UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

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

OBJECTION OF OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF SEA CONTAINERS LTD. TO DEBTORS' MOTION FOR ORDER APPROVING SETTLEMENT REGARDING PENSION CLAIMS

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INTRODUCTION

The Official Committee of Unsecured Creditors of Sea Containers Ltd. ("SCL Committee") objects to the Debtors' Motion for Order Approving Settlement Regarding Pension Claims ("Motion"). Pursuant to Rule 9019 of the Federal Rules of Bankruptcy Procedure, the Motion seeks approval of a settlement ("Settlement") among the Debtors, the Official Committee of Unsecured Creditors of Sea Containers Services, Limited ("Services Committee"), and the trustees (collectively, "Trustees") of the Sea Containers 1983 Pension Scheme and the Sea Containers 1990 Pension Scheme (individually, "1983 Scheme" and "1990 Scheme," collectively, "Schemes").

The Proposed Settlement contains the following key elements:

- The Schemes shall receive a single allowed general unsecured claim against SCL ("Pension Claim") in the aggregate amount of $194 million ("Pension Claim Settlement Amount"), with $153.8 million allocated to the 1983 Scheme and $40.2 million allocated to the 1990 Scheme, paid in the same currency and in the same proportion per dollar of allowed claim as the SCL unsecured creditors receive in respect of their unsecured claims. *See* Motion at 20 and Dep. Ex. 3 ("Term Sheet").[1]

- The Schemes shall have an administrative expense claim against the Debtors ("Administrative Claim") in the amount of $5 million, to be paid in cash (U.S. dollars). *See* Motion at 20; Dep. Ex. 3.

- The Debtors shall establish a reserve ("Equalisation Reserve") "in respect of a $69 million claim for equalization matters" ("Equalisation Claim") to be allocated between the Schemes, with (i) the allowed amount of such claim (if any) to be "determined by the Schemes' actuary as of and at the exchange rate applicable on November 30, 2007 of $2.05 per pound, discounted by 8.6%, and (ii) the reasonable costs of the Schemes in determining the Scheme members' benefits in respect of such claim to be paid by the Debtors as an administrative or post-emergence expense. *See* Motion at 20; Dep. Ex. 3.

[1] Unless otherwise indicated, exhibits referred to are those marked for identification at depositions in this contested matter; references to transcripts are to transcripts of those depositions.

- In response to any Financial Support Direction issued by the U.K. Pension Regulator ("TPR"), the Debtors shall propose and the Schemes shall support a financial support package consistent with the Term Sheet. *See* Dep. Ex. 3.

The Settlement would drain the bankruptcy estate of debtor Sea Containers Ltd. ("SCL") of the value of $268 million for a $194 million Pension Claim, a $69 million Equalisation Reserve, and a $5 million Administrative Claim. The lion's share of this amount is based upon a claimed U.K. statutory obligation that has not been triggered; contingencies that have not occurred, may never occur, and that have not been discounted for the likelihood that they will not occur; calculations based upon out-of-date data and "finger in the air" estimates; and a U.K regulatory notice obtained in violation of the automatic stay.

Quantum. The $199 million to be paid directly to the Schemes dwarfs the appropriate measure of the Pension Claim, as shown by four separate measures: (i) under the U.K. statutory provision that, given the actual status of the Schemes is the appropriate basis to measure the Pension Claim, the Schemes' actuary calculated the deficit needed to meet the 1983 Scheme's obligations as they fall due at approximately *half* of what the Settlement reflects; (ii) SCL's actuaries advised that insurance could be obtained for a "Section 75 buy-out" of the Schemes (described below) at scores of millions of pounds below the proposed Pension Claim Settlement Amount; (iii) £50 million, or about *half* the proposed Pension Claim Settlement Amount, was proposed by a qualified insurance provider to buy out both Schemes; and (iv) the SCL Committee's experts have calculated the Pensions Claim at approximately £35 million in value.

Priority. Although the Trustees' pre-petition contractual rights to contributions lie *only* against Sea Containers Services Ltd. ("Services"), the proposed Settlement would

allow the Trustees' Pension Claim against the parent, SCL, and thereby (i) avoid valid set-off rights that SCL has against Services for inter-company claims; and (ii) a significant risk that the Services Agreement between Services and SCL would *not* provide indemnity for the delta between the Actual Damages Measure (defined below) and the Section 75 Measure (defined below), which constitutes a penalty based on SCL's financial distress. This priority jump has been premised on a process by which a so-called "Financial Support Direction" was issued post-petition and in violation of the automatic stay. There is no lawful basis to recognize the Pension Claims at SCL (except, as described below, as to a comparatively insignificant portion arising from SCL's withdrawal from the 1983 Scheme).

Other Objections. Below we detail the other significant defects in the Settlement, including that the Settlement (i) employs an improper exchange-rate calculation that disregards the plain text of the Bankruptcy Code; (ii) proposes a baseless Administrative Claim; and (iii) must be rejected as a an improper *sub rosa* plan of reorganization.

In sum, the Settlement is in no way in the "paramount interest" of SCL or its creditors, and falls so far outside the reasonable range of litigation outcomes as to be impermissible. Accordingly, the Settlement must be rejected and the Motion denied.

BACKGROUND

The Chapter 11 Filing and the Schemes' Proofs of Claim

SCL, its indirect subsidiary Services, and an affiliate (collectively, "Debtors") filed voluntary petitions for relief under chapter 11 of the Bankruptcy Code on October 15, 2006 ("Petition Date"). The Office of the United States Trustee appointed the SCL Committee, whose membership was modified several times in 2007. Recognizing the

significance of the inter-creditor dispute between the Trustees and the other unsecured creditors, and the inability of the Debtors effectively to represent the respective inter-creditor interests, the U.S. Trustee constituted the Services Committee in January, 2007, and appointed the Schemes' Trustees as its sole members. Willkie Farr & Gallagher LLP ("Willkie Farr") was appointed as its counsel.

By order dated May 18, 2007 ("Bar Date Order"), this Court established July 16, 2007 as the last date on which any person might file a proof of claim with respect to any pre-petition claim asserted against any of the Debtors ("Bar Date"). Each of the Schemes filed proofs of claim against SCL on or about July 9, 2007, with the 1983 Scheme apparently seeking in excess of $211,440,424.00 and the 1990 Scheme apparently seeking in excess of $55,036,616. *See* Claim Nos. 57 and 76, respectively.

The Services Agreement

In 1989, SCL and Services entered into a Services Agreement ("Services Agreement"), which provides, among other things, that (i) Services will furnish management, administration, financial, accounting, and other services to SCL and various affiliated operating companies, (ii) Services "shall be entitled to charge SCL in respect of a proportion (as determined by SCSL) of the Cost" of providing those services, and (iii) if any of its affiliates fails to pay or indemnify Services for the costs that are charged to those affiliates, then "Services shall be entitled to recover from [SCL] that proportion of the amount which should have been paid by the defaulting company." Motion, Ex. B (Services Agreement § 2(a)(b)(c)(d)).

The Services Agreement gives rise to general unsecured claims of Services against SCL for reimbursement obligations arising in relation to the Schemes. Motion, Ex. B. Those claims are subject to set-off against claims of SCL against Services. *Id.*

The Schemes

The 1983 and 1990 Schemes are defined-benefit pension schemes managed by the Trustees for the benefit of employees and former employees of Services and affiliated companies. Services established the 1983 Scheme and the 1990 Scheme with Services as "principal employer" and SCL and certain SCL affiliates as "participating employers." SCL was never a principal or participating employer in the 1990 Scheme and withdrew as a participating employer from the 1983 Scheme on or about June 8, 2006. Motion ¶ 19. As of the Petition Date, then, SCL was neither the "principal employer" nor a "participating employer" in either Scheme.

In 2006, as the Sea Containers Group tailed into financial distress, SCL engaged Aspen Trustees (n/k/a Capita) as independent trustees for the two Schemes. Kennell Tr. 12-13. Rosemary Kennell, a long-time actuary and professional pension trustee, was the principal, assisted by Jane Fryer, a lawyer by training. *Id.* 10-11. Mrs. Kennell assigned herself to the 1990 Scheme, and Ms. Fryer to the 1983 Scheme. *Id.* 14. Broadly speaking, U.K. pension schemes include three categories of members (i) active members (individuals who are in service and continuing to accrue benefits); (ii) pensioners (individuals who are no longer in service and are receiving pension benefits); and (iii) deferred pensioners (individuals who are not accruing, and have not yet started receiving, pension benefits: often these are former employees who have not yet reached retirement age). Kennell Tr. 74-75. Neither Scheme has any active members. *Id.* 75;

Fryer Tr. 143. There are two kinds of pension benefits. *Accrued* benefits are those benefits that, although to be paid in future (perhaps, long in the future) have already been earned by a pension beneficiary under the scheme's rules. *Accruing* benefits are those future additional benefits that a scheme's members have not yet earned the right to receive, but predictably would be expected to earn on the basis of future employment. Both Schemes were closed to future accruals in late September or early October 2006. Hosegood Tr. 49-50; Kennell Tr. 35; Motion ¶ 33. That means that *accruing* liabilities were terminated. Thereafter, all of the Schemes' liabilities consisted of *accrued* liabilities and ongoing administrative costs. Hosegood Tr. 54-55.

U.K. Pensions Law

U.K. defined-benefit pension schemes, such as the Schemes here, are subject to numerous statutes and regulations. Two U.K. pensions statutes in particular are central to an understanding of the Pension Claim, the Pension Claim Settlement Amount proposed in the Motion, and the SCL Committee's objections to the Settlement.

Sections 75 and 75A of the Pensions Act 1995 provide, *inter alia*, that a debt will fall due from the employer to the trustees of a pension scheme in respect of the scheme ("Section 75 Debt") in the following circumstances: (i) where the employer commences an insolvency proceeding under U.K. law, *see* Section 75(4) Pension Act 1995; (ii) where the scheme itself is wound up, *see* Section 75(2) Pension Act 1995; or (iii) in the case of a multi-employer scheme, where an employer withdraws from the scheme. *See* Section 74(4) Pension Act 1995. This Section 75 Debt is calculated by the scheme actuary on the assumption that the scheme's liabilities will be discharged by the purchase of annuities.

See Section 5(11) Occupational Pension Schemes (Employer Debt) Regulations 2005, and is sometimes referred to under U.K. practice as the "buy-out debt."

The Pensions Act 2004 ("2004 Act") sits alongside the Pensions Act 1995 (and Pensions Act 1993) and creates The Pensions Regulator ("TPR"). Section 7 Pensions Act 2004. The 2004 Act also creates a new level of protection for scheme members through the Pension Protection Fund ("PPF"), which provides certain benefits to compensate members of distressed defined-benefit pension schemes under certain circumstances. Part 2 Pensions Act 2004. TPR was established, among other things, for pecuniary purposes: to protect the benefits of pensioners under occupational pension schemes, *see* Section 5(1)(a) Pensions Act 2004, and to reduce the risk of compensation being payable to pensioners from the PPF. *Id.*, § 5(1)(c).

The 2004 Act contains another new and important feature called the "Statutory Funding Objective," 2004 Act § 222, which requires that every ongoing defined-benefit pension scheme must have "sufficient and appropriate assets" to cover its "technical provisions" ("Technical Provisions"), defined as the amount required, through an actuarial calculation, to provide for all the particular scheme's accrued, present and future benefits obligations. Section 3(2) and 5 Occupational Pension Schemes (Scheme Funding) Regulations 2005.[2] This amount is *not* the Section 75 Debt. Instead, it is an actuarial assessment of benefits payable compared with current assets held by the scheme

[2] Before the 2004 Act, operating pensions were subject to actuarial valuation under a one-size-fits-all regime known as the "minimum funding requirement" ("MFR"). Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuations) Regulations 1996; Hosegood Tr. 29-31. The MFR approach assessed a scheme's deficit based on a set of assumptions the regulatory authorities imposed on all schemes. *Id.*; Hosegood Tr. 30-31. The Statutory Funding Objective standard contained in the 2004 Act is scheme-specific. Section 222 Pensions Act 2004; Hosegood Tr. 29-30.

in order to allow the Trustees to understand what it will actually cost to pay beneficiaries everything they are owed and to adopt a prudent plan to provide for any deficit. *Id.*

The 2004 Act addresses a common corporate structure, present here, involving establishment of a services company within a group. Under this structure, a services company is established as employer of employees within the group, and employee expense is allocated to operating companies within the group through inter-company accounts. Section 43 of the 2004 Act authorizes TPR to serve notices that, in certain circumstances, require certain affiliates of services companies to provide financial support up to the full amount of the principal employer's Section 75 Debt, which may take the form of cash or other consideration. The issuance of such a notice – referred to as a Financial Support Direction ("FSD") – is subject to a reasonableness requirement. Section 43(b)(5) Pensions Act 2004.

Prior to the issuance of an FSD, TPR must issue "warning notices" to the potential "target" of an FSD. Section 96(2)(a) Pensions Act 2004. Thereafter, TPR convenes a panel ("Determinations Panel") to determine whether an FSD should be issued. Section 96(2)(b) Pensions Act 2004. If an FSD is issued, the recipient must respond with a proposal to meet its requirements, and TPR determines whether the proposal is satisfactory. Section 96 Pensions Act 2004. Where, in TPR's view, the target of an FSD fails to provide adequate financial support, TPR may then issue a "contribution notice," which is subject to a reasonableness test and requires the target to make a specific payment to the trustees of a scheme, in an amount up to the full amount of the Section 75 Debt. Section 47 Pensions Act 2004.

THE ISSUES

The Central Issue – The Quantum of the Trustees' Claims

In a contest, at what amount would this Court adjudicate the Trustees' Claims? Central to the many issues raised by the Motion is the dispute about the quantum of the Pension Claim. The parties present two methods of valuing that quantum.

The first method, which we refer to as the "Actual Damage Measure," asks what sum of money, when added to the Schemes' assets, would enable the Trustees to pay all of the Schemes' liabilities as those liabilities fall due. This method values the quantum under the "prudent investor rule" applied in U.S. bankruptcy cases, and results in a quantum that closely coincides with a valuation performed under English law on the "Technical Provisions," as prescribed under the Statutory Funding Objective of the 2004 Act. The Schemes' actuary actually performed this valuation for the (larger) 1983 Scheme as of a date quite close to the Petition Date.

The second method, which we refer to as the "Section 75 Measure," arises under Section 75 of the Pensions Act 1995. It is a figure certified by the scheme actuary representing his *estimate* of the cost in the marketplace of obtaining a "buy-out" of the scheme's liabilities by a provider (*i.e.,* an insurance company) approved by the U.K. Financial Services Authority ("FSA"). Regulations 5(18) and 6(8), Occupational Pension Schemes (Employer Debt) Regulations 2005. It is important to recognize that, while the Schemes' actuary has given estimates under this method, he has not actually certified a Section 75 buy-out number.

At trial, we will show that the Actual Damage Measure applies here. In part this is a function of the better-reasoned U.S. pensions jurisprudence; in part it is because the

Section 75 Measure has not been triggered (except in a comparatively trivial respect); in part because the Settlement does not discount its Pension Claim amount for the significant likelihood that Section 75 will not be triggered soon, or indeed at all.[3] The point is significant because the Motion proposes a compromise based solely on the Section 75 Measure. Even if the Section 75 Measure applies and is not subject to any discounting for contingency, the measure itself has been so grossly overstated here, as the Debtors' own evidence will show, that the Settlement is unsupportable.

The Actual Damage Measure

The Schemes' actuary and the SCL Committee's experts approached the Actual Damage Measure in slightly different ways, but the results are quite consistent. Each shows that under the Actual Damage Measure, the valuation of the total Pension Claim for both Schemes is *well below fifty percent of the proposed Settlement.*

(1) Mr. Hosegood's Valuation on the "Technical Provisions"

The Court may begin with analysis actually – and recently – performed by the Schemes' actuary, Neville Hosegood, a U.K. actuary employed by Mercer Human Resource Consulting ("Mercer"). In November, 2007, Mr. Hosegood performed for the 1983 Scheme,[4] as of December 31, 2006, an actuarial report comparing the value of the

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[3] We discuss these and the other legal reasons why the Actual Damage Measure is the appropriate one below. We note here that the difference between the two measures is a non-pecuniary-damage penalty under U.S. law, and thus subject to a junior priority in chapter 7. For purposes of any subsequent test that arises in this case under 11 U.S.C. § 1129(a)(7), the delta may render a plan unconfirmable.

[4] Because of the effective date of the 2004 Act, and the fiscal years of the 1990 Scheme, such a report for the 1990 Scheme was not required under U.K. law and Mr. Hosegood did not prepare one.

1983 Scheme's assets with the amount of its accrued liabilities. Dep. Ex. 70.[5] He performed this valuation on the Technical Provisions under the Statutory Funding Objective of the 2004 Act, which obliged him to assess whether the Scheme "has sufficient and appropriate assets to pay its benefits as they fall due." Section 222 Pensions Act 2004; Dep. Ex. 68. Benefits due under a scheme are its accrued liabilities -- *i.e.*, the obligations it had incurred, and in time will pay out to its beneficiaries. *Id.* Because the Scheme had been closed to future accruals earlier that year, Hosegood Tr. 49-50, it had no liabilities except accrued liabilities. This means that the Scheme's statements of account (*i.e.*, its financial statements), including its balance sheet as of December 31, 2006, would capture all of its liabilities. Mr. Hosegood's analysis on the Technical Provisions included all of the 1983 Scheme liabilities; that is, the cost of providing *all* future Scheme benefits (except for future administrative costs). Hosegood Tr. 52-55.

To make this calculation, Mr. Hosegood *and the 1983 Scheme Trustees* agreed on assumptions "sufficiently prudent for benefits already in payment to continue to be paid, and to reflect the commitment which will arise from members accrued pension rights." Dep. Ex. 68; Hosegood Tr. 39-40. A "prudent margin will be included in the discount note and demographics assumption will be based on prudent principles." *Id. Mr. Hosegood's valuation expressly considered the fact, known to all by November, 2007, that the employer, as a chapter 11 debtor, had no on-going ability to pay future contributions.* Dep. Ex. 68 at 2 ("financial covenant" of employer). Given this and other

[5]The report brought current to December 31, 2006 an actuarial valuation on the same basis that Mr. Hosegood had performed effective year-end 2005. Dep. Ex. 4.

relevant facts, the assumptions to which Mr. Hosegood and the Schemes subscribed were *extremely* conservative. For example, although the Scheme's portfolio of assets included equity and debt securities in a mix allowing for prudent growth, Mr. Hosegood and the Trustees selected a discount rate based solely on AA-rated corporate bonds.[6] *Id.* at 5 (Annex). No provision was made for future equity out-performance, *id.* at 8 (Annex), although the Schemes projected that they would continue to hold equities, showing their intention to realize portfolio gains over the long term in excess of the discount rate, *see* Dep. Ex. 73 (1983 Scheme); Dep. Ex. 107 (1990 Scheme).

The result is expressed in the Sea Containers Actuarial Report as at 31 December, 2006 (Dep. Ex. 70), and the Scheme Accounts (Dep. Ex. 28). They show that the difference between the asset value of the 1983 Scheme and the cost of paying out all of its pension benefits is approximately £35 million. Dep. Ex 113 (calculating deficit). This was *not* an estimate: it was a full actuarial report prepared at a time when all relevant factors – chapter 11, employer withdrawal, closure of Schemes to future accruals, and indeed, the existence of the SCL Committee's claims objection – were known. In effect, Mr. Hosegood calculated the Actual Damage Measure for the 1983 Scheme, as of a date a few months after the Petition Date. While the same analysis was not performed on the smaller 1990 Scheme, we expect to show that a valuation on the Technical Provisions would place the total Pension Claims for both Schemes at *well under £50 million.*

[6] At the same time, the Schemes reaffirmed the desire to continue having equities as a component of the asset pool. Dep. Ex. 73 (1983 Scheme); Dep. Ex. 107 (1990 Scheme).

(2) The SCL Committee's Prudent Investor Calculation

The SCL Committee's experts also considered the Actual Damage Measure, through calculation of scheme deficits under the "prudent investor rule." The SCL Committee expects to offer at trial the expert testimony of David Gulley and John Parks of Navigant Consulting, Inc. Mr. Parks present-valued the Schemes' liabilities, making appropriately prudent assumptions (although not the unrealistic, bond-only assumptions made by Mr. Hosegood), including an assumed discount rate based on a study of pensions by Mr. Gulley. He compared those liabilities to the asset values, using guidance from SCL's own experts at Pricewaterhouse Cooper ("PwC").

Mr. Parks is expected to testify, based on more than forty years of experience with defined-benefit pension schemes and his review of the cash-flow projections of the 1983 and 1990 Schemes, that the proper and conservative mix for both Schemes would be an investment of 40 percent in equities and 60 percent in fixed and other investments. Mr. Gulley is expected to testify that, based on this allocation, the proper forward-looking rate-of-return is 7.0 percent for both Schemes. Mr. Parks is expected to testify that, based on a 7.0 percent discount rate, *the funding deficit for both Schemes is £34 million.* With that sum, the Schemes' Trustees would have all the money they would ever need to pay in full every pension beneficiary until the last benefit is paid. The Settlement is at almost three times that figure.

The Section 75 Measure

The Settlement would allow the Pension Claims at approximately £100 million. It rests on the Section 75 Measure. Section 75 Debt, which arises only upon the occurrence of certain triggering events, is meant to measure the cost of procuring

annuities from an insurance company to secure the payment of benefits. The actuary is to calculate, verify and certify an estimate of that debt on the assumption that the debt will be discharged by the purchase of annuities. Regulations 5(18) and 6(8) Occupational Pension Schemes (Employer Debt) Regulations 2005; Hosegood Tr. 16. Mr. Hosegood has certified no debt; he testified that no Section 75 Debt has been triggered, other than that related to the withdrawal of certain participating employers from the Scheme. Hosegood Tr. 17-18. Thus, if Section 75 is relevant here at all, the parties are left to estimate what the debt might be *if* it were triggered at some unknown point in the future.

The evidence disclosed three sources for such an estimate: (i) Mr. Hosegood's estimate; (ii) analysis by actuaries at PwC, which reviewed Mr. Hosegood's estimate on behalf of the Debtors; and (iii) a proposal actually made to the Debtors by Lucida, plc ("Lucida"), a qualified provider of buy-out annuities, to buy out both Schemes. The second and third sources of information, which the evidence will show to be far more reliable, demonstrate that Mr. Hosegood's evidence is manifestly unreasonable.

(1) Section 75 Buy-Out Estimates by the Schemes' Actuary

The most plausible future trigger for Section 75 would be a decision by the Scheme Trustees to "wind up" the Schemes. Once a decision is made to wind-up a pension scheme, the scheme trustees are not required to buy out the scheme with annuities or the like but have several, far less costly, options with respect to meeting a scheme's obligations to its members. But they have not decided to wind up, are not legally committed to wind up, and Mrs. Kennell testified that it could be "two, five, or ten years" before any wind-up. Kennell Tr. 117; *see also* Fryer Tr. 38. Nevertheless, Mr. Hosegood estimated the Section 75 Debt for both Schemes at various dates *in the past*.

Estimates concerning the insurance market are enormously challenging to begin with, because that market is in a state of flux. Kennell Tr. 152-53. It has seen new entrants in the past 2-3 years that have caused meaningful price erosion, according to Christopher Massey, a PwC actuarial expert who is expert on the marketplace. Massey Tr. 120. Mr. Massey agreed that this market activity has stimulated competition, which in turn has driven down prices, a trend that continues today. *Id.* 9-10.

So volatile is this market that Mr. Hosegood testified that his Section 75 estimate was subject to a *"high degree of error."* Hosegood Tr. 28, *see* Dep. Ex. 106. As he candidly conceded, he is not an expert concerning the insurance market for the provision of annuities for pension liabilities and, indeed, has *no* personal expertise of the insurance market. Hosegood Tr. 27, 95. He did not consult that marketplace for actual data about actual transactions. *Id.* 95. Instead, he applied data from a "central committee" of Mercer, located at a different Mercer office, most of whose members he has not met. *Id.* 96-97. So unfamiliar was Mr. Hosegood with this market that, for a period in 2007, as he was later embarrassed to admit, *see* Dep. Ex. 12, 123; Ashe Tr. 47-48, he applied outdated information, *see* Hosegood Tr. 107-111; Dep. Ex. 12. Mr. Hosegood did not realize he had applied the wrong data until PwC advised him of this error in the fall of 2007. Dep. Ex. 12. The error resulted in an overstatement of one liability by more than £11 million. *Compare* Dep. Exs. 114 and 115 *with* Dep. Ex. 8. Mr. Hosegood did not calculate his estimate of the buy-out deficit as of the Petition Date using the appropriate data. Fryer Tr. 154-55. Further, the "central committee" data changed *again* in late 2007, but Mr. Hosegood's calculation of the buy-out deficit as at November 30, 2007 *did not take into account these changes*. Hosegood Tr. 112-15.

Mr. Hosegood's estimates thus have been a product of an arbitrary and unreliable process. His valuations for the 1983 Scheme at various effective dates from October 15, 2006 to October 26, 2007 produced figures ranging from £69.2 million to £98.1 million for the 1983 Scheme (Dep. Exs. 8, 71, 114, 115, 116), and £17.3 million to £22.9 million for the 1990 Scheme. Dep. Exs. 105, 106, 109. His most recent estimate, as at November 30, 2007, is £79.6 million for the 1983 Scheme (Dep. Ex. 71) and £20.8 million for the 1990 Scheme (Dep. Ex. 105), for a total of £100.4 million for both Schemes. The Pension Claim Settlement Amount – $194 million – is not a compromise figure at all: it is simply Mr. Hosegood's estimate of the full Section 75 Debt as at November 30, 2007, translated through a Petition-Date exchange rate.[7]

(2) Section 75 Buy-Out Analysis by PwC

PwC reviewed Mr. Hosegood's Section 75 estimate for the Debtors. Dep. Ex. 9, 10; Massey Tr. 8. Its approach was quite different. Christopher Massey, who led PwC's actuarial team, has personal experience in securing annuities for clients in the U.K., and is regarded within PwC as an expert on the subject. Massey Tr. 8-9. In stark contrast to Mr. Hosegood, Mr. Massey assembles his own market data and is personally knowledgeable about developments in the U.K. market for the provision of annuities. *Id.* 15-16.

Most of PwC's work involved calculating a range, as at various dates, expressing the "high end" and "low end" of the annuities market. These ranges were remarkably broad. For example, PwC calculated the "range" for the annuity cost for the 1983

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[7] The Debtors have characterized as a "concession" the application of the Petition Date exchange rate of $1.87, *see* Barlow Tr. 42-43, but that rate is compelled by law, as discussed below.
(continued on next page)

Scheme as of the Petition Date to be anywhere from £54 million to £99 million. PwC's Section 75 calculations for the Schemes (Dep. Exs. 9 & 10) were as follows:

Date	1983 Scheme		1990 Scheme	
	PwC Low	PwC High	PwC Low	PwC High
10/15/2006	£54 M	£99 M	£12 M	£24 M
5/31/2007	£48 M	£86 M	£11 M	£22 M
7/16/2007	£44 M	£77 M	£10 M	£20 M
10/26/2007	£53 M	£89 M	£12 M	£23 M

The PwC ranges compare with the Mercer estimates as follows (Dep. Ex. 127):

Date	1983 Scheme			1990 Scheme			TOTAL		
	PwC Low	PwC High	Mercer	PwC Low	PwC High	Mercer	PwC Low	PwC High	Mercer
10/15/2006	£54 M	£99 M	£98.1 M	£12 M	£24 M	£22.9 M	£66 M	£123 M	£121M
5/31/2007	£48 M	£86 M		£11 M	£22 M		£59 M	£108 M	
7/16/2007	£44 M	£77 M	£69.2 M	£10 M	£20 M	£17.3 M	£54 M	£97 M	£86.5 M
10/26/2007	£53 M	£89 M	£74.4 M	£12 M	£23 M	£19.6 M	£65 M	£112 M	£94 M
11/30/2007	£59 M	£96 M	£79.6 M	£15 M	£26 M	£20.8 M	£73 M	£121 M	£100.4 M

As is evident, the "ranges" strain at the high end to accommodate Mr. Hosegood's figures. But characterization of PwC's figures as "ranges" is inaccurate, for the real task is to estimate at what price the Schemes could negotiate a buy-out.

Even *that* proved misleading. Mr. Massey conceded that all of the actual transactions he has observed in the buy-out market occurred *at the low end of his assumptions – he has not observed a single annuity-purchase transaction at the high-*

end.[8] Massey Tr. 19, 24, 98-99. He testified that for each valuation date, the low-end number in the PwC reports reflected a figure at which sellers of annuities in the marketplace[9] would actually furnish annuities. *Id.* 98-100. Since 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. The real import of PwC's conclusions, then, is that the actual marketplace for the purchase of annuities on the relevant dates is as follows (Dep. Ex. 127):

Estimate Date	**Estimated Amount Above Which Insurers Would Furnish Buy-Out of Both Schemes**
Oct. 15, 2006	£64mm
May 31, 2007	£59mm
July 16, 2007	£54mm
Oct. 26, 2007	£65mm
Nov. 30, 2007	£73mm

The highest of these figures, £73 mm, is about £27 mm less than the proposed Settlement.

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[8] To reach the "high end," sometimes absurd assumptions had to be made – such as that a discount rate would be less than the projected rate of pension increases: that is, that pensions would increase by inflation at a rate greater than the inflationary discount necessary to present-value those increases. Dep. Ex. 9; Massey Tr. 102-103.

[9] Mr. Massey admitted that his universe of sellers were all financially qualified by the FSA, or able to be. Massey Tr. 102-103.

(3) Lucida's proposal for a buy-out of both Schemes

Mrs. Kennell (herself an actuary) noted that in advising another client (EMAP) on an actual purchase of annuities, she did procure bids. Kennell Tr. 154. Mr. Massey also testified to knowledge about specific transactions that informed his "low end" calculation. Massey Tr. 23-24. Yet Mr. Hosegood's estimates were not predicated on actual bids by annuity providers. Hosegood Tr. 92; Fryer Tr. 159-60. His failure to consider actual transactions 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. Ashe Tr. 17-18. Lucida, an affiliate of Cerberus, is a creditworthy provider of scheme buy-outs in the U.K. market. Massey Tr. 10-11, 102-03. The Debtors and Lucida began communicating in August 2007. Ashe Tr. 15. Substantial data was sent to Lucida for review. *Id.* 15-17. On October 26, 2007, Lucida proposed to buy out *both* Schemes for a "*cash injection of around 50 million pounds*." *Id.* 17, 23.[10] Lucida has never backed away from its interest. The Debtors terminated discussions, but Lucida reaffirmed its continued interest in a buy-out of both Schemes as recently as March 2008. *Id.* 27-29.

(4) Summary of Evidence Regarding Section 75 Measure

In sum, the evidence as to the Section 75 Measure comes down to the following.

(i) An actual provider of annuities that continues to show interest in the Schemes offered a full buyout, subject to due diligence, in the amount of £50 million.

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[10] The offer was subject to customary due diligence to establish, for example, that the actuarial data furnished to Lucida concerning the Schemes' beneficiaries was accurate. Ashe Tr. 22-24.

(ii) An expert on the insurance marketplace calculated prices (which vary with effective date) from £54-£73 million, as the amounts above which actual market participants qualified to provide annuities would buy out the Schemes. He based this estimate on actual and personal knowledge of the marketplace.

(iii) The Scheme actuary, who is not knowledgeable about the marketplace, did not consult the marketplace, relied on a central office for form data, admitted a substantial mistake, has not updated his estimates for current data, and has never certified a Section 75 Debt for the Schemes, provided the sole estimate that backs the proposed Pension Claim Settlement Amount of approximately £100 million.

Failure to Discount

Mr. Hosegood's estimate of the Section 75 Debt is thus wildly out of line with the marketplace. But that is only the beginning of the problems. *None of the three approaches to the Section 75 Measure discounts the resultant calculation for any of the host of contingencies that surrounds whether it will ever arise.* There is no discount for the risk that a U.S. court might apply the Actual Damage Measure; nor to present value of the time delay in triggering a Section 75 Debt, although Mrs. Kennell testified that it might be as long as ten years before such debt were triggered.

Most significantly, there is no discount for the risk that the Section 75 Debt would never come to pass at all. [redacted]

In September, 2007, Mr. Hosegood advised the Trustees as to their options, focusing on their actual distribution from these cases. Dep. Ex. 126. His chart shows that at an actual recovery of less than £30 million, the Schemes might or might not be able to secure PPF benefits. Above £30mm and below £60mm, the Trustees *should "contemplate continuation as a closed scheme." Id.* That is because his analysis on the Technical Provisions shows that, at that sum, the Trustees could continue to pay the Schemes' liabilities in full, but could not afford to buy out annuities at full value. Only at £80 million recovery should they "buy out benefits." *Id.* That is because the high cost of buying benefits would result in a much poorer return to the pension beneficiaries than continuing to run the Schemes.

It is thus a certainty that for a considerable period of time the Trustees will not purchase annuities, and highly likely that they will continue to run the Schemes.

This is also shown by the Trustees' oversight of the Schemes in the recent past. If a fiduciary knows she will wind up a scheme, it would be sensible to transfer all assets into a form not subject to short-term losses – *i.e.*, as close to government bonds as possible. If she knows that she will hold and obtain value from a portfolio for fifty years,

a high percentage of equity (subject to short-term losses but much higher longer-term return) is warranted. Although both Schemes reduced their equity portfolio, equity remains a substantial component of the portfolios. Dep. Ex. 73 (1983 Scheme); Dep. Ex. 107 (1990 Scheme). As of year-end 2006, the 1983 and 1990 Schemes each held approximately 50 percent equities. Dep. Ex. 28, 88. In 2007, the equity holdings were reduced to a range of 35 percent for the 1983 Scheme and 25 percent for the 1990 Scheme. Dep. Exs. 73, 107. While these changes reflect a rising risk of wind-up in the short-term, they equally demonstrate an expectation that the Schemes will continue to operate, perhaps indefinitely.

The Second Issue – The Priority of the Trustees' Claims

The Trustees' Claims lie against Services. The Trustees would receive a ratable distribution from Services, which in turn would depend on its distribution from SCL. SCL's reimbursement obligation, arising under the Services Agreement, would off-set by be $61 million in inter-company claims. In addition, the reimbursement obligation would not reach anything more than the Actual Damage Measure. The Services Agreement indemnifies Services for "the cost of providing Services to companies in the Group including but not limited to the cost of the remuneration and employee benefits of the Employees including payments on termination of employment, however terminated, and all overheads." Motion, Ex. B at 3. The Services Agreement does *not* provide indemnity for the delta between the Actual Damages and Section 75 Measures because that delta does not represent the "cost of the remuneration and employee benefits of the Employees," but rather is a penalty based on SCL's financial distress. To avoid these issues, the Trustees and their advisors engaged in an elaborate and collaborative effort

with a so-called "regulator" that flagrantly violated the automatic stay, to procure U.K. orders that could be argued to give rise to a claim against SCL. Those orders are void, and thus the Settlement, whose structure is based on their issuance, must fail.

The Collaborative Pecuniary Efforts to Obtain Issuance of FSDs before the Bar Date

TPR is a novel creature of U.K. law, and became operational only in April 2006. Fryer Tr. 41. Upon appointment, Mrs. Kennell reached out to TPR for assistance. *Id.* 73-74. The relationship with TPR was pecuniary and unabashedly collaborative from the first. *See, e.g.*, Kennell Tr. 68-69 (TPR has an interest in seeing that the 1990 Scheme recovers as much as it can from these chapter 11 proceedings); Fryer Tr. 40 (TPR works to reduce likely risk of Schemes becoming subject to PPF). There was nothing "regulatory" about the relationship.

Without the employer present, the Trustees met with TPR at TPR's offices in Brighton, England on July 26, 2006. Kennell Tr. 79. TPR representatives included Tania Edwards and Ken Taylor, who led TPR's discussions at that meeting and as matters progressed. Dep. Ex. 110. Talking points posed the questions of "what specific assistance can the Regulators' provide to the Trustees?" and "what on-going relationship should we the trustees develop with the Regulator's team?" *Id.* TPR answered that it was "here to help and have discussions," and that its objective was to "1. Protect Members; 2. Protect PPF; 3. Educate Trustees." Dep. Ex. 110.

After TPR telephoned Mrs. Kennell to warn the Trustees off of their advisor, Chantrey, Dep. Ex. 110, the Schemes hired Kroll. Dep. Ex. 28 (Scheme Financial Statements). Ken Taylor of TPR, who would lead intense and collaborative meetings and

discussions with Kroll, *would go on to work for Kroll, and works there now*. Kennell Tr. 77.

In September, there ensued a series of rapid-fire discussions, in which SCL, the evident target of this "regulator," was never invited to participate:

September 6: Mrs. Kennell advises TPR that the Trustees would not wind up the Schemes and would make a contribution demand on SCL. Dep. Ex. 110. Mr. Taylor says that TPR is "trying to get to top table," and that he, Taylor, will communicate independently with Kroll. *Id.*

September 13: Mrs. Kennell asks TPR to "consider imposing a FSD on SCL if we have no other way of making a direct claim against SCL or obtaining a place at the negotiating table with the bondholders." Dep. Ex. 92.

September 20: Following a meeting between the Trustees and SCL, the Trustees confer with TPR to collaborate on developing negotiating leverage. Dep. Ex. 110. Mr. Taylor states: "Bondholders deal and we have leverage if trustees, Regulator not like offer." *Id.* The conference ends with the note that Gary (Kroll) will "feed back to Ken [Taylor] on any discussions with PwC." *Id.*

September 25: Mr. Taylor, clearly inside the "Kroll tent," states, "if go into Ch. 11 – Regulator cannot stop this . . . concern if some agreement to bondholders and not favorable to us." *Id.* Mr. Taylor adds: "trying to evaluate the possibility of an FSD to Topco . . . great deal of urgency . . . [and] Hammonds [Schemes counsel], Kroll and Regulator to *get us into Topco*." *Id.* (emphasis supplied). SCL has no notice of this discussion.

September 27: Mr. Taylor advises that he wants to "send a letter to Topco to say that the TPR will issue an FSD." *Id.* He asks: "If do the letter to Sea Containers and then goes into Ch. 11 will it be a contingent liability?" and, "important we do something before go into Ch. 11?" The Schemes' lawyer (Doraisamy) responds, "agree." *Id.*

September 28: The parties (again without SCL) confer again, with the Schemes asking TPR to issue a warning letter (Dep. Ex. 34), and noting that the chapter 11 timetable "would give Regulator plenty of time to issue FSD." *Id.* Mr. Taylor asks, "So an FSD would help?" *Id.* He notes: "PF [Pension Fund] seeking higher paying point, bondholders less." *Id.* Later *in the same call*, Mr. Taylor reports that "they have drafted a warning letter to send – tomorrow." *Id.*[11]

September 29: TPR issued a warning letter to SCL advising that the "Sea Containers Group may be subject to a financial support direction under section 43 of the Pensions Act 2004." Dep. Ex. 35.

This collaboration continued during the post-petition period. The Trustees urged TPR to take action that would have the effect of assessing a direct debt in their favor, and against SCL, for pension-related claims. They inquired whether TPR *wanted to join the Creditors' Committee*. Dep. Ex. 36-37. They also asked TPR to issue warning notices (Dep. Ex. 34, 93), which TPR did on October 19, 2006. Dep. Ex. 38 (1983 Scheme); Dep. Ex. 94 (1990 Scheme).

[11] When the Trustees ask for a warning letter, it is drafted by TPR within the hour. *Id.*

The Issuance of the FSDs

On January 31, 2007, the Trustees filed papers with TPR seeking issuance of FSDs. *See* Representations of the Trustees of the 1983 and 1990 Schemes to the TPR. These filings did not notify TPR of the impact of the automatic stay in these chapter 11 cases. The Debtors had to advise TPR of the pendency of these chapter 11 proceedings and the existence of the automatic stay, specifically noting that "the issue of an FSD and any attempts to seek contributions in furtherance thereof, would be a violation of the automatic stay." Debtors 0020519-21. The Debtors noted that the Trustees had elected to participate in these chapter 11 proceedings. *Id.* TPR issued amended warning notices to SCL on or about April 26, 2007, which advised, among other things, that TPR supported the issuance of an FSD. Motion ¶ 40.

A Determinations Panel of the Pensions Regulator ("Panel") conducted a hearing on June 12 and 13, 2007 in London ("Hearing") to determine whether to issue FSDs against SCL. Prior to the Hearing, the so-called "Regulator" twice traveled to collaborate with the Trustees *at the Trustee's lawyers offices in London.* Kennell Tr. 97-98; Dep. Ex. 40.[12] The second of these meetings, on the eve of the Hearing, was clearly an effort to collaborate in the presentation of evidence. Kennell Tr. 98.

Drafts of witness statements were shared by the Schemes with TPR and signed off on by the TPR. Dep. Ex. 47. The correspondence and testimony also showed a furious effort to complete and issue the Panel's decision prior to the July 2007 Bar Date. Fryer Tr. 103; Dep. Ex. 45. Before the Hearing, the Schemes filed briefs (referred to under

[12] That is, the "government agency" traveled up from Brighton to meet at the offices of its regulated entity in London.

U.K. practice as "Skeleton Arguments") with the Panel supporting the issuance of FSDs against SCL. The 1983 Scheme Trustees asserted, among other things, that an "FSD is needed urgently" *because of the Bar Date in these chapter 11 proceedings.* SCL Committee's Claims Objection ("Claims Objection"), Ex. D ¶¶ 4, 5. Without an FSD, they urged, their "direct claims" against SCL in the chapter 11 process would be "precarious." *Id.* On the other hand, they believed that issuance of an FSD would help them assess, liquidate, and pursue a direct claim against SCL. *Id.* ¶ 13. Indeed, the 1983 Scheme Trustees argued that an FSD would provide the Scheme with a prospective recovery of 62-76 percent, in contrast to a 7-31 percent recovery if an FSD were not issued. *Id.* The Trustees stated that "the issue of an FSD in good time before the Bar Date will facilitate the 1983 PST filing a claim in SCL's Chapter 11 proceedings, which will so far as possible enable the 1983 Scheme's rightful claim against the assets of SCL to be recognized *pari passu* with all other unsecured creditors of SCL." *Id.* ¶ 27.

The 1990 Scheme Trustee asserted, among other things, that "[a]n FSD will circumvent the arguments about the validity and scope of the Services Agreement . . . *an FSD will increase the liabilities of SCL* . . . [and] the absence of an FSD will therefore put the 1990 Scheme at a disadvantage in the [chapter 11] process." Claims Objection, Ex. E, ¶¶ 2(6), 18 (emphasis supplied), 21. The 1990 Scheme stated that an FSD should be issued "as soon as possible" given the upcoming Bar Date in SCL's chapter 11 case. *Id.* ¶ 32.

Marc Abrams, a member of Willkie Farr and lead counsel to the Services Committee, submitted a Witness Statement to the Panel that supported the issuance of FSDs. Dep. Ex. 48. At the hearing, Mr. Abrams testified on behalf of the Trustees,

acting directly and vigorously as their advocate, expressing the desire to assess a direct claim against SCL, and thus directly affect the claims process in these chapter 11 cases. *Id.* Prior to the Hearing, neither the Services Committee nor the Trustees sought to modify the automatic stay applying in these chapter 11 cases, nor provided notice to the Court regarding the FSD proceedings. Fryer Tr. 104-05.

While *Services* is the principal employer under each of the Schemes, and held pre-petition indemnity rights against SCL for the cost of provision of services, the *Trustees* had *no* direct contractual rights against SCL.[13] Mr. Abrams made clear that the Trustees were seeking to assess such direct claims, stating that "*what the Trustees are currently seeking* in supporting the FSD Notice is that the Schemes should be recognized by Sea Containers *as creditors of Sea Containers*, not just of Services, and as unsecured creditors should be treated *pari passu* with other unsecured creditors of Sea Containers, and in accordance with applicable law, including the Bankruptcy Code." Dep. Ex. 48 ¶ 8 (emphasis supplied).

No regulatory purpose nor police power was involved in these proceedings. The purpose of the entire exercise was to use a foreign regulatory body to assess *in favor of private creditors* pecuniary claims against a chapter 11 debtor. While any true act of police power would stand indifferent to a chapter 11 bar date, the Trustees and the Services Committee expressed their urgent desire that FSDs issue (and thus, as they would argue, that direct claims against SCL be assessed) *before the Bar Date*. Mr. Abrams stated that "[t]he issuance of an FSD will make clear to Sea Containers and

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[13] As noted, SCL had a statutory, comparatively small, liability to the 1983 Scheme Trustees by reason of its 2006 withdrawal as a participating employer.

the Sea Containers Creditors' Committee that Sea Containers must take responsibility for the Schemes' liabilities . . . [and] [i]t is essential that an FSD should be issued against Sea Containers prior to the 16 July [2007] deadline [the Bar Date], if the Schemes are to obtain the protections afforded by English law." Dep. Ex. 48, ¶¶ 14, 16. Mr. Abrams testified:

> If there is no FSD at the time the timely file[d] claims are objected to, which could occur in theory the second after they are filed, then we *would not have the ammunition we require* and that we are entitled to under US law to easily defeat those objections. I do not know whether we would ultimately defeat them without it, but the point I am simply making here is that these are claims on UK creditors under UK law to be determined by a UK tribunal and the more we advance that process the more those claims become unassailable as a matter of law in the US bankruptcy case.

Claims Objection, Ex. G, Hearing Testimony 141-42. *See also* Dep. Ex. 48, ¶¶ 24 ("If the FSD is granted requiring SCL to take responsibility for the Schemes' liabilities, then the claims determination and plan confirmation process will have to proceed on a basis which takes account of that liability, thus protecting the interests of the members of the Schemes.").

In short, through the testimony of Mr. Abrams, the Trustees took action before a non-bankruptcy tribunal, operating post-petition and without relief from the stay, to assess a claim against the debtor based on acts and omissions that occurred before the commencement of a chapter 11 case. While Mr. Abrams acknowledged that this Court would determine the amount of the Pension Claims, *see* Dep. Ex. 48 ¶ 17, he expressed the purpose that the FSDs would assess a direct claim at SCL prior to the Bar Date, to be determined solely pursuant to U.K. law. Mr. Abrams summarized his testimony as follows:

> What I think this process is designed to achieve in the most efficacious and effective way possible, *is to establish the claims of the Schemes*

> *against the ultimate parent* [SCL] and whether or not the company can ultimately abide by the terms of an FSD . . . the ability to attach an FSD to a proof of claim at the parent level *gives me all the comfort I need that the parent's liability has been established* and either through the FSD or subsequent proceedings or agreement it would be quantified . . .

Claims Objection, Ex. G, Hearing Testimony 130, 134-35 (emphasis supplied).

Following issuance of the FSD (the first ever issued), the 1983 Scheme sent an email to TPR thanking them for their assistance. Dep. Ex. 53. Sackers, the 1983 Scheme attorneys, issued a self-congratulatory press release. Dep. Ex. 52.

The Strategic Objectives of the Trustees and Services Committee in Seeking the FSDs

The Trustees and the Services Committee had several strategic objectives in their efforts to obtain issuance of FSDs before the Bar Date. The first was to elevate the structural priority of distribution on their claims in this Court by avoiding dilution and set-off at the Services level. The second objective was to argue for the Section 75 Measure and thereby escape the contractual limitations of the Services Agreement to the Actual Damage Measure. The difference between the two measures of the Trustees' claims is enormous here, and it appears that the Trustees procured a post-petition FSD process in an effort to undergird an argument that their chapter 11 claims might be inflated by applying a U.K. measure of the claims, and to seek to establish momentum for an argument that this U.S. Court should defer to U.K. law as to claims calculation. For example, Mr. Abrams advised the Panel that the issuance of FSDs would result in negotiations between the Schemes and SCL concerning the allowed *amount* of a direct claim against SCL. Claims Objection, Ex. G, Hearing Testimony 103-04. He further testified that "if, for example, the FSD process resulted in a hundred pound claim against [SCL] and we presented that stipulation to the bankruptcy court, that would allow that claim at the Sea Containers level as a general unsecured claim . . . ." *Id.* at 126.

A third consequence of the FSD process is that the assessment of a direct claim against SCL creates a risk of duplication as between the newly assessed, direct claim, and the pre-existing obligation of SCL to Services under the Services Agreement.[14]

The efforts of the Trustees and the Services Committee to procure (i) the post-petition support of TPR, and (ii) a post-petition FSD order from the Panel were successful. Swayed by Mr. Abrams' presentation, the Panel described its direct, pecuniary purpose in Determination Notices that it rushed to issue two days later, before a memorandum opinion (referred to as "Reasons") could even be written. Claims Objection, Ex. H. The notices advised that an FSD would issue against SCL with respect to each Scheme. *Id.* In each case the FSD would "require [SCL] to put in place financial support in the form of arrangements falling within section 45(2)(b) of the [2004] Act whereby [SCL] is liable for the part of [Services'] pension liabilities . . . in relation to the Scheme which may become due to the Trustees of the Scheme from [Services] by virtue of section 75 of the Pensions Act." *Id.* As evidence of the pecuniary purpose of both the Trustees and TPR itself, the Determination Notices indicated that "the most recent estimate" of the collective Section 75 Debt for the Schemes exceeded £90 million. *Id.* at ¶ 7.

The Panel did not issue its Reasons until ten days later. Claims Objection, Ex. I, Reasons ¶ 30 (June 15, 2007). The Panel noted that "an FSD would give the [Schemes'] trustees a direct claim against SCL," *id.* ¶ 30(5), and that, "[a]s Mr. Abrams made clear, the approach of the [Schemes'] trustees would be to seek to rely upon both an FSD (if

[14] The Trustees have asserted to TPR that this is not their objective.

issued) and the Services Agreement, the latter being used to claim in respect of the liabilities of Group companies other than SCL," *id.* ¶ 30(2) at 16-17. The Panel found that "an FSD would give the trustees a direct claim against Sea Containers," *id.*, ¶ 30(5) at 17, and "the Panel accepted for reasons explained in helpful detail by Mr. Abrams in his evidence . . . that a claim based upon the Services Agreement would be considerably more vulnerable than a claim based upon an FSD," *id.*, ¶ 37 at 25.

TPR expressed the view that once the FSDs issued, SCL would seek, but "might not get approval of the U.S. Bankruptcy Court to a claim based on an FSD or to actual payments under whatever financial arrangements SCL wished to implement to meet its obligations under the FSD." *Id.* ¶ 31. If that failed, TPR observed, the Trustees could attempt to show cause why TPR should not issue "contribution notices" – *i.e.*, notices requiring payment. *Id.*

Neither the Trustees nor the Services Committee have ever sought to lift or modify the automatic stay in connection with the proceedings before TPR or the Panel, or the orders issued by either.

SCL appealed the Notices and Reasons on July 27, 2007, thereby staying the actual issuance of FSDs. Motion ¶ 43. (After settling with the Schemes, SCL subsequently withdrew its appeal and the FSDs issued. Motion ¶ 44.) In response to this appeal, TPR filed "Statements of the Case" (briefs; hereinafter "TPR Statements") with the Pensions Regulator Tribunal, the U.K. tribunal that would decide the appeal. Claims Objection, Ex. J. The TPR Statements contain the following representations, providing further evidence of inappropriate post-petition conduct:

> The Panel also considered the existence of the chapter 11 proceedings in the United States noting that (a) it would be preferable from the point of

> view of each set of trustees looking to prove a claim in the Chapter 11 proceedings, to rely upon an FSD rather than the Services Agreement, (b) an FSD would give the trustees a direct claim against SCL and, as such, would rank on an equal basis with the other unsecured creditors of SCL, and (c) it was inevitable that, to the extent that a claim was based on an FSD was successful, it would reduce the potential recovery of other unsecured creditors of SCL.

TPR Statements ¶ 6(3)(ii)(v)(vi).

The TPR Statements state that the Panel also considered whether the Trustees would be better off with an FSD than proceeding on the basis of the Services Agreement and accepted, based upon the evidence given by Mr. Abrams and the 1983 Scheme Trustees, that a claim based on the Services Agreement would be more vulnerable than a claim based upon an FSD. TPR Statement ¶ 6(8). The papers before the Panel set out the facts and matters relied upon by TPR in its case before the Panel, noting in particular the witness statement of Mr. Abrams, dated June 6, 2007 and exhibits thereto. Claims Objection, Exs. I, J. TPR also relied the submissions of counsel for the 1983 Scheme and the 1990 Scheme as well as the Schemes' submissions. *Id.*, Ex. J, ¶ 7. The TPR Statements also confirm that the Trustees were attempting, post-petition, to obtain an FSD so that they could assert a direct claim against SCL in these proceedings. *Id.*

Each proof of claim filed by the Trustees in this Court, as to which the SCL Committee filed an objection on September 17, 2007,[15] states that SCL is liable to the Trustees based on SCL's "obligation to provide financial support to the Pension Scheme . . . under one or more financial support directions which may be issued to the Debtor by the Pensions Regulator in the United Kingdom." 1983 Scheme Claim, Ex. A

[15] The SCL Committee incorporates herein by reference its September 17, 2007 objection ("Objection") to the Trustees' proofs of claim.

at Rider, Item 4(V); 1990 Scheme Claim, Ex. B at Rider, Item 4(II)). The Debtors expressly state in the Motion that, except for SCL's Section 75 Debt incurred as a result of its withdrawal from the 1983 Scheme, "the Trustees' direct claim against SCL derives exclusively from the FSDs obtained by TPR, which the SCL Committee asserts was obtained in violation of the automatic stay." Motion ¶ 84.

The Third Defect of the Settlement – The Equalisation Reserve

The Settlement includes an Equalisation Reserve of $69 million in respect of what is called the "Equalisation Claim." The argument for this reserve is that the Trustees violated U.K. law by failing to equalise normal retirement ages between male and female members to age 65, with the result that U.K. law would imply equalisation to age 60, increasing the overall benefits due. Before turning to the merits, the Trustees claim this element of the Settlement on the basis of what they say is the possibility that earlier trustees and the employer failed to equalise the Schemes. As an equitable matter, how the estates should be liable to the Trustees for the posited failure of their predecessors is never explained.

The proposed reserve is based on a "worst case" assumption of complete failure to equalise the Schemes to age 65, and on a Section 75 measure of this liability. The distribution on the $69 million reserve would be placed in escrow, a process that does not exist today would be generated to insure that a significant portion, if not all of those funds are lost to litigation and settlement costs, and the unsecured creditors who otherwise would receive that distribution would have no role in that process, and thus no power to stanch the bleeding from this self-inflicted wound. Dep. Ex. 3 ¶ 5. All of this is

proposed despite evidence that shows overwhelmingly that the Schemes were, in fact, equalised to age 65, *and that no pension beneficiary has ever asserted to the contrary.*

In 1990, the European Court of Justice ruled in *Barber v Guardian Royal Exch. Assurance Group* [1990] 2 All ER 660, that male and female members of pension schemes are entitled to equal pension benefits. Cases have wrestled with the prospective and retrospective application of *Barber*, and the general rule requiring that formalities be observed in amending scheme instruments. Much U.K. law has been generated on the question of what formalities are required to amend a scheme deed that sets out a discriminatory difference in normal retirement age.

The 1983 Scheme. None of that law is relevant here, because of the unique terms of the 1983 Scheme Deed. Under the Scheme Rules, "normal retirement age" was not set at different ages for men and women. Rather, it was defined as *either* (a) 65 for men and 60 for women, *or* (b) as "otherwise agreed by the Employers and the Trustees." Dep. Ex. 25, Rule 1(H) of the 1988 trust deed. That is, no amendment of the Scheme deed was necessary to change the "normal retirement age;" the scheme deed itself permitted that normal retirement age could regularly be recalibrated by agreement. *There is no dispute – by anyone – that such an agreement was made more than fourteen years ago.*[16]

In response to the *Barber* decision, a number of steps were taken within the 1983 Scheme. On March 1, 1993, a deed of amendment was executed that provided that all members (male and female) who joined the 1983 Scheme on or after January 1, 1991 would benefit from an equalised normal retirement age of 65. Dep. Ex. 26. This deed of

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[16] Indeed, nothing in the Scheme's Rules require that this agreement even be in writing (Dep. Ex. 25), although here the parties' agreement was in writing. Dep. Ex. 74.

amendment successfully equalised normal retirement ages for all members of the 1983 Scheme who joined on or after January 1, 1991. To the extent that the deed cannot operate retrospectively, equalisation under the terms of this deed took place on March 1, 1993. The Equalisation Reserve has been calculated on the basis that this deed was ineffective.

In 1994, the Employers and the Trustees (who at the time were the management of the Employers) agreed, as they were permitted to do by law and by the Scheme Rules, to change the normal retirement age such that it would be age 65 for all employees. Dep. Ex. 74; Fryer Tr. 170-71. This was sufficient under the Scheme Rules. Nor could anyone suggest that the agreement somehow should be avoided as having misled scheme beneficiaries. On or about July 15, 1994, the 1983 Scheme sent an announcement to all members advising that the normal retirement age had been equalised to 65 in respect of all employees who were members of the 1983 Scheme prior to January 1, 1991. Dep. Ex. 74. In the past fourteen years, no pension beneficiary has ever contested this. Fryer Tr. 178-79. The Settlement assumes it was totally ineffective.

The crowning absurdity is that the 1983 Scheme Trustees executed a "cleanup" replacement definitive deed on December 16, 2005. Dep. Tr. 27. This deed confirms the 1994 agreement, and provides an equalised normal retirement age of 65. The proposed Equalisation Reserve ignores even *that* deed.

The 1990 Scheme. A definitive trust deed was executed on April 26, 1995 for the 1990 Scheme, which equalised the normal retirement age to 65 for employees who became 1990 Scheme members on or after January 1, 1991, effective August 21, 1990. Dep. Tr. 86. Even if this deed does not operate retrospectively, it validly equalised

normal retirement date for post-January 1, 1991 members as of April 26, 1995 at the latest.

On or about December 21, 1995, each member of the 1990 Scheme was sent a notice advising that the normal retirement age for men and women had been equalised to 65. Dep. Ex. 104. The 1990 Scheme Trustees later executed a replacement definitive deed and rules on October 29, 2003. Dep. Ex. 87. This deed provided an equalised normal retirement age of 65 for all members, effective September 1, 2003. Even if this deed does not operate retrospectively, it validly equalised normal retirement date for pre-January 1, 1991 members from October 29, 2003.

Historical Actions of the Parties. After 1994, Mr. Hosegood, and each of his predecessors as Scheme actuary, operated and accounted for the Schemes as having been equalized to age 65. Hosegood Tr. 127; Dep. Exs. 4, 106. The Trustees also distributed benefits, accounted for, and operated the Schemes until late 2006/early 2007 as though the Schemes had been equalized to age 65. Fryer Tr. 114; Kennell Tr. 129.

Mr. Hosegood inflated the Equalisation Reserve by the same inflated Section 75 methodology that infects the other components of the Settlement. He determined that £33 million should be reserved for the 1983 Scheme and £4 million for the 1990 Scheme, Hosegood Tr. 121, while admitting that if he changed his assumption to be consistent with how the Trustees, with his approval, historically operated the Schemes – *the additional liability would be "small or zero,"* Hosegood Tr. 131. PwC estimated that under its worst-case scenario the reserve for the 1983 Scheme at £17 million – *£16 million less than Mr. Hosegood's number* – based on the assumptions that only partial equalisation had occurred: (i) new scheme members after 1991 were correctly equalised

to age 65 from 1993; and (ii) other members were equalised to age 65 from 2005. Massey Tr. 85-86; Dep. Ex. 22.[17]

Other Defects of the Settlement

Other significant defects in the Settlement discussed below are that the Settlement (i) employs an improper exchange-rate calculation that disregards the text of the Bankruptcy Code; (ii) proposes a baseless Administrative Claim; and (iii) must be rejected as a an improper *sub rosa* plan of reorganization.

THE LEGAL STANDARD

Rule 9019 "requires a bankruptcy judge to assess and balance the value of the claim that is being compromised against the value to the estate of the acceptance of the compromise proposal." *In re Martin*, 91 F.3d 389, 393 (3d Cir. 1996) (citing *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424-25 (1968)); *see In re Marvel Entm't Group, Inc.*, 222 B.R. 243, 249 (D. Del. 1998). A settlement must be "fair and equitable" in order to obtain judicial approval. *TMT Trailer Ferry*, 390 U.S. at 424; *Will v. Northwestern Univ. (In re Nutraquest, Inc.)*, 434 F.3d 639, 644 (3d Cir. 2006). A four-factor test guides the court's analysis: (i) the probability of success in the litigation; (ii) the likely difficulty in collection; (iii) the complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it; and (iv) the paramount interest of creditors. *TMT Trailer Ferry*, 390 U.S. at 424; *Martin*, 91 F.3d at 393.

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[17] PwC lacked sufficient data to perform a similar analysis for the equalisation claim in respect of the 1990 Scheme. Massey Tr. 87.

BASES FOR OBJECTION

There is no dispute that litigating the Trustees' proofs of claim would be complex, lengthy, and expensive, and the outcome uncertain. But before a bankruptcy court may approve a settlement under Rule 9019(a), it must "canvass the issues and see whether the settlement 'fall[s] below the lowest point in the range of reasonableness.'" *Nellis v. Shugrue*, 165 B.R. 115, 121-22 (S.D.N.Y. 1994) (quoting *In re W.T. Grant Co.*, 699 F.2d 599, 608 (2d Cir. 1983)). "The court may not act as a mere rubber stamp or rely on the [movant's] word that the compromise is reasonable." *In re 110 Beaver Street P'ship*, 244 B.R. 185, 187, 196 (Bankr. D. Mass. 2000) (rejecting proposed settlement because it did not "fall within the range of reasonable compromises of the claims at issue").

A. In The Unusual Circumstances Presented Here, The Debtors' Business Judgment Is Entitled To No Deference.

Courts typically accord latitude to the business judgment of a settling debtor. The circumstances here are atypical. The inter-creditor dispute here is peculiarly for the creditors; indeed, the Services Committee was born of an acknowledgement that the Debtors were simply not in a position to resolve the pension disputes. Laura Barlow, SCL's Chief Financial Officer and Chief Restructuring Officer, admitted that the Debtors acted for many months simply as a mediator, *see* Barlow Tr. 13-14, stepping directly into the fray only after negotiations between the true parties in interest – the Schemes, Services Committee, and SCL Committee – reached an impasse. Thus, the business judgment entitled to respect here is that of the SCL Committee, which is the real steward of the compromised interest (that of the general unsecured creditors).

The proposed Settlement is in no way in the "paramount interest" of those creditors – or the Debtors. It falls so far outside the reasonable range of litigation

outcomes as to be "not even within the realm of those possibilities." *In re Thomas Michael Krizmanich*, 139 B.R. 456, 460 (Bankr. N.D. Ind. 1992) ("The settlement which has been put before the court miserably fails this test. . . . The proposed settlement falls below the lowest point of reasonableness in the range of litigation possibilities; it is not even within the realm of those possibilities."). *See In re David J. Perts*, No. 04-14471-RGM, 2008 WL 657394, at *3 (Bankr. E.D. Va. Mar. 6, 2008) (rejecting proposed settlement because it fell outside the range of reasonableness); *In re Congoleum Corp.*, No. 03-51524, 2007 WL 1428477, at *4 (Bankr. D.N.J. May 11, 2007) (rejecting proposed settlement where court could not find that it was reasonable); *In re Resource Tech. Corp.*, 356 B.R. 435, 443 (Bankr. N.D. Ill. 2006) (rejecting proposed settlement for being outside the range of reasonable litigation outcomes); *In re Interstate Cigar Co.*, 240 B.R. 816, 825 (Bankr. E.D.N.Y. 1999) (rejecting proposed settlement as not within range of reasonableness).

B. The Pension Claim Settlement Amount Is Presumptively Unreasonable Because (Except As To An Insignificant Portion Of The Pension Claims) Section 75 Has Not Been Triggered And The Pension Claim Settlement Amount Has Not Been Discounted By The Likelihood That Section 75 Will Be Triggered In The Future.

1. Except as to an insignificant portion of the Pension Claims, Section 75 has not been triggered.

The first and compelling defect of the proposed Settlement arises from its quantum. The Settlement at $194 million is effectively Mr. Hosegood's £100 million figure, discounted at the petition date exchange rate, is based *entirely* on the Section 75 Measure. Yet as the Schemes' actuary himself concedes, *see* Hosegood Tr. 21-22, no trigger for Section 75 liability has occurred (except in the trivial respect of SCL's withdrawal from the 1983 Scheme, resulting in a demand of approximately £6.7 million).

SCL has not commenced a U.K. insolvency proceeding, and foreign insolvency proceedings do not trigger Section 75. Although both Schemes are now closed – and therefore will not accrue further liabilities to beneficiaries – they have not been wound up. The Schemes' actuary has not certified a number representing his estimate of the Section 75 Debt. Accordingly, there is no Section 75 Debt other than that arising from SCL's withdrawal from the 1983 Scheme.[18]

Where pension claims are concerned, a claim based on a statutory liability does not arise absent a triggering event under the pertinent statute. *CPT Holdings, Inc. v. Indus. & Allied Employees Union Pension Plan, Local 73*, 162 F.3d 405, 409 (6th Cir. 1998) ("A multiemployer pension plan has no enforceable right to payment for withdrawal liability until an employer actually withdraws from a plan, leaving the plan underfunded. Since this may never occur, it cannot be said that a legal right to payment exists prior to withdrawal. . . . Withdrawal liability is based on an employer's share of unfunded vested benefits at withdrawal, not on failure to make required contributions. As a result, there can be no pre-withdrawal breach of ERISA giving rise to a 'right to payment' by a plan. Upon the facts at issue, a 'claim' cannot exist prior to withdrawal."); *In re United Merchs. & Mfrs., Inc.*, 166 B.R. 234, 241 (Bankr. D. Del. 1994) (pension

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[18] While the Trustees demanded contributions from employers under the Schemes' Rules, such demands do not trigger Section 75. SCL was not a participating employer of the 1990 Scheme, and the only demand made by the 1983 Scheme on SCL was issued *after* SCL withdrew from the Scheme. Accordingly, the demand was ineffective under the Scheme's rules. Further, the mere demand for contribution by the Trustees does not set the amount of a claim in this bankruptcy case. As fiduciaries, the Trustees are obliged to exercise their discretion in a reasonable, just and equitable manner and are bound by a duty of good faith. *See Bristol & West Bldg. Soc'y v. Mothew* [1996] 4 All ER 698. The issuance of the written demand to SCL after its withdrawal from the 1983 Scheme was not made in good faith, as it did not take into account all the material circumstances, including SCL's withdrawal from the Scheme.

fund did not possess a bankruptcy claim for withdrawal liability pre-confirmation: "[w]ithdrawal liability requires both an unfunded vested benefit amount and a withdrawal"; "[o]nly a withdrawal can trigger the contingent right to payment for withdrawal liability"; "[i]t is this withdrawal that first creates the legal relationship which gives rise to the asserted right to payment") (footnote omitted); *Oneida Ltd. v. PBGC (In re Oneida Ltd.)*, 383 B.R. 29, 38 (Bankr. S.D.N.Y. 2008) ("Where the pension plan is terminated in an out-of-court reorganization, the 'claim' is fixed. Where the reorganization takes place in connection with a Chapter 11 case, it is contingent and becomes enforceable only after the debtor receives a discharge or the court case is dismissed."). Because the Settlement is predicated on a Section 75 Measure that has not been triggered, it is wholly unreasonable and cannot be approved.

2. The Pension Settlement Claims Amount must, but has not been, discounted by the likelihood that Section 75 will be triggered in the future.

a. Section 75 liability is, at best, contingent, and must be discounted by the likelihood that Section 75 will be triggered in the future.

Assuming that the Trustees' theory is that they have contingent claims for Section 75 liability, and that, notwithstanding the authorities above, such a contingent claim can be made for pension claims, the claims would still have to be discounted for the likelihood that the contingency would not occur -- i.e. that a Section 75 triggering event will not occur in the future. *The Pension Settlement Claims Amount has not been so discounted and therefore cannot be approved.*

A debt is contingent "if it does not become an obligation until the occurrence of a future event." *In re Mazzeo*, 131 F.3d 295, 303 (2d Cir. 1997). "To value the contingent liability it is necessary to discount it by the probability that the contingency will occur

and the liability become real." *In re Xonics Photochemical, Inc.*, 841 F.2d 198, 200 (7th Cir. 1988). In *In re R.M.L., Inc.*, 92 F.3d 139 (3d Cir. 1996), the Third Circuit explained:

> [I]f a debtor's treatment of an item as an "asset" depends for its propriety on the occurrence of a contingent event, a court must take into consideration the likelihood of that event occurring from an objective standpoint. *See, e.g., In re Xonics Photochemical, Inc.*, 841 F.2d 198 (7th Cir. 1988) ("the asset or liability must be reduced to its present, or expected, value before a determination can be made whether the firm's assets exceed its liabilities"). Such an analysis is by no means unknown to the law . . . a court looks at the circumstances as they appeared to the debtor and determines whether the debtor's belief that a future event would occur was reasonable. The less reasonable a debtor's belief, the more a court is justified in reducing the assets (or raising liabilities) to reflect the debtor's true financial condition at the time of the alleged transfers.

Id. at 156 (affirming bankruptcy court's determination that the probability of a loan closing was zero and, thus, the amount of the loan that the debtor had carried on its balance sheet as an "asset" must be discounted to zero); *see also In re W.R. Grace & Co.*, 281 B.R. 852, 858 (Bankr. D. Del. 2002) ("[i]t is plain from R.M.L. and other cases cited by defendants that the appropriate discount factor is derived from the reasonable foreseeability (as of the transfer date) of the contingency coming to pass"); *In re Total Tech. Servs.*, 150 B.R. 893, 900 (Bankr. D. Del. 1993) (contingent liability "will be discounted according to the validity and collectibility of the liability") (citing *Xonics*).

The foregoing decisions arise in a more common context – determining insolvency for purposes of analyzing avoidance claims – but the applicability of the discounting principle is the same in the claims-allowance context, including in the context of claims estimation. *See Juniper Dev. Group v. Kahn (In re Hemingway Transport, Inc.)*, 993 F.2d 915, 923 (1st Cir. 1993) ("The bankruptcy court simply estimates the amount of the claim for purposes of its allowance, discounting its value to reflect the uncertainty of the contingency, in order to enable the holder to share in the

distribution of the insolvent estate.") (citing 11 U.S.C. § 502(c)(1)); *O'Neill v. Continental Airlines, Inc. (In re Continental Airlines)*, 981 F.2d 1450, 1461 (5th Cir.1993); *Oneida*, 383 B.R. at 38; *In re FV Steel & Wire Co.*, 372 B.R. 446, 454 (Bankr. E.D. Wis. 2007) (valuing contingent liability for purpose of estimating claim by discounting for probability that contingency will occur) (citing *Xonics*); *In re Dimensions Medical Ctr., Ltd.*, No. 95 B 10706, 1996 WL 559981, at *3 (Bankr. N.D. Ill. Oct. 1, 1996) ("It is appropriate for the Court to estimate the claim for purposes of its allowance, and discount its value to reflect the uncertainty of the contingency.").

b. The likelihood of Section 75 liability is remote.

Because no discounting was performed here, there is no basis upon which this Court could approve a settlement. Moreover, the evidence will show that a discount would have to be steep, for the odds are against a trigger occurring.

The most likely trigger for Section 75 would be a decision by the Scheme Trustees to "wind up" the Schemes. Such a wind-up, at least to the extent needed to establish or measure the claims, would be barred by the automatic stay. Mrs. Kennell testified that it could be "two, five, or ten years" before that happened. Kennell Tr. 117; *see also* Fryer Tr. 38. The Trustees have not decided to wind up and are not legally committed to wind up.

But it is worse than that: undisputed evidence shows that wind-up is remote because it would be counterproductive to the interests of pensioners. The purchase of annuities from an insurance company to secure the benefit is an exceedingly costly course. Hosegood Tr. 74-75. Here, based on the likely distributions in a reorganization plan, that course would result in a greatly diminished recovery by pensioners, while running the Scheme is likely to see them fully paid even with an allowed claim amount

that is much less than the Settlement Amount. Wholly apart from the fact that any distribution received by the Trustees in respect of their Pension Claims will be only a pro rata share, and thus insufficient to buy out the Schemes with annuities on a pound-for-pound basis, it is almost certain that the Trustees' distribution will not be in cash, but rather, an illiquid security. *See* GE SeaCo Motion (Dkt. 1709). Accordingly, annuity buy-out for the foreseeable future will not be an option at all.

While parties might debate the amount of a discount for the likelihood that Section 75 will not be triggered, it is undisputed that the Debtors have undertaken no discount. This approach cannot be squared with the *Xonics* line of authorities, and cannot support a settlement.[19]

3. The Actual Damage Measure affords the appropriate measure of the Trustees' Claims.

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, especially here where (i) no Section 75 Debt has been triggered and (ii) the Services Agreement does not provide an indemnity for the Section 75 Measure.

The Debtors' own actuary (PwC), who *does* have expertise and personal knowledge of the marketplace, concluded that the *actual* market participants qualified to provide annuities would buy out *both* Schemes for amounts ranging from £54-73 million – *£27 to £45 million less than Mr. Hosegood's estimations.* PwC's conclusions

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[19] Particularly in view of their active participation in this chapter 11 case, the Trustees are barred by the automatic stay from commencing U.K. insolvency proceedings for the purpose of collecting the Section 75 Debt. *See* 11 U.S.C. § 362(a)(6) (commencement of proceeding for purpose of collecting debt is stayed).

were on the conservative side, for an actual offer was made subject to further due diligence by Lucida, an actual qualified provider of annuities, to buy out both Schemes in full for £50 million. The SCL Committee's experts calculated the total funding deficit for *both* Schemes to be £34 million using the prudent investor rule under U.S. law, which the SCL Committee contends the Court should apply to determine the Trustees' claims.

The Debtors propose that the Court reject all of this evidence, and double the claim size by accepting uncritically Mr. Hosegood's estimate. Mr. Hosegood (i) has no personal knowledge of the insurance marketplace; (ii) did not even consult the marketplace for actual data about actual transactions; (iii) admitted that his calculations did not take into account recent changes in the marketplace; and (iv) has not certified a Section 75 Debt for the Schemes. For these reasons, Mr. Hosegood's estimations are unreliable and cannot equitably be credited to justify doubling the true claim value at the expense of the estate's other creditors. Indeed, "[w]hether a claim exists is determined by bankruptcy law." *In re Manville Forest Prods. Corp.*, 209 F.3d 125, 128 (2d Cir. 2000). "[T]he bankruptcy court always retains jurisdiction and the sole right to determine the allowability of the claim under the applicable standards set forth in section 502(b)." 4 COLLIER ON BANKRUPTCY, ¶ 502.03[1][a] (15th ed. rev. 2007) (citing *In re Johnson*, 960 F.2d 396 (4th Cir. 1992) (allowance of claims in bankruptcy is exclusive right of the bankruptcy court)). When bankruptcy claims involve streams of future payments, courts apply the "prudent investor rate" to value the claims, defined as the rate which "a reasonably prudent investor would receive from investing the funds." *CSC Indus., Inc. v. Belfance*, 232 F.3d 505, 508 (6th Cir. 2000). The Third Circuit has not yet ruled on whether the prudent investor rate should apply to value pension claims. *See In re Kaiser*

Aluminum Corp., 339 B.R. 91, 96 (D. Del. 2006). However, in analogous chapter 11 cases involving disputes between domestic regulators seeking more attractive statutory rates and chapter 11 debtors and trustees seeking an equitable distribution to creditors of scarce estate assets, courts of appeal have adopted the prudent investor rate to value pension claims. *CSC Indus.*, 232 F.3d at 509 (holding that "bankruptcy court's authority . . . to determine the amount of claims in bankruptcy proceedings and treat creditors in the same class equally gives it the authority to value unfunded benefit liabilities claims using a 'prudent investor rate'"); *CF&I Fabricators of Utah, Inc. v. PBGC*, 150 F.3d 1293, 1301 (10th Cir. 1998) (affirming application of prudent investor rate to calculate present value of pension obligations).

To adopt the Trustees' methodology would violate the "cardinal rule that all claims within the same class be treated alike." *CF&I Fabricators*, 150 F.3d at 1301; *CSC Indus.*, 232 F.3d at 509 (same). In domestic cases, the conflict is between a statutory discount rate[20] and the discount rate that the court finds to be applicable under the facts and circumstances of the case. Here, the calculus in effect is an arbitrary adjudication by an interested party -- employed by the Schemes themselves -- of what rates a profit-seeking marketplace actually imposes to assume the liability. *See* Section 75 Pensions Act 2004 Occupational Pension Schemes (Employer Debt) Regulations 2005, /678. In accordance with the core policy that unsecured creditors must be treated equally, this Court must apply the prudent investor rate to calculate the present value of the Pension Claims. *CSC Indus.*, 232 F.3d at 509 ("bankruptcy's court authority under 11 U.S.C.

[20] 29 U.S.C. § 1301(a)(18)(A) provides that PBGC may establish appropriate discount rates. The PBGC has prescribed such rates in 29 C.F.R. §§ 4044.41-.75 (1998).

§§ 502(b) and 1123(a)(4) to determine the amount of claims in bankruptcy proceedings and treat creditors in the same class equally gives it the authority to value unfunded benefit liabilities claims under a 'prudent investor rate'").

Considerations of comity do not counsel application of the Section 75 Measure here. First, the Actual Damage Measure, which is functionally identical to the prudent investor rate, arises under U.K. law -- and in the absence of a Section 75 trigger it is the proper measure for the loss. Second, "[t]he principle of comity has never meant categorical deference to foreign proceedings." *In re Treco*, 240 F.3d 148, 157 (2d Cir. 2001); *see Dependable Highway Exp., Inc. v. Navigators Ins. Co.*, 498 F.3d 1059, 1067 (9th Cir. 2007) ("No nation is under an unremitting obligation to enforce foreign interests which are fundamentally prejudicial to those of the domestic forum.") (quoting *Laker Airways Ltd. v. Sabena Belgian World Airlines*, 731 F.2d 909, 937 (D.C. Cir. 1984)). Comity remains a rule of "practice, convenience, and expediency" rather than of law, *Somportex Ltd. v. Philadelphia Chewing Gum Corp.*, 453 F.2d 435, 440 (3d Cir. 1971), and U.S. courts do not submit to foreign judgments where doing so would prejudice the rights of U.S. citizens or would contravene domestic public policy. *See, e.g., id*; *Victrix S.S. Co. v. Salen Dry Cargo A.B.*, 825 F.2d 709, 713 (2d Cir. 1987). Courts have expressly declined to extend comity where to do so would harm the interests of U.S. creditors. *See, e.g., Treco*, 240 F.3d at 159 (refusing to grant comity to Bahamian proceeding where American creditor's collateral would be used to pay administrative claims in light of "the special protected status that secured creditors enjoy under United States law"); *In re Papeleras Reunidas, S.A.*, 92 B.R. 584, 594 (Bankr. E.D.N.Y. 1988) (refusing to grant comity to Spanish liquidation because, *inter alia*, the proceeding

subordinated the American secured creditor's claim to an unsecured status); *Interpool, Ltd. v. Certain Freights of M/V Venture Star*, 102 B.R. 373, 377, 379-80 (D.N.J. 1988) (refusing to extend comity to Australian bankruptcy law where lack of procedural protections would not adequately protect U.S. creditors); *In re Toga Mfg. Ltd.*, 28 B.R. 165, 170 (Bankr. E.D. Mich. 1983) (refusing to grant comity to a Canadian bankruptcy because the secured creditor would receive "substantially unequal treatment" under Canadian law). Even if Section 75 was triggered (which it has not been), then especially here where the Trustees obtained the FSD in violation of the automatic stay, because Section 75 is a penalty, and because the proposed settlement relies on an actuary whose calculations are unreliable, the Court should not grant comity to U.K. law.

As a matter of U.S. law, the prudent investor rule establishes the real loss here -- the Actual Damage Measure of the claim. By contrast, estimating the cost of annuities, gropes at a margin for the middle-man selling the annuity. Distribution on a higher claim that funds an economically-inefficient annuity will return to the pensioner the same ratable return he would receive if the Trustees' claims were allowed under the prudent investor rule. The Section 75 estimation performed by Mr. Hosegood is even more inappropriate when one considers the evidence that the Trustees, having asserted a claim based on the Section 75 buy-out debt, in fact will not purchase annuities, but simply use this artifice to receive higher distributions on a higher nominal claim. The higher nominal claim improperly dilutes the return of other creditors, and would result in a priority antithetical to U.S. law's core proposition of equal distribution. Since a priority is fundamentally antithetical to a principal proposition of U.S. law, a U.K. measurement of the claims cannot be countenanced under the rubric of "comity."

The cases cited in the Motion do not require a different rule here. They establish only that ERISA provides the measure of a claim for pension benefits *where the pension plan has been terminated, calculated as of the date of the termination. See, e.g., In re US Airways Group, Inc.*, 303 B.R. 784, 787 (Bankr. E.D. Va. 2003). As noted, the Schemes in this case have *not* been terminated and, as Mr. Hosegood testified, no Section 75 Debt has been triggered.

4. Under these circumstances, imposition of scheme-deficit liability on the basis of the Section 75 Measure is an unenforceable penalty.

Because Section 75 has not been triggered, allowing the Pension Claims in an amount in excess of the amount calculated on the Technical Provisions would constitute a penalty to general unsecured creditors. The calculation on the Technical Provisions measures the Schemes' actual pecuniary loss. Anything in excess of that amount thus adds a significant non-pecuniary loss component to the Pension Claims – *indeed, it doubles the claims* – and does so based, not upon actual loss but on the Debtors' creditworthiness. The Section 75 Measure thus is like disfavored claims for default interest and non-pecuniary-loss tax penalties. *See, e.g., In re Virtual Network Servs. Corp.*, 902 F.2d 1246, 1250 (7th Cir. 1990) (applying equitable subordination to non-pecuniary loss tax penalty portion of IRS's claim, finding it "unfair to allow the IRS's tax penalty claims to come out of the 'pockets' of other general unsecured creditors who had not been paid their pecuniary losses"); *In re Tastyeast, Inc.*, 126 F.2d 879, 881-82 (3d Cir. 1942) (disallowing claim of mortgagee for additional interest, which court deemed a penalty, where "[a] bankruptcy court is essentially a court of equity and will therefore not enforce a penalty"); *In re Consol. Props. Ltd. P'ship*, 152 B.R. 452, 458 (Bankr. D. Md. 1993) (disallowing portion of secured creditor's claim that included default interest rate

higher than contract rate in addition to late charges, because this combination constituted a penalty to the detriment of general unsecured creditors); *In re Hollstrom*, 133 B.R. 535, 540-41 (Bankr. D. Colo. 1991) (disallowing portion of claim that included excessive default rate imposed by secured creditor where court concluded that the default interest provision "serves as a penalty, or hammer . . . against unsecured creditors" and did not represent "anything close to a reasonable estimate of actual damages").

Section 726(a)(4) of the Bankruptcy Code expressly subordinates penalty claims in liquidation cases. 11 USC § 726(a)(4).[21] Courts have applied this concept in chapter 11 cases. *See, e.g., In re Morande Enters., Inc.*, 371 B.R. 546, 547-48 (Bankr. M.D. Fla. 2007) (subordinating non-pecuniary tax penalty claim in chapter 11 case based principally on Section 726(a)(4)); *Erlin Manor Nursing Home, Inc. v. Rate Setting Comm'n (In re Erlin Manor Nursing Home, Inc.)*, 36 B.R. 672, 678 (Bankr. D. Mass. 1984) ("[C]laims for penalties should be subordinated in Chapter 11 as well as in Chapter 7 cases."). *See also Owens Corning v. Credit Suisse First Boston*, 322 B.R. 719, 724 (D. Del. 2005) ("[I]f subordination of punitive damage claims is mandated in Chapter 7 liquidations, it seems entirely appropriate to subordinate such claims in the Chapter 11 setting."). A foreign penalty provision like this one should be subordinated to general unsecured claims.

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[21] 11 USC § 726(a)(4) provides that (except as provided in section 510), "property of the estate shall be distributed --

> (4) fourth, in payment of any allowed claim, whether secured or unsecured, for any fine, penalty, or forfeiture, or for multiple, exemplary, or punitive damages, arising before the earlier of the order for relief or the appointment of a trustee, to the extent that such fine, penalty, forfeiture, or damages are not compensation for actual pecuniary loss suffered by the holder of such claim . . . ."

The same penalty problem renders the difference between the Actual Damage Measure and the Settlement Amount (or any Section 75 Measure) not subject to allowance for a different reason. Under Section 541(c) of the Bankruptcy Code, any "provision in . . . applicable nonbankruptcy law" that would have the effect of reducing estate property on the basis of the "insolvency or financial condition of the debtor" is unenforceable. 11 U.S.C. § 541(c). As it stands now, the Debtors have reversionary interests in the Pension Schemes that will accrue value to the estates should assets remain after discharge of the pension liabilities. Dep. Ex. 3., ¶ 6(b). The "Technical Provisions" analysis shows that the actual deficit is far smaller than the proposed Settlement Amount, and in the event mortality assumptions, discount rates, and rates of return on assets prove over-conservative, this property interest in the reversion would be a valuable one. That value would be lost, however, were the Section 75 Measure imposed. Thus, even if the Trustees were to access the increased Section 75 Measure on the basis of the solvency or financial condition of the Debtors (for example, through the failure of the "employer covenant" and consequent ability to provide future employer contributions), that would impermissibly erode the Debtors' reversionary interest. The delta between the Section 75 Measure and the Actual Damage Measure is therefore unenforceable.

5. The Pension and Equalisation Claims are overstated, as they rely upon an improper exchange-rate calculation that disregards the text of the Bankruptcy Code.

The Settlement ignores black-letter law by failing to convert the U.K. claim into U.S. dollars as of the Petition Date, as required by the plain text of section 502(b) of the Bankruptcy Code. 11 U.SC. § 502(b) (upon an objection to a proof of claim, "the court, after notice and a hearing, shall determine the amount of such claim in *the lawful*

currency of the United States as of the date of the filing of the petition") (emphasis supplied).

The Pension Claim. As of the Petition Date, the U.S./U.K. exchange rate was $1.87/GBP. An exchange rate of $1.87/GBP would be imposed by law, and thus the Schemes have made on "concession" in agreeing to such a rate. *Finanz AG Zurich v. Banco Económico S.A.*, 192 F.3d 240, 250 (2d Cir. 1999); *In re Global Power Equip. Group, Inc.*, No. 06-11045 (BLS), 2008 WL 435197, at *4-5 (Bankr. D. Del. Feb. 14, 2008).

The Equalisation Claim. The Proposed Equalisation Claim (discussed in detail below) is overstated to the same extent, as the amount in respect of the claim has not been converted into U.S. dollars as of the Petition Date. The Term Sheet provides with respect to the Equalization Reserve: "The allowed claim shall be determined by the Schemes' actuary as of and at the exchange rate applicable on November 30, 2007 of $2.05 per pound, discounted by 8.6%." Dep Ex. 3 ¶ 5. There is no basis for using an exchange rate other than the rate as of the Petition Date, and imposing $1.87 (through the veiled "8.6% discount of $2.05") represents no concession by the Schemes.

C. The Settlement's Allowance Of The Claims *at SCL* Is Unreasonable and Cannot be Approved.

1. The Claims arise and may be allowed only against Services.

The second fundamental problem with the Settlement is as to *priority* of the Pension Claims. It is undisputed that the contractual claims lie only against Services. We believe it will be undisputed that Services, in turn, may claim reimbursement from SCL only through the Services Agreement, but that its distributions would be diluted by the $61 million set-off. Thus, the Settlement has the effect of unlawfully avoiding $61

million of dilution. In addition, the Services Agreement does *not* provide indemnity for the delta between the Actual Damages Measure and the Section 75 Measure, because that delta does not fall within the indemnity language. That language limits indemnity to "the cost of providing Services to companies in the Group including but not limited to the cost of remuneration and employee benefits of the Employees including payments on termination of employment, however terminated, and all overheads." Motion Ex. B at 3. The Section 75 Measure is not a "cost of . . . employee benefits of the Employees;" it is rather a penalty imposed by reason of SCL's financial distress. Thus, only the Actual Damage Measure would come within the indemnity. To avoid the $61 million discount, as well as the limitation under the Services Agreement, the Trustees and their advisors engaged in an elaborate and joint venture with a so-called regulator. There is no lawful basis to premise a Settlement on direct claims by the Trustees against SCL, and the evident purpose of that structure is to avoid a $61 million Debtor set-off right.

2. The FSDs were procured and issued in violation of the automatic stay.

As the Debtors concede, except for SCL's Section 75 Debt incurred as a result of its withdrawal from the 1983 Scheme, "the Trustees' direct claim against SCL derives exclusively from the FSDs obtained by TPR." Motion ¶ 84. These FSDs were procured and issued in violation of the automatic stay, and are void. At a minimum, they are not entitled to comity as a justification for the proposed Settlement.

11 U.S.C. § 362(a)(1) provides that a "judicial, administrative, or other proceeding against the debtor that was or *could have been commenced before the commencement of the case* under this title, or *to recover a claim against the debtor that arose before the commencement of the case* under this title [is stayed]." (Emphasis supplied). 11 U.S.C. § 362(a)(6) provides that "any act to collect, *assess*, or recover a

claim against the debtor that arose before the commencement of the case under this title [is stayed]." (Emphasis supplied).

The Trustees and the Services Committee actively sought, post-petition, to assess a direct claim against SCL through the FSD process. In particular, they engaged in an effort to procure an FSD by (i) seeking the issuance of a warning notice by TPR; (ii) filing papers with TPR demanding the issuance of FSDs; (iii) encouraging TPR to hold a hearing before a Determinations Panel; (iv) filing briefs and affidavits with the Panel supporting the issuance of an FSD; and (v) testifying at the Hearing expressing their urgent desire that an FSD issue. Moreover, the record reveals, not a "regulatory" process, but a collaborative one, in which TPR actively and repeatedly engaged with the Trustees and their lawyers, and the Services Committee and their lawyers, in their efforts to obtain FSDs, which they thought would enable them to assess a direct claim against SCL, in advance of the Bar Date. No one filed a motion with this Court seeking to lift the automatic stay prior to taking any of these post-petition actions.

The Pension Claims arose from pre-petition events and contracts with Services. Except with respect to the withdrawal debt, the claims existed against Services, not SCL. Services' indemnity claim also arose from a pre-petition agreement, and existed against SCL. The stated and direct purpose of the Trustees was (i) to pursue an administrative proceeding outside the view of the bankruptcy court and (ii) to assess, and take the predicate steps to recovering from, SCL claims that arose in the pre-petition period. As Mr. Abrams conceded, the Schemes were seeking the FSDs so that "the Schemes should be recognized by Sea Containers as creditors of Sea Containers, not just of Services, and as unsecured creditors should be treated *pari passu* with other unsecured creditors of Sea

Containers, and in accordance with applicable law, including the Bankruptcy Code." Abrams Stmt., Ex. F, ¶ 8. This was a stay violation.

It is difficult to imagine a more central function of the chapter 11 process, more integral to the automatic stay, than the assessment and liquidation of claims against a debtor, with the implications that has for treatment of a debtor's creditor body and its ability to reorganize. "The automatic stay prevents different proceedings in different courts, which set in 'motion a free-for-all in which opposing interests maneuver to capture' a share of the debtor's assets." *In re Berman*, 352 B.R. 533, 540 (Bankr. D. Mass. 2006).

The Trustees violated the automatic stay by actively seeking the issuance of FSDs against SCL without first obtaining relief from the automatic stay. *Maritime Elec. Co. v. United Jersey Bank*, 959 F.2d 1194, 1204, 1207 (3d Cir. 1991) (holding that seeking a judgment against a debtor outside the bankruptcy court is a stay violation rendering the judgment procured void *ab initio*, and noting that the "stay protects creditors by preventing particular creditors from acting unilaterally in self-interest to obtain payment from a debtor to the detriment of other creditors"); *Berman*, 352 B.R. at 541 (finding stay violation where attorneys "actively sought an order from the Superior Court . . . [and] [i]t is obvious that their intent was to impact the bankruptcy estate"); *In re Weber*, 283 B.R. 630, 634-35 (Bankr. D. Mass. 2002) (finding that town violated automatic stay by requesting "that a Special Citation issue [against the Debtor] in the Land Court proceeding"); *In re Beaver St. P'ship*, 244 B.R. 185, 195-96 (Bankr. D. Mass. 2000) (holding that creditor violated stay by instigating enforcement action by town against

debtor for building code violations for purpose of gaining leverage over debtor and interfering with reorganization).

In re Nakash, 190 B.R. 763 (Bankr. S.D.N.Y. 1996), is instructive. There, the foreign receiver of the debtor had filed an instruction motion with an Israeli court requesting that it instruct the receiver to file a second involuntary petition against the debtor. 190 B.R at 767. The court held that the instruction motion as well as the second involuntary petition, which were filed three months into the chapter 11 proceedings, violated the automatic stay because they "were clearly acts against the Debtor, affecting property of the estate which served to impugn this court's jurisdiction over and administration of the state." *Id.* at 768-69.

In *In re Underwood v. Hilliard*, 98 F.3d 956 (7th Cir. 1996), a director and shareholder of Rimsat, Ltd. obtained an order from the High Court of Nevis (St. Kitts) appointing him receiver of Rimsat. 98 F.3d at 959. After Rimsat entered chapter 11 in and the bankruptcy court had enjoined the receiver from exercising control over Rimsat's property, the receiver returned to the High Court of Nevis and obtained an order enlarging his receivership powers. *Id.* at 961. In determining that the receiver had violated the automatic stay, Judge Posner held that "[u]nlike a creditor's action, [the receiver's] recourse to the Nevis court did not threaten to deplete the estate directly. But it did imperil the orderly administration of the bankruptcy proceeding, and by doing so it posed an indirect threat to the estate." *Id.* Further, the "efficacy of the bankruptcy proceeding depends on the court's ability to control and marshal the assets of the debtor wherever located (*see* § 541(a)), which in this case required that [the receiver] be prevented from exercising control over the debtor." *Id.* at 962.

So too here, the Trustees' conduct described above gave rise to at least two independent violations of the automatic stay: (i) in instigating the TPR proceedings; and (ii) in seeking and obtaining from the Panel a decision to issue FSDs. In both respects they acted as private creditors, seeking to secure and improve the position of their claims in SCL's chapter 11 case. Throughout, TPR actively collaborated in this effort, even preparing a draft warning notice within an hour of the Trustees' request that TPR issue one. Dep. Ex. 34; Kennell Tr. 104-06.

Neither the Panel's decision to issue FSDs, nor the parties' participation in the proceedings that led to these decisions enjoyed the safe harbor of section 362(b)(4). The "regulatory" exemption insulates certain non-pecuniary assertions of governmental power, but the section "is intended to be given a narrow construction in order to permit governmental units to protect the public health and safety and not to apply to actions by a governmental unit to protect a pecuniary interest in property of the debtor or property of the estate." *See* 124 Cong. Record H 11089. The statutory text illustrates. It exempts from the stay "the commencement or continuation of . . . a proceeding by a governmental unit . . . to enforce such governmental unit's police and regulatory power . . . ." 11 U.S.C. § 362(b)(4). This language highlights two independent reasons that the safe harbor is not available here. First, 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.

"[T]he term 'police or regulatory power' refers to the enforcement of state laws affecting health, welfare, morals, and safety . . . ." *Missouri v. United States Bankruptcy Court*, 647 F.2d 768, 776 (8th Cir. 1981). In determining whether a governmental action

qualifies for the section 362(b)(4) exemption, courts distinguish actions intended to effectuate public policy from those brought to protect the government's pecuniary interest. *In re Organized Maintenance, Inc.*, 47 B.R. 791, 795 (Bankr. E.D.N.Y. 1985), *vacated on other grounds*, 69 B.R. 298 (E.D.N.Y. 1987) ("the Courts, taking their cue from the legislative history of § 362, have evolved what is called a pecuniary interest test, that is the Government seeking to protect an economic interest of the debtor's property"); *In re Sidney Greenwald*, 34 B.R. 954, 956-57 (S.D.N.Y. 1983) (noting that it is well-established that "if the government action directed against the debtor relates mainly to the protection of a pecuniary interest rather than the enforcement of regulatory powers, subsection (b)(4) will not apply and the action will be subject to the automatic stay"). The latter are not protected. *Id. See also Penn Terra Ltd. v. Department of Envtl. Resources,* 733 F.2d 267, 275 (3d Cir. 1984) (holding that DER's attempt to "force Penn Terra to rectify harmful environmental hazards" was a proper exercise of police power because "[i]t did not seek the payment of compensation to the Commonwealth's coffers"); *Missouri*, 647 F.2d at 776 (finding that Missouri's grain laws do not fall within section 362(b)(4) exemption because "although regulatory in nature, [they] primarily relate to the protection of the pecuniary interest in the debtor's property and not to matters of public safety and health").

Here, it is plain that TPR was acting solely to advance a pecuniary interest and not to protect public health or policy. Both the advocates before TPR, and the tribunal itself, expressed an intention to fix *a claim in a U.S. bankruptcy case*. Abrams Stmt., Ex. F, ¶¶ 14, 16, 130, 134-35; Reasons, Ex. I, ¶¶ 30(5), 39, pp. 17, 25. Ken Taylor of the TPR was directly involved in this plan. Dep. Ex. 34 (stating that issuance of FSD "[w]ould

improve pension scheme position" and pension protection fund "seeking higher paypoint, bondholders less"). Assessing such a claim had no purpose other than to pursue a pecuniary interest against the Debtors' property. *See In re Ellis*, 66 B.R. 821, 826-27 (N.D. Ill. 1986) (automatic stay applied where focus of police power was directed at debtor's financial obligations rather than state's health and safety concerns); *see also Greenwald*, 34 B.R. at 957 (regulatory exception to automatic stay does not apply where state seeks to protect pecuniary interest in property of debtor by establishing liability of debtor through administrative proceedings in order to support proof of claim); *Organized Maintenance*, 47 B.R. at 796 (regulatory exception to automatic stay does not apply because proceeding before Department of Labor to establish unpaid wages was not brought to protect the health and safety of any party but was brought to protect the pecuniary interest of the debtor's employees).

The second reason is even more fundamental. Here, TPR, the Trustees, and the Services Committee were not pursuing a *governmental* pecuniary interest, but rather the pecuniary interest of private litigants. As noted, section 362(b)(4) insulates only a proceeding "to enforce *such governmental unit's* . . . power." *Organized Maintenance*, 47 B.R. at 796 (holding that police-power exception to automatic stay does not apply to administrative proceeding because purpose of proceeding was to place employee creditors – *i.e.*, private litigants – "in a preferred position over other creditors"); *Missouri*, 647 F.2d at 776 (holding that police-power exception does not apply to state court proceeding initiated by state because its "grain laws . . . primarily relate to the protection of the pecuniary interest in the debtors' property" and attempt to protect the economic interests of its citizens); *In re Sampson*, 17 B.R. 528, 530 (Bankr. D. Conn. 1982)

(holding that police-power exception does not apply to Connecticut's financial responsibility law because the "actual effect of the statute is to protect the pecuniary interests of judgment creditors").

The conduct in this case does not fall within *United States v. Nicolet*, 857 F.2d 202 (3d. Cir. 1988), in which the Third Circuit applied the police-power exception to exempt from the automatic stay the EPA's exercise of power arising from its statutory and regulatory clean-up obligation in seeking reimbursement of actual environmental response costs. 857 F.2d at 209-10. By seeking reimbursement for environmental clean-up costs, the EPA was merely fulfilling its congressional mandate to protect the public from environmentally hazardous sites. *Id.* In any event, the holding in *Nicolet* would not protect the Trustees' actions.

The Third Circuit noted that, where a regulatory or police power (cleaning polluted sites, enforcing pollution laws) is implicated, imposing a penalty in aid of that power will enjoy an exemption. But no such facts are presented here, where the entire governmental process was procured and pursued for the sole purpose of assessing the claims for money of private creditors. This series of events furthered no regulatory purpose. Because proceedings whose object or effect is to enforce powers or rights of private litigants are not embraced by the section, the police-power provisions of section 362(b)(4) do not apply.

Orders and other process that issue in violation of the automatic stay are void. *See Acands, Inc. v. Travelers Cas. & Sur. Co.*, 435 F.3d 252, 261 (3d Cir. 2006); *Maritime Elec.*, 959 F.2d at 1206 ("Absent relief from the stay, judicial actions and proceedings against the debtor are void *ab initio*."); *Berman*, 352 B.R. at 541 ("Court

declares the 2006 Order void *ab initio*" because of attorney's violation of the automatic stay); *In re Braught*, 307 B.R. 399, 404 (Bankr. S.D.N.Y. 2004) ("Judicial actions taken against a debtor are void *ab initio*, absent a relief from the automatic stay.").

In sum, the Panel decided to issue the FSDs as a direct consequence of an intentional and calculated effort by the Trustees to procure a quasi-judicial determination of a disputed *claims* issue, in direct and intentional violation of the automatic stay. This was an effort by the Trustees and the Services Committee to usurp this Court's jurisdiction to allow claims – a process central to the equal treatment of creditors and the ability of debtors to reorganize – by seeking to have another tribunal assess and determine their claims, in amounts that are far greater than what is permissible under bankruptcy law.

Accordingly, the Determination Notices and FSDs issued in consequence of the Hearing are void. The Court should disregard all of this material. No basis has arisen which could justify imposing the claims on SCL.

3. The Court should not accord comity in these proceedings to the TPR-generated FSDs and notices.

Even if the conduct did not constitute a stay violation, the Court should not accord comity to the FSDs as a basis for determining the reasonableness of calculating a Pension Claim Settlement Amount under Section 75. Comity is "the recognition that one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws." *Hilton v. Guyot*, 159 U.S. 113, 143 (1895). The factual history shows an intense and pecuniarily-driven collaboration with estate creditors who at the same time were active participants in a U.S.

case, for the sole purpose of padding those creditors' recovery in this case. That action flouts the sovereign interests of the United States in the conduct of judicial proceedings before its courts. Comity, by contrast, is a discretionary doctrine founded upon the mutual respect due between sovereigns. The Settlement would proceedings undertaken in disrespect of this Court and encourage future litigants – even estate professionals – to demonstrate similar disrespect for U.S. judicial proceedings. *See generally Maxwell Commc'n Corp. v. Societe Generale (In re Maxwell Commc'n Corp.)*, 93 F.3d 1036, 1047-48 (2d Cir. 1996). The actions in this case, undertaken in disrespect of that sovereignty, contravene that core basis upon which comity rests, and should be accorded none.

D. The Reserve In Respect Of Equalisation Is Presumptively Unreasonable.

On August 15, 2007, Laura Barlow, SCL's CFO, advised at a meeting that the Schemes "have lodged [an equalisation] claim in the U.S. Bankruptcy Court which is a 'finger in the air' estimate, which has previously been put at [$60 million]." Ms. Barlow noted that "[t]his is a significant amount in terms of the pot of money that will be available for creditors . . . [and] has to be validated like all other claims." *Id.* The evidence shows that Ms. Barlow was right. But the claim has not been validated. The Schemes were equalised to age 65 historically and were administered in that way for more than a decade. Dep. Ex. 74, 104; Hosegood Tr. 127; Fryer Tr. 114, 170, 174-75; Kennell Tr. 129. No scheme beneficiary has ever asserted, even informally, that equalisation to age 65 did not occur. Kennell Tr. 136-37; Fryer Tr. 178.

The Motion raises the question whether the proposed Settlement is fair, equitable, and in the range of reasonableness. *E.g.*, *Nutraquest*, 434 F.3d at 645-647. If there is no reasonable likelihood of exposure, it is unreasonable to reserve, indefinitely, all

distributions on a $69 million amount. Moreover, if an error of such extravagant cost *had* occurred, it would be one for which SCL's creditors bear no responsibility whatever. The Settlement's proposed solution, however, will require SCL's creditors to pay the lion's share of that cost. This, in turn, requires some analysis of the claim itself.

Mr. Hosegood's valuation of the Equalisation Reserve inexplicably fails to account for the effect of *any* of measures taken by the Schemes to effect equalization to age 65 at any point in time. It also fails to take cognizance of the fact that Mr. Hosegood operated and accounted for the Schemes as having been equalized to age 65 for years, Hosegood Tr. 127; Dep. Exs. 4, 106, or the fact that the Trustees too operated the Schemes until late 2006/early 2007 as though the Schemes had been equalized to age 65, Fryer Tr. 114; Kennell Tr. 129. Instead, Mr. Hosegood calculated the Equalisation Reserve, using a Section 75 analysis, on the worst-case-scenario basis – *i.e.*, assuming that *no* attempts to equalise the Schemes at any point in time had been effective – and without applying any discount for the contingency that an English court would conclude that the Schemes had been equalised. Hosegood Tr. 121-125. The Equalisation Reserve should be reduced to give effect to these historical facts and at a minimum, should be reduced by a comparable factor to that applied to the Pension Claim because Mr. Hosegood calculated the reserve on the same on the same arbitrary basis as his Section 75 analysis.

Mr. Hosegood's calculation of a £37 million reserve (£33 million for the 1983 Scheme and £4 million for the 1990 Scheme), Hosegood Tr. 121, is an enormous

inflation of PwC's calculation of a £17 million reserve for the 1983 Scheme,[22] which was based on the assumptions that (i) new scheme members after 1991 were correctly equalized to age 65 from 1993; and (ii) other members were equalised to age 65 from 2005. Massey Tr. 85-86; Dep. Ex. 22. Mr. Hosegood testified that if he changed his assumption to be consistent with how he operated the Schemes – *i.e.*, that equalisation had taken place – *the additional liability would be "small or zero."* Hosegood Tr. 131. He also testified that if the Equalisation Claim were calculated under the Technical Provisions, rather than under Section 75, the result would be a lower reserve. Hosegood Tr. 173.

The Settlement imposes on SCL's creditors – and not the Trustees, themselves – all of the risk of liability. Yet, it would disenfranchise SCL's creditors from the process by which the Equalisation Claim will be determined:

> The Pension Schemes will work with the Debtors to determine the most efficient way to handle the Equalization Claim and to structure the reserve. Upon final determination of the amount of the Equalization Claim in accordance with this paragraph (5), such amount, if any, shall be allowed against SCL as a general unsecured claim and paid out of the reserve. The allowed claim shall be determined by the Schemes' actuary as of and at the exchange rate applicable on November 30, 2007 of $2.05 per pound, discounted by 8.6%.

Dep. Ex. 3 (Term Sheet ¶ 5). The creditors would have no control over, or representation in the process by which this litigation is resolved.

In view of the foregoing, the proposed Equalisation Reserve and structure for resolution is unfair, inequitable, and the very definition of unreasonable. The Court should reject it in its entirety.

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[22] PwC did not have sufficient information to perform a similar analysis for the equalisation claim (continued on next page)

E. The Settlement Is Premised On Unlawful Multi-million-Dollar Administrative Treatment Of A Portion Of The Claims.

The Term Sheet provides for an Administrative Claim in the amount of $5 million for certain "ordinary course expenses (such as PPF levies, insurance expenses, and audit, actuarial, Trustee and investment management fees)." Dep. Ex. 3. This proposed settlement term is presumptively unreasonable, given that the Trustees made no request for administrative-expense treatment in their proofs of claim. Moreover, the estate, in effect, is already paying substantial administrative expenses to the Trustees in the form of Services Committee and advisor fees. The Court should reject the term in any event because there is absolutely no basis administrative-expense treatment for these costs.

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. § 503(b)(1)(A), and gives priority treatment to allowed administrative expense claims, 11 U.S.C. § 507(a)(2). A debtor's administrative expenses receive the highest priority in chapter 11 cases. *Supplee v. Bethlehem Steel Corp. (In re Bethlehem Steel Corp.)*, 479 F.3d 167, 172 (2d Cir. 2007). In view of the overarching bankruptcy policy of equality of distribution of the debtor's limited resources among creditors, statutory priorities are narrowly construed, *Howard Delivery Serv. v. Zurich Am. Ins. Co.*, 547 U.S. 651, 667 (2006); *Bethlehem Steel*, 479 F.3d at 172; *Trustees of Amalgamated Ins. Fund v. McFarlin's, Inc.*, 789 F.2d 98, 100 (2d Cir. 1986), and requests for administrative expense priority are sparingly granted, *In re CIS Corp.*, 142 B.R. 640, 643 (S.D.N.Y. 1992); *In re Amfesco Indus., Inc.*, 81 B.R. 777, 785 (Bankr. E.D.N.Y. 1988).

The purpose of granting administrative expense priority in a chapter 11 case is to

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in respect of the 1990 Scheme. Massey Tr. 87.

give creditors an incentive to continue to conduct business with the debtor, thereby aiding in the debtor's maintenance, preservation, and rehabilitation. *McFarlin's*, 789 F.2d at 101; *Microsoft Corp. v. DAK Indus., Inc. (In re DAK Indus. Inc.)*, 66 F.3d 1091, 1097 (9th Cir. 1995); *In re Jartran, Inc.*, 732 F.2d 584, 586 (7th Cir. 1984); *In re CIS Corp.*, 142 B.R. 640, 642 (S.D.N.Y. 1992). Consistent with this purpose, well-established law imposes upon a party claiming entitlement to administrative-expense priority the burden of demonstrating that: (i) the claim arises out of a post-petition transaction between the creditor and the debtor's bankruptcy estate; and (ii) post-petition consideration supporting the claim is both supplied to and substantially beneficial to the debtor in possession in the operation of its business. *In re Pinnacle Brands, Inc.*, 259 B.R. 46, 51 (Bankr. D. Del. 2001) (citing *DAK*, 66 F.3d at 1094); *see Bethlehem Steel*, 479 F.3d at 172; *McFarlin's*, 789 F.2d at 101; *Jartran*, 732 F.2d at 587; *Cramer v. Mammoth Mart, Inc.* (*In re Mammoth Mart, Inc.*), 536 F.2d 950, 954 (1st Cir. 1976); *In re Mid-American Waste Sys., Inc.*, 228 B.R. 816, 821 (Bankr. D. Del. 1999).

Significantly, the question whether a claim is entitled to administrative-expense priority "focuses on the actual benefit that such transactions confer on the estate, not the loss sustained by such creditors." *CIS*, 142 B.R. at 642; *see also American Anthracite & Bituminous Coal Corp. v. Leonardo Arrivabene, S.A.*, 280 F.2d 119, 126 (2d Cir. 1960). Thus, "the estate must accrue a real benefit from the transaction, before administrative expense priority will be granted on claims against the estate." *In re Drexel Burnham Lambert Group, Inc.*, 134 B.R. 482, 488 (Bankr. S.D.N.Y. 1991). Accordingly, the value of an administrative claim (if one does indeed exist) is determined by the amount of the post-petition benefit *to the estate itself*. *In re Garden Ridge Corp.*, 323 B.R. 136, 142

(Bankr. D. Del. 2005); *see In re Finley, Kumble, Wagner*, 160 B.R. 882, 893 (Bankr. S.D.N.Y.1993).

It has not been and cannot be shown that the costs proposed to be afforded administrative-expense treatment arose post-petition in a transaction with the Debtors or that such costs provided any benefit to the estate, let alone the required "substantial benefit." First, if the Trustees, as unsecured creditors, are entitled to *pre-petition* expenses as a matter of contract, those costs do not constitute an administrative claim but rather are simply part of their unsecured claim.

Second, the Schemes were closed to new accruals pre-petition and now have only accrued, not accruing, liabilities, *see* Hosegood Tr. 49-50; Kennell Tr. 35; Motion ¶ 33. Securing pension benefits thus forms no part of the compensation to the few employees providing services to the Debtors post-petition and, accordingly, there is no post-petition benefit to the Debtors' estates. While administrative-expense claims might be properly be recognized in the case of an ongoing pension scheme where the benefits of that scheme are part of the compensation to the post-petition debtors' employees, that is not the case here. All of the Trustees' claims arise from liabilities that have already accrued and thus are entitled only to general unsecured claim status. *In re Sunarhauserman, Inc.*, 126 F.3d 811, 816 (6th Cir. 1997); *In re Bayly Corp.*, 163 F.3d 1205, 1210 (10th Cir. 1998); *In re Westmoreland Coal Co.*, 213 B.R. 1, 13 (Bankr. D. Co. 1997); *In re Kent Plastics Corp.*, 183 B.R. 841, 845-46 (Bankr. S.D. Ind. 1995); *In re CF & I Fabricators of Utah, Inc.*, 179 B.R. 704, 708-09 (D. Utah 1994); *In re Finley, Kumble, Wagner*, 160 B.R. 882, 893 (Bankr. S.D.N.Y. 1993); *In re Chateaugay*, 115 B.R. 760, 774-75 (Bankr. S.D.N.Y. 1990).

In sum, there is no justification for an administrative expense related to costs associated with the Schemes and the Court should reject the $5 million Administrative Claim proposed in the Settlement. It would be particularly inappropriate to allow, directly or indirectly, whether on an administrative expense or general unsecured basis, any expense of the Schemes incurred in the course of any stay violation, including those expenses incurred in connection with the FSD process.

F. The Settlement Must Be Rejected As A *Sub Rosa* Plan.

Creditors are entitled to vote on a plan of reorganization and not on a settlement. Accordingly, a settlement that is really a plan is impermissible. That is the case here.

1. The Motion should not be allowed and the Settlement should not be considered apart from a full reorganization plan.

The exclusive period by which the Debtors may file a plan of reorganization in these cases expired as of April 15, 2008,[23] and all parties in interest, including, without limitation, the Debtors, the SCL Committee, and the Services Committee, are now permitted to file a plan. Although no party has filed a plan at this time, approval of this Motion and a subsequent approval of the GE SEaCo Motion, involving one of the largest creditors in this case (really the only significant creditor other than the bondholders and Schemes),[24] likely will result in the filing of a plan of reorganization very soon.

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[23] The exclusive period had been extended on multiple occasions. April 15, 2008, however, was 18 months following the Petition Date, which is the maximum allowable under the Bankruptcy Code.

[24] The GE SeaCo Motion was filed on May 2, 2008. If approved, as described by the Debtors, the GE SeaCo Motion will "resolve all disputes, between the parties, establish a platform for a normalized business relationship, and maximize GE SeaCo's value for its stakeholders." GE SeaCo Motion, at 2. It will also provide a "basis upon which to file and confirm a chapter 11 plan." *Id.*

In *In re Braniff Airways, Inc.*, 700 F.2d 935 (5th Cir. 1983), the Fifth Circuit held that a settlement that has the practical effect of being a *de facto* plan, thereby resulting in a failure to comply with the requirements for confirming a plan, may not be approved. 700 F.2d at 940. In *In re Louise's, Inc.*, 211 B.R. 798 (D. Del. 1997), the debtor and its largest creditor had sought entry of an order approving the settlement of numerous issues and claims among the parties, including the resignation of certain principals, installation of a management team and reorganization of the board of directors. 211 B.R. at 800. An objection was raised, citing *Braniff*, that such provisions amounted to a *sub rosa* plan because the settlement agreement would permit the transfer of control of the debtor without the protections intended by chapter 11. *Id.* The district court held that the settlement was a *sub rosa* plan and thus denied the settlement motion. *Id.* at 802.

Here, if a reorganization plan is based on allowing the Trustees' claims as provided in the proposed Settlement, there will certainly be objections from impaired SCL creditors. These objections will necessitate analysis of whether the plan meets the best-interests-of-creditors test under section 1129(a)(7) of the Bankruptcy Code. 11 U.S.C. § 1129(a)(7). In determining whether creditors would do better in a chapter 7 liquidation than under the proposed reorganization plan, the Court will, of course, have to consider the creditors' claims in a chapter 7 context.

The delta between the Actual Damage and Section 75 Measures is not a true cost of the Schemes but rather is a penalty based on SCL's financial distress. and As noted, section 726(a)(4) of the Bankruptcy Code reduces claims for penalties that do not amount to actual pecuniary loss to a junior priority to general unsecured claims. 11 U.S.C. § 726(a)(4). General unsecured claims are thus entitled to payout in full before non-

pecuniary loss claims receive anything. Because the Debtors openly seek Rule 9019 relief to advance their desire to confirm a plan, section 1129 of the Bankruptcy Code makes application of the subordination principle of section 726(a)(4) particularly compelling in this chapter 11 case. *See, e.g., In re Friedman's, Inc.*, 356 B.R. 766, 777-78 (Bankr. S.D. Ga. 2006) (concluding that courts must apply principle of section 726(a)(4) in confirming plan under section 1129(a)(7) in a chapter 11 case); *In re Morande*, 371 B.R. at 547-48.

Section 1129(a)(7) requires a bankruptcy court in confirming a plan to find that the general unsecured claimants have either accepted the plan or will receive as much under the chapter 11 plan as they would in a hypothetical chapter 7 liquidation – commonly referred to as the "best interest of creditors test." As one court has explained:

> Thus, if in Chapter 11 cases, penalties were treated on a parity with unsecured claims, the amount of unsecured liabilities would increase, and the proportional dividend to Chapter 11 unsecured creditors would not be equivalent to their distribution in a Chapter 7. If claims for penalties were allowed in Chapter 11, no Chapter 11 plan could be confirmed because creditors would receive more in Chapter 7. Accordingly, under the Code claims for penalties are accorded inferior status in Chapter 11.

Erlin Manor Nursing Home, 36 B.R. at 678.

In a contested plan confirmation, the Pension Claims' allowed amount would have divided into pecuniary and penalty components, according junior status to the penalty component. Accordingly, the Pension Claims could be allowed only in the amount of the Actual Damage Measure – that is, the actual deficit between the Schemes' assets and its accrued liabilities – and the difference between the Schemes' actual pecuniary loss, as calculated on the Technical Provisions or on a prudent investor basis. The Section 75 Measure would have to be subordinated.

A Settlement that proposes to compromise the Pension Claims based on an allowed amount calculated by the cost of winding up the Scheme and buying annuities, when the trustees do not contemplate winding up the scheme and buying annuities, would in effect extract a penalty from the Debtors in excess of the actual measure of the claims to the detriment of the SCL Committee and is unreasonable. The Court should allow the claim in the real amount of the damage sustained by the Trustees; that is, the actual deficit between scheme assets and the liabilities that will be incurred in paying the pension benefits as they fall due. Alternatively, the Court should withhold consideration of the 9019 Motion until presented in conjunction with a plan.

2. The Settlement's common-currency term restricts the plan and violates the sub rosa rule.

The Term Sheet provides that "[t]he Pension Schemes are to receive the same currency (in the same proportion per dollar of allowed claim) as SCL's bondholders on their general unsecured claims." Dep. Ex. 3. This provision is tantamount to a *sub rosa* plan of reorganization, as an order by the Court permitting the inclusion of such a provision would tie the hands of all creditors in pursing a plan of reorganization by impermissibly dictating a key term (and one of the few remaining open terms) of a future plan and thus short circuit the requirements for confirmation of such future plan. *In re Braniff Airways, Inc.*, 700 F.2d 935, 940 (5th Cir. 1983) (debtors cannot establish the terms of a plan *sub rosa*).

Approval of the proposed common currency provision will short circuit the plan process by dictating a key term, thus precluding negotiation by *all* creditors of a consensual plan. The imposition of this key term in the Settlement is especially troubling, as the Trustees do not have a claim sufficiently large to confirm a plan on their

own. The interests of creditors would be better served by an open and free plan process, including negotiation among, and ultimate vote of, all unsecured creditors on this key plan term than by a plan process in which a key term has already been set in stone for no valid reason. The elimination of this provision will provide the Debtors and creditors with much greater flexibility in formulating a plan of reorganization and will ensure that the Debtors are able to exit bankruptcy with a viable corporate structure supported by its creditor body. It may ultimately be that the Pension Claims will not receive the same currency as that of the general unsecured creditors, and there is no justification for setting a common currency requirement at this point in the process.

The Debtors, Trustees, and Services Committee have slipped into the Settlement one of the few remaining terms still left to negotiate in an effort to side-step the plan negotiation and confirmation process. Like any creditors, the Trustees (advised by the Services Committee's lawyers) will have their chance to vote on a plan of reorganization, and thus on the treatment they ultimately will receive.

RESERVATION OF RIGHTS

This SCL Committee reserves its right to assert other and further grounds for objection to the Motion, to submit one or more additional briefs in support of its objections, and to proffer additional evidence at trial. The SCL Committee also objects to any provisions of the proposed Settlement that by their terms are not final, that are not precisely specified, or that require further agreement between the parties (such as an agreement to implementation). The SCL Committee should have the opportunity to object in the future on these matters and should not be frozen out of the process as the

result of some vague reference to future matters set forth in the Motion and/or Term Sheet.

CONCLUSION

For the foregoing reasons, the Settlement as proposed in the Motion should be rejected and the Motion denied. Alternatively, consideration of the Motion should be withheld until it can be considered in connection with a plan of reorganization.

Dated at: Wilmington, Delaware
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Respectfully Submitted,

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