United States Court of Appeals
for the
Third Circuit

Case No. 04-4080

IN RE: OWENS CORNING, a Delaware Corporation

CREDIT SUISSE FIRST BOSTON, as Agent for the prepetition bank lenders,

Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE
(NO. 00-03837 JUDGE JOHN P. FULLAM)

REPLY BRIEF OF APPELLANT CREDIT SUISSE FIRST BOSTON, AS AGENT

MARTIN J. BIENENSTOCK
JOHN J. RAPISARDI
TIMOTHY E. GRAULICH
WEIL, GOTSHAL & MANGES LLP
767 Fifth Avenue
New York, New York 10153
[Tel.] (212) 310-8000
[Fax] (212) 310-8007

ROY T. ENGLERT, JR.
ROBBINS, RUSSELL, ENGLERT, ORSECK & UNTEREINER LLP
1801 K Street, N.W., Suite 411
Washington, DC 20006
[Tel.] (202) 775-4500
[Fax] (202) 775-4510

KENNETH H. ECKSTEIN
ELLEN R. NADLER
PHILIP S. KAUFMAN
JEFFREY S. TRACHTMAN
KRAMER LEVIN NAFTALIS & FRANKEL LLP
919 Third Avenue
New York, New York 10022
[Tel.] (212) 715-9100
[Fax] (212) 715-8000

RICHARD S. COBB
REBECCA L. BUTCHER
LANDIS RATH & COBB LLP
919 Market Street, Suite 600
Wilmington, Delaware 19810
[Tel.] (302) 467-4400
[Fax] (302) 467-4450

Attorneys for Appellant Credit Suisse First Boston, as Agent

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REPLY BRIEF FOR THE APPELLANT

Nonconsensual substantive consolidation is an extraordinary remedy for identifiable harms. The district court's seven-page opinion said nothing that could justify that remedy. It imposed consolidation not to undo harm, but to undo the Bankruptcy Code in numerous respects.

Appellees' 189 pages of appellate briefs do not justify the remedy either. *Even if* all their asserted facts had been found below, they would not support substantive consolidation as a matter of law. The facts asserted do not show corporate irregularities that caused creditors to misunderstand which entity they were dealing with, which is what "substantial identity" requires. There has been no showing of any *legitimate* necessity for substantive consolidation in this case. Instead, there have been pleas to avoid work, redistribute value, and round corners – using substantive consolidation as a "free pass" to spare appellees the burden of proving challenges, like fraudulent conveyance and successor liability, that appellees liberally brandish but are conspicuously reluctant to prove. And the banks' reliance on the separate credit of OCD's subsidiaries is as obvious after the filing of appellees' briefs as it was before: One does not negotiate for subsidiary guarantees without relying on the subsidiaries' credit. The questions appellees raise about *how much information* the banks had about those entities' credit, *how well* they protected themselves against hypothetical eventualities that never occurred, or *which* of their unambiguously bargained-for benefits the banks subjectively cared about, are beside the point.

To the extent appellees' factual assertions matter, however, virtually all of them go far beyond any findings by the district court, and many of them are false or misleading, as the record demonstrates. In the face of *stipulations* that corporate formalities were observed, appellees ask this Court to conclude they were not. In the face of testimony by two of OCD's own officers that the financial statements of all the subsidiaries were accurate in all *material* respects, and despite OCD's continued representations to the bankruptcy court that it has reconciled the intercompany accounts, appellees rely on immaterial imbalances and unquantified "claims" that might be (but have not been) asserted to try to create the illusion that reconciling the intercompany accounts is a Herculean task.

In the face of a Credit Agreement chock full of negative covenants to protect the banks against diminution in the value of the guarantees, appellees ask this Court to conclude the banks did nothing to protect themselves. In the face of *concessions* by OCD's own chief negotiator of the Credit Agreement that "everything in the document is very important to everyone" (JA1510), and that avoiding structural subordination and achieving structural seniority are "twin inevitable sides of the same coin" (JA1526-27), appellees ask this Court to conclude that only the former and not the latter mattered to the banks. Along the way, appellees strive to mislead this Court into thinking the banks' failure to obtain a "bankruptcy-remote" or "non-consolidation" opinion used in a fundamentally different kind of financing – a special-purpose entity established for the sole purpose of effectuating the financing – is relevant to the conventional lending arrangement involved in this case.

In the end, this is an important case, but not a difficult one. Imposing consolidation here would fundamentally undermine the Bankruptcy Code and render unreliable the whole concept of separateness of entities within commonplace corporate structures. It would also allow substantive consolidation to serve as an end run around the well-established processes and doctrines for challenging a creditor's priority in bankruptcy – thereby rewarding appellees (and their counterparts in bankruptcies to come) for trumping up dubious claims that they cannot prove. The ill-conceived order granting appellees' motion for substantive consolidation should be reversed.[1]

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[1] Appellees OCD et al. tellingly miscaption their brief as one concerning an appeal from an order "overruling [an] objection to substantive consolidation." The district court did not merely overrule an objection, but held a lengthy trial and "GRANTED" "[t]he Debtor's motion for substantive consolidation" (JA8) with an accompanying published opinion (JA1-7, 316 B.R. 168). Appellees' wishful thinking about what the district court did is apparently designed to bolster their motion to dismiss the appeal.

I. NEITHER THE BANKRUPTCY CODE NOR THE APPLICABLE STANDARD OF REVIEW GIVES THE DISTRICT COURT BROAD LATITUDE TO IMPOSE SUBSTANTIVE CONSOLIDATION

Appellees advance a hodgepodge of arguments seeking relatively deferential review of the district court's exercise of what appellees claim are broad powers. Each argument is without merit.

First, appellees assert that Section 105 of the Code either is not the sole statutory authority for substantive consolidation or is not as restrictive as appellant has argued.[2] Appellees suggest, citing *In re Stone & Webster, Inc.,* 286 B.R. 532, 540-41 (Bankr. D. Del 2002), that the power to consolidate may also be based on language in 11 U.S.C. § 1123(a)(5)(C) permitting a chapter 11 plan to provide for a "merger or consolidation of the debtor with one or more persons."

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[2] Appellee tort claimants also devote many pages to attacking the argument – which we have not made – that there are no circumstances in which substantive consolidation is authorized. See also OCD Br. 64. Section 105 gives the courts power to grant substantive consolidation when there is no objection or no creditor is harmed. In those circumstances, policies of the Code are carried out and no provision of the Code is overridden. Section 105 also gives the courts power to grant substantive consolidation when "all creditors will benefit because untangling is either impossible or so costly as to consume the assets." *Union Sav. Bank v. Augie/Restivo Baking Co. (In re Augie/Restivo Baking Co.*), 860 F.2d 515, 519 (2d Cir. 1988). Making *all* creditors better off fits comfortably within the language of Section 105 and this Court's cases interpreting it. Finally, the Code does not (unless it specifically says so) preclude doing within bankruptcy things that could be done outside of bankruptcy, such as piercing the corporate veil through an appropriately stringent showing under state law. Beyond those situations, however, the use of Section 105 to override creditor rights is highly suspect for the

The *Stone & Webster* court erred, because this section merely provides that an otherwise legal *postconfirmation* merger or consolidation may be effectuated through a plan; it does not furnish an independent basis for altering the *prepetition* rights of creditors. In this case, OCD's Plan, which calls only for a momentary "deemed" consolidation, expressly disclaims that an actual merger or consolidation is occurring (rendering Section 1123(a) irrelevant even if *Stone & Webster* were correct).[3]

Likewise, appellee tort claimants' lengthy effort (at 24-31) to distinguish this case from *In re Combustion Engineering, Inc.*, 391 F.3d 190, 236 (3d Cir. 2004), does nothing to undercut the limitations this Court has *repeatedly* placed on the use of *any* purported Section 105 power. Section 105 simply "does

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reasons stated at pages 34-40 & n.7 of our opening brief, pages 23-29 of the CFA amicus brief, and pages 7-9 & n.2 of the Professors' amicus brief.

[3] Indeed, as we explained (CSFB Br. 51-52), the use of a fictional "deemed" consolidation to redistribute value is an independent ground for reversal. Contrary to OCD's suggestion (Br. 68), there are not "legions" of *nonconsensual* deemed consolidation cases. The consolidation issue in *WorldCom*, although initially hotly contested, was ultimately settled. See *In re WorldCom, Inc.*, 2003 WL 23861928, at *23 (Bankr. S.D.N.Y Oct. 31, 2003). *In re Genesis Health Ventures* permitted partial deemed consolidation that harmed no creditor. 266 B.R. 591, 618-19 (Bankr. D. Del. 2001), appeal dismissed, 280 B.R. 339 (D. Del. 2002). OCD fails to respond to the banks' argument that, if OCD intends to continue its corporate structure as is, and wants only a "deemed consolidation," OCD is effectively admitting either that creditors have not been misled as to which entity they were dealing with or that OCD wants to continue misleading them. Presumably, OCD is saying the former, but that is fatal to its substantial identity argument because, as

not authorize the bankruptcy court to create rights not otherwise available under applicable law." *Southern Ry. v. Johnson Bronze Co.*, 758 F.2d 137, 141 (3d Cir. 1985); accord *In re Morristown & Erie R.R.*, 885 F.2d 98, 100 (3d Cir. 1989); *United States v. Pepperman*, 976 F.2d 123, 131 (3d Cir. 1992) (reaffirming same observation after *United States v. Energy Resources Co.*, 495 U.S. 545 (1990)); *IRS v. Kaplan*, 104 F.3d 589, 597 (3d Cir. 1997); *Gilman v. Continental Airlines (In re Continental Airlines)*, 203 F.3d 203, 211 (3d Cir. 2000); see also, *e.g.*, *In re Kmart Corp.*, 359 F.3d 866, 871 (7th Cir.), cert. denied, 125 S. Ct. 495 (2004).[4]

Second, appellees assert this Court must follow the test articulated by the D.C. Circuit in *Drabkin v. Midland-Ross Corp. (In re Auto-Train Corp.)*, 810

OCD points out in its own brief (at 35, 39), substantial identity is intended to show that all creditors believed they were dealing with a single company.

[4] Section 105 came into existence with the Bankruptcy Code in 1978. "Older doctrines may survive as glosses on ambiguous language enacted in 1978 or later, but not as freestanding entitlements to trump the text." *Kmart*, 359 F.3d at 871. The one pre-1978 decision of this Court that addressed a doctrine resembling substantive consolidation, *In re Pittsburgh Railways*, 155 F.2d 477 (3d Cir. 1946), inherently provides little guidance in light of the changes wrought by the Code – so little, in fact, that this Court did not even *mention Pittsburgh Railways* in canvassing the relevant case law in *Nesbit v. Gears Unlimited, Inc.,* 347 F.3d 72, 86-87 n.7 (3d Cir. 2003), cert. denied, 124 S. Ct. 1714 (2004). In any event, *Pittsburgh Railways* is not on point: It turned on the "highly important public interest" of maintaining public transportation and the public duties associated with government-granted franchise rights, which rendered the subsidiaries at best "quasi-corporations in character," 155 F.2d at 483. Even in the transportation realm it has been recognized to be of "question[able] * * * vitality" (*In re Reading Co.*, 59 B.R. 1011, 1014 n.4 (E.D. Pa. 1986)) in light of *Calloway v. Benton*, 336 U.S. 132 (1949).

F.2d 270 (D.C. Cir. 1987). Although appellees lose under the *Auto-Train* test for reasons stated in our opening brief (at pages 62-63 and elsewhere), nothing precludes this Court from following the Second Circuit's decisions – which *Auto-Train* itself followed, 810 F.2d at 276 – or from synthesizing other courts' case law (and this Court's Section 105 authorities) into its own test. A stipulation by the parties about what the law is could not possibly bind this Court, but in any event the supposed stipulation to follow *Auto-Train* for all purposes never existed. See JA1983 (alluding to agreement to follow *Auto-Train* "for purposes of burdens and procedure").

Third, appellees (*e.g.*, McMonagle Br. 13-14) suggest that the rigorous test for substantive consolidation we have outlined would contradict a so-called "liberal trend" toward granting consolidation of complex, multi-tiered corporate groups. But no such trend exists; what do exist are some cases in district and bankruptcy courts – including most of the ones on which appellees rely – in which consolidation was granted on an express finding that no creditor had objected and/or that no creditor would be harmed by consolidation. Such cases provide scant guidance in formulating a rule to govern cases in which parties seek to *impose* consolidation to effect radical redistribution of value among creditors.[5]

[5] See*, e.g., In re Am. HomePatient, Inc.*, 298 B.R. 152, 155-56, 167 (Bankr. M.D. Tenn. 2003) (objecting secured lenders to be paid in full, no other creditor objection); *In re GC Cos.,* 274 B.R. 663, 673 (Bankr. D. Del. 2002) (no creditor

No appellee has countered the banks' showing (CSFB Br. 68-71) that the only appellate decision arguably supporting a "liberal trend" provides nothing but an arbitrary, unpredictable standard for consolidation.

Fourth, appellees contend (OC Br. 32) the district court's ruling is reviewable only for abuse of discretion. The premise of appellees' argument is incorrect. What is reviewable only for abuse of discretion is an equity court's *fashioning of remedies*, not its identification of the harm to be remedied. 1 STEVEN ALAN CHILDRESS & MARTHA S. DAVIS, FEDERAL STANDARDS OF REVIEW § 4.16 (3d ed. 1999). Here, the sole remedy at issue is substantive consolidation, and the question presented is whether the district court's conclusions of *law* (reviewed *de novo*) and nonconclusory *factual findings* (reviewed for clear error) support that remedy.[6]

objection other than U.S. Trustee seeking fees from multiple entities), *aff'd in part, rev'd in part on other grounds*, 298 B.R. 226 (D. Del. 2003); *Genesis Health Ventures*, 266 B.R. at 619 (no harm); *In re Standard Brands Paint Co.*, 154 B.R. 563, 571-72 (Bankr. C.D. Cal. 1993) (consolidation actively supported by all major parties, leading court to infer absence of harm); *In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. 723, 766-67 (Bankr. S.D.N.Y. 1992) (no prejudice from consolidation, no specific objection noted, no separate outside creditors).

[6] OCD contends (Br. 34) *In re Integrated Telecom Express, Inc.*, 384 F.3d 108 (3d Cir. 2004), does not stand for the proposition (CSFB Br. 28) that "broad conclusory statements not tied to specific facts are entitled to no deference." But in that case the bankruptcy court "made no findings that are entitled to deference," because, in treating as valid a number of the debtor's considerations for invoking chapter 11, the bankruptcy court specified only that the debtor "'was losing a lot of money.'" 384 F.3d at 124. Thus, the bankruptcy court had made a discretionary

Furthermore, "an error of law * * * is an abuse of discretion," *United States v. Mitchell*, 365 F.3d 215, 247 (3d Cir. 2004), cert. denied, 125 S. Ct. 446 (2004), and the scope of review even under the abuse-of-discretion standard varies with the stringency of the legal standards to be applied, CHILDRESS & DAVIS, *supra*, § 4.21. In the context of a remedy that is "difficult to achieve," *Nesbit*, 347 F.3d at 86, appellate supervision is properly stringent, not light, and leading cases such as *Auto-Train* and *Augie/Restivo* appropriately reverse substantive consolidation orders without pretending to give district courts wide latitude.

II. THERE IS NO SUBSTANTIAL IDENTITY BETWEEN OCD AND ITS SUBSIDIARIES SATISFYING THE SUBSTANTIVE CONSOLIDATION TEST

The law indicating what kinds of financial entanglement can support substantive consolidation is as stated in our opening brief.

There are "hopeless commingling" cases, in which "*all* creditors will benefit because untangling is either impossible or so costly as to consume the assets." *Augie/Restivo*, 860 F.2d at 519 (emphasis added). In such cases, substantive consolidation can be granted without any further showing, but no one has ever contended that the billions of dollars of assets of OCD and its subsidiaries would be wiped out by the processes (if any) needed to make the books even more accurate than the ones Chairman/CFO Thaman was comfortable presenting to the

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ruling and had made an underlying finding, and both were given no deference bankruptcy court. See CSFB Br. 24-25. As we noted in our opening brief, and appellees have not disputed, there is no confusion or dispute as to the principal assets of each entity. See record citations at CSFB Br. 25.

And there are "substantial identity" cases, which the district court thought this case to be. Those cases, unlike "hopeless commingling" cases, require further showings of necessity for consolidation and the absence of reliance by consolidation opponents on corporate separateness. But "substantial identity" is not just a watered-down version of "hopeless commingling." Rather, as we demonstrated in our opening brief (at 48 & nn.12-13), the essence of substantial identity is that corporate finances were entangled in such an *irregular* way that creditors believed they were dealing with a different corporate entity than they really were. OCD's brief adopts various inconsistent formulations, but at two points admits the same. OC Br. 35, 39.[7]

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because of the scarcity of supporting findings.

[7] Having once acknowledged the proper legal test, OCD devotes most of its brief to facts that do not meet it. At one point, OCD makes the grandiose statement that "OCD's officers testified that as a general matter all vendors and customers dealt with OCD and did not have a separate relationship with any subsidiary (A680:8-682:9; 682:20-683:14)." OC Br. 12. The transcript pages OCD cites, however, show only that an OCD employee (Timothy Kearney) explained that some vendors were instructed to send invoices to OCD post office boxes because Shared Services paid many accounts payable. On the same page (JA682) Kearney gives one example of vendors sending invoices to a subsidiary, and elsewhere (JA688-90) he admits that Shared Services did not pay vendors of

The district court did not apply that legal test, and appellees do not do so either. One set of appellees, the bondholders, do try – without any supporting findings made below – to show corporate irregularity (veil-piercing facts) and that they were misled, *not* by corporate irregularity but by a 1998 OCD prospectus, into believing they were obtaining promises of repayment from OCD's subsidiaries as well as OCD itself. Those arguments can be easily disposed of, as will be shown momentarily. OCD also attempts to address "substantial identity," but, because it applies the wrong legal test, its entire discussion is a distraction not supporting the decision below. OCD also presents a demonstrably false and misleading picture of the record. A few of OCD's misstatements are noted below; the larger point is that this Court cannot accept OCD's version of the facts (which is neither undisputed nor the subject of findings below) and need not resolve any factual disputes to determine that there is *not* substantial identity on this record.[8]

OCFT and IPM and that checks written to vendors of Integrex and Exterior had those subsidiaries' names on the checks.

[8] The principles of *law* that make potential second-guessing of company accounting and normal indicia of corporate control of wholly owned subsidiaries insufficient for "substantial identity" are well illustrated in the detailed decision in *R^2 Investments, LDC v. World Access, Inc.* (*In re World Access, Inc.*), 301 B.R. 217 (Bankr. N.D. Ill. 2003), a contested substantive consolidation case. The court noted that, although the *World Access* debtors had consolidated financial statements and tax returns, a unity of ownership, overlapping officers and directors, intercorporate guarantees, and a central cash management system, "[t]hese phenomena are * * * quite common in today's corporate groups. The same is true of the high level corporate oversight services that New World Access

The Bondholders' Arguments. No party ever sought a ruling below that the standards for piercing the corporate veil could be met in this case.[9] Such a contention has now surfaced on appeal along with a contention that the bondholders were defrauded. Those contentions should be disregarded but fail for many other reasons too. First, the bondholders' accusations are against only 11 of the 43 members of the bank syndicate that made the loan. Second, the bondholders' accusations not only are mere accusations, but also are actually rebutted on the face of the prospectus, as explained below. No court has addressed the truth or falsity of the bondholders' accusations, and substantive consolidation cannot be based on a party's opportunistic allegations. Third, the bondholders'

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officers and administrative staff provided with respect to cash management, insurance, tax compliance, and legal functions." *Id*. at 276. The court went on to stress the *absence* of "other more important factors," including "the commingling of assets, poor record keeping causing great difficulty in the segregation of individual assets and liabilities, and transfers made without formal observance of corporate formalities." *Id*. The lack of these indicia of *financial* entanglement was decisive in denying substantive consolidation in *World Access*; the similar absence of such indicia here (detailed in our opening brief at 18-25 and supported almost entirely by stipulations or statements of OCD's own personnel) should be equally dispositive.

[9] The banks declared in their opening pretrial brief below (at 18) that "[a]ny suggestion that the veil could be pierced in this case would be absurd," and cited case law to back up that assertion; no party submitted any legal argument to the contrary, either before or after trial. The moving parties merely stated in their pretrial reply brief (at 3 n.6) that the bondholders had informed them that they believed grounds for veil piercing existed. The posttrial briefs did not follow up on that suggestion, and Judge Fullam was never asked to determine that grounds for veil piercing existed, nor – of course – did he so determine.

allegations that OCD's prospectus was false is not a ground for piercing the veil; it's a claim for money damages that the bondholders are actually pursuing.

The record (for reasons discussed in our opening brief) lacks the necessary evidence of disregard of corporate formalities and separateness, and veil piercing also requires a finding that the corporation was a "sham" that existed "for no other purpose than as a vehicle for fraud." *Liafail, Inc. v. Learning 2000, Inc.*, 2002 WL 31667861, at *11 (D. Del. Nov. 25, 2002) (cited in Bondholder Br. 28). The relevant OCD subsidiaries had far too much substance and far too many assets for anyone to take seriously the notion that fraud was even part of their purpose. On the contrary, it is precisely because the guarantor subsidiaries' assets are substantial that appellees bondholders and tort claimants seek a way to share with the banks in the distribution of those assets.

The district court made no finding that the bondholders were misled as to who their debtor was, and that improbable allegation is contradicted by the record. The bondholders argue they were defrauded when a prospectus supposedly led them to believe the bonds they purchased would give them the same repayment rights as the banks. The prospectus stated correctly, however, that the bonds would be unsecured and would rank equally with "the Company's" other unsecured debt – with "the Company" defined in the *same paragraph* as "Owens Corning." JA2653, 2698. The bondholders nonetheless argue that, because "the

Company" was defined *elsewhere* in the document to refer to OCD *and* its subsidiaries, the banks must have known they had no structural seniority with respect to the assets of the subsidiaries.

This argument is ridiculous: The sophisticated entities purchasing the bonds knew they were not getting guarantees from (or any other rights against) the subsidiaries. The issuer of the bonds was OCD itself, which is made clear by the definition of "Owens Corning" as "the Company" in the paragraph discussing the issuance of debt and the offering itself. JA2698. The reference elsewhere to "the Company" as including the subsidiaries carefully notes that this definition does *not* apply *if the context indicates otherwise*. JA2656, 2711. The existence of the Credit Agreement, the guarantees of the bank debt, and OCD's corporate structure were also fully disclosed in public filings incorporated by reference in the prospectuses – filings that these sophisticated institutional purchasers surely scrutinized before purchasing the bonds. JA2654-55, 2675-76, 2709-10; CA748: Stips. 830(g), (j), (k). This information was transparent to the investing public. Reflecting the open and notorious nature of the guarantees, a Bear Stearns report published in August 2000 (JA5747-71), based on the same public sources, explicitly noted that the bank debt, unlike the bonds, was guaranteed; listed the guarantors to the Credit Facility; and further observed, "Bank Debt [Is] Senior to Bonds which Rank Pari Passu to the Asbestos Claims." JA5749, 5755-56, 5761;

see also JA1850-51. In short, no bond investor performing even the most rudimentary due diligence in 1998 could have failed to discern that the bank debt, which had been issued in 1997, was guaranteed by OCD subsidiaries and that the bondholders would therefore be structurally subordinated to the banks.[10]

Judge Fullam did not address the bondholders' claims about having been defrauded, and he did not need to. If the bondholders were defrauded, the remedy is the one that – as OCD points out (Br. 31) – they are already pursuing in the District of Massachusetts, not the remedy they are pursuing here.

<u>OCD's Picture of the Record</u>. OCD is a large, modern, multinational corporation with many wholly owned subsidiaries. When OCD owns all of a subsidiary's stock, it predictably selects the subsidiary's board, determines major capital expenditures, and generally conducts planning, budgeting, and marketing on a centralized basis. But those facts – established in excruciating detail in appellees' briefs – are not the kind of corporate-irregularity or misled-creditor facts that can support a conclusion of "substantial identity."

It is also true that "consent" minutes for meetings of the boards of directors of subsidiaries were sometimes prepared in lieu of actual meetings. OC

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10 Based on the public understanding of these relative rights, the Bear Stearns report observed that the bonds were at that point trading only in the "high-40's to low 50's" of par. JA5749. In sharp contrast to the unguaranteed bonds, during that same period the guaranteed bank debt was trading "north of 90." JA1850-51.

Br. 7. To do so was to *observe* – not to ignore – corporate formalities. When a company has only a single shareholder, it does and should act in accordance with the shareholder's desires as long as they are legal, but it must do things that reflect its form as a separate corporation.

On the other hand, there is much in OCD's version of the record that is wrong not just because it draws the wrong conclusions from facts, but because it gets the facts wrong. OCD ignores the copious evidence establishing, among other things, that its subsidiaries kept separate and detailed financial records; that intercompany transactions were both regularly documented and tracked and coded by legal entity; and that OCD's meticulous postpetition audit has eliminated any financial uncertainty, particularly with respect to the larger guarantor subsidiaries. See record citations at CSFB Br. 18 nn.4-5.

Typical of OCD's approach to the facts is its statement that "legal formalities were frequently not observed with few, tax-related exceptions." OC Br. 8. The six citations to the joint appendix that follow that sentence, and further citation (JA393) following a similar sentence (OC Br. 45-46), say nothing about corporate formalities; they either support the unsurprising proposition that the subsidiaries' sole shareholder controlled their economic *substance* (not formalities), *e.g.*, JA1203-04, or seem to have nothing to do with anything, *e.g.*, JA7252. The record that *does* address corporate formalities establishes – by stipulation – that extensive pains were taken to observe corporate formalities on a regular and ongoing basis. See record citations at CSFB Br. 18 n.3.

OCD similarly attempts to trivialize its subsidiaries' financial recordkeeping, but hundreds of stipulated facts and the testimony of OCD's own witnesses establish that OCFT, IPM, and Exterior – the three most valuable subsidiaries – prepared and maintained their *own* detailed financial records (including general ledgers, daily journals, balance sheets, and income statements) that enabled OCD's summarized SAP records of each of these legal entities to be verified for accuracy. See CSFB Br. 23-24. And Integrex, which functioned within the central SAP system, had its own CFO, controller, and accounting staff who prepared that company's financial statements. CA898: Stips. 330, 541-42, 544.

OCD's tactics are exemplified by its statement that, "[f]or 5 million of [specified intercompany] transactions, *the accounting records* did not even reflect OCD's trading partner." OC Br. 10 (emphasis added). It is certainly true that OCD's *centralized SAP system* did not do so, but the reason cuts *against*, not in favor of, a conclusion that OCD was substantially identical to its wholly owned subsidiaries. OCFT, IPM, and Exterior did *their own accounting*, and their records were uploaded into the SAP system in summary form only. JA1659-60. If OCD needed to make its records more precise, it had only to examine its subsidiaries' separate books. That is exactly what OCD did in its postpetition, $6 million "intercompany finance project" to get its own records and those of *each* Debtor subsidiary into such shape that "we felt really comfortable we could vouch for their accuracy." JA465-67 (Chairman/CFO Thaman); see record citations at CSFB Br. 24-25. Even now OCD concedes that all its intercompany accounts are "close to being balanced," OC Br. 11 n.5, and, as we explained in our opening brief (at 45-46, 57-58), *de minimis* imbalances have never been thought a reason to effectuate a massive transfer of value and a wholesale disregard of corporate form through substantive consolidation.[11]

Equally false is appellees' repeated insistence that IPM, OCFT, and Integrex were created and maintained as separate corporations *purely* for tax reasons. Tax minimization is, of course, a perfectly legitimate corporate purpose

[11] OCD similarly distorts the cash management of the most important guarantor subsidiaries. While conceding that neither OCFT nor IPM had its cash swept into concentration accounts, OCD asserts (Br. 9 n.3) that "IPM had no cash of its own and was used as a mere conduit for cash going to foreign investments or dividends received from those entities." But it is undisputed that IPM's cash was very much its own – it was maintained in IPM's own discrete bank accounts and obtained from dividends issued to IPM from its wholly owned foreign subsidiaries. Moreover, the cash IPM received was used for the benefit of IPM, either to fund investments in the foreign subsidiaries or as loans to OCD that yielded substantial interest. JA1344, 10056, 10072-74; CSFB Br. 23. And Exterior's receipts and disbursements were swept into and paid from an account owned by *Fibreboard*, not OCD. *Id.* OCD's further suggestion (Br. 12 n.6) that OCFT was the only subsidiary that did not receive common administrative support from the "Shared Services" division is similarly misleading. See CSFB Br. 22.

and indeed a *duty* owed to shareholders. That aside, contemporaneous OCD documents and the trial testimony of OCD's witnesses establish that each of these guarantor subsidiaries was created and maintained for multiple legitimate business purposes, often *including*, but certainly not limited to, tax planning. See CSFB Br. 18-20. The author of a number of the statements attesting to business purposes, Mark Faulkner, confirmed at trial that every one of them was *true*. JA1233, 1262-64, 1268-71; see also JA10465. Nor can OCD erase its written acknowledgments, both internally and to its creditors, of the numerous *nontax* business reasons for OCFT's existence. JA2914-52, 2978-85, 5829. [12]

The argument that the key guarantor subsidiaries were created or maintained *solely* for tax reasons also defies common sense. Keeping valuable domestic IP in a separate corporation like OCFT was, as OCD envisioned from the outset, a perfectly rational way of protecting those assets and making other

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[12] OCD's sophisticated and legitimate use of the corporate form for tax minimization *as well as* other legitimate purposes is a far cry from "[e]mpty observance of legal formalities." OC Br. 46. This renders inapposite the cases OCD cites in which courts supposedly brushed aside a purely tax-driven pretense of separateness offered to resist substantive consolidation. The cases OCD cites are inapplicable on other grounds as well. See*, e.g., Am. HomePatient,* 298 B.R. at 166-67 & n.10 (permitting consolidation where certain formalities were observed "solely for tax reasons" and consolidation would not harm creditors, who were being paid 100% of their claims); *Central Claims Servs., Inc. v. Eagle-Picher Indus., Inc. (In re Eagle-Picher Indus., Inc.)*, 192 B.R. 903, 907 (Bankr. S.D. Ohio 1996) (permitting consolidation where no reasonable creditor could have believed it was dealing with separate companies).

subsidiaries salable without worrying about transferring valuable trademarks. See CSFB Br. 19. PriceWaterhouse independently valued the IP at more than $500 million even in 1991 (JA9204) and the additional IP added from newly acquired subsidiaries at $329 million in 1998 (JA9018).[13] Moreover, OCFT operated a pilot plant and obtained patents on its own. JA1244-48, 1269, 9370-71, 2987; CA990: Stip. 70. Likewise, although the tax benefits achieved from maintaining IPM as a separate entity totaled only $780,000 over six years (JA1319-20), OCD understandably decided to preserve IPM as a separate company, recognizing its value in isolating valuable foreign subsidiaries from OCD's asbestos liability while simultaneously protecting OCD from the liabilities of those operating subsidiaries. See CSFB Br. 19-20. In fact, OCD stipulated before trial that IPM was *not* created solely for tax purposes (CA1022: Stip. 8(b)) but now refers to IPM's undisputed passive investment activity pejoratively as "so-called business activity" that was "non-existent by design." OC Br. 17.

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[13] Equally misleading is OCD's suggestion (Br. 14 n.8) that taxing authorities widely challenged OCFT's substance. In fact, as Faulkner conceded, only *two* of the 30 to 35 States in which OCD filed tax returns – Massachusetts and New York – ever challenged OCD's deductions on that ground, and only Massachusetts denied the deductions; OCD settled its dispute with New York before a final ruling was issued. JA1163-70. And OCD vigorously *contested* these challenges, arguing repeatedly that OCFT had a great deal of substance far beyond tax objectives. JA1230-35, 1261-64, 2966-77.

As for Exterior, OCD has never contended – and does not contend even now before this Court (see OC Br. 22-23) – that it has any tax-driven purpose. On the petition date, Exterior owned more than $1 billion in property, including a score of factories and well over one hundred distribution centers (see record citations at CSFB Br. 20), but somehow OCD contends before this Court that Exterior "existed only on paper." OC Br. 23. Nor is there any dispute that Integrex, whatever tax benefits it provided, was managed as an entrepreneurial startup designed to function as a freestanding company marketing services to third parties – as OCD itself explained to the banks. JA10574. The Integrex board even approved a plan to move operating assets into LLCs to facilitate outside investments. JA840-43.

In short, on every level appellees wildly distort the extent even of *operational* identity, beyond the erroneous findings of the district court. Even more telling – and fatal to the district court's ruling – this record contains *no* evidence of genuine *financial* entanglement and no evidence that OCD's and its subsidiaries' way of doing business misled any creditor, precluding any finding of "substantial identity" as a matter of law.

III. APPELLEES, LIKE THE DISTRICT COURT, OFFER ONLY ILLEGITIMATE NEEDS FOR AND BENEFITS OF SUBSTANTIVE CONSOLIDATION

The primary "benefit" appellees say substantive consolidation would achieve is equality of distribution as between the banks – who bargained for guarantees from the subsidiaries – and the tort claimants and bondholders, who did not. *E.g.*, OC Br. 47; McMonagle Br. 36. That is not a *benefit* of substantive consolidation, however; it is a self-evidently forbidden objective. If it were a desirable objective, the law could simply grant it without any other requirements such as substantial identity. The Bankruptcy Code would simply authorize courts to deprive creditors of guarantee claims and other statutory rights against subsidiaries on proof that a creditor obtained greater rights in its loan documents than the debtor contends the creditor really wanted, without regard to the rigorous standards for substantive consolidation.

Of course, that is not the law. "Equality among creditors who have lawfully bargained for different treatment is not equity but its opposite * * *." *Chemical Bank New York Trust Co. v. Kheel*, 369 F.2d 845, 848 (2d Cir. 1966) (Friendly, J., concurring). "[C]onsolidation almost invariably redistributes wealth * * * [and t]his *problem* is compounded by the fact that liabilities of consolidated entities *inter se* are extinguished by the consolidation." *Auto-Train*, 810 F.2d at 276 (emphasis added). See also *Augie/Restivo*, 860 F.2d at 520 ("The plain fact is that Union's claim against Augie's assets is superior to that of MHTC, and, as a result, the undesirability of consolidation is as clear in the instant case as it was in our earlier decision in *Flora Mir*."); *id*. at 520-21 ("even though the denial of consolidation would thwart an otherwise desirable arrangement among creditors * * * [that objective cannot be achieved] '*at the cost of sacrificing the rights of * * * debenture holders*'") (quoting, and adding emphasis to, *Flora Mir Candy Corp. v. R.S. Dickson & Co.*, 432 F.2d 1060, 1063 (2d Cir. 1970)).

It is not just the leading substantive consolidation decisions that make clear that redistribution of value in this manner is fatal to, rather than a benefit of, consolidation. This Court's – and other courts' – Section 105 cases confirm that Section 105 (the only basis of any power to order substantive consolidation) can never be used for the *purpose* of altering creditor rights, although it may have that incidental effect if validly invoked in support of other sufficiently weighty objectives not inconsistent with the Code. See *Kmart*, 359 F.3d at 871; *In re Chicago, Milwaukee, St. Paul & Pacific R.R.*, 791 F.2d 524, 528 (7th Cir. 1986), *cited in Pepperman*, 976 F.2d at 131; see also *Integrated Telecom*, 384 F.3d at 128-29 ("[R]edistributions are not the Code's *purpose*.").

Case law also makes clear that "simplifying and expediting resolution of the Owens Corning bankruptcy" (OC Br. 47), though of course desirable if parties' significant rights are not sacrificed along the way, is insufficient to override the banks' considerable bargained-for rights and Code rights. See CSFB Br. 56-57; Professors' Br. 16-17. And disregarding bargained-for credit enhancements whenever doing so would simplify and expedite a later bankruptcy case would have nightmarish consequences for credit markets. See LSTA Br. 25-32.

"[A]voiding costly and time-consuming litigation of potentially millions of intercompany claims" (OC Br. 47) is a red herring. Unless they stand to benefit materially, parties do not litigate claims just because they have the "right" (*id.*) to do so, and bankruptcy courts have considerable powers to use estimation rather than litigate every possible claim to the *n*th degree. Here, there is no showing that intercompany disputes exist or have merit, or that their resolution would have any impact on the banks' recovery. Moreover, 11 U.S.C. §§ 704(5), 1106(a)(1), and 1109(a) require debtors to review and object to claims. The Debtors have already expended considerable effort to achieve such confidence in OCD's *and its subsidiaries'* books that they file monthly operating reports with the bankruptcy court in addition to the schedules of assets and liabilities with which Chairman/CFO Thaman was "really * * * comfortable." See record citations at CSFB Br. 23-25. OCD's scare tactic of referring to "millions" of transactions should not influence this Court when the record shows that those transactions do *not* create material imbalances (JA1645-46).

Nor, even if this Court were to take that scare tactic seriously, would avoiding the work of sorting out legitimate claims be a proper basis for substantive consolidation – for the same reasons "simplification and expedition" are not. See CSFB Br. 56-58; see also*, e.g., Woburn Assocs. v. Kahn (In re Hemingway Transp., Inc.*), 954 F.2d 1, 11 n.15 (1st Cir. 1992) ("Consolidation is permitted only if it is first established that the related debtors' assets and liabilities are so intertwined that it would be impossible, or financially prohibitive, to disentangle their affairs."); *World Access*, 301 B.R. at 277-79; *In re DRW Property Co.*, 54 B.R. 489, 496-97 (Bankr. N.D. Tex. 1985).[14]

It is irrelevant that "[s]ubstantive consolidation will allow confirmation and consummation of a single plan of reorganization rather than separate plans for OCD and no fewer than 17 debtor subsidiaries." OC Br. 47. Substantive consolidation is *not* necessary to resolve these bankruptcy cases through a single plan (see CSFB Br. 37 n.9), and the only case OCD claims offers this "benefit" as justification for materially changing the rights of any creditor is an

[14] The four cases OCD cites as supporting consolidation to avoid litigation over intercompany claims (OC Br. 51) all fall into the no harm, no objection, or hopeless entanglement categories and thus do not define the level of "necessity" that could justify consolidation to the severe prejudice of the banks here. *GC Cos.,* 274 B.R. at 673 (no creditor objection other than U.S. Trustee seeking fees from multiple estates); *Genesis Health Ventures,* 266 B.R. at 619 (no creditor harm); *Standard Brands*, 154 B.R. at 571-72 (no creditor harm or objection), *In re Murray Indus.,* 119 B.R. 820, 831-32 (Bankr. M.D. Fla. 1990) ("impossible" to allocate certain assets; no objection by outside creditors).

outlier. See 5 COLLIER ON BANKRUPTCY ¶ 105.09[2], at 105-110 (Lawrence P. King, et al., 15th ed. rev. 2001) (criticizing *Eagle-Picher*, 192 B.R. at 907). OCD's further attempt to frighten the Court with the vision of different creditor groups controlling different OCD subsidiaries, joint ventures, or intellectual property (OC Br. 47) is nonsense. There is no need to change the relationship among the OCD entities or to require more than one management group to oversee them; rather, the joint reorganization plans can (and must) simply create different creditor classes consistent with 11 U.S.C. § 1122 to reflect the *value* fairly attributable to each category of claim against each debtor, as is routinely done in major bankruptcy cases.

Finally, a "benefit" of substantive consolidation that appellees advance strenuously is that it will allow them to avoid having to litigate (and the courts to avoid having to resolve) *other* theories on which they seek – or even *might* seek – to vitiate the banks' guarantees. OC Br. 48-49; McMonagle Br. 42-50. The guarantee-vitiating theory that appellees pushed most strenuously below was that OCD's pending action to invalidate the guarantees as fraudulent conveyances might succeed, but on appeal they add that as-yet-unasserted claims for successor liability (giving the tort claimants a claim against the subsidiaries' assets and thereby diluting the banks' recovery) and as-yet-unasserted veil-piercing claims might succeed.

It is not a legitimate "benefit" of substantive consolidation – or use of Section 105 – to give parties the same relief they could obtain in a separate action *if* they proved its legal elements and litigated it to judgment. See CSFB Br. 59. That is especially so when the separate action has not yet even withstood a motion to dismiss (fraudulent conveyance) or has not even been filed (successor liability and veil piercing). And the theories appellees seek to avoid litigating to judgment are exceptionally weak. For example, the most OCD can bring itself to say about successor liability is "it cannot be said that the successor liability claims are frivolous." OC Br. 49. As that ultradefensive formulation suggests, the claims actually *are* frivolous.[15]

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[15] No tort claimant has *ever* sued these companies for successor liability, and neither OCFT nor IPM expressly or impliedly agreed to assume tort liability; the transactions through which they were established were not *de facto* consolidations or mergers with OCD or a "continuation" of a discontinued company's business; and the transactions assigning the major assets to the companies were entered into nearly a decade before the bankruptcy for legitimate business purposes and not to defraud creditors. See*, e.g., Miami County Incinerator Qualified Trust v. Acme Waste Mgmt. Co.*, 61 F. Supp. 2d 724, 729 (S.D. Ohio 1999) (applying customary principles of successor liability under Ohio law); *Diamond Int'l Corp. v. Sulzer Bros., Inc.*, 1989 WL 97749, at *3 (E.D. Pa. Aug. 21, 1989) (same factors under Delaware law). The tort claimants argue (at 42-50) that the transfer of assets to OCFT and IPM for the purpose, among others, of protecting such assets from OCD's liabilities satisfies the "fraud" category of successor liability. Aside from destroying appellees' position that OCFT and IPM were purely tax-driven entities, this argument fails because the transactions in question were entered into for a *range* of legitimate business purposes years before OCD became insolvent. In contributing capital to wholly owned subsidiaries, OCD in any event received good consideration for the transfers through the enhanced value of its stock ownership. OCD retained billions of dollars in other assets, continued all its

Furthermore, appellees are mistaken if they believe they have spared themselves the trouble of litigating those other theories. The district court granted substantive consolidation but disclaimed having resolved whether because of the guarantees "the Banks' claim is entitled to priority, in whole or in part, over the claims of other unsecured creditors." JA7. To resolve that issue, the district court must decide whether the guarantees are valid or voidable, and whether there is any other theory by which the non-bank creditors have a claim on the assets of the guarantor subsidiaries. The supposed "benefit" of avoiding litigation is thus illusory as well as illegitimate.

Finally, the tort claimants threaten to exercise their alleged power to block a channeling injunction for OCD's asbestos liabilities under 11 U.S.C. § 524(g) unless they prevail on substantive consolidation. McMonagle Br. 50-53. OCD uses that threat (OC Br. 49 n.21), but this Court should not be strong-armed. *If* Section 524(g) gives tort claimants the extraordinary veto power they claim – a subject to be debated elsewhere, not on this appeal – surely their threat to block a plan that respects the banks' rights cannot serve as the *justification* for substantive

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operations, and thus defrauded no one through this legitimate corporate structuring. These facts are entirely different from cases like *Schmoll v. ACandS, Inc.*, in which a company in the midst of a mass-tort crisis attempted "to avoid liability by transferring its profitable assets leaving no more than a corporate shell to satisfy its asbestos-related obligations." 703 F. Supp. 868, 874 (D. Or. 1988), aff'd, 977 F.2d 499 (9th Cir. 1992).

consolidation. That is bootstrapping of the first order, made all the worse when appellees ask this Court to distort the negotiating dynamics Congress created by depriving the banks of their rights against each separate subsidiary. Of all appellees' illegitimate reasons why substantive consolidation is "necessary," this one is the most bald and outrageous.

IV. THE BANKS' SHOWING OF RELIANCE REMAINS IRREFUTABLE ON THIS RECORD

Consistent with its opening statement at trial (JA208), OCD contends that substantive consolidation "leaves the bank debt holders with the benefits of the lenders' bargain." OC Br. 36. But that bargain is in writing and confirms the existence and enforceability of the guarantees. Section 10.01 of the Credit Agreement provides (CA68):

> Each of the Guarantors hereby (a) guarantees to each Guaranteed Person the due and punctual payment and performance of all of the Guaranteed Obligations * * * and (b) agrees to pay the same when so due, or deemed to be due, upon demand.

To turn the banks' written, bargained-for guarantees into a bargain for nothing, OCD argues "the term 'guaranty' alone does not describe the substantive content of the parties' bargain." OC Br. 55. OCD would thereby destroy the parol evidence rule by asking this Court to ignore written guarantees in favor of some divination of the bargain the lenders intended. Then – although OCD concedes some bank representatives "testified that the guaranties were also intended to provide ‘structural seniority’ to the banks” – OCD insists the written bargain should be ignored in favor of testimony of one CSFB credit officer who, OCD claims, testified the guarantees’ only purpose was to avoid structural subordination. OC Br. 26. (In actuality, that witness, Ms. Lopez, testified that the “major purpose” of the guarantees was to avoid structural subordination, JA2303, and that “the purpose of the guarantees was to have a claim, a direct claim on the guarantor,” JA2302, *i.e.*, structural seniority. See also JA2296.) The banks’ attorney testified that he negotiated the guarantees to provide the banks with structural seniority, JA2314, and it is uncontested that OCD knew the loan had to be syndicated to other banks and the term sheet on which other banks signed up provided for guarantees without any qualification that they could be used only to avoid structural subordination. JA3246.

Accordingly, OCD is contending not only that the written guarantees should be contradicted and eviscerated by parol evidence, but also that a court should determine the inner meaning of a written document by looking to one banker involved and ignoring all the other bankers and the banks’ attorney. For OCD to prevail, this Court must thus conclude that, if bankers retain an attorney to negotiate the best credit enhancements possible, the banks will be precluded from attaining the fruits of the attorney’s work unless each one of them fully appreciated every benefit the attorney procured for them.

No case has ever required this type of mindreading to justify "reliance" on the credit of a separate debtor. To the contrary, reliance is established when parties know they are dealing with separate entities. See CSFB Br. 61 (discussing *Augie/Restivo, Gulfco*, *599 Consumer Electronics*, and *Donut Queen*, in which consolidation was denied, in part, simply because lenders who specifically sought guarantees *knew* they were dealing with separate corporations);[16] *id*. at 62-63 (discussing *Auto-Train*, which reversed an order applying substantive consolidation retroactively because of the vendor's "reliance

[16] Incredibly, OCD cites *Augie/Restivo* as a case that "granted substantive consolidation despite (and, in part, because of) the existence of inter-corporate loan guarantees." OC Br. 54. The Second Circuit in that case *denied* substantive consolidation, reversing the lower courts' orders. It cited the existence of a guarantee (860 F.2d at 519) as proof that a creditor "operated on the assumption that it was dealing with separate entities," and did so without inquiring into the credit analysis or subjective expectations of the creditor that obtained the guarantee. OCD cites two other cases from bankruptcy courts and a treatise for the proposition that inter-corporate guarantees *can* support substantive consolidation, but *of course* that abstract proposition is true – and irrelevant. Guarantees were first cited as a factor favoring consolidation in *Soviero v. Franklin National Bank*, 328 F.2d 446, 448 (2d Cir. 1964), which mentioned the issuance of consumer guarantees by sham retail affiliates in the name of the bankrupt parent company as part of a fact pattern showing hopeless financial entanglement and total disregard of corporate integrity. Different types of guarantees will have different characteristics, which in some cases will support substantive consolidation (for example, when the lender that ultimately seeks substantive consolidation has earlier insisted on a guarantee from a parent because it knew a subsidiary to be undercapitalized) and in other cases will preclude it. The guarantee in *this* case precludes substantive consolidation for the reasons given in the text and in our opening brief.

on the separate credit" of a subsidiary, without any discussion of what credit metrics the vendor used or what parts of its bargain it cared about).

OCD seeks to expand the *Auto-Train* test into a requirement that the banks demonstrate reliance on what it calls the "separate creditworthiness of the guarantor subsidiaries" (OC Br. 57), apparently viewing each guarantor as a stand-alone borrower. But there is no case that says this is the test. Nor could it be in a case such as this, where the banks sought and obtained rights against the subsidiaries as *guarantors*, not primary borrowers – *i.e.*, the guarantees were credit *enhancements*. Their purpose, as the record overwhelmingly demonstrates, was to give the banks separate sources of recovery in the event OCD defaulted – through the ability to bring direct claims against the subsidiaries that would rank ahead of the claims of OCD's own creditors, who had no direct claims against the subsidiaries.

Thus, the issue is not whether each guarantor subsidiary could independently repay the loan or even any specific portion, but whether the banks relied on the direct claims provided by the guarantees as providing additional value in the event of default. The record is crystal clear that they did. See record citations at CSFB Br. 12-13, 64-65. Bargaining for direct contract claims against entities with hundreds of millions of dollars of value (see *id.*) meets any construct of reliance on the "credit" or "creditworthiness" of the guarantor subsidiaries.

That should have been the end of the "reliance" inquiry. But appellees invite this Court to inquire into "the purpose for which CSFB * * * obtained guarantees" (OC Br. 56), how much "financial information about the subsidiary guarantors" the banks obtained (OC Br. 57), and how well the banks protected themselves against diminution in the assets of the subsidiaries (OC Br. 58-61). All three subjects are irrelevant as a matter of law, and the record is contrary to OCD's position on each subject.

<u>The banks' subjective purpose for obtaining guarantees</u>. OCD says that "the guaranties existed to prevent structural subordination." OC Br. 56. True, but they *also* existed to achieve structural seniority. As we explained above (pages 2 and 29-30), it is impossible to separate protection against structural subordination from the achievement of structural seniority through the same guarantees, and the record supports no such artificial distinction. OCD's chief negotiator Nowland admitted that the guarantees "by definition" put the banks "in a superior position to the other unsecured lenders of the parent who don't have that direct claim against the subsidiary's assets," and that both OCD and the banks understood this in 1997. JA1526-27. That testimony was consistent with the testimony of every CSFB witness. See CSFB Br. 14-15. This record shows beyond any possible contradiction that the banks knew – and cared – that the guarantees would afford them structural seniority and place them ahead of parent-only creditors.

The financial information the banks obtained about the guarantors. According to OCD (Br. 57), "the banks never sought or obtained financial information about the subsidiary guarantors beyond the bare listing of subsidiaries having assets with a book value of at least $30 million." That is not even close to being true.

First of all, the banks certainly did *seek* the very information OCD says would show reliance, but *OCD* counterproposed selecting guarantors on the basis of book value. See JA2333-34 (Kurz), 1761-62 (Carey), 1503 (Nowland), 1001-02 (Miller). It is bizarre that OCD would refuse to furnish information to the banks and then come to this Court and claim that the banks never asked.

Second, the banks' opening brief in this Court demonstrated, in detail, what information the banks *obtained*. CSFB and the other major syndicate banks knew of the existence and substantial value of the subsidiary guarantors, particularly OCFT (which the banks knew held all the domestic intellectual property), IPM (which the banks knew owned the very substantial foreign operations that accounted for 25% to 28% of OCD's revenues), and Fibreboard's subsidiaries (which the banks knew to be worth approximately $700 million). CSFB Br. 12-13. Indeed, OCD's Treasurer conceded the banks did receive "detailed financial information" regarding the value of the Fibreboard subsidiary guarantor businesses. JA1017. The banks also knew both the Fibreboard subsidiaries and the OCD guarantor subsidiaries would be largely debt-free and had no asbestos liabilities. CSFB Br. 13. The banks thus knew there was massive value standing behind the guarantees, *and this is exactly what turned out to be the case*.

Third, knowing that each guarantor subsidiary had at least $30 million in book value was itself highly significant information. The book value of assets captures value and preserves the ability to access the assets – which OCD Treasurer Miller conceded in almost every instance are worth considerably more than their book value (JA1010-11) – in the event of a parent company default, and does so even if a guarantor has liabilities or, like OCD itself, negative net worth. JA1832-33; see also JA2202-03, 2155 (Pickhardt). For example, a subsidiary with $100 million in assets and $100 million in liabilities other than its guarantee of the OCD debt may not have any positive net worth, but the banks would nevertheless be entitled to nearly 95% of its assets if the guarantee obligations were triggered, based on the banks' $1.6 billion claim under the guarantee versus other subsidiary liabilities of $100 million.

Perhaps most important, OCD continues to pretend Schedule 5.01(b)(1) of the Credit Agreement, CA231-33 – "Schedule of Existing Debt" – does not exist. In that schedule, the banks obtained *exactly* what OCD claims (and the district court clearly erroneously found) they did not have: detailed information about the debts of the guarantor subsidiaries. Compare JA6 and OCD Br. 56 with CA231-33 and CSFB Br. 13, 63-64. OCD claims without record citation (Br. 58) that Schedule 5.01(b)(1) was incomplete, but that contention is both irrelevant and wrong. Incomplete information would still be information – which the district court said the banks lacked. Furthermore, OCD attempts grossly to mislead this Court when it says that the supposed omission of "the two $501 million dividend notes" (OC Br. 58) from the Schedule – dated, along with the rest of the Credit Agreement, June 26, 1997 (see CA1) – shows its incompleteness. The two $501 million dividend notes *did not exist* until December 24, 1997, and are in any event held by a guarantor, Integrex. CA914 (Stips. 140, 145).[17]

[17] OCD's further suggestion that the banks failed to satisfy published underwriting guidelines for credits backed by guarantees (Br. 58 n.25), even if true, would go only to the banks' prudence, not their reliance. And the cited guidelines are more flexible and discretionary than OCD suggests: They provide generally for such procedures as are "prudent" in view of the "types of loans" and the "nature of the markets" involved. 12 C.F.R. Pt. 30, App. A(D). Thus, obtaining more information about a guarantor's willingness or ability to repay a loan "may be appropriate under certain circumstances," such as in connection with a troubled credit (FED. RESERVE BD., COMMERCIAL BANK EXAMINATION MANUAL §2080.1, at 16 (May 2000)) or where the guarantee is being used to enhance a credit's formal risk rating (OFFICE OF THE COMPTROLLER OF CURRENCY, COMPTROLLER'S HANDBOOK: RATING CREDIT RISK 27 (Apr. 2001)). Neither factor existed here, and for reasons stated in text the banks had more than enough information to support their prudence as well as their actual reliance.

The protections the banks negotiated against diminution in the subsidiaries' assets. The assets of the subsidiaries remain extremely substantial – that is why the tort claimants and bondholders are so eager to share in them. Hypothetical scenarios in which they *could have been* diminished by merger are not relevant. OCD, however, contends that such scenarios somehow prove lack of reliance by the banks on the credit of the subsidiaries. No case supports OCD's legal position. Aside from that, OCD's interpretation of what the Credit Agreement hypothetically would have allowed is unsupported by any determinations below or by the record. Furthermore, not everything that the Credit Agreement fails to forbid is therefore *permissible*. Applicable law – such as the prohibitions on fraudulent transfers and illegal dividends, and fiduciary duties to creditors of insolvent entities – protected (and protect) the banks against transactions that would diminish the value of their guarantees. And Section 13.03 of the Credit Agreement (CA80) makes clear that the banks' rights under applicable law to avoid mergers of guarantor subsidiaries into OCD with all its liabilities were preserved for the banks.

OCD throws down the gauntlet on pages 1-2 of its brief, declaring that the Credit Agreement allowed many actions that would have diminished the value of the guarantees, including allowing "subsidiary guarantors to be merged into the parent without limitation." The district court said nothing of the kind, however, even though this very proposition was hotly disputed below. The banks stand by their reading of the Credit Agreement.

The Credit Agreement meticulously precludes all mergers that would impair the structural seniority afforded by the guarantees. Section 8.09 – which like all negative covenants in the Credit Agreement must be independently satisfied not only by OCD but also by each subsidiary (see CA56 ("The Company shall not, and shall not permit any Subsidiary to * * *")) – restricts mergers. CA61-62. OCD cannot merge with a subsidiary, because Section 8.09(a)(ii)(A) would require both of them to survive – an impossibility as William Kurz, the principal architect of Section 8.09's overall structure, pointed out at trial. JA2354-56. Section 8.09 also prohibits a guarantor subsidiary from merging with a second subsidiary unless either (i) the guarantor subsidiary is the survivor or (ii) the second subsidiary is also a guarantor. CA61: § 8.09(a)(iii) & (iv); JA1448-49 (Nowland). As OCD conceded, this additional prohibition was added at the banks' insistence because, in contrast to OCD's prior credit facility, which was not guaranteed, "the banks felt it was no longer appropriate to allow subsidiaries and subsidiaries to merge willy-nilly." JA1415-16 (Nowland). Instead, "they wanted to have certain restrictions on subsidiaries merging *and it was to protect their interest in the guarantees.*" JA1445-47 (emphasis added); JA1446, 1449.

OCD also claims – again without benefit of any ruling below – that the Credit Agreement allows (a) assets of the subsidiaries to be liened for OCD's benefit, (b) assets of the subsidiaries to be sold "without meaningful limitations," and (c) the subsidiaries to deal with OCD on less than an arm's-length basis. OC Br. 2, 27-28.

Section 8.07(b) of the Credit Agreement does not provide OCD open-ended power to lien a subsidiary's assets for its benefit. CA57. It allows liens only to secure subsidiary debt owing to OCD. If OCD lends a subsidiary money and takes a lien to secure its repayment, the effect on subsidiaries' creditors is neutral (if not positive, since presumably the loan was made for a valid business purpose and, as noted above, on arm's-length terms). Section 8.10 of the Credit Agreement limits OCD's rights to dispose of assets to a cumulative total of 10% of the book value of OCD and its subsidiaries. CA61-62. OCD does not explain why the banks' reservation of 90% of book value does not show they relied on the guarantees. Furthermore, Sections 10.08 and 13.05 of the Credit Agreement together prohibit any action by OCD that terminates or diminishes the validity or value of any guarantee without the banks' vote (100% of the bank debt for Fibreboard operating subsidiary guarantors; 51% for all other guarantors). The only exception is a limited sale of assets for fair value under Section 8.10. CA69-

70, 81-82; CSFB Br. 16-17.[18] In short, although these covenants should be irrelevant to the issue on appeal, the construction of the Credit Agreement that OCD trumpets at the very beginning of its brief is completely wrong.[19]

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[18] Nowland, who negotiated the agreement for OCD, conceded that Sections 10.08 and 13.05 embody these limitations. JA1536-38. Of equal import — in light of OCD's insistence that reliance should be measured by *subjective* intent — every bank witness testified that if one were to interpret Section 8.09, 8.07, or 8.12 of the Credit Agreement as OCD now purports to, using those sections with respect to *guarantor* subsidiaries would in their view have been a breach of the overarching protective provisions relating to the guarantees for which they negotiated and bargained. And Nowland himself conceded that the banks, through their counsel William Kurz, fought hard to obtain these protections as well as those built into Section 8.09 itself. JA2388, 2392-93 (Kurz); JA2238-42 (Pickhardt); JA1839, JA1841-42, JA1854-55 (Carey); JA1445-49, JA1415-16 (Nowland).

[19] OCD also tries to show lack of "reliance" by pointing to the banks' failure to declare OCD in default when the banks learned that two of the initial guarantors — UC Industries ("UCI") and Western Fiberglass — "no longer exist as subsidiaries." JA6372-78; JA1523. But the banks were not told of UCI's 1998 merger into OCD and Western Fiberglass's 1997 dissolution until March 1999, more than a year after they occurred. CA748: Stip. 116, 124; JA1516; JA10583; JA2372; JA1513-17; JA1519. That is when an OCD lawyer, Nowland, casually mentioned to CSFB's counsel, Kurz, that "there were two Owens Corning subsidiaries that no longer existed, that they were small companies, one of them had been in bad financial condition, that one of them had been disposed of and the other merged into another entity." JA2368. On learning this, Kurz, far from being inattentive, wrote to OCD the next day seeking confirmation that the banks in fact had guarantees from all the "significant subsidiaries," as required under the Credit Agreement, and that, as Nowland had stated, UCI and Western Fiberglass "have been merged with other subsidiaries or sold." JA9784-89; JA2367-70; JA1521. OCD then wrote a letter reassuring the banks that they did indeed have all the significant subsidiary guarantees. However, rather than providing accurate information about UCI and Western Fiberglass and correcting what Nowland had told Kurz, the letter merely stated that the two companies "no longer exist as subsidiaries." Exh. 502; JA2371-73; JA1521-23. In light of the reassurances in OCD's letter, OCD's failure to tell Kurz that the transactions involved a

OCD claims Section 8.12 of the Credit Agreement allows OCD to deal with subsidiaries in ways resulting in losses to the subsidiaries. OC Br. 27-28. OCD has it exactly backwards. Section 8.12 bars OCD and its subsidiaries from effecting "any transaction with any Affiliate (other than a Subsidiary) on a basis less favorable to the Company or such Subsidiary than would be the case if such transaction had been effected with a Person that was not an Affiliate." CA62. For example, if OCD is dealing with a subsidiary, the parenthetical phrase in the quoted language allows OCD to deal on terms less favorable to the Company, not less favorable to the Subsidiary. Conversely, a subsidiary dealing with OCD does *not* come within the exception. Thus, Section 8.12 prohibits each subsidiary from dealing with OCD on terms less favorable to the subsidiary than otherwise available.

The Credit Agreement also contains separateness covenants. Section 8.01 requires preservation of each subsidiary's corporate existence and business.

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dissolution and a merger into OCD, and Nowland's statements that the two guarantors were "minor subsidiaries" (JA1521-25; JA2370-72), the banks did not pursue the matter further (JA2372; JA2392). The notion that this shows a lack of "reliance" *ab initio* on the guarantees is a litigation concoction. A commercial lender can hardly be faulted for "failing" to declare a Fortune 200 company borrower in default under a $2 billion credit facility over the loss of two minor subsidiary guarantees. OCD pads its discussion of these two transactions (Br. 29-30) with others having nothing to do with mergers into the OCD parent – *e.g.*, involving disposition of assets clearly below the Section 8.10 limit, or the merger of guarantor subsidiaries with each other, which keeps assets at the guarantor level

CA55. Section 8.02 requires each subsidiary to maintain books and records to enable preparation of financial statements for each legal subsidiary. *Id*. Section 8.04 entitles the banks to visit each subsidiary and to discuss their businesses with each management. CA56. Section 8.07(b) protects subsidiaries against liens except for money loaned from OCD. CA57. Section 8.07(n) protects each subsidiary against liens for debt existing on the date of the Credit Agreement. CA58. Sections 8.09 and 8.12 are discussed above. Section 9.01(d)(ii) requires OCD to furnish the banks information about subsidiaries. CA66. Article 10 grants the subsidiary guarantees and bars their termination. CA68-70. OCD's claim that there are no separateness covenants in the Credit Agreement (Br. 60) is false.

OCD ultimately falls back on an absurd theory that also played no part in the decision below: that guarantees should fail the "reliance" test unless their beneficiaries obtained a so-called "bankruptcy remote" opinion typically given in connection with the creation of a "special purpose entity" in an asset or receivables financing transaction. OC Br. 59-61. That kind of opinion is simply not available for operating subsidiaries, such as the guarantors in this case, which had been in existence for many years and were not set up in connection with a financing transaction and have creditors other than the lenders. That kind of opinion is, rather, available for entities – such as OCFunding, discussed below – whose only

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and was therefore expressly permitted under Section 8.09(a)(iv). Such transactions activities are "*restricted* to those necessary or incidental to the financing." Comm. on Bankr. and Corporate Reorganization of the Association of the Bar of the City of New York, *Structured Financing Techniques*, 50 Bus. Law. 527, 554 (1995) (emphasis added). The standard non-consolidation opinion includes an assumption that neither the special-purpose entity nor the parent will guarantee the debts of the other. *Id*. at 603. An opinion containing that assumption obviously could not apply to this Credit Agreement, in which the guarantees were an essential credit enhancement.

As Richard Carey of CSFB testified without contradiction, in his many years of negotiating credit facilities, he has never asked for such an opinion or seen anyone else do so. JA1842-43. OCD's own witnesses conceded that the banks sought and obtained opinions as to the validity and enforceability of the Credit Agreement obligations and the guarantees. See CA237-45. They also concurred that the references in those opinions to the possibility that a bankruptcy might affect recoveries (*e.g.,* under fraudulent conveyance theories) were boilerplate "customary exceptions" that "come out of a treatise book" and that the basic purpose of the opinion was to assure the banks that the guarantees were valid and enforceable obligations of the subsidiaries. JA1464, JA1538-39, JA1547; accord JA2364-66.

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say nothing about any party's understanding of Section 8.09(a)(ii).

As its example of how subsidiaries can be rendered bankruptcy remote, OCD holds up Owens-Corning Funding Corporation ("OCFunding"), a special-purpose entity formed to borrow money using accounts receivable from OCD as collateral. According to OCD, the banks used "well-known techniques that are routinely used to assure that a lender will not be confronted with substantive consolidation." OC Br. 28. Specifically, OCD asserts that the banks could have confirmed their rights by obtaining opinions of counsel such as the one given in connection with OCFunding. OC Br. 37.

The opinion OCD flaunts, however, is a 37-page discussion advising that there is no precedent directly on point (JA 9097) and that a "lack of clarity adds to the unpredictability of whether substantive consolidation should be granted where it would prejudice the rights of objecting creditors" (JA9096). The opinion states, "[w]e have found no precedent under the Bankruptcy Code that addresses directly substantive consolidation of a special purpose entity created primarily for the purpose of holding particular assets as part of a securitization transaction analogous to this transaction" (JA9085), and ultimately offers no actual assurance of a favorable outcome: "[I]t is our opinion that, if OCF were to be a debtor under the Bankruptcy Code in a properly presented and argued case, it would not be a proper exercise of the court's equitable discretion to disregard the separate existence of Funding so as to order substantive consolidation." JA9097.

Based on this, OCD concludes that CSFB eliminated the risk of substantive consolidation in respect of OCFunding, but took the risk in connection with OCD because it did not obtain a similar opinion. OC Br. 71. That conclusion does not mesh with reality. First, the opinion relies, among other things, on the assumption that OCFunding could not guarantee parent company debt (JA9098), demonstrating the irrelevance of OCD's argument on the facts of this case. And it is in any event clear that the carefully qualified OCFunding opinion offers a "comfort level" not materially different from the opinion letters the banks *did* obtain with respect to the guarantor subsidiaries. Conversely, OCD's insistence that OCFunding is not subject to substantive consolidation actually supports appellants' argument here given that OCFunding shares the "Owens Corning" name with OCD and has most of the same attributes as IPM, OCFT, Exterior, and Integrex.

* * * * *

The banks negotiated for enforceable guarantees. They cared about the rights those guarantees gave them. The district court's conclusion that the banks did *not* rely on the "separate credit" of the subsidiary guarantors is based on the wrong legal standard (CSFB Br. 61-63) as well as an insupportable reading of the facts (CSFB Br. 63-65). Appellees' efforts to defend that conclusion – efforts largely based on issues the district court did not reach – are unavailing. "It would be fanciful to suggest that a major syndicate of banks providing a $2 billion credit facility with the aid of sophisticated counsel did not appreciate the benefit of having a direct claim against the subsidiaries. That should end the matter." Professors' Br. 27.

CONCLUSION

For the foregoing reasons and those stated in our opening brief and the briefs of supporting amici, the judgment of the district court should be reversed.

Dated: January 26, 2005

WEIL, GOTSHAL & MANGES LLP

By:______________________________

Martin J. Bienenstock
John J. Rapisardi (S.D.N.Y. No. JR 7781)
Timothy E. Graulich
767 Fifth Avenue
New York, NY 10153
Telephone: (212) 310-8000
Facsimile: (212) 310-8007

ATTORNEYS FOR CREDIT SUISSE FIRST BOSTON, AS AGENT

[Full listing of counsel appears on front cover.]

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This brief contains 11,941 words, excluding the parts of the brief exempted by FED. R. APP. P. 32(a)(7)(B)(iii). By motion dated January 26, 2005, the Appellant has moved the Court for an augmentation of the type-volume limitation of FED. R. APP. P. 32(a)(7)(B).

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John J. Rapisardi (S.D.N.Y. No. JR 7781)
Weil, Gotshal & Manges LLP
767 Fifth Avenue
New York, NY 10153
212.310.8000
Attorney for Appellant
Dated: January 26, 2005

CERTIFICATE OF BAR MEMBERSHIP (L.A.R. 46.1)

Pursuant to Third Circuit Local Appellate Rule 46.1, I hereby certify that I am a member of the bar of the United States Court of Appeals for the Third Circuit.

John J. Rapisardi (S.D.N.Y. No. 7781)
Weil, Gotshal & Manges LLP
767 Fifth Avenue
New York, NY 10153
212.310.8000
Attorney for Appellant
Dated: January 26, 2005

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Owens Corning
Third Circuit Service List

Norman L. Pernick, Esq.
Saul Ewing LLP
222 Delaware Avenue
P.O. Box 1266
Wilmington, DE 19899-1266
(Counsel to Owens Corning, et al.)

Adam H. Isenberg, Esq.
Saul Ewing
1500 Market Street
Centre Square West, 38th Floor
Philadelphia, PA 19102
(Counsel to Owens Corning, et al.)

Jane W. Parver, Esq.
Edmund Emrich, Esq.
Kaye Scholer LLP
425 Park Avenue
New York, NY 10022
(Counsel to Future Representative)

Elihu Inselbuch, Esq.
Rita Tobin, Esq.
Caplin & Drysdale, Chartered
399 Park Avenue
New York, NY 10022-4614
(Counsel to Asbestos Committee)

James L. Patton, Jr., Esq.
Young Conaway, et al.
The Brandywine Building
1000 West Street, 17th Floor
Wilmington, DE 19801
(Counsel to Future Representative)

Marla Eskin, Esq.
Mark Hurford, Esq.
Campbell & Levine, LLC
800 King Street, Suite 300
Wilmington, DE 19801
(Counsel to Asbestos Committee)

J. Andrew Rahl, Jr., Esq.
Anderson Kill & Olick, P.C.
1251 Avenue of the Americas
New York, NY 10020
(Special Counsel to Creditors' Committee)

Ellen R. Nadler, Esq.
Kenneth H. Eckstein, Esq.
Jeffrey S. Trachtman, Esq.
Kramer Levin, et al.
919 Fourth Avenue
New York, NY 10022
(Bank Group)

Francis A. Monaco, Jr., Esq.
Monzack & Monaco, P.A.
1201 Orange Street
400 Commerce Center
Wilmington, DE 19899
(Special Counsel to Committee)

Roy T. Englert, Jr., Esq.
Robbins, Russell, Englert, Orseck & Untereiner
1801 K Street, N.W.
Suite 411
Washington, DC 20006

Robert K. Rasmussen, Esq.
Vanderbilt University Law School
131 21st Avenue South
Nashville, Tennessee 37240
(Counsel to Proposed Amici Rasmussen, et al.)

Ralph I. Miller, Esq.
Weil, Gotshal & Manges
100 Crescent Court
Suite 1300
Dallas, Texas 75201-6950
(Counsel for Bank Group)

Martin J. Bienenstock, Esq.
Richard A. Rothman, Esq.
John J. Rapisardi, Esq.
Weil, Gotshal & Manges
767 Fifth Avenue
New York, NY 10153
(Counsel for Bank Group)

Charles O. Monk, II, Esq.
Saul Ewing LLP
100 S. Charles Street
Baltimore, MD 21201

John Berringer, Esq.
Howard Ressler, Esq.
Anderson Kill & Olick P.C.
1251 Avenue of the Americas
New York, NY 10020

Rebecca L. Butcher, Esq.
Richard S. Cobb, Esq.
Landis Rath & Cobb LLP
919 Market Street, Suite 600
P.O. Box 2087
Wilmington, DE 19899
(Counsel to Credit Suisse First Boston, As Agent)

Alexandra A. E. Shapiro, Esq.
Mitchell A. Seider, Esq.
Alan L. Leavitt, Esq.
Latham & Watkins LLP
885 Third Avenue, Suite 1000
New York, NY 10022
(Counsel to Proposed Amici Loan Syndications and Trading Association, Inc. and The Clearing House Association, LLC)

Owens Corning
Third Circuit Service List

Jonathan N. Helfat, Esq.
Otterbourg, Steindler, Houston
& Rosen, P.C.
230 Park Avenue
New York, NY 10169
(Counsel to Proposed Amicus
Commercial Finance
Association)

Amanda P. Biles, Esq.
Latham & Watkins, LLP
Two Freedom Square
11955 Freedom Dr., Ste 500
Reston, VA 20190-5651
(Counsel to Proposed Amici
Loan Syndications and
Trading Association, Inc. and
The Clearing House
Association, LLC)

Richard M. Kohn, Esq.
Andrew R. Cardonick, Esq.
Goldberg, Kohn, Bell, Black,
Rosenbloom & Moritz, Ltd.
55 East Monroe St., Ste 3700
Chicago, IL 60603
(Counsel to Proposed Amicus
Commercial Finance
Association)