and equitable compromise that is well above the lowest point in the range of reasonable outcomes.

Lastly, the Settlement facilitates the formulation of a chapter 11 plan and the Debtors' exit from these chapter 11 cases. Without the Settlement, the Trustees may cease participating in these chapter 11 cases and, as noted above, the Debtors may face numerous competing collection proceedings. Under these circumstances, it is not certain that the Debtors or any other party could proceed with formulating a confirmable chapter 11 plan. Indeed, failure of the Settlement could lead to a host of unfavorable consequences ultimately ending in liquidation. In particular:

- Opposition to and abandonment of the chapter 11 process by the Trustees likely means zero possibility for a consensual plan of reorganization.
- Extraordinary professional fees will continue to burden the estate, causing real liquidity concerns.
- The parallel proceeding in Bermuda can remain a "provisional" liquidation only if the Bermuda Joint Provisional Liquidator has a reasonable belief that the Chapter 11 process will result in a plan that benefits creditors. Failure to resolve the pension claims may result in conversion of the provisional liquidation to a full-blown liquidation, which in turn may trigger the very change of control with respect to GE SeaCo that the chapter 11 filing sought to avoid.
- Even if the Debtors could confirm a "cram down" plan, the Debtors could not implement such a plan in Bermuda, where no counterpart to Bankruptcy Code Section 1129(b) exists.
- Failure of the Settlement could jeopardize: (1) the Debtors' prospects for exit financing; (2) the implementation of the GE SeaCo "Framework Agreement" (set for Court approval on June 4), both of which hinge on clarity in the plan process; and (3) and could create insurmountable obstacles to any intercompany claim resolution which hinges, *inter alia*, on removing the threat of pension claim enforcement against non-debtors in the SCL group.

- Apart from any continued action by the Trustees, in the absence of a settlement the Debtors must assume that TPR would take enforcement actions and Section 75 liabilities would be imposed throughout the SCL group, resulting in more cross-border litigation with the U.K. government.

In sum, weighing all the risk factors, failure to obtain approval of the Settlement likely would lead, in short order, to liquidation of the estates. The Settlement avoids this result.

## LEGAL STANDARD

As discussed more fully in the Motion, the Third Circuit has adopted a four-factor balancing test for considering motions to approve compromises under Rule 9019 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules.") (*See* Motion at ¶ 66.) These factors are: "(1) the probability of success in litigation; (2) the likely difficulties in collection; (3) the complexity of litigation involved, and the expense, inconvenience and delay necessarily attending it; and (4) the paramount interest of the creditors." *Myers v. Martin* (*In re Martin)*, 91 F.3d 389, 393 (3rd Cir. 1996). Courts are also directed to consider whether a proposed settlement is "fair and equitable." *In re Nutraquest, Inc.*, 434 F.3d 639, 645 (3rd Cir. 2006).

In analyzing a proposed settlement, courts seek to determine "whether or not the terms of the proposed compromise fall within the reasonable range of litigation possibilities." *In re Energy Corp., Inc.*, 886 F.2d 921, 929 (7th Cir. 1989) (citing *Protective Comm. of Indep. Stockholders of TMT Trailer Ferry v. Anderson*, 390 U.S. 414, 424-25 (1968).) In fact, the settlement need only be above "the lowest point in the range of reasonableness." *In re Coram Healthcare Corp.*, 315 B.R. 321, 330 (Bankr. D. Del. 2004).[7] That litigation may result in a better outcome does not render a settlement unreasonable. *Official Unsecured Creditors' Comm.*

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7 *See, e.g., Official Unsecured Creditors' Comm. v. Pa. Truck Lines, Inc. (In re P.A. Truck Lines, Inc.)*, 150 B.R. 595, 601-02 (E.D. Pa. 1992) (affirming bankruptcy court's approval of settlement despite debtor's "sketchy" analysis of cost, time and risk); *Coram*, 315 B.R. at 331 (approving settlement where success "not assured," difficulties in proposing plan absent settlement, and expense, inconvenience and delay to all creditors.)

*v. Pa. Truck Lines, Inc.( Pa. Truck Lines),* 150 B.R. at 603.[8] In approving a settlement, the court need not conclude that a settlement is the best possible compromise, and the approval of a compromise is within the bankruptcy court's sound discretion. *Id*. at 329, 330. Moreover, in deciding whether to approve a settlement, courts consider whether the issues litigated are complex and the results are uncertain, and whether the settlement will facilitate a plan of reorganization. *See In re Kaiser Aluminum Corp.*, 339 B.R. 91, 96 (D. Del. 2006) (approving as reasonable a pension claim settlement in excess of the "prudent investor rate" calculation espoused by an objecting creditor because "in the face of these complex and uncertain issues, it is difficult to envision who would succeed, but not difficult to envision complex, costly and time-consuming litigation")

Here, the evidence presented makes abundantly clear that the Settlement before the Court easily passes the "lowest point in the range of reasonableness." In fact, as explained in detail below, the Settlement embodies a fair compromise which would avoid costly and protracted litigation, will likely prevent a chain of events that could result in the collapse of the SCL group, will prevent the need to litigate complex legal issues (such as choice of law issues in quantifying the Trustees' claims and the specter of direct enforcement and insolvency proceedings in the U.K) and avoid uncertain litigation results, will facilitate a plan of reorganization, and will provide benefits to the estates which could not have been achieved other than through settlement.

The SCL Committee concedes that, in approving a settlement, the courts typically adhere to the debtor's business judgment rule. (*See* Objection at 39; *see also* 11 U.S.C. § 363(b)(1) of the Bankruptcy Code). Notwithstanding this concession, the SCL Committee advances the novel and somewhat astounding proposition that the Court should substitute the SCL Committee's

8 *See also Nutraquest*, 434 F.3d at 646 (approving a settlement over a creditor's objection that the likelihood of success was zero, and the claimant was probably time-barred from bringing a claim.)

parochial business judgment for the Debtors. (*See* Objection at 39.) The SCL Committee cites no precedent. Rather, it justifies the argument by suggesting that somehow the Debtors are disqualified from resolving the Trustees' claims. This is absurd.

As described more fully in the Background Section, *supra*, the Debtors initially opted to play the role of mediator and facilitator between the parties because of the intercompany nature of the dispute. That approach, however, did not yield a resolution. It was only after the Determinations Panel decided to issue Financial Support Directions (each an "FSD," and collectively, the "FSDs") directly against SCL and the SCL Committee inexplicably dropped out of the negotiations,[9] that the Debtors stepped forward. It was abundantly clear at that point that the Debtors had to act to advocate the estates' interests or risk the unraveling of the Debtors' bankruptcy estates. At no time did the Debtors relinquish their roles as stewards of these estates whose mission is to maximize value for the estates' creditors. In fact, even when the Debtors acted as a mediator and facilitator, the Debtors' business judgment provided the touchstone for the ultimate settlement. Accordingly, the Debtors' business judgment is fully entitled to the deference required under the business judgment rule. *See, e.g., In re After Six, Inc.*, 154 B.R. 876, 883 (Bankr. E.D. Pa. 1993) (finding that debtor's, not creditor's, views are subject to deference under Section 363(b) of Bankruptcy Code); *In re Integrated Res., Inc.*, 135 B.R. 746, 753 (Bankr. S.D.N.Y. 1992) (holding that standard under Section 363(b) is the debtor's business judgment.)

Under Section 363(b)(1) of the Bankruptcy Code, a debtor's business decision should be approved unless the decision "is shown to be so manifestly unreasonable that it could not be based upon sound business judgment, but only on bad faith, or whim or caprice." *In re G-I*

[9] Contrary to the SCL Committees' glib assertion, (*see* Objection at 39), the parties had not "reached an impasse;" the SCL Committee simply stopped negotiating.

*Holdings, Inc*., 313 B.R. 612, 657 (Bankr. D.N.J. 2004) (quoting *In re Aerovox, Inc.*, 269 B.R. 74, 80 (Bankr. D. Mass. 2001).)[10] As the evidence presented at the hearing will show, the Debtors' entry into the Settlement clearly constituted a sound exercise of business judgment. Courts have consistently approved settlements as within a debtor's business judgment where, as here, the settlement preserves funds for creditors, resolves costly and complex litigation, and facilitates the debtor's restructuring. *See, e.g., In re Mirant Corp.*, No. 03-46590 (DML) 11, 2005 WL 1000266, at *7 (N.D. Tex. Apr. 14, 2005) (holding that settlement was appropriate exercise of debtors' business judgment as it avoided complex litigation involving issues of first impression, provided debtor with significant cost-savings, and facilitated debtor's reorganization); *In re Syscom Enters., L.P*., 310 B.R. 669, 675 (Bankr. D. N.J. 2004) (approving settlement as within debtor's business judgment where settlement would preserve funds for distribution to creditors); *In re Victoria Alloys, Inc*., 261 B.R. 918, 921 (Bankr. N.D. Ohio 2001) (approving settlement as within debtor's business judgment where settlement resolved complex cash collateral litigation and facilitated debtor's restructuring.)

## ARGUMENT

### I. THE EVIDENCE DEMONSTRATES THAT THE SETTLEMENT OF THE SCHEMES' CLAIMS FALLS WELL WITHIN THE RANGE OF REASONABLE LITIGATION OUTCOMES.

#### A. A SUBSTANTIAL RISK EXISTS THAT ENGLISH LAW APPLIES TO THE PENSION SCHEMES' CLAIMS

As discussed in the Motion, a strong argument can be made that the Trustees' claims should be determined in accordance with English law. (*See* Motion at ¶¶ 76-81.) This is because

10 *See also GBL Holding Co., Inc. v. Blackburn/Travis/Cole, Ltd.*, 331 B.R. 251, 254 (N.D. Tex. 2005) (finding that a court is to give "great judicial deference . . . to the [debtor's] exercise of business judgment"); *In re Cadkey Corp.*, 317 B.R. 19, 22-23 (D. Mass. 2004) (finding that debtor's business decision should be approved unless it is manifestly unreasonable); *In re Bakalis*, 220 B.R. 525, 532 (Bankr. E.D.N.Y. 1998) (debtor's business judgment enjoys "great judicial deference").

applicable non-bankruptcy law generally governs the validity and amount of a claim. *See, e.g.*, *Raleigh v. Ill. Dep't of Revenue*, 530 U.S. 15, 20 (2000) ("Creditors' entitlements in bankruptcy arise in the first instance from the underlying substantive law creating the debtor's obligation, subject to any qualifying or contrary provisions of the Bankruptcy Code.").

Here, Delaware's choice of law principles dictate which substantive law governs the Trustees' claims against SCL. *In re Garden Ridge Corp.*, 338 B.R. 627, 632 (Bankr. D. Del. 2006); *In re Deemer Steel Casting Co.*, 117 B.R. 103, 107 (Bankr. D. Del. 1990). Delaware courts apply the "most significant relationship" test to determine which law applies to a given dispute. *Edelist v. MBNA Am. Bank*, 790 A.2d 1249, 1255 (Del. Super. Ct. 2001). This test applies equally where foreign law is implicated. *Travelers Indem. Co. v. Lake*, 594 A.2d 38, 47-48 (Del. 1991) (applying "most significant relationship" test to determine whether Delaware or Quebec law applies.) Delaware courts generally consider five factors when applying the "most significant relationship" test to contract (as opposed to tort) actions: "(a) the place of contracting; (b) the place of negotiation of contract; (c) the place of performance; (d) the location of the subject matter of the contract; and (e) the domicile, residence, nationality, place of incorporation and place of business of the parties." *Edelist*, 790 A.2d at 1256.

Applying the factors to the case at hand results in a substantial likelihood that English law would apply to the Trustees' claims. First, the Schemes' deeds were executed in London and were explicitly created pursuant to the U.K. Pensions Act and are governed by the U.K. Pensions Act. *See, e.g.*, 1983 Scheme Replacement Deed, Schedule, Part 2 at 9. Second, SCSL, the principal employer under the 1983 and 1990 Schemes, is a U.K. organization with its principal place of business in the U.K. Third, the Schemes' members are almost exclusively U.K. residents and the work compensated for was done almost exclusively in the U.K. Fourth, the Schemes both have always been administered in the U.K. Fifth, the Schemes' Trustees reside in the U.K. Sixth, TPR has assumed its regulatory powers over the Schemes. Consequently, there is a substantial risk that English law applies given that the Schemes' most significant relationship is with the U.K. At a minimum, there appears to be no nexus with the U.S. on which one may justify the application of U.S. law to the Schemes' claims.

### B. UNDER ENGLISH LAW, THERE ARE A NUMBER OF LEGAL SOURCES THAT COULD GIVE RISE TO A LIABILITY AGAINST SCL TO CONTRIBUTE TO THE 1983 AND 1990 SCHEMES

The uncontroverted evidence in this case with respect to English law will be presented at the hearing by Mr. Jonathan Evans, a leading barrister who is an expert on U.K. pension law.[11] Mr. Evans' expert report describes in detail the various sources under English pensions law that impose an obligation on an employer, and in certain circumstances other entities, to contribute to a scheme.[12] (Trial Ex. 16 at ¶¶ 11-15.) To summarize, the various obligations "arise in different ways and at different times." (*Id.* at ¶ 11.) As Mr. Evans explained, these obligations exist independently of each other and may result in different amounts. (*Id.*) Specifically, "[t]he fact that one obligation has arisen and is calculated according to one method does not mean that this is the only obligation or that another obligation is not properly calculated according to a different method." (*Id.*)

The four applicable sources under U.K. pensions law for SCL's potential liability to fund the Schemes, as well as the measure of calculating such liability, are summarized in short below:

- <u>Contractual</u>: the "employer's covenant" contained in a scheme requires participating employers to pay contributions to fund the benefits provided by the scheme. (*Id.* at ¶ 12.)

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[11] The Debtors are the only party that will be offering expert testimony on U.K. pensions law. As such, Mr. Evans' testimony will be uncontested.

[12] The opinions expressed by Mr. Evans in his expert report are his and are not based on any legal advice received from Debtors' counsel.

In the case of the 1983 Scheme and the 1990 Scheme, the funding covenant is contained in rule 12 of the Schemes. (*Id.)*

- Statutory - the Statutory Funding Objective Under the 2004 Act: the "statutory funding objective" was imposed by the 2004 Act.[13] (*Id.* at ¶ 13, 19.) This is sometimes referred to as the "technical provisions," namely the amount required on an actuarial calculation to provide for the scheme's liabilities as they fall due. (*Id.* at ¶ 20.) As discussed in more detail below, the technical provisions are determined by the trustees who must take advice from the Scheme Actuary. (*Id.*)

- Statutory - Section 75 of the 1995 Act: a Section 75 debt arises if upon (i) the insolvency of the employer; (ii) the winding-up of the scheme; or (iii) the withdrawal of the employer from the scheme (each considered a "trigger event"); the scheme is in deficit calculated on a prescribed basis. (*Id.* at ¶¶ 14, 28-31.) The prescribed method of valuation under Section 75 requires the scheme actuary to assume that the liability to provide pension and other benefits would be met by the purchase of annuities. This is commonly referred to as the "buy-out" valuation basis. As Mr. Evans explained: "[t]here is no element of discretion in relation to the selection of an appropriate valuation methodology in relation to the quantification of this debt: the statute prescribes this method of valuation." (*Id.* at ¶ 34.)

- The Pensions Regulator ("TPR") Powers Under The 2004 Act: under the 2004 Act, FSDs (pursuant to section 43 of the 2004 Act) and contribution notices (pursuant to Section 47 of the 2004 Act) may be issued upon the occurrence of certain prescribed events. (*Id.* ¶ 15.) The amount owed under an FSD is calculated by reference to the amount payable by any of the participating employers and therefore may be equivalent to a Section 75 debt. (*Id.*)

These various sources of obligation, as applied to SCL, will be discussed in more detail below.[14]

### C. APPLYING ENGLISH LAW IN THIS CASE LEADS TO THE FOREGONE CONCLUSION THAT A SECTION 75 DEBT AGAINST SCL IS A PRESENT LIABILITY, NOT A CONTINGENT LIABILITY

The Objection makes much of the fact that a Section 75 debt has not been technically triggered under the 2004 Act. The SCL Committee therefore argues that a Section 75 debt is not only contingent, but that the "likelihood of Section 75 liability is remote." (Objection at 44.)

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13 The 2004 Act is attached as Appendix 7 to Trial Ex. 17.

14 As noted in Mr. Evans' Report, under the Services Agreement, SCSL has a contractual claim against SCL as well. Trial Ex. 16 ¶ 68(7).

Accordingly, the SCL Committee argues that the Section 75 debt should be discounted to take into account its improbability. (Objection at 20.) Notwithstanding these arguments, and as explained in more detail below, a Section 75 liability may arise -- and ***did*** arise in this case -- even though technically a trigger event under the 2004 Act has not yet occurred for the full scheme deficits. In short, the FSDs issued by TPR against SCL have created a ***present*** liability, which is measured by reference to a Section 75 debt that "may become due" and which is based on an actuary's "estimate." There is nothing contingent, however, about that liability. As a result, SCL is ***currently*** liable for securing SCSL's full Section 75 debt.

1. The Pensions Regulator Has Issued An FSD Against SCL For The Estimated Section 75 SCSL Debt And Such Liability Is Present, Not Contingent

The 2004 Act (section 43 (2) and (5)) provides that the Pensions Regulator may issue an FSD if it considers that the employer in relation to the scheme either (a) is a "service company," or (b) is insufficiently resourced and (in both cases) considers it reasonable to issue an FSD. (Trial Ex. 16 at ¶ 38.) A "service company" is defined in section 44 of the 2004 Act as a member of the group whose business is the provision of the services or employees to other members of the group. (*Id.* at ¶ 39.)[15] An FSD requires the person or persons to whom it is issued to secure that financial support for the "employer's pension liabilities" is put in place within the period specified in the direction. (*Id.* at ¶¶ 42-43.) An FSD may be issued only against a person who is either the employer or a person "connected" or "associated" with the employer, which under section 51 of the 2004 Act includes all companies in the same group and would therefore include SCL. (*Id.* at ¶ 44.) Most significantly for present purposes, an FSD may issue even if the employer's pension liabilities are contingent and references to the amount of

15 As discussed below, in connection with the hearing before the Determinations Panel, SCL conceded that SCSL was a service company within the meaning of the Act.

such debt include the amount of such contingent debt. (*Id.* at ¶ 43.) Indeed, section 51(2) of the 2004 Act incorporates that principle by providing that the interpretation to be used in respect of sections 43-50 is "references to a debt due under section 75 of the Pension Act 1995 (c. 26) include a ***contingent*** debt under that section; and (b) references to the amount of such debt include the amount of a ***contingent*** debt." (*Id.* (emphasis added.))[16]

The specific process for issuing an FSD is described in detail in Mr. Evans' expert report (*id.* at ¶ 7), but to sum, a Determinations Panel decides whether to issue an FSD following the issuance of warning notices and receipt of representations from the persons directly affected by the proposed course of conduct. If the entity against whom the FSD was issued (the "target person") does not comply with the FSD, the Pensions Regulator may, under section 47(2) of the 2004 Act, issue a "contribution notice" providing notice that the person is under liability to pay the trustees the sum specified in the notice. (*Id.* at ¶ 48.) Despite suggestions to the contrary, there is no requirement for a Section 75 trigger event to have occurred for a contribution notice to be issued. As Section 48 of the 2004 Act clarifies, the liability "in a case where, at the time of non-compliance, no such debt was due" is "the amount which the Regulator ***estimates*** to be the amount of the debt under section 75 of the 1995 Act which ***would become*** due." Section 48(2)(b) of the 2004 Act (emphasis added.) As Mr. Evans eloquently summarizes:

> It is clear from these provisions that non-compliance with an FSD can result in a contribution notice being issued, which in turn gives rise to a statutory debt becoming due from the person named in the notice to the trustees. Moreover, this statutory debt arises independently of any Section 75 debt (***and can arise even if no Section 75 debt has in fact arisen***) and is calculated by reference to the amount of that (actual or estimated) Section 75 debt and may be for the full amount of that (actual or estimated) Section 75 debt.

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16 *See also* section 45(4)(b) of the 2004 Act, entitled meaning of "financial support" which defines "the employer's pension liabilities" as "the liabilities for any debt which is or ***may become due*** to the trustees or managers of the scheme from the employer whether by virtue of section 75 of the Pensions Act of 1995 . . . or otherwise." (emphasis added.)

(*Id.* at ¶ 52. (emphasis added.))

In this case, the Trustees' attorneys contacted the Pensions Regulator in June 2006, prior to the Debtors entering into chapter 11, to raise their concerns about the Schemes.[17] Following a meeting the TPR had with SCL on July 24, 2006, the TPR wrote to SCL on September 29, 2006 to notify it that "it is our view that the Sea Containers Group may be subject to a financial support direction under section 43 of the Pensions Act 2004."[18] Warning notices in relation to each scheme were sent to SCL on October 19, 2006 and representations were received from the parties. Amended Warning Notices were issued on 26 April 2007 and representations were again received from the Parties. SCL requested an oral hearing, which then took place during June 12 and 13, 2007. Following the hearing, the Determinations Panel issued determination notices on June 15, 2007 for both Schemes, which stated that FSDs would be issued within 28 days unless an appeal to the Pensions Regulator Tribunal was made requiring SCL "to put in place financial support in the form of arrangements falling within section 45(2)(b) of the Act whereby [SCL] is liable for the Employer's pension liabilities (as defined in section 45(4)(b) of the Act) in relation to the Scheme which may become due to the Trustees of the Scheme from the Employer by virtue of Section 75 of the Pensions Act, the ('Section 75 Debt'.)"[19] Specifically, the Determination Notice for the 1983 Scheme stated that "[t]he most recent estimate of that

17 As Mr. Evans noted, it is entirely appropriate for scheme trustees to communicate with TPR. Trial Ex. 16 ¶ 45-46. Indeed, under certain circumstances, reporting to TPR is mandatory. It is noteworthy that the Determinations Panel addressed the argument that the TPR was acting with undue haste and rejected it outright. *See* Reasons of the Determinations Panel of the Pensions Regulator issued on June 15, 2007 ¶ 34(1), 47, attached as Appendix 24 to Evans' Report.

18 *See* Reasons of the Determinations Panel of the Pensions Regulator issued on June 15, ,2007 ¶¶ 12-18, attached as Appendix 24 to Trial Ex. 17.

19 *Id.*

Section 75 Debt (effective date 8 June 2006) was £73,691,342."[20] The Determination Notice for the 1990 Scheme noted that "[t]he most recent estimate of that Section 75 Debt (effective date 31 March 2006) was £17,587,332."[21] After SCL withdrew its appeal to the Pensions Tribunal,[22] the Determinations Panel issued on February 5, 2008 FSDs against SCL with respect to both Schemes, directing SCL to put in place within 30 days satisfactory arrangements for any debt which "may become due" to the trustees of the Schemes from SCSL "by virtue of section 75 of the Pensions Act 1995 or otherwise."[23]

As described in much detail above (*see* Background Section *supra*), SCL entered into the Settlement agreement on February 8, 2008. The Settlement is based on a Section 75 debt, estimated by the Schemes' Actuary as at November 30, 2007.[24] Although the SCL Committee argues that the settlement agreement should be premised on a different basis (such as the "prudent investor" or the "technical provisions"), Mr. Evans' expert report makes it abundantly clear that any basis other than a Section 75 debt would be unacceptable to the Trustees, PPF and the TPR. *See* Trial Ex. 16 at ¶ 76 ("I would not expect the Pensions Regulator to be satisfied with an arrangement which calculated the claim on a basis that does not accord with Section 75

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20 *Id.*

21 *Id.*

22 It should be noted that the SCL Committee was made aware of all submissions before the Determinations Panel and refused to join SCL in the appeal to the Pensions Tribunal. Once the Settlement was obtained, the appeal was withdrawn by SCL.

23 *See* FSDs dated February 5, 2008, attached as Appendix 25 to Trial Ex. 17. Note that although this is the first time an FSD has been issued, the act under which the TPR received powers to issue an FSD was enacted only in 2004. (Trial Ex. 16 at ¶¶ 13 and 16.)

24 As explained in Mr. Evans' expert report with respect to a Section 75 debt certification, under English law, there is little to no room to challenge the Actuary's calculations and, once a Section 75 debt is triggered, the scheme's actuary is the only person who may certify the amount of the debt. (Trial Ex. 16 at ¶¶ 56.8-56.9.) While the estimated Section 75 debt has not yet been certified in this case (with respect to the SCSL debt), the due diligence conducted by the Debtors' advisers indicates that the Actuary's estimate is reasonable. *See* Section III.A, *infra*.

and the Employer Debt Regulations. In substance, the Bankruptcy Court would be declining to admit the proof of claim in relation to the Section 75 debt and substituting a claim calculated on a non-statutory basis for the statutory debt.").[25]

Consequently, absent an acceptable settlement, the TPR will likely issue contribution notices against SCL for SCSL's full Section 75 debt. As Mr. Evans opined:

> SCL is now obliged to make arrangements under which it is liable for SCSL's Section 75 debt, failing which I would expect a contribution notice in the amount of that debt to be issued against SCL. Thus the amount of the liability arising under the FSD is SCSL's Section 75 debt.

(Trial Ex. 16 at ¶ 61.1.) Once a contribution notice issues, "the Regulator may, on behalf of the trustees or managers of the scheme, exercise such powers as the trustees or managers have to recover the debt." Section 49(4) of the 2004 Act.[26] Needless to say, TPR is not a party to these Chapter 11 proceedings and has not submitted itself to the jurisdiction of this Court.

In sum, notwithstanding the SCL Committee's protestations to the contrary, the fact that a Section 75 debt has not been technically triggered is of no moment.[27] In fact, Mr. Evans addressed this exact same point in his report, leaving no room for doubt that SCL's liability under the issued FSD is present and not contingent:

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[25] As explained in more detail in the Evans Report, the Trustees would be careful not to jeopardize the Schemes' eligibility to enter the PPF. PPF regulations provide that a scheme ceases to be eligible for PPF when the trustees enter into an agreement with the employer which reduces the amount of debt due to the scheme under Section 75. Trial Ex. 16 ¶ 75. In this context, it should be noted that the TPR has indicated that "it would be minded to approve" the arrangements proposed in the framework of this settlement agreement as acceptable financial support pursuant to the FSDs. *See* the Pensions Regulator letter to SCL dated April 23, 2008, attached as Appendix 59 to Evans' Report.

[26] *See also* Trial Ex. 16 at ¶ 50.

[27] Similarly, whether or not the Trustees plan on buying out the Schemes following the approval of the settlement is likewise irrelevant. As Mr. Evans explained in his report, the quantification of a Section 75 debt is prescribed by English law and is irrespective of the trustees' actual intentions with regard to the application of scheme assets. Specifically, Mr. Evans noted that "even if the trustees decided (for whatever reason) not immediately to buy out all benefits by purchasing annuities, the actuary is still required to calculate the section 75 debt on the assumption that this is what will be done." (Trial Ex. 16 at ¶ 35.)

> I understand that no trigger event has yet occurred in relation to SCSL . . . . In those circumstances, SCSL's Section 75 debt remains contingent. However, as explained above, SCL's liability under the FSD (or any ensuing contribution notice) is a ***present*** liability: the liabilities which it is obliged to arrange to assume under the FSD, and the amount which it would in default be required to pay under a contribution notice, include SCSL's contingent Section 75 debt: *see* sections 45(4)(b), 48(2)(b) and 51(2) of the 2004 Act.

(*Id.* at ¶ 61.2. (emphasis added); s*ee also id.* at ¶ 68(6.))

2. The FSDs Issued By The Pension Regulator Are Not Void And Cannot Be Ignored

The SCL Committee argues that, to the extent the Settlement is based on the issuance of the FSDs, The Settlement is an unreasonable exercise of the Debtors' business judgment. First, the SCL Committee argues that the FSDs were "procured" by the Trustees and "issued" by TPR in violation of the automatic stay imposed by section 362 of the Bankruptcy Code. (*See* Objection at 54-62.) Second, the SCL Committee argues that even if TPR's issuance of the FSDs did not violate the automatic stay, this Court should accord no recognition to the FSDs based on principles of comity because their issuance supposedly "flouts the sovereign interests of the United States in the conduct of judicial proceedings before its courts." (*Id*. at 63.) Both of these arguments wrongly analyze the issue before this Court and should be rejected.

As a factual matter, the SCL Committee's depiction of events surrounding the FSD proceeding neglects certain important facts. The Objection portrays the issuance of the FSDs as a "collaborative" and even conspiratorial effort by the Trustees, the SCSL Committee and TPR, outside of the purview of this Court, to procure for the Schemes a "quasi-judicial determination of a disputed *claims* issue," and to "usurp this Court's jurisdiction to allow claims" in a manner that affronts the dignity of this Court. (Objection at 62-63.) But the Objection fails to explain why, if the SCL Committee believed the FSD proceeding was such a gross violation of this Court's jurisdiction, it took no action to notify the Court or enjoin the proceeding.

The SCL Committee cannot assert that it was unaware of the proceedings before the Pensions Regulator.  Indeed, it was fully aware of the FSD proceeding long before the Determinations Panel hearing.  The SCL Committee was aware, for example that the Debtors were working with the SCSL Committee on a stipulation to allow the FSD proceeding to go forward short of enforcement.  When negotiations over the stipulation broke down, the Debtors consulted with the SCL Committee before confirming to the Trustees that Debtors would not invoke the automatic stay to challenge the FSD process (while reserving all rights in connection with any enforcement action), though both the Debtors and the SCL Committee knew the Trustees would be involved in the Determinations Panel proceedings.  Finally, the SCL Committee itself was actively involved in the Debtors' efforts to prepare its defenses for presentation to the Determinations Panel and, through its counsel, attended the entire proceeding (although the SCL Committee declined to have direct representation at the hearing .)

In any event, one of the main issues before the Court is whether the Settlement is reasonable in light of the risk that TPR or the Schemes will commence proceedings to enforce the FSDs against the Debtors or the non-debtor participating employers in the United Kingdom or some other forum if the Settlement is not approved.  As discussed below (Section I.C.2(A), *infra*), because a significant risk exists that U.K. courts would not defer to the Chapter 11 process and enforce the stay, the Settlement in this regard is eminently reasonable.  Nevertheless, the Debtors address below the SCL Committee's arguments with respect to the propriety of recognizing the FSDs issued by the U.K. Pensions Regulator.

(A) The Issuance of The FSDs Did Not Violate The Automatic Stay

Turning first to whether the issuance of the FSDs in fact violated the automatic stay, TPR had authority to issue the FSDs notwithstanding the automatic stay, as an exercise of its police and regulatory power.  The SCL Committee asserts that the FSDs are void because "[t]he

Trustees and the Services Committee actively sought, post-petition, to assess a direct claim against SCL through the FSD process" in contravention of section 362(a) of the Bankruptcy Code. (Objection at 55.) While true that section 362(a) can enjoin, among other things, "any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case," section 362(b)(4) exempts "the commencement or continuation of an action or proceeding by a governmental unit" to enforce such governmental unit's "police and regulatory power." *See Penn Terra Ltd. v. Dep't of Envtl. Res.*, 733 F.2d 267, 271-72 (3d Cir. 1984).[28]

The Debtors addressed this point in the Motion, comparing the actions of TPR and the Determinations Panel to regulatory actions by more familiar U.S. analogs, such as the Equal Employment Opportunity Commission, the National Labor Relations Board and the Secretary of Labor acting under the Employee Retirement Income Security Act of 1974, 29 U.S.C. Section 1001 *et seq*. ("ERISA"). (*See* Motion at ¶¶ 87-88.) The Motion also cites a number of cases in which courts have held that actions taken by these agencies to assess a debtor's monetary liability under statutory schemes falls within the Section 362(b)(4) exemption. (*See id.*) And, in fact, the only evidence before this Court on TPR and the Determinations Panel demonstrates that they have authority and functions with respect to U.K. pension schemes similar to those of the pension insurance program established by Title IV of ERISA and the Secretary of Labor and the Pension Benefit Guaranty Corporation (the "PBGC") with respect to U.S. pension plans. (*See* Trial Ex. 16 at ¶¶ 16-17, 38, and 45-47.) To the extent that comparable

[28] It is worth noting that none of the cases cited by the SCL Committee with respect to section 362(a) implicate section 362(b)(4). (*See* Objection at 56-57 (citing *In re Rimsat, Ltd.*, 98 F.2d 956 (7th Cir. 1996; *Maritime Elec. Co., Inc. v. United Jersey Bank*, 959 F.2d 1194 (3d Cir. 1991); *In re Berman*, 352 B.R. 533 (Bankr. D. Mass. 2006); *In re Weber*, 283 B.R. 630 (Bankr. D. Mass. 2002); *In re 110 Beaver St. P'ship*, 244 B.R. 185 (Bankr. D. Mass. 2000); *In re Nakash*, 190 B.R. 763 (Bankr. S.D.N.Y. 1996).) Thus, for the reasons discussed below, the lengthy discussion of these cases in the Objection does not address the issue that is before the Court.

U.S. governmental entities are exempted by Section 362(b)(4), there is a strong argument that the same exemption should apply to TPR.

The Objection completely ignores the Debtors' Motion on these points. Instead, the SCL Committee asserts that Section 362(b)(4) must be narrowly construed to exempt from the automatic stay only "certain non-pecuniary assertions of governmental power." (*See* Objection at 58.) The Objection then argues that because of the participation of the Trustees in the proceedings before the Determinations Panel and their "collaboration" with TPR, issuance of the FSDs does not fall within the Section 362(b)(4) exemption. In particular, the SCL Committee argues that "[f]irst, the U.K. proceeding was focused on pecuniary rights, not police or regulatory power. Second, the proceeding was commenced and continued for the protection, not of governmental rights, but of private creditor rights." (Objection at 58.)

On each of these points the SCL Committee is wrong. First, under Section 362(b)(4), the SCL Committee's call for a narrow interpretation is contrary to Third Circuit authority directly on point. *See Penn Terra*, 733 F.2d at 273 ("we find that the exception to the automatic stay provision contained in subsections 362(b)(4)-(5) should itself be construed broadly, and no unnatural efforts be made to limit its scope"). In *Penn Terra*, the Third Circuit specifically discussed Representative Don Edwards' floor remarks during the House debate concerning the "narrow" interpretation of section 362(b)(4), found them unhelpful, and declined to follow their guidance. *See id.* at 274 ("Those remarks, however, do no more than state the very problem which we are required to resolve."); *see also In re Reliance Group Holdings, Inc.*, 273 B.R. 374, 384 (Bankr. E.D. Pa. 2002) (Carey, J.).

Second, the SCL Committee's argument that TPR's interest in issuing the FSDs was "pecuniary" misapplies and misconstrues the term as it has been applied in the context of section

362(b)(4). The SCL Committee relies on *Missouri v. U.S. Bankruptcy Court*, 647 F.2d 768, 776 (8th Cir. 1981), which—unlike the case presently before this Court—involved circumstances in which a governmental actor sought to assert direct physical control over estate property. *But see In re Commonwealth Cos., Inc.*, 913 F.2d 518, 524 (8th Cir. 1990). By contrast, in *Commonwealth*, the Eighth Circuit distinguished the "pecuniary interest" at issue in *Missouri* from the regulatory interest at issue in cases in which a governmental entity merely seeks to fix the amount of a claim against the estate—much like issuance of the FSDs in this case. *See id.* at 524 (disagreeing with "a number of bankruptcy court decisions that have applied the 'pecuniary interest' notion in such a way as to effectively preclude the application of Section 362(b)(4) to any action or proceeding that includes a significant pecuniary element"), *cited with approval by In re Univ. Med. Center*, 973 F.2d 1065, 1075 n.11 (3d Cir. 1992). The SCL Committee's reliance on the Eighth Circuit's *Missouri* decision, therefore, is misplaced: it does not address whether the action taken by TPR in issuing the FSDs is in furtherance of a "pecuniary interest." Rather, *Commonwealth*, a later decision of the same court, suggests that TPR action would not be considered to advance a "pecuniary interest." The other cases cited by the SCL Committee also are not applicable.[29]

More instructive in this instance are the numerous cases which have recognized that actions taken by the Secretary of Labor or the PBGC to enforce the provisions of ERISA and fix a debtor's prepetition pension liabilities fall under Section 362(b)(4), notwithstanding the fact that enforcement will inure to the pecuniary benefit of a debtor's employees or will prevent a

[29] For instance, *In re Organized Maint., Inc.*, 47 B.R. 791, 795 (Bankr. E.D.N.Y. 1986), *vacated as moot, Organized Maintenance, Inc. v. Brock*, 69 B.R. 298 (E.D.N.Y. 1987), which is repeatedly cited by the SCL Committee, was not only vacated by the district court but declared to be "of no precedential value." *Brock*, 69 B.R. at 299. Moreover, the case's analysis of section 362(b)(4) has been roundly criticized as "problematic" and "simplistic." *In re Career Consultants, Inc.*, 84 B.R. 419, 422, 424 (Bankr. E.D. Va. 1998), *cited with approval, Commonwealth*, 913 F.2d at 525.

pecuniary loss to the pension insurance fund. *See generally Pension Benefit Gua. Corp. v. LTV Corp. (In re Chateugay Corp.)*, 87 B.R. 779 (S.D.N.Y. 1988) ("*Chateugay*"), *rev'd on other grounds*, *Pension Benefit Guar. Corp. v. LTV Corp.*, 875 F.2d 1108 (2d Cir. 1989) ("*LTV I*"), *rev'd on other grounds*, 496 U.S. 633 (1990) ("*LTV II*").[30] In *Chateugay*, 87 B.R. at 784, for example, the PBGC issued a Notice of Restoration directing the debtor to resume full responsibility for funding and administering three of its prepetition pension plans, and the debtor moved the court for an order finding that this action violated the automatic stay. After the debtor obtained an order to show cause from the bankruptcy court, the PBGC successfully moved to withdraw the reference of the matter to the district court. *Chateugay*, 87 B.R. at 792.

The PBGC moved for summary judgment on the order to show cause, and the district court held that Notice of Restoration was exempted from the automatic stay by section 362(b)(4). *Chateugay*, 87 B.R. at 803. The district court rejected the debtor's arguments that the PBGC's interest in restoring the plans was merely pecuniary, saying:

> [i]n enacting Title IV, Congress recognized that the financial security and the well-being of the employees whose pensions Title IV insures are virtually inseparable interests. *See* 29 U.S.C. Section 1001(a.) Thus, as the court astutely observed in *In re Century Brass Products, Inc.*, No. 85 Civ. 585, slip op. (D. Conn. Nov. 24, 1986), "[i]t is hard to imagine any action taken by the PBGC that did not involve its pecuniary interest." *In re Century Brass*, slip op. at 11. Unlike employment discrimination or environmental laws, which arguably have a more

[30] *See also Dole v. Hansbrough*, 113 B.R. 96, 97-98 (D.D.C. 1990) ("Although the Secretary [of Labor] seeks to adjudicate the rights of the Plan's beneficiaries, any monetary amounts recovered will go to those beneficiaries, and not the government. More important, suits such as this one were clearly intended to further an important public policy. They were intended to secure more than just private rights."); *Sec'y of Labor v. Incor, Inc.*, 10 Employee Benefits Cas. (BNA) 2661, 2664 (B.A.P. 9th Cir. 1988); *McLaughlin v. Craig*, 10 Employee Benefits Cas. (BNA) 1437, 1440 (N.D. Tex. 1988) ("actions brought by the Secretary to enforce provisions of ERISA are actions to effectuate public policy, and incidental benefits from the enforcement of the Act should not convert such enforcement from one of public policy to one characterized by as an adjudication of individual rights."); *Donovan v. Porter*, 584 F. Supp. 202, 206-07 (D. Md. 1984) ("Courts have distinguished actions of governmental agencies where the sole concern of the agency is to protect the agency's pecuniary interest in property and found those actions to be subject to the automatic stay. . . . However, here, the government seeks only to enforce the provisions of ERISA and to assess a penalty for the violation of those provisions. This is clearly the type of regulatory action Congress had in mind when it developed the exceptions to the automatic stay provision.").

> direct impact on the non-monetary aspects of the public health and welfare, Title IV of ERISA provides for the health and welfare of employees by securing their pecuniary interests. In carrying out its statutory obligations under Title IV, the PBGC is, therefore, authorized to take certain actions to protect itself from unreasonable or unnecessary pecuniary loss.

*Id.* at 805.[31] On appeal, the Second Circuit reversed the district court's ruling on other grounds but specifically agreed with the district court that issuance of the Notice of Restoration by the PBGC was exempted from the automatic stay by section 362(b)(4). *LTV I*, 875 F.2d at 1020. The United States Supreme Court later reversed and remanded the Second Circuit's decision but did so on grounds unrelated to the section 362(b)(4.) *See generally LTV II*, 496 U.S. 633.

Here, the SCL Committee asserts that TPR's purpose is "pecuniary" because TPR was established "to protect the benefits of pensioners under occupational pension schemes" and "to reduce the risk of compensation being payable to pensioners from the PPF." (Objection at 7 (citing Section 5(1)(a) and (c) of 2004 Act.) This rhetorical turn flatly ignores the case law with respect to TPR's American analogs: the PBGC and the pension insurance program established by Title IV of ERISA. The case law is clear that the PBGC may take regulatory action which is exempted from the automatic stay by section 362(b)(4)—even though that action may ultimately result in a pecuniary benefit of individual pension beneficiaries, or even the Title IV pension insurance program—including determining the liability of a debtor for prepetition pension obligations.

In any event, assuming (for argument's sake only) the Trustees' actions violated the automatic stay, it has no bearing on TPR's issuance of the FSDs. TPR is not, for example, merely an administrative tribunal that may only act upon a complaint or petition filed before it.

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31 It is worth noting that the cases cited by the debtor *Chateugay*, and found to be unhelpful and unpersuasive by the district court, were the very same that have been cited by the SCL Committee in the Objection. *Compare* Objection at 58-59 *with Chateugay*, 87 B.R. at 805 n.20.

The evidence demonstrates that, much like the PBGC under ERISA, TPR has independent authority, and even an obligation, under English law to review the funding level of U.K. pension schemes, issue FSDs if the statutory criteria are met, reduce the risk of situations which may lead to compensation having to be paid from the Pension Protection Fund and take other actions to carry out the public policy of the United Kingdom to protect benefits under pension schemes. (*See* Motion at ¶ 22; Section 5(1) of 2004 Act; Trial Ex. 16 at ¶ 73.) TPR has never consented to the jurisdiction of this Court or to be bound by the automatic stay. The SCL Committee's assertion that the FSDs are void because private parties brought the matter to TPR's attention and advocated for action finds no support in any of the cases cited in the Objection or evidence presented to this Court. Indeed, legislation and TPR Guidelines establish circumstances in which scheme trustees have a positive duty to update TPR as to the status of the scheme, such as when the scheme is underfunded or the employer commences insolvency proceedings. *See* Trial Ex. 16 at ¶ 45-46; *see also* section 70 of the 2004 Act.

(B) This Court Should Recognize The Settlement Based On The FSDs Issued By The Pensions Regulator

In light of the foregoing discussion of TPR's role, it should also be clear that the SCL Committee's comity arguments are misplaced. First, the SCL Committee's suggestion of a nefarious conspiracy between the Trustees and TPR against the Debtors' is not consistent with the facts. Indeed, the evidence demonstrates that TPR often works closely with pension scheme trustees to ensure that schemes are properly administered and adequately funded. (*See* Trial Ex. 16 at ¶¶ 45-46.) Second, as discussed above, there is a strong argument that, contrary to the SCL Committee's suggestions, in issuing the FSDs, TPR was fulfilling its statutorily directed role in a manner that would not offend "the sovereign interest of the United States in the conduct of judicial proceedings before its courts" if a similar action were taken by a domestic regulatory agency, such as the PBGC.

Third, the true issue with respect to comity, which the Objection does not address, is whether an English court would give comity to the automatic stay with respect to the FSDs or wind-up or insolvency proceedings against SCL. As discussed herein (Section I.C.2(A), *supra*), there is a significant risk that a U.K. court would not defer to the Chapter 11 proceeding and enforce the automatic stay. Moreover, there is no guarantee that the Trustees or TPR will not take action against the Debtors' non-debtor affiliates (*see* Section II.A, *supra*), which could implicate any number of possible litigation venues and raise even more difficult questions with respect to choice of law issues and comity for the automatic stay.[32]

It was precisely in part to avoid the cost and uncertainty that such a fight would bring (and the ensuing jeopardy posed to the Debtors' reorganization efforts) that the Debtors concluded in the exercise of their business judgment that they should enter into the Settlement. The existence of the automatic stay does not change the practical difficulties the Debtors would face in seeking to enforce the automatic stay in other jurisdictions where the Schemes could litigate, such as the United Kingdom. Nor does it invalidate a settlement which takes litigating that issue into account. In discussing comity, the Objection does not address these difficult,

[32] The automatic stay does not apply to actions taken by the Trustees' or TPR against the Debtors' non-debtor affiliates, nor does it preclude a wind-up of the Schemes themselves, since the Schemes and their assets are not property of the estates. *See, e.g., Chugach Timber Corp. v. N. Stevedoring & Handling Corp. (In re Chugach Forest Prods., Inc.)*, 23 F.3d 241, 246 (9th Cir. 1994); *Teachers Ins. & Annuity Ass'n v. Butler*, 803 F.2d 61, 65 (2d Cir. 1986); *Adv. Ribbons & Offics Prods., Inc. v. U.S. Interstate Destrib., Inc. (In re Adv. Ribbons & Office Prods.)*, 125 B.R. 259, 263 (B.A.P. 9th Cir. 1991); *In re Winer*, 158 B.R. 736, 743 (N.D. Ill. 1993); *Local 478 Trucking & Allied Indus. Pension Fund v. Jayne*, 778 F. Supp. 1289, 1324-25 (D.N.J. 1991); *In re Cardone Realty Corp.*, 99 B.R. 202, 205-06 (W.D.N.Y. 1989); *Cornick v. Hi Grade Cleaners, Inc.*, 595 F. Supp. 718, 246 (D.C. Ill. 1984). Moreover, even assuming this court were to find that the presence of unusual circumstances justified extending the automatic stay to cover actions against the non-debtor affiliates, or even a winding-up of the Schemes, *see, e.g., A.H. Robins Co. v. Peccinin (In re A.H. Robins Co.)*, 788 F.2d 944 (4th Cir.), *cert. denied*, 479 U.S. 876 (1986), the Debtors would still be faced with the obstacle of enforcing the stay in the United Kingdom and possibly other foreign jurisdictions.

substantive issues. Instead, it merely seeks to provoke indignation that TPR has taken action with respect to the regulation of two U.K. pension schemes. The SCL Committee hopes that, as a result, this Court will reject the Settlement, notwithstanding the fact that entering into the Settlement is a matter within the Debtors' reasonable business judgment, and irrespective of the potential devastating consequences to the estates in the event the Settlement is not approved.

3. The FSDs Do Not Constitute An Impermissible Penalty

Recognizing the emptiness of their argument that the FSDs issued by the Pensions Regulator are void, the SCL Committee has cobbled together a novel fall-back argument that the Court should construe a Section 75-based claim, in part, as a penalty claim subject to subordination. The SCL Committee, however, does not, and cannot, cite any precedent supporting the proposition, either under U.S. or English law.

As explained above, pursuant to section 75 of the 1995 Act, upon the occurrence of a triggering event, a defined benefit pension scheme deficit is calculated pursuant to the "buy-out" method. This is not a penalty. This is the method prescribed by the U.K. legislature. (Trial Ex. 16 at ¶¶ 33-37.) That the Section 75 "buy-out" valuation translates into a higher claim than under the "prudent investor" standard advocated by the SCL Committee does not render the differential a "penalty." Similarly, ERISA set forth a methodology for calculating a pension plan deficit which, like the Section 75 "buy-out" methodology, results in a more conservative calculation of a rate of return, and thus the size of the necessary asset pool to cover a pension plan's liabilities than the prudent investor standard. See, e.g., 29 U.S.C. Section 1391; *see also Kaiser Aluminum*, 339 B.R. at 96 (rejecting argument that DBGC settlement amount must be calculated at the "prudent investor rate").

Indeed, the cases cited by the SCL Committee support the conclusion that the Section 75 debt should not be treated in whole, or in part, as a penalty. Thus, for example, in *Erlin Manor*

*Nursing Home, Inc. v. Rate Setting Comm'n of Mass. (In re Erlin Manor Nursing Home, Inc.)*, 36 B.R. 672, 678-79 (Bankr. D. Mass. 1984), the court explained that "[a]n obligation is a penalty if its amount is measured neither by the obligee's loss nor by the valuation placed by him upon what he has given in exchange." *Id.* at 679. But Section 75 is intended to do exactly that -- namely to measure a scheme's loss by assuming that the liability to provide pension and other benefits would be met by the purchase of annuities. In this regard, the Court should decline the SCL Committee's implicit invitation to revisit a U.K. legislative directive.

Similarly unavailing is the SCL Committee's argument that Section 726(a)(4) of the Bankruptcy Code should apply here (*See* Objection at 50-51, 70-72.) Section 726(a)(4) applies to "fine[s], penalt[ies], forfeiture[s], or damages [that] are not compensation for actual pecuniary loss suffered by the holder of such claim."[33] The legislative history further evidences that the intent of Section 726(a)(4) was to subordinate *punitive* claims. "Paragraph (4) provides that *punitive* penalties, including pre-petition tax penalties, are subordinated to the payment of all other classes of claims . . . ." S.Rep. No. 95-989 at 97, reprinted in, 1995 U.S.C.C.A.N. U.S. Code Cong. & Admin. News at 5883 (emphasis added.) But there is nothing punitive about a Section 75 debt. It is the prescribed method under English law for determining the amount of money necessary to ensure a pension scheme is fully funded in a manner that shields its beneficiaries, as much as possible, from any further market risk upon the occurrence of certain events such as the insolvency of the employer (*see* Trial Ex. 16 at ¶¶26-35.) It is therefore not subject to subordination under Section 726(a)(4.)

Finally, and apparently as part of its "penalty" argument, the SCL Committee believes that Section 541(c) of the Bankruptcy Code precludes the Settlement. The SCL Committee

[33] The Debtors take no position at this time regarding the applicability of Section 726(a)(4) to chapter 11 cases.

appears to argue that any increase in the Trustees' claims beyond the SCL Committee's of calculation of the Schemes' "Actual Damages" would reduce estate property because the estates would have less of a reversionary interest in the Schemes' assets. Section 541(c) provides that a debtor's interests in property become property of the estate notwithstanding, *inter alia*, the insolvency or financial condition of the debtor. It does not, however, address a debtor's reversionary interest in property. Also, it in no way speaks to the issue of allowance or disallowance of claims against estates. Taken to its logical extreme, the SCL Committee's argument implies that any claim greater than zero against assets in which a debtor has a reversionary interest should be disallowed under Section 541(c), as the estates reversionary interest would by definition shrink. This argument is obviously absurd and should be rejected.

### D. EVEN IGNORING THE FSDS, A NUMBER OF EVENTUALITIES MAKE THE IMMEDIATE TRIGGERING OF SCSL'S SECTION 75 DEBT LIKELY

As discussed above, the SCL Committee would have this Court simply ignore the FSDs issued against SCL. For a variety of reasons discussed above (Section I.A.C) and below (Section II.A), this Court should not -- and cannot -- ignore their existence. But even ignoring the FSD, it is apparent that a Section 75 debt is not a "remote" possibility, as the SCL Committee would have this Court believe, but rather a significant and likely possibility. Indeed, the evidence will demonstrate that the Trustees have taken steps that would allow them -- if the Settlement is not approved -- to crystallize the SCSL Section 75 debt immediately, so that under the 2004 Act it is no longer contingent. Moreover, as described below, there are a number of other eventualities that may cause an immediate triggering of the SCSL Section 75 debt, some of which have already triggered Section 75 debts against other participating employers.

The Settlement creates an environment making it more likely that the Trustees would forebear from winding-up the Schemes. Absent a settlement, the Trustees are induced to take certain steps, including winding up the Schemes, which would -- as the SCL Committee concedes -- immediately trigger a Section 75 debt.[34] The Trustees' testimony makes it abundantly clear that, in light of the settlement, the Trustees do not plan on winding-up the Schemes until they know the amount of proceeds they will actually receive in the bankruptcy proceeding, at which point they will evaluate whether they are able to continue operating the Schemes. (Trial Ex. 54 at 27-33; Trial Ex. 55 at 54-59, 64-69.) This testimony, however, should not be confused with the conclusion which SCL's Committee wishes -- incorrectly and misleadingly-- to draw: that it is unlikely that the Schemes will wind-up in the next few years. (Objection at 44.) In fact, as the 1983 Scheme's independent trustee, Ms. Fryer, made clear, absent the Settlement a wind-up is all but "inevitable." (Trial Ex. 54 at 37:4-10, *see also* Trial Ex. 55 at 65:8-11: "It is just not feasible to run a scheme of this size with no new money going in and assets just having to be dissipated to do the ongoing costs and pay things like the PPF levy.")

Consequently, absent the settlement which is based on a Section 75 liability, Mr. Evans has opined that he "would expect the Trustees of the Schemes or the Pensions Regulator to take steps to recover monies from SCL to meet the [Section 75] liability." (Trial Ex. 16 at ¶ 78.) Indeed, as noted in Mr. Evans' Report, the Trustees have taken the necessary steps that would enable them to wind-up the Schemes immediately. Specifically, on October 12, 2006, the

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34 Although the SCL Committee has argued that Trustees are barred from winding up the Schemes due to the automatic stay (Objection at 44), as was stated by the Trustees prior to the filing of these bankruptcy petitions, and the SCSL Committee and Trustees reiterated throughout these cases, the Trustees fully reserved all right to pursue such remedies, *see*, *e.g.*, Response of the Official Committee of Unsecured Creditors of Sea Containers Services Ltd. to Debtors' Motion to Extend Their Exclusive Periods to File and Solicit Votes for Their Chapter 11 Cases at 6 (Docket No. 1030.)

In any event, as explained below, even if the Trustees are prevented from winding up the Schemes due to the automatic stay, under Section 11(1)(c) of the 1995 Act, the Regulator may order a wind-up if "it is necessary in order to protect the interests of the generality of the members of the scheme that it be wound up." *See* Appendix 6 to Trial Ex. 17.

Trustees of the 1983 Scheme made a demand on SCSL for £87,988,999.[35] Barring arguments such as lack of due process, SCSL's failure to pay that amount constitutes a winding-up trigger, enabling the Trustees of the 1983 Scheme to wind-up that Scheme. Trial Ex. 16 ¶ 81. In this context it extremely important to note that although SCL is no longer a participant in the 1983 Scheme, it will continue to be responsible for SCSL's Section 75 debt and liable for it as a "former employer." *See* Trial Ex. 16 at ¶¶ 60, 68(5), and 81; *see also* Regulation 9(1), 9(3) of the Employer Debt Regulations, attached as Appendix 21 to Trial Ex. 17. As a result, once the Trustees (or Regulator) wind-up the 1983 Scheme, a Section 75 debt will crystallize instantly in the amount in which the Scheme's Actuary certifies.[36]

Similarly, the Trustees of the 1990 Scheme made a demand against SCSL and two other companies, requiring them to provide the funding necessary to restore the Scheme to solvency. The demand against SCSL was for £15,828,599.[37] Assuming the demand is valid and the sum is not paid, the 1990 Scheme could be wound up and a Section 75 debt would be triggered under the 1990 Scheme as well. (Trial Ex. 16 at ¶ 82.)

Moreover, as the Objection acknowledges, a triggering event may occur upon insolvency of the employer or withdrawal from the scheme. (Objection at 6.) Consequently, upon the insolvency of SCSL or its withdrawal from the Schemes, a Section 75 debt will crystallize.

In short, there is nothing in the record that would demonstrate that, absent a settlement, the Schemes' winding up or the triggering of a Section 75 debt by other means is a "remote"

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35 *See* demand letter, attached as Appendix 57 to Trial Ex. 17.

36 *See* Trial Ex. 16 at ¶ 56.8-56.9.

37 *See* demand letter dates September 13, 2006, attached as Appendix 58 to Trial Ex. 17.

possibility. Indeed, the SCL Committee's position is ironic -- absent a settlement, the triggering of a Section 75 debt is all but inevitable.

### E. THE TECHNICAL PROVISIONS ARE IRRELEVANT TO THE ISSUE OF MEASURING A SECTION 75 DEBT

The SCL Committee has argued that the "Actual Damage Measure - as calculated on the Technical Provisions as prescribed by the Statutory Funding Objective of the 2004 Act or under the prudent investor rule -- is the proper method to measure the Trustees' Claims." Objection at 45. This argument, however, demonstrates the SCL Committee's complete misunderstanding of the "technical provisions" and the way they operate. First, the argument ignores that the FSDs issued in this case are required by statute to be measured by Section 75 and not by the technical provisions. Second, and significantly, the argument ignores the fact that technical provisions may be modified to take into account the fact that the employer is insolvent and consequently could require contributions up to the full Section 75 debt. Lastly, the argument ignores the fact that the technical provisions on which the SCL Committee relies to demonstrate the supposed "Actual Damage Measure" were introduced in 2005, long before the Debtors entered into Chapter 11, and have not been updated since.

As explained above (*see* Section I.B, *supra*), the technical provisions were introduced by the 2004 Act. Under the 2004 Act, when a scheme is ongoing, the statutory funding objective requires it to be funded to at least the level of its "technical provisions." A scheme's "technical provisions" means the amount required, on an actuarial calculation, to make provision for the scheme's liabilities. (Trial Ex. 16 at ¶ 20.) The trustees or managers of a scheme must determine the method and assumptions which are to be used in calculating a scheme's technical provisions, and must take advice from the Scheme Actuary before doing so. (*Id.*) Regular valuations at intervals of no more than three years must be obtained by the trustees to check whether the statutory funding objective is met. (*Id.* at ¶ 21.) If a full valuation is not obtained in any year, a less detailed report on funding, known as an "actuarial report," must be obtained instead. (*Id.*) The method selected for the valuation of the scheme depends on various factors. (*Id*. at ¶ 22.) In particular, when making decisions in relation to the scheme's technical provisions, the trustees should consider the strength of the employer's covenant to fund the scheme, *i.e.* its financial position and prospects as well as its willingness to continue to fund the scheme's benefits. (*Id.* at ¶ 23.) In the case of an employer which provides services to another company (such as SCSL), the financial position of the company to which it may look for support (here, SCL) must be considered by the trustees as part of this exercise too. (*Id.*)

Technical provisions, however, should not be confused with a Section 75 calculation. Indeed, the two are wholly unrelated. As explained above, when dealing with a Section 75 liability, the 1995 Act prescribes the calculation method, which is based on the presumption that the liabilities would be met by the immediate purchase of annuities. (*Id.* at ¶ 34.) It thus follows, as Mr. Evans explained, that "the quantification of a Section 75 debt has nothing to do with the calculation of contributions due under a schedule of contributions or the determination of a scheme's technical provisions." (*Id.*)

Moreover, as described above, technical provisions may be amended by taking into account the fact that an employer is insolvent. (Trial Ex. 16 at ¶ 23.) In fact, where an employer is insolvent, the trustees may amend the technical provisions, so that they reflect the employer's liability at a Section 75 level. Ms. Kennell, the 1990 Scheme Trustee, explained while addressing this point that "where the principal employer is insolvent or has an extremely poor covenant, then the technical provisions would be done on what is called the buyout basis." (Trial Ex. 55 at 50:9-12.) The fact that the Trustees have not yet amended the technical provisions in this case does not mean that they may not do so in the future, thereby rendering the SCL Committee's argument irrelevant, at best.[38]

Finally, the SCL Committee's argument regarding the technical provisions calculation is based on the 1983 Scheme actuarial report prepared as of December 31, 2006 (and signed in 2007.) (Objection 10-13.) What the SCL Committee intentionally fails to mention is that the actuarial report prepared as of December 31, 2006 was based on the technical provisions which were in place in 2005, long before the initiation of the chapter 11 proceedings. (Trial Ex. 58 at 53-54.) Because the 1983 Scheme was not required to amend its technical provisions in 2006 (as explained above, it would only be required to do so every three years), the actuarial report had to be based on the old technical provisions. As Mr. Hosegood, the 1983 Scheme's Actuary testified:

> The requirement is that the technical provisions of the statutory funding objective is followed and so the technical provisions follow the basis that was set at 31st December 2005 actuarial valuation. We would not have had, ***I would not have had a choice about what basis to use***.

Trial Ex. 58 54:4-10. (emphasis added.)

### F. THE U.S. PRUDENT INVESTOR STANDARD IS SIMPLY INAPPLICABLE HERE

As explained above (Section I.A, *supra*), there is a substantial risk that the Trustees' claims against the Debtors are governed by English law. Thus, under applicable English law, the buyout basis of valuation of liabilities is the only permissible method for calculating SCL's liability. Trial Ex. 16 ¶ 61.3. Yet, remarkably, the SCL Committee insists that SCL's liability

[38] It is important to note in this context that amending the technical provisions is a costly process which the trustees would not undertake unless they have no other alternatives. As Ms. Kennell, The 1990 Scheme Trustee testified: "[F]or the trustees to call for an actuarial valuation, which we have a right to do, it is an extremely expensive exercise. An actuarial valuation for a scheme like this would cost a lot and, as I have said or you appreciate, we are not trying to throw away the scheme funds on anything that is not absolutely necessary." Trial Ex. 55 at 45:25-46:8.

should be calculated not on the basis prescribed by English law, but rather by a "prudent investor rate" arguably applicable under U.S. law.

This argument, however, is destined to fail. First, as demonstrated above in Section I.A *supra*, it is English law that likely applies to these claims and therefore the prudent investor basis of valuation is simply inapplicable. *See* Trial Ex. 16 ¶ 56.6, 56.10. Second, even if this Court were to apply U.S. law to the Trustees' claims (which it should not), it is far from certain that the prudent investor rate would apply to a U.S. pension claim. *See, e.g., In re Rhodes, Inc.*,382 B.R. 550, 560 (Bankr. N.D. Ga. 2008) (holding that PBGC claims should be calculated under statutory ERISA rate as "PBGC is authorized by law to make a determination of the amount of claim that is binding on the [d]ebtors and therefore the Court"); *In re U.S. Airways Group, Inc.*,303 B.R. 784, 792-93 (Bankr. E.D. Va. 2003) (holding that ERISA rate, not prudent investor rate, applies to calculate pension claims because ERISA is the substantive law creating obligation that gave rise to claim.) Thus, this Court should reject the SCL's Committee's invitation to apply a standard which is inconsistent with U.K. pension law and does not even necessarily apply to U.S. pension claims.

## II. THE PARAMOUNT INTEREST OF THE CREDITORS IS SERVED BY THE SETTLEMENT BECAUSE, WITHOUT IT, THE ESTATE RISKS FACING A LIKELY MELTDOWN OF THE SCL GROUP AND FURTHER DEPLETION OF THE ESTATE ASSETS

### A. ABSENT THE SETTLEMENT, THE ESTATE FACES THE SUBSTANTIAL RISK OF A COMPLETE MELTDOWN OF THE SCL GROUP

Perhaps the most striking fact in this case is that absent a settlement based on a Section 75 debt, the estate faces a likely risk of a complete meltdown, which would topple the various entities in the SCL Group, including many non-debtors, and result in a substantial depletion of the estates' assets.[39] The facts that make this risk a possible, indeed likely, scenario, compelling the Debtors to seriously consider this eventuality when negotiating and agreeing on a settlement of the pension claims, are as follows:

- The Determinations Panel issued on February 5, 2008 FSDs against SCL with respect to both Schemes directing it to put in place within 30 days satisfactory arrangements for any debt which "may become due" to the trustees of the Schemes from SCSL "by virtue of section 75 of the Pensions Act 1995 or otherwise." (*See* Section I.C.1, *supra*.)

- In the absence of a settlement based on a Section 75 liability, the uncontroverted evidence presented by Mr. Evans is that it is likely "that the Pensions Regulator would not be satisfied that the arrangements proposed by SCL constituted sufficient financial support and therefore would decline to approve such arrangements." (Trial Ex. 16 ¶ 72.)

- The undisputed evidence on U.K. pension law is that if the Settlement were not based on a Section 75 calculation, "[i]t is likely that one or more of the English Court, the Pensions Regulator or the PPF would not be satisfied that the negotiations had been conducted properly." (*Id.* ¶ 74.)

- Consequently, the uncontradicted evidence concerning English law is that in the absence of a Section 75 settlement, the TPR will likely issue contribution notices against SCL for the full SCSL Section 75 debt. (*See*, Section I.C.1, *supra*; Trial Ex. 16 ¶ 48, 86, 86.1.)

- Contribution notices issued by the TPR are enforceable by the Pensions Regulator and, under certain circumstances, by the Pension Protection Fund. (*See* Section I.C.1, *supra*; Trial Ex. 16 ¶¶ 77.)

- The Pensions Regulator and the Pension Protection Fund are not parties to this Chapter 11 proceeding.

- The undisputed evidence on English law is that the U.K. courts would ***not*** impose the automatic stay in relation to a claim brought by the Pensions Regulator on behalf of the Trustees or by the Trustees, because under U.K. regulations, actions by regulators are excluded from the ambit of the cross border provisions. (Trial Ex. 16 ¶ 83, 85; Article 20.1 and 4 (b) of the Cross Border Insolvency Regulations, Trial Ex. 17, Appendix 41 at 5, 9.)

- Moreover, the uncontested evidence on English law will show that it is unlikely that the English Courts, or any other court applying English common law principles, such as the Court in Bermuda, will prevent the Pensions Regulator or the Trustees from enforcing a

[39] As noted above, the TPR has issued a letter in which it indicated it would be minded to approve the settlement which is the subject of this Motion. *See* Trial Ex. 16, Appendix 59.

contribution notice, where the U.S. bankruptcy court has refused to admit a pension claim based on a Section 75 liability. (Trial Ex. 16 ¶ 85.)

To summarize, absent a settlement based on a Section 75 liability, it is likely that the TPR will issue contribution notices against SCL for the full SCSL Section 75 liability and that the TPR will be allowed to enforce the contribution notices without being enjoined by the automatic stay imposed as a result of the chapter 11 proceeding. It goes without saying that such action -- in and of itself -- would have a devastating effect on the estate. But this is not all that the Pensions Regulator could do. Under English law, the Pensions Regulator could take the following steps, which, for the same reasons discussed above, would likely not be subject to the automatic stay, and would likely result in the complete meltdown of the SCL Group:

- The Pensions Regulator could issue further FSDs (followed by contribution notices in the event of noncompliance) to other companies in the SCL Group which are or were "associated" with SCSL if the Pensions Regulator considered it reasonable to do so. (Trial Ex. 16 ¶ 86.2.)

- The Pensions Regulator could issue FSDs (followed by contribution notices) against any other companies in the SCL Group which had been participating employers in the Schemes if satisfied that in the events which have happened they are insufficiently resourced. (Trial Ex. 16 ¶ 86.3.)

- The Pensions Regulator could issue FSDs (followed by contribution notices) against any other company in the SCL Group (including SCL) on the grounds that it was associated with these other insufficiently resourced participating employers in the Schemes. (Trial Ex. 16 ¶ 86.4.)

- The Pensions Regulator could cause the Schemes to be wound up, thereby triggering Section 75 debts against all participating employers in the Schemes under section 11 of the 1995 Act. (Trial Ex. 16 ¶ 86.5.)

The impact of these actions cannot be overstated. Faced with the significant risk of causing a complete meltdown of the SCL Group absent the Section 75 based settlement, it is evident that it is in the paramount interest of the creditors to have this Court approve the Settlement.

### B. Maintaining One Claim At The SCL Level Is Beneficial To The Estate And Will Likely Prevent A Meltdown Of The SCL Group

The SCL Committee would have the Court believe that because the Settlement allows for one claim at the SCL level, the other SCL creditors are diluted. This is simply not true. The Debtors' analysis indicates that in fact a single Trustee claim against SCL under the Settlement enhances recoveries for SCL's non-pension-related creditors. The improvement in SCL creditor recoveries occurs principally by ensuring that SCL creditors realize value currently residing at the non-debtor subsidiaries in the SCL group in the near term. The Settlement also eliminates the significant risk from the assertion of pension-related claims of internecine warfare among the SCL group.

As the Court knows from the multiple motions filed in these cases to facilitate non-debtor sales and other transactions, valuable assets are held by non-debtor subsidiaries. The Debtors anticipate that, as their exit planning accelerates, so will their program of selling non-core assets and repatriating cash and other proceeds to SCL. This will result in significant value that the SCL creditors will directly realize under a chapter 11 plan. As explained above, without the Settlement, the Trustees and TPR effectively could trap this value (including significant cash) at the non-debtor-subsidiary level by asserting claims against the other participating employers or "associated" entities in the group, including SCSL. Because the non-debtor subsidiaries have not filed chapter 11 petitions, the Debtors likely would encounter severe difficulties attempting to enjoin any such actions, particularly given the near certainty that the Trustees and TPR would be exercising remedies in non-U.S. venues.

The web of intercompany claims among the SCL group entities guarantees that, in such a scenario, the Trustees' and TPR's reach could extend to entities that are not even participating employers. In many instances, sizable intercompany claims are viewed by the directors of the non-debtor subsidiaries as assets for payment of creditor claims. As a result, assertion by the Trustees or TPR of claims against one legal entity may very well result in a ripple-effect of intercompany claims and collapse of the group into U.K. or other non-U.S. administrations, liquidations, or other insolvency proceedings. While true that SCL and/or SCSL would have remedies, the Trustees in many instances still would retain a structural priority over SCL creditors as to non-debtor assets. Also, while the intercompany battle rages, SCL creditor recoveries would be delayed, administrative costs would mount, and value would be destroyed.

In agreeing to settle and channel their claims into one claim against SCL, the Trustees in effect have facilitated an intercompany détente and to share value at the non-debtor subsidiaries with other SCL creditors. This enhances SCL creditor recoveries in two significant ways: it increases the pool of assets for all SCL creditors, and it eliminates any value loss from litigation and the attendant costs and delays. For these reasons, the Debtors' model shows a better recovery for all SCL creditors under the Settlement than other non-settlement scenarios.

## III. THE DUE DILIGENCE CONDUCTED BY THE DEBTORS OVERWHELMINGLY SUPPORTS THE SETTLEMENT.

The Debtors have engaged several legal and actuarial consultants to advise them during the settlement negotiations with the Trustees. As the testimony will show, the actuarial advice received by PwC was instrumental in negotiating and obtaining the Settlement and strongly supports the conclusion that the agreed upon Settlement is reasonable. Specifically, PwC opined that the Schemes' actuarial Section 75 calculations as of November 2007, upon which the Settlement is based, fall within a reasonable range of Section 75 estimates.

### A. PWC FOUND THE SCHEMES' ACTUARY'S SECTION 75 ESTIMATE WITHIN THE RANGE OF REASONABLENESS.

During the negotiation process with the Trustees, and prior to the Debtors agreeing to settle the Trustees' claims, the Debtors and the SCL Committee requested that PwC review the

Section 75 estimate prepared by the Schemes' actuary (Mercer[40]) and calculate, using reasonable valuation assumptions, the range within which a reasonable actuary would determine the Section 75 liability of the Schemes.[41] The PwC review was led by an actuary, Mr. Christopher Massey, who the SCL Committee concedes is an expert on the subject of Section 75 liability estimates. (Objection at 16, 20) On November 21, 2007, PwC issued reports concluding that as of May 31, 2007, a reasonable actuary could calculate the Schemes' Section 75 liability as low as £59M and as high as £108M -- supporting the Mercer May 31, 2007 calculation of £99.1M as within the range of reasonableness. (Trial Ex. 9 at 33; Trial Ex. 10 at 2.) In fact, as the chart prepared by the SCL Committee illustrates (Objection at 17), at all comparison dates, the Mercer number fell well within the PwC reasonable range.

Following PwC's issuance of the aforementioned reports, the Debtors requested that PwC calculate its own Section 75 estimate as an additional benchmark. The PwC Section 75 estimate resulted in a number that is very close to that of the Schemes' Actuary, Mr. Hosegood. Calculated as of November 30, 2007 -- the calculation on which the Settlement is based -- Mr. Hosegood estimated the Section 75 liability as £100M and PwC estimated the Section 75 liability as £92M. (Trial Ex. 7 at 7)

Instead of accepting the full range of the PwC analysis, or at the very least acknowledging PwC's own Section 75 estimate, as would be expected given their recognition of Mr. Massey's expertise, the SCL Committee conveniently chose to accept in its Objection only the "low end" of PwC's finding. The SCL Committee explained their logic by arguing that

40 Mercer is one of the largest consulting firms providing actuarial services in the world.

41 Critically, the SCL Committee joined the Debtors in negotiating the scope of work according to which PwC would provide this range of reasonable Section 75 liabilities. (*See, e.g.*, Ex. 9 at DEBTORS0014037 (noting that PwC met with representatives of the Debtors ***and the SCL Committee*** prior to commencing the PwC review); Ex. 10 at 18. In this light, then, the SCL Committee strains credulity beyond the breaking point when it now argues that the PwC ranges represent an "inaccurate" approach. (Objection at 17.)

"[s]ince buyers -- i.e., scheme trustees - have no incentive to buy annuities at any higher rate, that means the so-called "low end" is the marketplace." (Objection at 18.) This logic, however, is fundamentally flawed. It ignores the fact that not all buyers or sellers are equal and assumes that insurers compete only on price -- assumptions which are patently wrong. (*See* Trial Ex. 57 at 116; *see also id.* at 98 (calling SCL's Committee assumption that insurers compete only on price "false").) Moreover, it ignores Mr. Massey's testimony that PwC's "high end" findings reflect an actual market for annuities under these circumstances. (Trial Ex. 57 at 19-20 ("The high end is the highest amount that we believe a buyer would be prepared to pay for an annuity on that date."); (*id.* at 23 (answering in the affirmative to "Would any buyer in the market, in your experience, purchase annuities at the high end of 95?").) The fact that Mr. Massey testified that he had only witnessed buy-outs at the "low end" discount rates is irrelevant in this case, because, as he acknowledged, none of his experience included buy-outs under Section 75. (Trial Ex. 57 at 43-44, 110)

**B. MERCER UPDATED CERTAIN ASSUMPTIONS UNDERLYING THEIR SECTION 75 CALCULATION AS OF NOVEMBER 30, 2007**

When PwC conducted their analysis of the Mercer estimate of Section 75 liability referred to above, Mr. Massey and his team communicated with Mr. Hosegood's team at Mercer regarding the bases for the Mercer assumptions. During these communications, PwC identified certain assumptions which were based on data that was arguably out-of-date. (Trial Ex. 12 at 1.) Following discussions with PwC, Mercer updated their assumptions, which ultimately led to a lower Mercer estimate of the Section 75 liability. ((*Compare* Trial Ex. 114 at 3 *with* Trial Ex. 8 at 4) (*see also* Trial Ex. 58 at 141-3).)

The SCL Committee seeks to turn this clear benefit bestowed on the estate against the Debtors, arguing that Hosegood's reliance on the older data was a "substantial mistake" that he failed to correct. (Objection at 20.) But this argument cannot be squared with the fact that Hosegood applied the revised assumptions to the November 30, 2007 calculation (upon which this Settlement is based), resulting in a figure extremely close to PwC's estimate and rendering any argument about incorrect assumptions moot. (Trial Ex. 7 at 7) While the SCL Committee attempts to rely on Hosegood's testimony that Mercer revised its assumptions again after their first revision, it is clear that such revision occurred only at "the very end of 2007 . . . ." (Trial Ex. 58 at 112) The SCL Committee presented no evidence showing that this second revision to the assumptions would apply to the November 30, 2007 calculations on which the Settlement is based.

## IV. THE EVIDENCE PRESENTED BY THE SCL COMMITTEE DOES NOT -- AND CANNOT -- DEMONSTRATE THAT THE SETTLEMENT IS OUTSIDE THE RANGE OF REASONABLE OUTCOMES

### A. THE SCL COMMITTEE'S ATTACKS ON THE SCHEMES' ACTUARY ARE UNSUPPORTED BY EVIDENCE

The SCL Committee attacks the Schemes' Actuary for: (i) having "no personal expertise of the insurance market" but instead relying on a central office to collect his data; (ii) applying out-dated data; and (iii) having never certified a Section 75 debt for the Schemes. (Objection at 15-16, 20.) None of these attacks lands, however, because the SCL Committee presents no evidence that demonstrates that the Schemes' Actuary, Neville Hosegood, acted contrary to English law or produced an unreasonable Section 75 estimate.

First, as discussed above, a calculation of a Section 75 debt "is based on the actuary's estimate of the cost of securing the liabilities by annuity purchase . . ." (Trial Ex. 16 ¶ 35.) "The guidance itself says very little about how actuaries should go about calculating the debt . . . ." (Trial Ex. 167 ¶ 4.5) The SCL Committee merely argues, but fails to present evidence, that the actuary must have personal expertise in the insurance market and collect his own data. In fact, the evidence disproves the SCL Committee's very theory. The SCSL Committee's expert, David Cule, a U.K. actuary, testifies that he and the industry in general calculate Section 75 debts in much the same manner as Neville Hosegood did here:

> ***In line with many other pensions consultancies in the U.K.***, Punter Southall Limited monitors the buyout market in a pragmatic manner for the benefit of the advice it can give its clients either in calculating Section 75 debts or in advising on the merits of buying out part of all of a DB Scheme's benefits. We have a team of individuals within the organization who are in regular contact with some of the key providers in the buyout market and who meet regularly to discuss the latest developments in the market and factors affecting buyout pricing. . . . . ***Whilst I am not part of that team myself***, I do have regular access to several of the buyout team's members and debate the issues with them from time to time.

(*Id.* ¶¶ 4.6, 4.7) (emphasis added.)

Second, as discussed above, the Mercer calculation on which the Settlement is based reflects updated market data. (Trial Ex. 7 at 7.) Therefore, any argument about Hosegood's supposed "error" is moot. In fact, the only thing the "error" serves to prove is that PwC's due diligence positively affected the Settlement in favor of the rest of the creditors.

Finally, the SCL Committee's argument that Mr. Hosegood did not certify a Section 75 debt (Objection at 14, 20) is a red herring. Under English law a debt is certified only after the occurrence of a trigger event under Section 75. (*See* Regulations 5(18) and 6(8) to The Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2008, Trial Ex. 16, Appendix 20 at 9, 11.) As discussed above, a trigger event that would crystallize SCSL's Section 75 debt has not yet occurred and therefore SCSL's debt under the Schemes has not yet been certified.[42] In contrast, a liability under Section 75 may be contingent and need only be estimated (*see* Section I.C.1, *supra*.)

[42] As the SCL Committee acknowledges (Objection at 40), when SCL withdrew from the 1983 Scheme a trigger event occurred and a debt was certified by the Scheme's Actuary at £6.7 million. Although the SCL Committee does not mention this, other trigger events have occurred with respect to other participating employers as a result of ceasing to employ any members accruing benefits, which have not yet been satisfied Those debts

## B. THE SCL COMMITTEE'S EXPERT TESTIMONY IS IRRELEVANT AND WRONG

The only evidence presented on English law demonstrates that the Schemes' liability must be calculated on a Section 75 "buy-out" basis. (Trial Ex. 16 ¶¶ 61.2, 68(6); Trial Ex. 167 ¶ 4.14.) Mr. Evans has opined that under the issued FSDs, "the buyout basis of valuation of liabilities is the prescribed and hence the only permissible method. There is no scope for adopting a 'prudent investor' basis of valuation for this debt." (Trial Ex. 16 ¶¶ 61.3) David Cule, a U.K. actuary, has opined that under the present circumstances, where some of the employers associated with the Schemes are in bankruptcy, the Schemes' liability should *not* be calculated on the "technical provisions" basis urged by the SCL Committee. (Trial Ex. 167 ¶ 4.14) Indeed, as discussed in more detail above (Section I.E., *supra*), the technical provisions are wholly inapplicable under these circumstances.

Notwithstanding the above, the SCL Committee's expert testimony advocates calculating the Schemes' deficit under a "technical provisions" basis. It is evident, however, that the SCL Committee's experts, Mr. John Parks and Dr. David Gulley, cannot provide expert testimony on those topics, as they have no U.K. legal or actuarial training,[43] and provide testimony that is at odds with U.K. pension law.

To illustrate, under the Statutory Funding Objective set forth in the Pension Act of 2004, scheme actuaries must for each individual scheme assess the employer's ability to contribute and

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have not yet been certified. The total amount of debt triggered in addition to that of SCL's is estimated to be approximately £17.6 million for both Schemes.

43 Neither Parks nor Gulley disclose in their reports any experience that is relevant to U.K. pensions schemes. Mr. Parks has apparently had a long career as a consultant and actuary to U.S. corporations; however, he does not profess to have *any* experience as the actuary or even consultant to U.K. pension schemes. (Trial Ex. 19, Appendix A) Dr. Gulley's expertise appears to be even farther a field. His expertise does not relate to pensions -- let alone U.K. pensions -- but rather, Dr. Gulley holds a Ph.D. in Mineral Economics and his career has apparently been devoted in large part to teaching and writing about minerals and metals -- particularly gold (*See* Trial Ex. 46; Trial Ex. 79.)

“[w]here the employer covenant has limited or highly questionable value, the Trustees should take a more cautious assessment in setting the method and assumptions for determining the Technical Provisions.” (Trial Ex. 167 ¶ 3.29.) Where the employer has no ability to contribute to the scheme, the trustees should take a risk free approach to investing the scheme’s assets and establish a prudent reserve for future mortality improvements. (*Id.* ¶ 4.19.) Parks and Gulley each overlook these fundamental aspects of U.K. pension law. Parks does not assess the unique circumstances of the Schemes -- namely, their employers’ inability to contribute to the Schemes. Instead, Parks roundly opines that the Schemes’ portfolios should contain 40% equities and 60% fixed and other investments based on the “weighted average asset allocation as of 30 March 2007” of 5,892 PPF eligible schemes in the U.K. (Trial Ex. 19 at 7) Parks bases his asset allocation for the Schemes not on their specific circumstance, but rather the “weighted average” of a large cross-section of all U.K. pension schemes. Parks’ approach is thus at odds with the 2004 Pensions Act, which created a scheme-specific regime. (Trial Ex. 16 ¶¶ 19, 22)

In addition, Parks and Gulley make a number of erroneous assumptions that render their conclusions unreliable. For example, Parks bases his conclusion that the Schemes’ portfolios should include 40% equities and 60% bonds on the assumption that, on average, U.K. schemes hold 60% equities and 40% bonds. (Trial Ex. 19 at 7) Parks notes that the 60% equity figure “compares to and is a slight reduction in equity investment from 61.1% in the prior year which implies that the investment mix has remained fairly stable from the prior year’s data.” *Id.* What Parks omits from his report, however, is that U.K. schemes have for more than a decade trended away from equities and into bonds: “[F]rom around 1997 there has been a shift away from equities towards gilts and fixed interest assets. During the mid-1990s the proportion of equities was relatively stable at around 73%, but this has fallen to just 57% by the end of 2005. Gilts and fixed interest assets on the other hand have seen an increase from 15% in 1997 to 21% of total assets in 2005." The Purple Book 2007 -- DB Pensions Universe Risk Profile, Trial Ex. 168 at 66. In sum, Mr. Parks' own source, The Purple Book, undercuts his assumption that year-to-year U.K. pension schemes' equity/debt ratios have remained stable.[44]

Mr. Parks concludes that the correct "methodology and implications of the Technical Provision calculations" are set forth in the 2006 annual report for the 1983 Scheme. (Trial Ex. 19 at 12.) This conclusion is equally unreliable because Parks improperly assumes that the methodology applied in the 2006 Mercer report is based on up-to-date technical provisions. Parks betrays his inexperience with respect to U.K. pensions when he describes the technical provisions calculations but omits that a scheme actuary provides a valuation only every three years. (*Compare* Trial Ex. 19 at 11-12 with Trial Ex. 16 ¶ 21) Parks submits, "the Trustees and Mercer agreed that the assumptions used to calculate the Technical Provisions were sufficiently prudent." (Trial Ex. 19 at 12) As the Cule Report shows, however, this agreement that the methodologies and assumptions were sufficiently prudent was reached a year earlier and are now out-of-date: "[T]he Technical Provisions reflected in the actuarial report as at 31st December 2006 are based on the assumptions and methods determined at the time the Statement of Funding Principles was established, i.e. 31st December 2005 in the case of the 1983 Scheme (and thus are not current.)" (Trial Ex. 167 ¶ 4.14) Thus, Parks ignores the statutory triennial cycle, treating the 2006 "mechanical monitoring document" (*id.*) as a full-blown valuation, so that he can reach the conclusion most serving his argument. But his conclusion regarding the 2006 technical

[44] Parks offers no explanation of why he simply "flipped" the purported average equity/debt ratio from 60%/40% to 40%/60%. He states "analysis of the cash flow projections" for the Schemes "reveals that both are maturing . . ." (Trial Ex. 19 at 8) But Parks fails to explain the extent to which the Schemes' "payment profile" has changed, *see* Trial Ex. 168 at 63, or how a 60%/40% debt/equity ratio meets the Schemes' present payment profile.

provisions calculation finds no basis in English law or actuarial practice and should be disregarded.

Dr. Gulley also relies on flawed assumptions to reach his conclusions. The SCL Committee states that Dr. Gulley conducted a study of pensions to reach his conclusion that the Schemes should generate a 7.0% rate of return. (Objection at 13.) Dr. Gulley's report shows no such study. For example, Dr. Gulley discloses that he reviewed the asset allocations for the Schemes (Trial Ex. 18 ¶ 15), and compared those allocations to surveys of other U.K. schemes' allocations. (*Id.* ¶ 8) But, critically, Dr. Gulley admits that he did not study the securities that make up the allocations in U.K. schemes generally: "Since I have had no indication that the ratio of U.K. equities as compared to overseas equities or the ratio of gilts to corporate bonds would be significantly different at a 40/60 allocation as compared to the allocations specified in the investment strategy for each scheme, I have utilized the reported ratios within each asset class." (*Id.* ¶ 31) This assumption, however, ignores developments in U.K. pensions that one of his own sources reports: "Chart 7.12 indicates that, within equities, there has been a big shift in asset allocation away from U.K. equities towards overseas equities." (Trial Ex. 168 at 69.) Or, to quote another development Dr. Gulley assumed away, "In recent years there has been a trend for pension schemes to use liability driven investment strategies. Schemes can either use long-dated bonds to try to match the duration of their assets to their liabilities . . . or can continue investing in assets with high returns whilst hedging unintended risks by the use of swaps." (*Id.* at 71) In short, Dr. Gulley did not study pensions as the SCL Committee represents he did. His conclusions are therefore unreliable and should be rejected.

Consequently, the expert testimony presented by the SCL Committee is materially flawed and inconsistent with common sense and the U.K. approach to technical provisions. It should therefore be rejected by the Court.

### C. LUCIDA'S PRELIMINARY INTEREST IN THE SCHEMES DOES NOT RENDER THE SETTLEMENT UNREASONABLE

The SCL Committee argues that Mr. Hosegood's Section 75 estimate is unreliable because he did not consider actual transactions -- which, according to the SCL Committee, "is particularly remarkable in light of the fact that *the Debtors were in the process of receiving a proposal from a key market player to buy out the Schemes* subject to further due diligence." (Objection at 19 (emphasis in original).) As with its other attacks on Mr. Hosegood, the SCL Committee fails to offer any evidence to support this assertion that Hosegood was required under English law to consider other transactions. Worse, the only evidence on record demonstrates that English law imposes no such requirement, but rather leaves the Section 75 calculation to the discretion of the scheme actuary. (Trial Ex. 16 ¶ 35 ("the calculation of the liabilities is based on the actuary's estimate of the cost of securing the liabilities by annuity purchase, rather than what quotations might reveal the actual market cost to be: see regulation 5 of the Employer Debt regulations");Trial Ex. 167 ¶¶ 4.5, 4.6, 4.7.)

In any event, the SCL Committee has artfully transformed Lucida's preliminary interest in the Schemes into something it is not, and never was. First, Lucida never provided a "proposal" of a £50M buy out. (Trial Ex. 56 at 35-36) Lisa Ashe, the main person who communicated with Lucida on behalf of the Debtors, testified that Lucida indicated verbally that "it might be possible, subject to further due diligence, to buy out the Pension Schemes for a ***cash injection*** of around £50 million." (*Id.* at 17, emphasis added.) Importantly, even if the £50M figure was a firm offer (which it by no means was), it would have required that the Debtors provide £50M in ***cash*** plus the Schemes' assets. (*Id.* at 17.) But the Debtors did not -- and still do not -- have £50M or approximately $100M in cash. (*Id.* at 26-27.)[45] Second, Lucida's preliminary interest was subject to substantial and specific due diligence regarding the Schemes' specific members and the equalization claims, which needed to be completed: "They indicated that to -- for further due diligence they would need to receive member data, individual Scheme data, including post codes for the members, and that there would need to be an understanding, I believe, of the equalization issues." (*Id.* at 24; *see also* Trial Ex. 163, which notes that with respect to Lucida that "uncertainty over quantum of equalization may make this unworkable.") And, third, contrary to the SCL Committee's assertion that Lucida is a "key market player," Lucida is in fact a new entrant. (*Id.* at 33-34.) Indeed, at the time Lucida met with Debtors' representatives, it was still not approved by the FSA to undertake long term insurance business and had therefore never been a party to such a transaction before. (TrialEx. 122 at 2.)

The evidence will also show that other market participants were not interested in buying out the Schemes. As Ms. Ashe's testimony demonstrates, the Debtors contacted a number of other entities (Merrill Lynch, Citigroup and Pension Insurance Corporation; all three having recently done buyout transactions) and none of them were interested in pursuing a buyout transaction involving the Schemes. (Trial Ex. 56 at 60-61.)

## V. THE EVIDENCE DEMONSTRATES THAT THE EQUALIZATION RESERVE IS REASONABLE

The SCL Committee's attacks on the equalization reserve are unfounded. The reserve is part and parcel of the global settlement. The alternative, just giving the Trustees an allowed

[45] The SCL Committee was aware of the £50M cash indication by Lucida, as they had brought Lucida to the Debtors' attention and then followed up with the Debtors. (Trial Ex. 56 13-14; 71-72.)

claim on account of equalization, does not make sense as it is a contingent claim. The reserve strikes a reasonable balance in light of the uncertainties around this reserve.

### A. THE EQUALIZATION OF THE SCHEMES HAS NOT BEEN ESTABLISHED

As discussed above, the Settlement establishes a distribution reserve for certain, contingent, unliquidated claims that could be brought against the Debtors for an alleged failure to "equalize" the retirement age for certain of the Schemes' male and female members. The Debtors agreed to a $69 million claim reserve only after conducting an extensive investigation of the bases and scope of these equalization claims.

In its Objection, the SCL Committee states that the Schemes likely were properly equalized prior to these cases, and according to the SCL Committee, have operated as such. (Objection at 36-37.) The SCL Committee's argument misses the point. First, the Trustees have not agreed that the Schemes have been properly equalized. Second, under English law, the fact that the Trustees operated the Schemes until recently as if equalized is irrelevant.

By way of background, the 1990 case of *Barber v. Guardian Royal Exchange Assurance Group* [1990] 2 All ER 660, held that male and female pension scheme members were entitled to equal pension benefits. Consequently, if a pension scheme did not alter its rules to "equalize" the retirement ages of males and females, all male members of a scheme which allowed females to receive full benefits at age 60 were entitled to receive full benefits at age 60 as well. *Barber* generated litigation in the U.K. over the question of whether schemes effectively "equalized" through proper amendment to their trust deeds. Mr. Evans generally described this litigation as follows:

> In short, the necessary formalities were not always followed. Typically, announcements or explanatory booklets were issued to members, perhaps in conjunction with a decision (with varying degrees of compliance with the required formalities) by the sponsoring employer and perhaps the trustees to amend the scheme so as to equalize retirement ages, but then no effective

> amendment (i.e. in the required form required by the power of amendment) was ever in fact executed. The English courts have required strict compliance with the formal requirements of a scheme's amendment power.

(Trial Ex. 16 ¶¶ 97-98.)

As discussed in the Motion, nobody has yet conclusively established that proper equalization of the Schemes occurred. (*See* Motion at ¶¶ 48-52.) In particular, the SCL Committee has not presented any evidence to the contrary. If the Schemes did not effectively equalize for pre-1991 members, pre-1991 male members may be entitled to compensation to the extent they did not receive full benefits until 65. Any failure to properly equalize for pre-1991 employees could cause the Trustees to increase their claims.

Because of the uncertainty surrounding the equalization claims, the Debtors expended considerable resources at considerable expense to assess their merits. As set forth in a confidential memorandum dated October 18, 2007 (the "Memorandum"), K&E and PwC, conducted a comprehensive investigation of the bases and scope of the equalization claims. K&E and PwC collected and reviewed the Debtors' historical and current information on the issue, interviewed the Schemes' trustees, and directed Mercer to review all of its information on the equalization issue. Furthermore, the Debtors retained special pensions and employment counsel to analyze all of the marshaled evidence. The results of the Debtors' advisors' investigation were summarized in the Memorandum and shared with the SCL Committee pursuant to a joint defense privilege.

In light of the access SCL's Committee had to the Memorandum, its failure to mention it and its attack on the equalization reserve are surprising. The Memorandum clearly identifies the uncertainty around equalization and considers the same arguments made by the SCL Committee. But the SCL Committee fails to address this fact in its Objection. Even more, the SCL Committee fails to mention that English Courts have not conclusively established that retirement ages can be equalized absent formal amendment of a scheme's deed. (*See* Trial Ex. 16 ¶ 98 (noting that English courts have required strict compliance with formal requirements of a scheme's amendment power).)

Additionally, contrary to the SCL Committee's assertions, the fact that the Trustees operated the Schemes until recently as if equalization occurred, does not answer the question or resolve the contingency. As Mr. Evans opined, an estoppel argument under these circumstances may prove difficult in an English court: "Since the decision in *Redrow v. Pedley* [2002] PLR 339, it is hard to conceive of circumstances in which a group estoppel, binding all the members of a pension scheme, could be established so as to achieve equalization in circumstances where there was no effective amendment according to the amendment power in the scheme." (Trial Ex. 16 ¶ 100.) Consequently, the estoppel defense is no basis for diminishing or eliminating the reserve for the equalization claims. And the SCL Committee provides no authority or evidence to the contrary.

### B. THE AMOUNT OF THE EQUALIZATION RESERVE IS APPROPRIATE

The equalization reserve is appropriate in light of the uncertainty around the claims. As of the date of this reply, the Trustees have not acknowledged, nor has any English court ruled, that proper equalization occurred at all. Nonetheless, the SCL Committee argues, without providing any supporting legal or other authority, that the Debtors should not conservatively calculate the equalization reserve. (Objection at 36-37.) But there is nothing improper about creating a reserve for the equalization claims, which assumes the worst case scenario. Despite the SCL Committee's view, it is well within a debtor's right to establish a reserve for the full amount of contingent claims. *See In re MCorp Fin. Inc.*, 160 B.R. 941, 962 (S.D. Tex. 1993) (holding that "contingent claim is entitled to a reserve for its full amount.)[46] In point of fact, to not reserve conservatively would be irresponsible. The alternative, reserving for less, risks having to disgorge distributions post-confirmation, a highly unpalatable scenario. Further, any reduction of this reserve likely would have required a corresponding increase in the amount of the Trustees' claims. In this regard, it is unclear why the Trustees would have accepted more risk on equalization as the SCL Committee seems to suggest they should.

Moreover, to reduce the reserve would create a risk before a Bermuda court as part of proceedings to implement a plan, of the Bermuda court finding that the Debtors did not adequately reserve and refusing to endorse the plan. In turn, the Bermuda court could order conversion of the provisional liquidator into a full-blown liquidation. For all the reasons already discussed, this result should be avoided.

Finally, by approving the reserve, the Court is by no means passing on the merits or value of the equalization claims. Approval of the Settlement merely establishes a reserve: it does not effectuate any distribution, much less a distribution on a $69 million claim.[47]

## VI. THE EVIDENCE DEMONSTRATES THAT THE $5 MILLION ADMINISTRATIVE COSTS ARE REASONABLE

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46 The SCL Committee makes much of the fact that Mr. Massey testified that PwC calculated a £17 million reserve for the 1983 Scheme based on assumptions that Mr. Hosegood did not apply in his calculation of the £33 million reserve for the 1983 Scheme -- namely, PwC assumed that equalization has already become effective. (Objection at 37 and 64-65.) Focusing on this difference ignores a crucial fact -- equalization has not yet been established and as a result it is not unreasonable to assume that proper equalization may have not occurred.

47 Although the Debtors do not dispute that in this matter the SCL Committee may test their judgment in reserving for a $69 million claim, they note that this Court has confirmed plans granting unchecked discretion to debtors in possession to reserve for disputed claims. *See, e.g.*, *In re Fleming Co., Inc.*, Case No. 03-10945 (Bankr. D. Del. May 25, 2004) ("Article IX.M . . . Share Reserve. In addition to the provisions of section X.A.3 herein, Core-Mark Newco shall be required to establish and maintain an appropriate reserve of New Common Stock to ensure the distribution of New Common Stock to the Holder of any Disputed Claim upon its allowance."); *In re Cable & Wireless USA, Inc.*, Case No. 03-13711 (Bankr. D. Del. May 13, 2004) ("ArticleV.G: . . . The Liquidating Trust shall be authorized to establish a reserve in respect of any Disputed Claim(s.)".)

The SCL Committee's objections to the $5 million Administrative Expense Claim should be overruled. The Administrative Expense Claim is essentially a settlement of the Trustees' right to a postpetition claim based on the continued administration of the Schemes for the benefit of the estates. Section 503 of the Bankruptcy Code affords administrative-expense status to claims arising from "the actual, necessary costs and expenses of preserving the estate." 11 U.S.C. Section 503(b)(1)(A). Section 507(a)(2) further gives administrative expense claims priority treatment. 11. U.S.C. Section 507(a)(2). As the Objection correctly observes, the purpose of granting administrative expense priority in a chapter 11 case is to give creditors an incentive to continue to conduct business with the debtor, thereby aiding in the debtor's maintenance, preservation, and rehabilitation. (Objection at 66-67.) Here, the Trustees' postpetition forbearance and administration of the Schemes granted a substantial benefit to the Debtors' estates. It allowed the Debtors time to continue to negotiate a favorable settlement of the pension scheme liabilities. On that basis, the Trustees arguably have a right to an administrative claim, even without the Settlement, and the Debtors have concluded it is prudent to resolve that potential claim as part of a global compromise. It should be noted that the $5 million postpetition Administrative Expense Claim represents a discount when compared to the postpetition costs expended by the Schemes with respect to this Settlement of over $3m and the estimated costs for keeping the Schemes open for two years which could exceed $10 million.[48]

In similar situations, courts have recognized that a decision by a trustee or debtor in possession "to spare the creditors the expense of litigating over a non-frivolous claim where the expense of litigation is 'certain' to exceed the amount of a settlement is eminently reasonable" and should not be disturbed by the courts. *In re Servisense.com, Inc.*, 382 F.3d at 68, 75-76 (1st

[48] It should also be noted that, upon information and belief, the Schemes have expended over $3 million in connection with Settlement motion itself.

Cir. 2004). In *Servisense*, the debtor's vice president provided services to the estate postpetition. Although the vice president's prepetition severance agreement was never assumed, when the vice president was eventually terminated as part of the debtor's chapter 7 liquidation, he filed a request for payment of administrative expense based on the severance agreement. *Id.* at 70-71. The liquidating supervisor appointed in the case concluded that the vice president's claim was at least colorable and that it would cost more than the amount claimed to litigate the issue. Thus, rather than dispute the vice president's severance claim, the liquidating trustee agreed to pay the claim in full as an administrative expense and filed a motion with the bankruptcy court pursuant to Bankruptcy Rule 9019. *Id.* at 71. The debtor's former chief executive officer, who was also an unsecured creditor, objected. *Id.* Notwithstanding the objection, the bankruptcy court approved the settlement and the district court affirmed. *Id.* On appeal to the First Circuit, the Court of Appeals analyzed the vice president's claim and concluded that it was not, in fact, colorable. *See id.* at 74-75. Nevertheless, noting that the bankruptcy court had found that the expense of liquidating the vice president's claim would likely exceed the settlement amount, the First Circuit affirmed the settlement as within the bankruptcy court's discretion to approve. *Id.* at 76.

Here, the Administrative Expense Claim is an integral part of the proposed global settlement. Litigating the Administrative Expense Claim also means litigating a host of complex issues resolved by the Settlement. It therefore falls within the Debtors' business judgment to agree to a relatively small administrative expense claim on account of the Schemes' postpetition costs and expenses, in exchange for the settlement of issues that would cost the estates significantly more than $5 million to litigate. Furthermore, under the Settlement, the Schemes will continue to incur additional costs which will ultimately benefit the Debtors' estates.

## VII. THE SETTLEMENT DOES NOT CONSTITUTE A SUB ROSA PLAN

The SCL Committee argues that the Settlement is a *sub rosa* plan, because it will inevitably lead to an unconfirmable chapter 11 plan. As an initial matter, this argument makes two unwarranted, and unsupported, leaps of logic. The first is that creditors will reject the plan, leading to a Section 1129(a)(7) review; the second is that a Section 75-based claim includes a penalty that should be subordinated. As already discussed, no portion of the Trustees' claims under the Settlement constitutes a penalty. Further, the Court should decline the invitation to reject the Settlement based on a hypothetical solicitation and confirmation outcome. *See In re Colin*, 44 B.R. 806, 809 (Bankr. S.D.N.Y. 1984) ("the confirmation of the proposed plan is not yet in issue. There is no dissenting creditor before the Court at this time, and one may never materialize. Since the 'best interest of creditors test' of Section 1129(a)(7) only becomes applicable upon the casting of a negative vote against the plan, the committee's argument is premature."); s*ee also In re Marvel Entm't Group, Inc.*, 222 B.R. 243, 251 (D. Del. 1998) ("All parties will still have the opportunity to litigate the details of the reorganization plan, and to explain to the court why they believe the plan is not confirmable. Thus, the court finds that the Settlement is not a *sub rosa* plan").)

The SCL Committee also alleges that the "common currency" provision in the Settlement results in a *sub rosa* plan because it would "tie the hands of creditors in pursing [sic] a plan of reorganization by impermissibly dictating a key term." (Objection at 72.) The SCL Committee misconstrues this provision. The "common currency" provision merely stands for the proposition that the chapter 11 plan cannot unfairly discriminate against the Trustees. It should come as no surprise that, in exchange for agreeing to channel their claims against SCL, the Trustees wanted assurance that the plan could not undermine that bargain by treating their claims less favorably than other SCL unsecured creditors.

Further, the Settlement simply does not bear the hallmarks of a *sub rosa* plan. *Pension Benefit Guar. Corp. v. Braniff Airways (In re Braniff Airways, Inc.)*, 700 F.2d 935, 939-40 (5th Cir. 1983), cited by the SCL Committee, defined three general factors for a *sub rosa* plan: the transaction effectively dictates the terms of any future reorganization plan, places restrictions on creditor voting, and alters creditor rights. None of these factors are present here. The subject matter of the Settlement is limited almost entirely to the Schemes and related claims. A myriad of issues remain to be settled at the plan level, such as the administration of assets, classification and priority of claims, the claims reconciliation process, distribution amounts and timing, and post-confirmation control and management. The Settlement does not require any party to vote for any forthcoming plan. Indeed, if the Settlement is a *sub rosa* plan, the parties' mutual promise to negotiate plan terms in good faith would be surplusage. (Trial Ex. 150 at 4.)

Courts considering facts similar to those at hand have consistently rejected arguments that a settlement constituted a *sub rosa* plan. Thus, for example, the Fifth Circuit found that a settlement with the debtor's two largest creditors was not a *sub rosa* plan where several significant issues remained unsettled and the settlement would further the goal of reorganization:

> The instant settlement . . . does not dispose of all claims against Cajun, nor does it restrict creditors' right to vote as they deem fit on a proposed reorganization plan. Finally, the settlement does not dispose of virtually all of Cajun's assets, leaving little prospect or occasion for further reorganization. Instead it disposed of one particular "asset," River Bend, which is not so much the crown jewel of Cajun's estate but its white elephant . . . . The removal of River Bend from the estate will facilitate Cajun's reorganization . . . without denigrating the rights of the unsecured trade creditors.

*Official Comm. of Unsecured Creditors v. Cajun Elec. Power Coop., Inc. (In re Cajun Elec. Power Coop., Inc.)*, 119 F.3d 349, 355 (5th Cir. 1997) (citations omitted); *see also Marvel Entm't Group*, 222 B.R. at 251 (not a *sub rosa* plan where trustee agreed to vote on a plan he intended to support anyway and where settlement was contingent upon confirmation and consummation of a plan); *In re Columbia Gas Sys., Inc.*, No. 91-803, 1995 WL 404892, *2 (Bankr. D. Del. 1995) ("it makes eminent sense to [settle with largest creditors], as this process can result in the formation of a building block to a consensual plan of reorganization, which should be the goal of every Chapter 11 proceeding.")[49]

As these cases illustrate, the Settlement should not be considered a *sub rosa* plan. The Settlement does not liquidate any of the Debtor's assets. Additionally, as opposed to supplanting the plan process, the Settlement provides a basis for formulating a plan, without which the plan process might be too cumbersome and adversarial to possibly result in confirmation. This argument should therefore be rejected.

## **CONCLUSION**

For all the reasons set forth herein and in the Motion, the Debtors respectfully request that this Court grant the relief requested in this Motion.

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[49] *In re Louise's, Inc.*, 211 B.R. 798 (D. Del. 1997), which is cited by the SCL Committee, is inapposite to the present case. In *Louise's*, the creditor filed a motion to modify the debtor's exclusive right to file a plan. *Id*. at 799. The proposed agreement resolving the motion also transferred control of the debtor to the creditor, who would then be in control of the subsequent plan process. *Id*. at 800. The court found that the agreement was "tainted with provisions unrelated to the exclusivity issue" and supplanted the requirements of a chapter 11 plan. *Id*. at 802. The Settlement, on the other hand, is singularly focused on resolving a significant subset of claims against the estates, thereby paving the way for a reorganization.

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