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Objection Deadline: February 7, 2013 at 4:00 p.m.
Hearing Date: February 14, 2013 at 10:00 a.m.

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re	:	Chapter 11
	:	
MF GLOBAL HOLDINGS LTD., *et al.*,	:	Case No. 11-15059 (MG)
	:	
Debtors.	:	Jointly Administered

OBJECTION OF JPMORGAN CHASE BANK, N.A. TO MOTION OF THE PLAN PROPONENTS FOR AN ORDER (I) APPROVING DISCLOSURE STATEMENT AND THE FORM AND MANNER OF NOTICE OF THE DISCLOSURE STATEMENT, (II) ESTABLISHING PROCEDURES FOR SOLICITATION AND TABULATION OF VOTES TO ACCEPT OR REJECT THE PLAN, (III) SCHEDULING HEARING ON CONFIRMATION OF THE PLAN, (IV) APPROVING RELATED NOTICE AND OBJECTION PROCEDURES, AND (V) APPROVING CERTAIN PRE-CONFIRMATION MATTERS

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JPMorgan Chase Bank, N.A. ("JPMorgan"), for itself and as administrative agent (in such capacity, the "Administrative Agent") under that certain $1,200,875,000 Revolving Credit Facility, dated as of June 15, 2007, among MF Global Finance USA Inc. ("Finco"), as borrower, MF Global Holdings Ltd. ("Holdings"), the lenders from time to time parties thereto (collectively, the "Lenders"), and JPMorgan Chase Bank, N.A., as administrative agent (as amended, supplemented or otherwise modified from time to time and as in effect prior to the Petition Date, the "Liquidity Facility"), hereby files this objection (the "Objection") to the motion of the Plan Proponents[1] for an order (i) approving the Disclosure Statement and the form and manner of notice of the Disclosure Statement, (ii) establishing procedures for solicitation and tabulation of votes to accept or reject the Plan, (iii) scheduling hearing on confirmation of the Plan, (iv) approving related notice and objection procedures, and (v) approving certain pre-confirmation matters (the "Motion"), and in support thereof, respectfully represents as follows:

PRELIMINARY STATEMENT

1. As of the Petition Date, Finco and Holdings were jointly and severally liable as borrowers and guarantors for approximately $1.175 billion owed to the Lenders pursuant to the Liquidity Facility (the "Liquidity Facility Liability"). Of that amount, Holdings, in a series of draw requests made days before bankruptcy, borrowed approximately $931 million under the Liquidity Facility and transferred the money to Finco through the intercompany accounts, giving rise to an intercompany payable by Finco to Holdings of approximately $928 million (the "Finco Payable"). Finco, also a borrower under the Liquidity Facility, could have

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[1] Capitalized terms used but not otherwise defined herein shall have the meanings ascribed to them in the *Disclosure Statement for the Joint Plan of Liquidation for MF Global Holdings Ltd., MF Global Finance USA Inc., MF Global Capital LLC, MF Global FX Clear LLC, MF Global Market Services LLC, and MF Global Holdings USA Inc.*, dated February 1, 2013 [Docket No. 1029].

borrowed directly from the Lenders without incurring this payable to Holdings. But, because of the way Holdings structured the borrowings, Finco became liable twice for the same obligation: once to the Lenders who funded the loans into Holdings' account and once to Holdings who transferred the proceeds to Finco. The Disclosure Statement does not contain adequate information because it fails to disclose that the Plan would make Finco liable twice for the same obligation.

2. The Disclosure Statement also fails to disclose that Finco has claims and defenses that would, if successful, eliminate its liability for the Finco Payable. First, the Finco Payable can be avoided as a fraudulent conveyance. Finco was a borrower on the Liquidity Facility. It could have borrowed the $928 million directly from the Lenders without having to incur a duplicate liability to Holdings. Finco thus received no benefit by borrowing from Holdings and certainly did not receive reasonably equivalent value in exchange for the Finco Payable. The relevant borrowings occurred between October 18, 2011 and October 27, 2011—literally days before bankruptcy. Thus, based on the facts as we now understand them, it is apparent that when the Finco Payable was incurred, Finco was insolvent, not adequately capitalized and/or could not repay its debts when due. Accordingly, the Finco Payable may be avoidable as a fraudulent conveyance.

3. Second, Finco should have the right to setoff the full amount of its liability to the Lenders against its liability to Holdings for the repayment of loan proceeds. Accordingly, to the extent Finco pays the Lenders, its liability for the Finco Payable should be reduced.[2]

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[2] The portion of the Holdings intercompany claim against Finco attributable to the Liquidity Facility may be as high as $1.175 billion if the remaining $255 million of Liquidity Facility Liability was borrowed by Holdings and transferred through the intercompany accounts to Finco.

4. Third, the Finco Payable should be equitably subordinated. It fails the test of inherent fairness that applies to every insider transaction. "The essence of the test is whether or not under all of the circumstances the transaction carries the earmarks of an arm's length bargain. If it does not, equity will set it aside."[3] There is nothing less arm's length than making a subsidiary borrow from its parent what it could obtain on its own.

5. Fourth, to the extent the Finco Payable is allowed and not subordinated under section 510(c), it should be subordinated to the Lenders' claims under the Liquidity Facility. Section 509(c) of the Bankruptcy Code requires the subordination of a reimbursement claim by one co-debtor (*i.e.*, Holdings) against another co-debtor (*i.e.*, Finco) to their common creditor's claim (*i.e.*, the Lenders) until the common creditor is paid in full. Section 509(c) insures that a debtor does not pay twice for the same liability. It also insures that a co-debtor does not compete with the common creditor for payment until the creditor is paid in full. If Holdings' claims against Finco for the loan proceeds were allowed and not subordinated, Finco would be liable twice for the same liability. In addition, Holdings would compete with the Lenders for the repayment of loan proceeds which Holdings itself owes the Lenders. In this circumstance, section 509(c) requires the subordination of those intercompany claims.

6. The Disclosure Statement discloses none of these claims or defenses. It also fails to disclose that any of the foregoing claims and defenses, if successful, would materially increase creditor recoveries from Finco. The Disclosure Statement's current range of

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Discovery will be required to make this determination. Although the setoff and section 509(c) subordination claims described herein reference the Finco Payable, they would also apply to as much of the $1.175 billion as was borrowed by Finco through the intercompany accounts. The fraudulent conveyance and equitable subordination claims described herein, however, applies only to the Finco Payable.

[3] *Pepper v. Litton*, 308 U.S. 295, 306-07 (1939).

recoveries for Finco's creditors—14.2% to 33.6%—might increase to a range as high as 25.3% to 59.6% as a result of these claims and defenses.

7. Finally, the Disclosure Statement should be clear about how Holdings' claims against Finco are supposed to be resolved. The Disclosure Statement seems deliberately vague here, even though the Plan Proponents have been well aware of the issues raised in this Objection. For example, the Plan's definition of "General Unsecured Claim" expressly includes "Intercompany Claims." However, Intercompany Claims, unlike the only other specifically identified claims—those under the Liquidity Facility and the Notes—are not expressly allowed. But they also are not expressly disallowed either. More important, the Disclosure Statement fails to clearly tell Finco creditors that Holdings, as Plan Administrator for both Debtors, will decide whether to allow its own claims against Finco. The Disclosure Statement should say so plainly and obviously. It should not mislead Finco creditors into thinking that an unconflicted fiduciary, looking out only for their interests, is supposed to make this important decision.[4]

8. For all of the above reasons, the Disclosure Statement fails to contain "adequate information," and the Court should deny the Motion.

RELEVANT BACKGROUND

9. Holdings and Finco are borrowers under the Liquidity Facility and are jointly and severally liable to the Lenders for approximately $1.175 billion as of the Petition

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[4] Although the Plan is silent on whether Holdings' intercompany claims against Finco will be allowed, the Disclosure Statement's recovery analysis and Liquidation Analysis assume they are allowed in full. Disclosure Statement, Articles I.C.1, XV.B and Ex. VI, Assumption I.i. Accepting this assumption as the truth raises serious confirmation issues under the best interests test of section 1129(a)(7) of the Bankruptcy Code. And proposing a Plan that lets Holdings alone decide if this will be true raises serious conflict issues, *see, e.g., In re Adelphia Communications Corp.*, 336 B.R. 610 (Bankr. S.D.N.Y. 2006), *aff'd* 342 B.R. 122 (S.D.N.Y. 2006), and serious confirmation issues under section 1129(a)(1) and (3) of the Bankruptcy Code. As to these, and all other potential confirmation issues, JPMorgan reserves its rights.

Date. Holdings also is the issuer of approximately $1 billion of publicly traded, unsecured notes (collectively, the "Notes"). Finco is not a guarantor of the Notes. The claims of the Lenders and holders of the Notes are both unsecured claims (other than to the extent of a small amount of cash collateral held by JPMorgan) and rank *pari passu* at Holdings.

10. Between October 18, 2011 and October 27, 2011, Holdings borrowed approximately $931 million under the Liquidity Facility.[5] It then immediately transferred $928 million to Finco.[6] Over the same period, Finco funded approximately $875 million to MFGI.[7]

11. Finco was the financing arm for US operations.[8] It provided working capital to the Debtors' regulated and non-regulated businesses. It acted as MFGI's counterparty on billions of dollars in repo transactions pursuant to a master repurchase agreement with MFGI. It directly financed margin requirements for certain MFGI customers. As a borrower under the Liquidity Facility, it also had direct access to all funding available under the Liquidity Facility, including the $928 million in loan proceeds which came to Finco through Holdings and which gave rise to the Finco Payable.

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[5] *See Report of the Trustee's Investigation and Recommendations*, dated June 4, 2012 (the "SIPA Report") at 153 and Annex E thereto at 200 [Docket No. 1865]; *Chapter 11 Trustee's Report Regarding the Forensic Analysis of the Cash Collateral Held in the Bank Account of MF Global Finance USA, Inc.*, dated February 16, 2012 (the "Chapter 11 Trustee Report") at 4 and Ex. A thereto at 19 [Docket No. 451].

[6] *See* Chapter 11 Trustee Report, Ex. A at 19; Disclosure Statement, Articles II.B ("Finance USA . . . provided financing services to Affiliates and third parties.") and II.G.4.(a).2(ii) ("Finance USA generally acted as the financing arm for the U.S. operations of MF Global Group.").

[7] *See id.*

[8] *See id.*, Ex. A at 18.

12. According to the Disclosure Statement,[9] Finco owes an affiliate payable of approximately $1.87 billion to Holdings, which is inclusive of the Finco Payable. The Finco Payable is included in the "Intercompany Claims" that make up the bulk of Class 5B, General Unsecured Claims against Finco.[10] The Lenders' Liquidity Facility Claims against Finco are separately classified in Class 4B, Liquidity Facility Unsecured Claims. These claims include claims for the loan proceeds that created the Finco Payable when Holdings transferred the proceeds to Finco.

13. The Plan expressly allows claims under the Notes and the Liquidity Facility Claims.[11] It neither allows nor disallows Holdings' Intercompany Claims against Finco. Instead, Holdings, as Plan Administrator for both Debtors, is supposed to determine whether these claims are allowed or disallowed. On the Plan's Effective Date, Holdings alone will have the power to object to claims and pursue all Causes of Action, including any chapter 5 cause of action, belonging to the Estates, including Finco.[12] Given this, the allowance of the Finco Payable appears to be a foregone conclusion. In fact, in its Summary of Sources of Recovery, the Disclosure Statement states that "[t]he Plan Proponents similarly prepared a Recovery Analysis for Holdings Ltd., taking into account . . . its claims filed against Finance USA . . . ."[13]

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9 *See* Disclosure Statement at 50-1.

10 *See id.*

11 *See* Plan, Article III.B. 4, 5 and 7.

12 *See* Plan, Article VII.B.1 ("As of the Effective Date, objections to, and requests for estimation, of all Claims against the Debtors may be interposed and prosecuted only by the Plan Administrator, which shall consult with the applicable Debtor's director(s) or manager regarding the same.").

13 *See* Disclosure Statement, Article I.C.1. Likewise, in the Liquidation Analysis, the Disclosure Statement says: "the Plan Proponents have assumed that Holdings Ltd. will receive a Distribution from Finance USA on account of its Intercompany Claim". *See* Disclosure Statement, Article XV.B and Ex. VI, Assumption I.i.

14. As a result, the Plan would appear to make Finco liable twice for the same $928 million in loan proceeds—once to the Lenders and once to Holdings. The impact of this double liability on Finco creditor recoveries is significant. Approximately 30% of the Finco claims pool ($928 million of approximately $3.07 billion) is caused by this double count. Put another way, eliminating this double count would increase Finco recoveries by an additional 6.1% and possibly as much as 26.3% or more.

15. The Disclosure Statement does not disclose this double liability; nor does it disclose its negative impact on Finco creditor recoveries. It says nothing about claims and defenses Finco may have against the Finco Payable, and it does not disclose that in the end Holdings will decide for Finco creditors how much of Holdings' Intercompany Claims against Finco will be allowed.

ARGUMENT

I. This Court Should Not Approve the Disclosure Statement Because the Disclosure Statement Does Not Contain "Adequate Information."

16. Section 1125 of the Bankruptcy Code provides that a debtor may not solicit acceptances of a plan of reorganization from a holder of a claim or interest, "unless, at the time of or before such solicitation, there is transmitted to such holder the plan or a summary of the plan, and a written disclosure statement approved, after notice and a hearing, by the court as containing adequate information."[14] The Bankruptcy Code clearly defines the term "adequate information":

> (a) In this section – (1) "adequate information" means information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, that would enable a hypothetical

[14] 11 U.S.C. § 1125(b).

> reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the plan . . . ."[15]

17. The role of disclosure in the chapter 11 process cannot be overstated. As described in the House Report:

> If adequate disclosure is provided to all creditors and stock holders whose rights are to be affected, then they should be able to make an informed judgment [on] their own rather than having a court or the Securities and Exchange Commission inform them in advance whether the proposed plan is a good plan. Therefore, the key to the consolidated chapter is the disclosure section.[16]

18. The definition of "adequate information" contained in section 1125 of the Bankruptcy Code requires that a disclosure statement include information in sufficient reasonable detail as far as is practicable.[17] One court has held that a disclosure statement must clearly and succinctly inform the average creditor what it is going to get, when it is going to get it, and what contingencies there are to getting its distribution.[18] By definition, the extent of the information necessary to provide this level of detail to creditors will vary on a case-by-case basis.[19] This analysis comports with the flexible approach to the determination of "adequate information" that is reflected in the legislative history:

> Precisely what constitutes adequate information in any particular instance will develop on a case-by-case basis. Courts will take a

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[15] 11 U.S.C. § 1125(a)(1).

[16] H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 226 (1977).

[17] *See* 7 COLLIER ON BANKRUPTCY ¶ 1125.02 (16th ed.).

[18] *See id.* (citing *In re Ferretti*, 128 B.R. 16, 19 (Bankr. D.N.H. 1991)).

[19] *See, e.g.*, *In re PC Liquidation Corp.*, 383 B.R. 856, 865 (E.D.N.Y. 2008) ("The standard for disclosure is, thus, flexible and what constitutes 'adequate information' in any particular situation is determined on a case-by-case basis with the determination being largely within the discretion of the bankruptcy court." (internal citations omitted)).

> practical approach as to what is necessary under the circumstances of each case, such as the cost of preparation of the statements, the need for relative speed in solicitation and confirmation, and, of course, the need for investor protection. There will be a balancing of interests in each case.[20]

A. *The Disclosure Statement Fails to Disclose That the Plan Would Make Finco Liable Twice for the Same Obligation.*

19. Creditors should be told that the Plan would make Finco liable twice for the same obligation. Class 4B contains the Lenders' claims against Finco under the Liquidity Facility. Class 5B contains Holdings' Intercompany Claims against Finco. Both include claims for the repayment of $928 million in loan proceeds Holdings borrowed days before the bankruptcy and transferred to Finco.

20. Creditors should be told that although Finco could have borrowed the money directly from the Lenders, it did not. Instead, Holdings borrowed the money and then immediately transferred it to Finco. As a result of how Holdings structured the borrowings, Finco now faces double liability. This double liability would have been avoided had Finco been permitted to borrow directly from the Lenders.

B. *The Disclosure Statement Fails to Disclose the Impact of Double Liability on Finco Creditor Recoveries.*

21. The claims pool at Finco consists of two significant groups of claims in the estimated allowed amounts: (i) Class 4B Liquidity Facility Unsecured Claims of approximately $1.175 billion,[21] and (ii) Class 5B General Unsecured Claims of approximately

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[20] H.R. Rep. No. 95-595, 95th Cong., 1st Sess. at 409 (1977).

[21] The Disclosure Statement incorrectly estimates the Lenders' claim against Finco and Holdings to be $1,148,087,718. The difference between these figures appears to be the Plan Proponents' assumption that the Classes 3A and 3B JPMorgan Secured Setoff Claim and amounts received by JPMorgan pursuant to the Cash Collateral Order should be treated as paydowns of the Liquidity

$1.9 billion. The Class 5B General Unsecured Claims consists of three parts: (i) the Finco Payable, which is at least $928 million, (ii) the balance of the Intercompany Claims held by Holdings, which is approximately $959 million, and (iii) other claims against Finco, which are approximately $12.4 million. If the Finco Payable is avoided as a fraudulent conveyance, the recovery for all unsecured creditors at Finco would increase from a range of 14.2% and 33.6% to a range of approximately 20.2% and 47.7%. If the Finco Payable is subordinated to the claim of Lenders at Finco pursuant to section 509(c) of the Bankruptcy Code, the Lenders' recovery at Finco would increase from a range of 14.2% and 33.6% to a range of approximately 25.3% and 59.6%.

22. The Disclosure Statement mentions none of this. It gives Finco creditors no sense of what is at stake here for their recoveries.

C. *The Disclosure Statement Fails to Disclose Claims and Defenses that Eliminate the Finco Payable.*

23. The Disclosure Statement fails to disclose the claims and defenses described below that would eliminate Finco's exposure to double liability.

The Finco Payable Can Be Avoided as a Fraudulent Conveyance.

24. The Finco Payable can be avoided as a fraudulent conveyance pursuant to section 548 of the Bankruptcy Code and similar state law provisions. Section 548 of the Bankruptcy Code provides in relevant part:

> The trustee may avoid any transfer . . . of an interest of the debtor in property, or any obligation . . . incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—

Facility Liability rather than offsets against other claims held by JPMorgan. JPMorgan has not yet determined how such funds shall be applied and reserves all of its rights with respect thereto.

> (i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
>
> (ii) (I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;
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> (II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; [or]
>
> (III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured . . . .[22]

25. The trustee or a party acting on behalf of the estate may challenge the Finco Payable as a fraudulent conveyance. It would need to prove that Finco (a) received less than reasonably equivalent value and (b)(i) was or became insolvent as a result of the transaction, (ii) was undercapitalized or (iii) incurred debts beyond its ability to pay them as they became due.

26. Based on the facts as we now understand them, once Holdings exercised what the SIPA trustee called the "break the glass" scenario in October 2011, Finco was insolvent.[23] Multiple statements in the SIPA Report support this conclusion.[24] It also is clear that Finco received no value on account of the Finco Payable, much less reasonably equivalent

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[22] 11 U.S.C. § 548(a)(1).

[23] *See* SIPA Report at 148-49 (in mid-October 2011, "[t]he simultaneous occurrence of a customer 'run on the bank' and unwinds of repo counterparty and proprietary positions within a three-day timeframe overwhelmed the Firm.").

[24] *See, e.g.*, *id.* at 93 (By mid to late October 2011, the Debtors' "available sources of liquidity were, however, insufficient to meet MF Global's ever-increasing liquidity needs. The announcement of poor financial results coupled with the two Moody's rating downgrades [on October 24 and October 27, respectively,] began what the SIPA trustee called a 'run on the bank' scenario."); and 90 (Throughout the week of October 24 to October 28, "[c]redit events impacting MF Global . . . escalated its liquidity drain to crisis proportions.").

value. Finco itself was a borrower on the Liquidity Facility and could have borrowed the entire $928 million directly from the Lenders without incurring any liability to Holdings. Had Finco done so, it would have had the benefit of the loan proceeds without the burden of a separate obligation to Holdings. Therefore, an insolvent Finco became liable to Holdings for $928 million without receiving reasonably equivalent value. Accordingly, Finco can seek to avoid the Finco Payable.

The Finco Payable Is Subject To Setoff.

27. Section 553(a) of the Bankruptcy Code provides in relevant part:

> Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case . . . .[25]

28. "Setoff is a right of equitable origin designed to facilitate the adjustment of mutual obligations."[26] Rights of setoff arise in connection with the terms of a contract or pursuant to common law or state statute. The Bankruptcy Code is not an independent source of setoff rights; rather, it preserves rights of setoff that already exist under applicable state law.[27] In New York, setoff is both a common law and statutory right.[28]

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[25] 11 U.S.C. § 553(a).

[26] 5 COLLIER ON BANKRUPTCY ¶ 553.01 (16th ed.).

[27] *Id.* at ¶ 553.01[2].

[28] *See In re Bennett Funding Group, Inc.*, 146 F.3d 136, 140 (2d Cir. 1998) (common law); N.Y.Debt. & Cred.Law § 151 (statutory) provides in relevant part:

> Every debtor shall have the right upon: (a) the filing of a petition under any of the provisions of the federal bankruptcy act or amendments thereto . . . by or against a creditor; . . . to set off and apply against any indebtedness, whether matured or unmatured, of such creditor to such debtor, any amount owing from such debtor to such creditor, at or at any time after, the [filing of the petition] and the

29. Finco should have the right here to setoff against the Finco Payable the full amount of its liability to the Lenders. It should have this right not only to give effect to whatever claims it, as co-obligor may have against Holdings,[29] but because the Finco Payable and the claims of the Lenders against Finco effectively constitute the same liability.[30] Setoff is appropriate precisely so Finco does not pay the same obligation twice.[31]

> aforesaid right of set off may be exercised by such debtor against such creditor or against any trustee in bankruptcy, debtor in possession . . . .

[29] *See* 4B N.Y.Prac., Com. Litig. in New York State Courts § 75:40 (3d ed.) ("Unless otherwise agreed to by them, two or more parties who are jointly liable on an instrument ordinarily may have the right to contribution from each other to the extent that any party pays more than its contributory share."); *Kristiansen v. Kristiansen*, 280 A.D.2d 584, 585 (2d Dep't 2001) ("[a] guarantor who has paid more than his or her proportionate share of a common liability is entitled to contribution from any co-guarantors."); *Falb v. Frankel*, 73 A.D.2d 930 (2d Dep't 1980) ("It is well settled that where one joint obligor pays more than his proportionate share of the common liability, he is entitled to contribution from the other joint obligors."). Contingent co-obligor claims for reimbursement or contribution are subject to disallowance under section 502(e) of the Bankruptcy Code. That, however, should not impair Finco's setoff rights (assuming, arguendo, that Finco's claims against Holdings are still contingent at this point). A right of setoff may be asserted defensively even if the right to a recovery on the claim has been disallowed. *See In re Denby Stores, Inc.*, 86 B.R. 768, 777, n.8 (Bankr. S.D.N.Y. 1988) (Brozman, J.)(and cases cited therein).

[30] *See In re Denby Stores, Inc.*, 86 B.R. at 778-79 (guarantor's obligation to a landlord under a lease guarantee and to the debtor-lessee under a separate, but related note, was the same liability; the court reasoned that if the note liability was not setoff against payments under the guarantee, it would "effectively require the guarantor or surety to pay twice, once when he is called upon to pay the creditor, and once when he is called upon to pay the debtor"); *see also In re Flanagan Brothers, Inc.*, 47 B.R. 299, 303 (Bankr. D.N.J. 1985) (the obligation of a co-obligor contractor to a materialman was the same as its separate obligation to pay the debtor for its work inasmuch as the debtors' claim against the contractor included what the debtor owed the materialman; "Rogers, as surety for the debtor's obligations on the project according to state law, is thus liable directly to Billows on its claim, as well as being indebted indirectly to Billows through its indebtedness to the debtor. Hence, if no distribution of the estate is accorded to unsecured creditors due to insufficient assets, Rogers will have paid twice on Billows' claim.")(permitting setoff).

[31] 4 COLLIER ON BANKRUPTCY ¶ 502.06[7] (16th ed.).

The Finco Payable Should Be Equitably Subordinated.

30. The Finco Payable, if allowed, should be equitably subordinated pursuant to section 510(c) of the Bankruptcy Code. Section 510(c)(1) of the Bankruptcy Code provides:

> Notwithstanding subsections (a) and (b) of this section, after notice and a hearing, the court may under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest.[32]

31. Section 510(c) codified pre-Code case law.[33] Decades ago, the Supreme Court's seminal decision, *Pepper v. Litton*, established that:

> [t]he bankruptcy court in passing on allowance of claims sits as a court of equity. . . . [I]n the exercise of its equitable jurisdiction the bankruptcy court has the power to sift the circumstances surrounding any claim to see that injustice or unfairness is not done in administration of the bankruptcy estate.[34]

32. The Court instructed that "[t]he essence of the test is whether or not under all of the circumstances the transaction carries the earmarks of an arm's length bargain. If it does not, equity will set it aside."[35] Pepper thus set the standard for determining the fairness of insider transactions:

> In *Pepper v. Litton*, the Supreme Court, laying the groundwork for the doctrine of equitable subordination now codified as section 510(c), stated that the dealings of a controlling stockholder are subject to rigorous scrutiny and that when such dealings are challenged the burden is on the stockholder to show not only good faith but inherent fairness of the transaction.[36]

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[32] 11 U.S.C. § 510(c)(1).

[33] *See United States v. Noland*, 517 U.S. 535, 538 (1996).

[34] *Pepper*, 308 U.S. at 307-08 (1939)

[35] *Id.* at 306-07.

[36] 4 COLLIER ON BANKRUPTCY ¶ 510.05[3][d] (16th ed.)

33. There is nothing inherently fair about making a subsidiary borrow from its parent what the subsidiary could have obtained on its own. And, having done so, there is also nothing inherently fair about making the subsidiary pay for the loan twice, at its third party creditors' expense. In the extreme circumstances leading up to the filing of these cases, the "earmarks of an arm's length bargain" would have required Holdings to permit Finco to borrow what it needed directly from the Lenders or, failing that, to contribute the loan proceeds to Finco as equity, not debt. Holdings did neither and instead made a loan that was manifestly unfair to Finco's third-party creditors. As a result, the Finco Payable should be equitably subordinated.

The Finco Payable Must Be Subordinated to the Claims of Lenders.

34. The Finco Payable, if allowed and not subordinated under section 510(c), must be subordinated to Finco's liability on the Liquidity Facility Liability pursuant to section 509(c) of the Bankruptcy Code. Section 509(c) of the Bankruptcy Code provides:

> The court shall subordinate to the claim of a creditor and for the benefit of such creditor an allowed claim, by way of subrogation under this section, or for reimbursement or contribution, of an entity that is liable with the debtor on, or that has secured, such creditor's claim, until such creditor's claim is paid in full, either through payments under this title or otherwise.[37]

35. Section 509(c) "insures that only one creditor will be entitled to satisfy its claim for the same debt from the estate."[38] It also operates to prohibit a co-debtor from competing "with the creditor he has assured until the assured party's claim has paid in full."[39]

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[37] 11 U.S.C. § 509(c).

[38] *Id.*

[39] *See* 124 CONG. REC. H11094 (daily ed. Sept. 28, 1978); S17410–11 (daily ed. Oct. 6, 1978), reproduced in NORTON BANKRUPTCY LAW AND PRACTICE 3d (remarks of Rep. Edwards and Sen. DeConcini) ("Accordingly, section 509(c) of the House amendment subordinates both a claim by way of subrogation or a claim for reimbursement or contribution of a surety or codebtor

36. The Lenders are owed approximately $1.175 billion. Of that amount, no less than $928 million—the amount of the Finco Payable—was transferred to Finco, creating the affiliate payable from Finco to Holdings (*i.e.*, the Finco Payable). Holdings and Finco are jointly and severally liable to the Lenders for these claims under the Liquidity Facility. The Finco Payable is a "reimbursement" claim.[40] If the Finco Payable is allowed and not subordinated, Finco would suffer double liability. In addition, Holdings would compete with the Lenders for the repayment of loan proceeds which Holdings itself owes the Lenders. Given this, section 509(c) requires the subordination of those intercompany claims.

D. *The Disclosure Statement Should Tell Finco Creditors That Holdings Alone Will Decide Its Claims Against Finco.*

37. The Disclosure Statement should say how the Finco Payable will be resolved. Finco creditors should be clearly informed of the issues surrounding the Finco Payable, and be told that no independent fiduciary will decide whether and to what extent the Finco Payable will be allowed. And though the Disclosure Statement remains silent on these issues, it is clear about one thing—Holdings, as Plan Administrator, will decide whether to allow its own claims against Finco or whether Finco will be allowed to object or assert any claims and

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to the claim of the assured party until the assured party's claim is paid in full."); *In re Friendship Child Development Center, Inc.*, 164 B.R. 625, 628 (Bankr. D.Minn. 1992) (guaranty claim of guarantor, who was jointly and severally liable on underlying note to the lender, was subordinated until the bank was paid in full). When the co-debtor is an insider, sections 509(c) and 510(c)'s policies often work toward the same result—to subordinate the insider's claim to third party creditors.

[40] The Bankruptcy Code does not define the term "reimbursement." Courts have applied a "substance over form" approach to determine whether a claim would be a claim for reimbursement. *See In re Chemtura*, 443 B.R. 601, 627 (Bankr. S.D.N.Y. 2011). One test to determine whether the claim would impose double liability on a debtor for an obligation it and a co-debtor owes to their common creditor. *See id.* at 622 (noting that if a private claim were allowed, such a claim "presents precisely the danger of double recovery from the Debtors on account of the same liability"). The Finco Payable is a reimbursement claim because it satisfies this double liability test. *See, e.g., In re Denby Stores*, 86 B.R. at 778-79; *In re Flanagan Brothers, Inc.*, 47 B.R. at 303.

defenses. Finco creditors should know these facts and know what it means to them and their recoveries. They should be told that if the Plan is confirmed there will be no unconflicted fiduciary looking out for their interests on these issues.

CONCLUSION

WHEREFORE, JPMorgan respectfully requests that this Court sustain the Objection, find that the Disclosure Statement does not contain "adequate information" as required by section 1125 of the Bankruptcy Code, and grant such other and further relief as is just and proper.

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