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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	
MOTORS LIQUIDATION COMPANY, f/k/a GENERAL MOTORS CORPORATION, *et al.*,	Chapter 11 Case No. 09-50026 (MG) (Jointly Administered)
Debtors.	
MOTORS LIQUIDATION COMPANY AVOIDANCE ACTION TRUST, by and through the Wilmington Trust Company, solely in its capacity as Trust Administrator and Trustee,	Adversary Proceeding
Plaintiff,	Case No. 09-00504 (MG)
against	
JPMORGAN CHASE BANK, N.A., *et al*.,	
Defendants.	

PLAINTIFF'S REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF ITS MOTION FOR PARTIAL SUMMARY JUDGMENT DISMISSING DEFENDANTS' EARMARKING DEFENSE

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Plaintiff respectfully submits this reply memorandum of law in further support of its motion for partial summary judgment dismissing defendants' affirmative defense of earmarking.[1]

PRELIMINARY STATEMENT

Despite nearly a decade of litigating this action before this Court, the Second Circuit, and the Delaware Supreme Court, the Term Lenders argue that this action, which was expressly authorized by the Final DIP Order entered in the GM bankruptcy proceeding, was pointless from its inception because the $1.5 billion post-petition payment of DIP Proceeds to them was earmarked and thus should not be considered a transfer of property of the GM estate. As explained below, the Term Lenders' opposition to Plaintiff's motion for partial summary judgment has no merit and the defense should be dismissed.

The Term Lenders argue that the Trust's motion should be denied and that the elements of the earmarking defense are met because: (1) the debtors were obligated to use a portion of the post-petition DIP Proceeds to repay the Term Lenders and therefore the DIP Proceeds were not in the debtors' control; (2) repayment of the Term Loan with the DIP Proceeds augmented and did not diminish the debtors' estate; and (3) although they cite no case where a court has extended the earmarking doctrine to post-petition DIP proceeds, this Court should do so here.

The Term Lenders are wrong on all fronts and identify no genuine dispute of material fact to salvage any element of their defense. First, the DIP Proceeds were used to meet numerous obligations of the debtors, including but not limited to repayment of the Term Loan, and the transfer to the Term Lenders was explicitly contingent on the right of the Committee (and later the Trust) to challenge that very transfer under the Final DIP Order, rendering the

[1] Capitalized terms not otherwise defined have the meaning set forth in Plaintiff's Memorandum of Law in Support of its Motion for Partial Summary Judgment Dismissing Defendants' Earmarking Defense (hereinafter "Brief" or "Br."). References to "Opposition Brief" or "Op. Br." are to the Term Lenders' memorandum of law in opposition.

earmarking defense inapplicable. Second, the debtors exercised control over the DIP Proceeds subject to their "prudent business judgment to use the DIP Proceeds consistent with their fiduciary duties," and the Term Lenders do not genuinely dispute the various indicia of the debtors' control over the DIP Proceeds. Third, because any proceeds recovered in this action are for the benefit of the Unsecured Creditors and the DIP Lenders, the bankruptcy estate will be diminished if the Term Lenders are entitled to retain any overpayment. To conclude otherwise would lead to a windfall for the Term Lenders. Fourth, the Term Lenders misconstrue the law in attempting to convince this Court to extend the earmarking doctrine to the transfer of post-petition DIP Proceeds here. This extraordinary extension of the law is unwarranted.

Ultimately, the Term Lenders attempt to conjure disputes of material facts where none exist, identifying only evidence that is speculative or taken out of context to support their argument that their earmarking defense should survive the Trust's motion.[2] The parties disagree only as to the import and legal impact of undisputed facts and there are no credibility issues the Court needs to weigh. For these reasons and those herein, the Trust's motion should be granted, and the earmarking defense dismissed.

ARGUMENT

I. THE UNDISPUTED MATERIAL FACTS SHOW THAT OLD GM CONTROLLED THE DIP PROCEEDS

As set forth in the Trust's Brief, the debtors exercised dominion and control over the DIP Proceeds used to pay the Term Lenders. The DIP Lenders provided credit to Old GM on general terms for working capital, Old GM could draw on the DIP facility for many purposes, and Old

[2] The Term Lenders attempt to create a dispute of material fact by relying on inadmissible speculation to draw unwarranted conclusions. *See e.g.*, Term Lenders' Counterstatement of Facts ¶¶ 64, 80, 82, 83, 85-88; *see also* Pl.'s Response to the Term Lenders' Counterstatement of Facts (Responses 64, 80, 82, 83, 85-88). Such unsupported statements are insufficient to defeat the Trust's motion. *See Woodman v. WWOR-TV, Inc*., 411 F.3d 69, 85 (2d Cir. 2005) ("The law is well established that conclusory statements, conjecture, or speculation are inadequate to defeat a motion for summary judgment.") (internal quotations omitted).

GM was named the beneficiary of the DIP Funding—not the Term Lenders. *See* Br. at 14-15, 17. The DIP Lenders did not insist that Old GM escrow the funds and did not impose any specific requirements,[3] such as additional approvals, before the funds could be used. *See id.* at 7, 16-17. Instead, the uncontroverted evidence shows that the debtors controlled the DIP Proceeds because the funds were deposited into Old GM's general account and were authorized for use for numerous purposes, not just payment to the Term Lenders. *See id.* at 14-18. The Term Lenders concede that the funds were kept in the same bank account that Old GM used both before and after its bankruptcy petition to fund its regular business operations. Opp. Br. at 20 n.9. [4]

In response, the Term Lenders argue that because Old GM was required to use DIP Proceeds to repay them pursuant to the "clear obligation" to do so set forth in the Final DIP Order and DIP Credit Agreement, the funds were earmarked. Opp. at 5, 13-19. The undisputed evidence, however, shows that the cited "obligations" do not support the conclusion that the funds were earmarked. The reading of the Final DIP Order and DIP Credit Agreement urged by the Term Lenders is at odds with the complete language of the Final DIP Order, the context in which it was entered by the Court, the Confirmed Plan of Reorganization, and the realities of the bankruptcy proceedings that led to this Avoidance Action. For these reasons and those below, there is no genuine dispute of material fact that Old GM controlled the DIP Proceeds.

[3] The Term Lenders accuse the Trust of mischaracterizing Mr. Feldman's testimony on this point, but it is the Term Lenders who fail to cite his relevant testimony in its entirety. *See* Celentino Decl. Ex. A (Feldman Dep.) at 168:5-171:07; Pl.'s Response to the Term Lenders' Counterstatement of Facts (Response 65).

[4] The undisputed material evidence shows that the DIP Proceeds were wired into, and then paid out of, Old GM's general concentration account that Old GM controlled and that held other sources of cash. By contrast, *In re Flanagan* involved a loan from the debtor's father "for the sole purpose of purging [debtor's] contempt . . . through satisfaction of the underlying Judgment." 503 F.3d at 185 (internal quotations omitted). Acting as a mere conduit, immediately upon receiving the funds, the debtor delivered them to satisfy the judgment. *Id.* at 176; *see also, In re Superior Stamp & Coin Co., Inc.*, 223 F.3d 1004, 1008 (9th Cir. 2000) (loan to debtor to pay a particular creditor on a specified antecedent debt).

A. The Funds Paid to the Term Lenders Are Not Subject to Earmarking Pursuant to the Final DIP Order's Carveout for the Avoidance Action

The Term Lenders ask this Court to ignore the unambiguous language of the Final DIP Order and the circumstances that led to this action in an effort to convince the Court that the funds paid to them are earmarked for the Term Lenders. The conclusion urged by the Term Lenders would impermissibly rewrite both the Final DIP Order and the history that led to this action being preserved for the benefit of the bankruptcy estate.

The Final DIP Order represents a negotiated, and then court-approved, resolution among the debtors, the DIP Lenders, the Term Lenders, the Committee, and others that permitted the critical 363 Sale to New GM to proceed expeditiously. On the one hand, the DIP Lenders wanted to ensure that the Term Lenders would have no basis to object to the 363 Sale. *See e.g.*, Opp. Br. at 4. But on the other hand, the Committee had an interest in preserving its right to recover the transfer of funds to the Term Lenders if it was later determined that the Term Loan was not fully secured. Supplemental Declaration of Eric Fisher ("Fisher Supp. Decl.") Ex. A (June 25, 2009 Hearing Tr. at 24:4-26:7) (Committee's counsel explaining to Court that changes reflected in Final DIP Order were made at the Committee's request, including change to ensure the Committee could investigate claims against Term Lenders).

The Final DIP Order reflects the negotiated resolution that addressed these competing interests. Under the deal, the Term Lenders were paid in full, ahead of all other creditors. Final DIP Order ¶ 19(a). The Term Lenders were paid without having to first prevail in a protracted valuation hearing, in which the status, scope, and value of their collateral would be challenged by the Committee. In exchange for receiving the immediate $1.5 billion post-petition payment, the Term Lenders were required to make allowance for the investigation and prosecution of the

claims in the instant Avoidance Action to allow the estate to recover any overpayment to the Term Lenders. *Id.* ¶ 19(d). Those were the terms of the bargain struck by all parties.

Accordingly, the Final DIP Order provides not only for payment to the Term Lenders, but also, in the very same paragraph, makes that payment expressly contingent on the right of the Committee (and later the Trust) to investigate and litigate the claims in this action for the potential benefit of the estate. *Id.*; *Official Comm. of Unsecured Creditors of Motors Liquidation Co. v. U.S. Dep't. of Treasury et al. (In re Motors Liquidation Co.)*, 460 B.R. 603, 612 (Bankr. S.D.N.Y. 2011), *vacated on other grounds*, 47 B.R. 347 (S.D.N.Y. 2012). Both the Term Lenders and the Committee supported the entry of the Final DIP Order under these terms and conditions. *See* Fisher Supp. Decl. Ex. A (June 25, 2009 Hearing Tr. at 21:21-22:1) (debtors' counsel stating, "[w]e're pleased to report that in connection with the motion to approve the debtor-in-possession financing on a final basis, we have reached a consensus with all of the objecting parties as well as with the creditors' committee and the secured lenders. And that is embodied in a revised order….").[5]

Even though the Term Lenders agreed that the payment to them was subject to potential recovery in this action, they now urge the Court to read only the portion of the Final DIP Order that benefits them. According to the Term Lenders' selective reading, earmarking applies because the Final DIP Order "required Old GM to repay the Term Loan from the DIP Loan proceeds" *see* Opp. Br. at 13-14, because it provided that "the Debtors . . . *shall apply* the proceeds of the DIP Credit Facility or repay amounts outstanding under the Prepetition Senior

[5] The Term Lenders' references to the preliminary DIP Order, the motion in support of the preliminary DIP Order, and the transcript of the June 1, 2009 hearing—all dated prior to the discovery of the possible termination of the Term Lenders security interest in the Term Loan—are not relevant because they do not address the ultimate bargain reflected in the Final DIP Order. *See* Final DIP Order ¶ 22 ("In the event of any inconsistency between the terms and conditions of the DIP Credit Facility or the Interim Order and this Final Order, the terms and conditions of this Final Order shall control."); Opp. Br. at 15 (same).

Facilities." Final DIP Order ¶ 19(a) (emphasis added). But the DIP Order must be read in its entirety to include the allowance for recovery of the transfer in this action. *See id.* ¶ 19(d); *see also In re Motors Liquidation*, 460 B.R. at 623 (concluding that court orders must be read as a whole with all provisions given meaning). And while the Term Lenders did not expressly waive any defenses in connection with the Final DIP Order, the funds could not have been earmarked because payment to them was expressly contingent on the Committee's litigation rights. It is nonsensical for the Term Lenders to argue now that the contingency is not dispositive evidence that earmarking cannot apply here.

Nor do the Term Lenders have any meaningful response to (1) the fact that the DIP Credit Agreement provided that the debtors and not the Term Lenders "are the ultimate beneficiaries of this Agreement and the Loans to be received hereunder," DIP Credit Agreement § 3.20, and therefore the funds transferred to the Term Lenders were under Old GM's control, or (2) that Old GM was entitled to exercise prudent business judgment as to when and how the $33 billion in DIP Funding was used, so long as it was used in a manner generally consistent with the Applicable Budget, *id.* § 5.5. Instead they emphasize that the Final DIP Order controls over the DIP Credit Agreement. *See* Opp. Br. at 15 (citing Final DIP Order ¶ 22). But the Trust does not dispute this fact; the Final DIP Order only further supports the conclusion that the Term Lenders were paid on an expressly contingent basis, and therefore earmarking cannot apply.[6]

The Term Lenders also claim that if they had not been pledged repayment in full in connection with the DIP funding, they could have prevented the 363 Sale from proceeding. *See*

[6] The Term Lenders criticize the Trust for relying on § 3.20 of the DIP Credit Agreement "in isolation" because it is in the "Representations and Warranties" section. *See* Opp. Br. at 15, 18. But the Term Lenders themselves rely heavily on the "Use of Proceeds" provision in the DIP Credit Agreement, which explicitly references § 3.20, providing that the Loan Proceeds shall be used "only for the purposes set forth in Section 3.20 and in a manner generally consistent with the Applicable Budget." DIP Credit Agreement § 5.5.

Opp. Br. at 21. But the Term Lenders did not object to being paid only provisionally under the Final DIP Order. Instead, they supported entry of that order. Nor did they object to the Confirmed Plan of Reorganization, which restated the Trust's right to recover the payment made to the Term Lenders if this action is successful. *See* Bankr. Dkt. No. 9836 at § 6.5 (Plan). This is not surprising. Had they objected to the 363 Sale, the Term Lenders would have forgone the benefit of being repaid in full immediately, ahead of other creditors, and Old GM may have been forced to liquidate the Term Lenders' collateral.

B. Evidence Regarding the DIP Budgets and DIP Sizing Is Irrelevant

The Term Lenders assert that "had the Term Loan been unsecured, it would not have been included in the DIP sizing analyses and the DIP financing would have been $1.5 billion less." Opp. Br. at 5. The evidence cited does not support that argument. *See* Pl.'s Response to the Term Lenders' Counterstatement of Facts (Responses 83-86).

Moreover, evidence regarding the DIP budget and sizing is irrelevant.[7] It is typical for DIP lenders to require information about how much funding is required and for what purposes and for a DIP loan to be accompanied by a budget detailing the planned use of funds, and a debtor's need to satisfy various financial obligations is a standard consideration in determining the amount of a DIP loan.[8] *See In re Republic Airways Holdings Inc.*, No. 16-10429 (SHL), 2016 WL 2616717, at *12 (Bankr. S.D.N.Y. May 4, 2016) ("[A] budget requirement is a very

[7] The Term Lenders' repeated reliance on extrinsic evidence such as emails regarding the intent of those negotiating the unambiguous DIP Credit Agreement and Final DIP Order is improper. *See, e.g.*, *Wayland Inv. Fund, LLC v. Millenium Seacarriers, Inc.,* 111 F. Supp. 2d 450, 454 (S.D.N.Y. 2000)*; In re Jamesway Corp.*, 205 B.R. 32, 34 (Bankr. S.D.N.Y. 1996) ("General rules of contract construction apply in construing orders and judgments.").

[8] The Initial Budget contained in Annex 1 to the DIP Credit Agreement relied on by the Term Lenders does not reference the Term Loan. It merely references an anticipated 5,224 million "Non-Operating Disbursement" in Week 7, including "projected debt payments, cash restructuring costs, payments related to Delphi and GMAC and other non-operating payments." DIP Credit Agreement, Annex 1. Payment to the Term Lenders was made on June 30, 2009, in Week 5 (not Week 7) as set out in the Budget. No consent was sought nor required under the DIP Credit Agreement for that "modification."

common requirement for DIP financing…Such budgets are designed to provide a lender with a breakdown of how its money is being used."). The conclusion urged by the Term Lenders would lead to the absurd result that earmarking would apply to *any* use of DIP loan proceeds in a budget prepared for or considered by a lender in sizing its loan.

II. PERMITTING THE TERM LENDERS TO RETAIN ANY OVERPAYMENT WILL DIMINISH THE BANKRUPTCY ESTATE AND LEAD TO AN INEQUITABLE RESULT

The undisputed material facts show that permitting the Term Lenders to retain the full $1.5 billion post-petition payment to them, even if it is shown that their loan was undersecured, will deprive the estate of funds for distribution to the Unsecured Creditors and the DIP Lenders. Yet the Term Lenders argue in opposition that because Old GM was required to use a portion of the DIP Proceeds to repay the Term Loan, the funds cannot be considered to be property of the estate. They further argue that because "the funds used to pay the defendant were made available to the debtor at no cost to the unsecured creditors, solely for the purpose of making a payment to the secured creditors, the unsecured creditors have been deprived of nothing." Opp. Br. at 21.

However, based on undisputed material facts, it is plain that the estate will be diminished if the transfer to the Term Lenders is insulated from recovery. Whether the DIP Loan would or would not have been $1.5 billion less absent the need to repay the Term Loan (a question that is entirely speculative, *see* Opp. Br. at 22) is beside the point. It cannot be disputed that if a portion of the post-petition transfer is recovered in this action, it will "augment" the estate for the benefit of the unsecured creditors and DIP Lenders. Accordingly, the bankruptcy estate has been diminished by the payment to the Term Lenders, to the extent that they have been overpaid.

Finally, the equities do not support a finding of earmarking. It is the Term Lenders—not the Trust—who request an improper windfall by seeking to retain funds paid to them under the

presumption they were fully secured, even if it is determined they were not. The alternative—recovery for the benefit of the Unsecured Creditors and DIP Lenders if the Term Lenders are undersecured—is not unjust because the Term Lenders will receive the same distribution on the unsecured portion of their claim as all other unsecured creditors. Fisher Supp. Decl. Ex. B (Executed Third Amended and Restated Motors Liquidation Company Avoidance Action Trust Agreement).

III. THE EARMARKING DOCTRINE SHOULD NOT BE EXTENDED TO DIP PROCEEDS

The Term Lenders do not and cannot cite any case where the earmarking doctrine was applied to a post-petition transfer of DIP loan proceeds. This is unsurprising because, as discussed in the Trust's Brief, such an extension of the doctrine would distort its historical purpose and undermine the strong presumption that the DIP proceeds are property of the estate under § 541(a)(7) and subject to recovery under § 549 of the Bankruptcy Code. *See* Br. at 11-13.

The Term Lenders accuse the Trust of inaccurately arguing that there is a per se rule against applying earmarking to a post-petition transfer. Opp. Br. at 8. The Trust makes no such claim. As set forth in its Brief, the Trust asserts that there is no case *in this district* where earmarking has been applied to post-petition transfers and the Court should not do so here. *See* Br. at 2, 13. The handful of cases from *outside* this district cited by the Term Lenders are inapposite and do not address transfers involving DIP loan proceeds like the one at issue here.[9]

[9] *See Boldt v. Alpha Beta Co. (In re Price Chopper Supermarkets, Inc.)*, 40 B.R. 816 (S.D. Cal. 1984) (earmarking applies to debtor's wife's stock pledged pursuant to pre-petition agreement as collateral for debtor's letter of credit where stock sold to satisfy the letter of credit post-petition); *Herzog v. Sunarhauserman (In re Network 90 Degrees, Inc.)*, 98 B.R. 821 (N.D. Ill. 1989) (earmarking applies to customer checks for pre-petition orders sent directly to manufacturer creditor pursuant to pre-petition agreement that authorized manufacturer to apply proceeds to dealer's debt; two of six checks were received post-petition); *In re Barefoot Cottages Dev. Co., LLC*, No. 09-50089-LMK, 2009 WL 2842735 (N.D. Fla. July 28, 2009) (earmarking applies to supersedeas bond posted pre-petition by debtor's former lawyer to stay execution of judgment pending appeal and bond was released post-petition); *see also Cooper v. Centar Invs. (Asia) Ltd. (In re TriGem Am. Corp.)*, 431 B.R. 855 (C.D. Cal. 2010) (earmarking may apply in non-preference, inter-company fraudulent conveyance claim; post-petition transfer not at issue); *In re Bos*., 561

The Term Lenders also confirm that there has been just a single decision by a court in this circuit, *Musso v. Brooklyn Navy Yard Dev. Corp. (In re Westchester Tank Fabricators, Ltd.)*, where earmarking was applied to a post-petition transfer, and that case did not apply earmarking to a transfer of DIP loan proceeds. 207 B.R. 391 (Bankr. E.D.N.Y. 1997). There, the debtor entered into a post-petition agreement to pay its landlord $100,000 to satisfy prepetition arrears and borrowed $100,000 from Queens Plaza, a third party consisting of the debtor's family members, to pay the landlord. *Id.* at 395-96. Queens Plaza issued a check drawn on its own account payable directly to the debtor's landlord. *Id.* at 396. Unlike the DIP Proceeds here, the post-petition proceeds at issue there were directed and delivered by the third-party creditor to the landlord, were not deposited into the debtor's account, were not provided as part of funding for business operations, were never made available to pay any creditor other than the landlord, and were never within the debtor's control in any way. *Id.* at 398.[10]

In sum, there are no cases to support the Term Lenders' argument to extend the earmarking doctrine to shield post-petition transfers of DIP loan funds from recovery.

CONCLUSION

For the foregoing reasons, Plaintiff respectfully requests that the Court grant its motion for partial summary judgment dismissing the Term Lenders' earmarking defense.

B.R. 868 (N.D. Fla. 2016) (no earmarking where entities controlled by debtor made "loans" for post-petition transfers to defeat a Chapter 7 petition but noting that *In re Westchester* applied earmarking defense to a §549 avoidance action).

[10] Despite the Term Lenders' claim to the contrary, *In re Westchester* suggests that post-petition DIP funding is not subject to earmarking. In criticizing the Trust, *see* Opp. Br. at 10 n.5, the Term Lenders fail to quote the full language of the decision: "Unlike the Queens Plaza check, the Defendant does not dispute that the DIP Checks constituted property of the estate. The evidence and trial testimony are clear that these checks were *drawn on the Debtor's DIP account* and that the $52,333.36 so transferred was generated from the Debtor's postpetition operations." 207 B.R. at 401 (emphasis added). They also misconstrue *Cadle Co. v. Mangan (In re Flanagan)*, 503 F.3d 171 (2d Cir. 2007). As in *In re Westchester*, the funds subject to earmarking there were provided by a family member to satisfy an antecedent debt and were not available for the debtor's general use. *Id.* at 185.

Dated: New York, New York
December 14, 2018

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