No. 19-___

IN THE

Supreme Court of the United States

GEORGE L. MILLER, Chapter 7 Trustee for the Estate of HOMEBANC CORP.,

Petitioner,

v.

BEAR STEARNS & CO., INC.;
BEAR STEARNS INTERNATIONAL LIMITED;
HOMEBANC CORP.;
STRATEGIC MORTGAGE OPPORTUNITIES REIT, INC.;

Respondents.

WELLS FARGO, N.A.,
in its capacity as Securities Administrator,

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

PETITION FOR WRIT OF CERTIORARI

JOHN T. CARROLL, III
COZEN O'CONNOR
1201 N. Market St.
Suite 1001
Wilmington, DE 19801
(302) 295-2000

STEVEN M. COREN
Counsel of Record
KAUFMAN, COREN & RESS, P.C.
2001 Market Street
Suite 3900
Two Commerce Square
Philadelphia, PA 19103
(215) 735-8700
scoren@kcr-law.com

Counsel for Petitioner

June 5, 2020

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

QUESTION PRESENTED

In times of acute economic distress, the automatic stay of the Bankruptcy Code functions as a critical circuit breaker: it backstops a vulnerable financial system by slowing collateral grabs to protect the creditors of reorganizing or liquidating bankruptcy estates. Borne of the last financial crisis, this case is the canary in the coal mine for the current one. As the next wave of bankruptcies sweeps in, this appeal presents an opportunity to protect the financial system before mountains of collateral are swept away.

The 2007-2008 Financial Crisis was fueled by a run on collateral underlying short-term lending facilities known as repurchase agreements, in which securities are sold with an agreement to repurchase them at a specified date and price. The Third Circuit decision below ignored express limitations in the safe harbor provisions of the Bankruptcy Code relating to repo financing and sanctioned the out-of-court liquidation of $90 million of cash-flowing financial assets to satisfy an $8 million prepetition debt. The Third Circuit's decision will have an outsized national impact on a financial system spinning out of control as courts nationwide look to the Delaware bankruptcy court for guidance.

In this appeal, the Court is asked to decide whether the Bankruptcy Code's safe harbor language of limitation should be enforced as written or the statute interpreted as though the language of limitation does not exist?

PARTIES TO THE PROCEEDING AND RULE 29.6 STATEMENT

Petitioner is George L. Miller, Chapter 7 Trustee for the Estate of HomeBanc Corp., appellant below. Respondents are Bear Stearns & Co., Inc., and affiliates (collectively, "Bear Stearns"), appellees below.

TABLE OF CONTENTS

TABLE OF CONTENTS—Continued

TABLE OF AUTHORITIES

CASES Page(s)

STATUTES

TABLE OF AUTHORITIES—Continued

Page(s)

OTHER AUTHORITIES

PETITION FOR WRIT OF CERTIORARI

George L. Miller, Chapter 7 Trustee for the Estate of HomeBanc Corp., petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit.

OPINIONS BELOW

The opinion of the Third Circuit (Pet. App. 1a) is reported at 945 F.3d 801. The order denying rehearing en banc (Pet. App. 29a) is unreported. The opinion of the district court (Pet. App. 33a) is reported at 590 B.R. 69. The opinion of the bankruptcy court is reported at 573 B.R. 495 (Pet. App. 46a).

JURISDICTION

The Third Circuit entered its judgment on December 24, 2019 (Pet. App. 31a), and the court denied a timely petition for rehearing on January 24, 2020 (Pet. App. 29a). This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 559 of Title 11 provides in pertinent part:

> The exercise of a contractual right of a repo participant … to cause the liquidation, termination, or acceleration of a repurchase agreement because of a condition of the kind specified in section 365(e)(1) of this title shall not be stayed, avoided, or otherwise limited by operation of any provision of this title ….

Section 101, subsection 47 of Title 11 provides

> (47) The term "repurchase agreement" (which definition also applies to a reverse repurchase agreement)—

(A) means—

* * *

(v) any security agreement or arrangement or other credit enhancement related to any agreement or transaction referred to in clause (i), (ii), (iii), or (iv) … **but not to exceed the damages in connection with any such agreement or transaction, measured in accordance with section 562 of this title** …. (emphasis added).

REASONS FOR GRANTING THE PETITION

The financial system almost collapsed entirely in 2008 due, in large part, to the type of agreements at issue in this appeal. Gary Gorton, Toomas Laarits & Andrew Metrick, *The Run on Repo and the Fed's Response*, NAT'L BUR. ECON. RES., Working Paper 24866, at 2 (July 2018), *available at* https://www.nber.org/papers/w24866.pdf. "The 2008 financial crisis has prompted widespread criticism of the bankruptcy safe harbors for repurchase agreements (repos) and derivatives, which allow a failed firm's counterparties to enforce these contracts outside the bankruptcy process. The emerging consensus holds that these provisions facilitated a run on the assets of troubled financial institutions such as Lehman Brothers and should be curtailed to afford such firms greater protection from their counterparties." Nathan Goralnik, *Bankruptcy-Proof Finance and the Supply of Liquidity*, 122 YALE L.J. 460 (2012).

The Third Circuit's decision disabled a critical brake that prevents a recession from sliding into full-scale economic collapse. Further percolation in the lower courts is unwarranted and impractical. This impactful issue is rarely raised because litigants in bankruptcy proceedings are financially constrained already and typically forgo years of cost-prohibitive litigation which may further consume limited assets available in the bankruptcy estate. Given that runs on the assets of troubled financial institutions present during infrequent recessions, the time is ripe for this Court to decide the scope of the automatic stay in the context of repo financings that have the potential to disable the financial system.

STATEMENT OF THE CASE

When it filed for bankruptcy in August 2007—the eve of the last financial crisis—HomeBanc financed its residential mortgage loan business through repurchase agreements with Bear Stearns. Bear held residential mortgage-backed securities—HomeBanc's most-valuable assets—as collateral. Pet. App. 4a.

When a bankruptcy is filed, an estate is created to preserve debtor property for the benefit of all its creditors, and an automatic stay under 11 U.S.C. § 362 halts debt collection by individual creditors. The automatic stay is a hallmark of the bankruptcy system, as it fosters the Bankruptcy Code's fundamental objectives of debt restructuring and orderly liquidation in accordance with specified distribution priorities.

Section 559 of the Bankruptcy Code affords safe harbor protection to permit repo participants to liquidate their repo collateral without violating the automatic stay. 11 U.S.C. § 559. The scope of the safe harbor protection, however, is determined by the type of collateral. Critical to this case, safe harbor protection for additional collateral designated as "credit enhancements" under 11 U.S.C. § 101(47)(A)(v) is significantly limited. Traditional repos enjoy maximum safe harbor protection and therefore should be liquidated first to repay the repo debt. If the traditional repo collateral is sufficient to satisfy the repo debt, the additional collateral "credit enhancements" should be returned to the bankruptcy estate. If liquidation of the traditional repos is insufficient to repay the repo debt, the credit enhancements are available to satisfy the deficiency.

The Third Circuit decision erroneously interpreted the statute to eviscerate the limitation applicable to credit enhancements, a result which permitted Bear Stearns to retain a windfall of approximately $81 million to the detriment of all other creditors of the HomeBanc bankruptcy estate. In short, the Third Circuit decision provides a roadmap to repo lenders who hold credit enhancements worth substantially more than any deficiency which they secure—forgo the deficiency claim like Bear did here, keep the credit enhancements for yourself like Bear did here, and keep a huge windfall like Bear did here.

THE PROCEEDINGS BELOW

Upon filing for bankruptcy, HomeBanc had a $64 million repo debt to Bear, which held 37 HomeBanc mortgage-backed securities as collateral: 28 of which were traditional repos as defined by the Bankruptcy Code and 9 (referred to in this case as the "Securities at Issue" or "SAI") were additional collateral characterized by the Bankruptcy Code as "credit enhancements."

On August 14, 2007, Bear lumped the 9 SAI with 27 of the 28 traditional repo securities and exposed them to auction. The auction yielded two bids: a third-party bid of approximately $2.2 million for two of the traditional repo securities; and an "all or nothing" bid of $60.5 million from Bear itself. Pet. App. 6a. Declaring itself the winning bidder and keeping the HomeBanc securities for itself, Bear allocated its $60.5 million bid—which was never actually paid since the buyer and seller were one and the same—the next day across the 37 securities: $52.4 million to the 27 traditional repo securities; and $8.1 million divided evenly among the 9 SAI ($900,000 apiece). Pet. App. 6a. Critically, the SAI credit enhancements for which Bear credited HomeBanc a mere $8.1 million quickly proceeded to cash flow far more than Bear had been owed at the time of the auction, and went on to yield more than $89 million, JA413 (Stipulation ¶ 19), JA1208-1210 (Trial Ex.), thereby bestowing on Bear a windfall of approximately $81 million beyond what it was owed.

While the Bankruptcy Code affords stay relief to repo lenders that is not afforded to secured lenders in other contexts, repo financing is nothing more than a lending transaction, and the safe harbor provisions of the Bankruptcy Code should be interpreted with that in mind. Lenders are entitled to be repaid with interest. Windfalls are out of bounds, especially when they come at the expense of the other creditors of a bankruptcy estate.

ARGUMENT

THE BANKRUPTCY CODE EXPRESSLY LIMITS STAY RELIEF ACCORDED CREDIT ENHANCEMENTS (SUCH AS THE SAI) TO PROTECT CREDITORS OF THE BANKRUPTCY ESTATE. THE THIRD CIRCUIT WRONGLY NULLIFIED THE STATUTORY LIMITATION.

Qualified only as credit enhancements under the catchall provision of 11 U.S.C. § 101(47)(A)(v), the SAI's repo status and accompanying safe harbor protection were expressly limited by the statutory definition itself.

In this regard, the Bankruptcy Code provides:

> 11 U.S.C § 101. Definitions . . .
>
> (47) The term "<u>repurchase agreement</u>" . . .
>
> (A) means—
>
> * * *
>
> (v) any . . . other credit enhancement related to any agreement or transaction referred to in clause (i), (ii), (iii), or (iv), . . . **but not to exceed the damages in connection with any such agreement or transaction, measured in accordance with section 562 of this title**[.]

11 U.S.C. § 101(47)(A)(v) (emphasis added).

Quoting the statutory language of limitation which itself invokes the objective valuation parameters of Section 562, the Third Circuit acknowledged:

> Subparagraph (v) specifies that repos include credit enhancements, but such credit enhancements are "**not to exceed the**

> **damages** in connection with any such agreement or transaction, **measured in accordance with section 562 of this title**." 11 U.S.C. § 101(47)(A)(v) (emphasis added).

Pet. App. 16a.

Yet, in its effort to interpret the limiting language of the statutory definition, the Third Circuit added a word found nowhere in the statutory text—*i.e.*, the word "claimed"—the addition of which caused the court to imply a condition found nowhere in the statutory text—the filing of a deficiency claim by the repo lender—without which the limitation would become a nullity:

> While the protections of § 559 are generally available, the safe harbor does not encompass a recovery beyond the "damages" **claimed**. We therefore must define "damages" as found in 11 U.S.C. § 101(47)(A)(v), to determine if § 562 applies to the nine SAI—each of which is a credit enhancement.

Pet. App. 17a (emphasis added).

Accordingly, the Third Circuit interpreted the word "damages" to require the filing of a deficiency claim without which the limiting language of the statute and the valuation parameters of § 562 would be disregarded.

By adding the word "claimed," the Third Circuit altered the plain language of the statute. In doing so, the Third Circuit's decision failed to give effect to Congress's intent that credit enhancements be treated differently and more restrictively than traditional repos. Indeed, the court improperly read the limiting language of subsection (v) out of the Code, emptying it of meaning. *See Loughrin v. United States*, 573 U.S. 351, 358 (2014) (quoting *Williams v. Taylor*, 529 U.S. 362, 404 (2000)) (recognizing the "cardinal principle" of statutory interpretation requiring courts to "give effect, if possible, to every clause and word of a statute"); *Rosenberg v. XM Ventures*, 274 F.3d 137, 141 (3d Cir. 2001) ("[W]hen interpreting a statute, courts should endeavor to give meaning to every word which Congress used and therefore should avoid an interpretation which renders an element of the language superfluous.").

Moreover, the notion that "damages" must be "claimed" in a legal proceeding to constitute "damages" in the context of the statutory scheme limiting credit enhancement safe harbor is belied by the purpose behind the statutory limitation itself. The "but not to exceed the damages …" is plainly language of limitation, the purpose of which is to protect the creditors of the bankruptcy estate from excessive liquidation of the bankruptcy debtor's property and to prevent repo lenders from obtaining windfalls such as the $81 million reaped by Bear Stearns.

While the existence of damages is certainly an element of a legal claim, the absence of a filed legal claim says nothing about whether damages exist or may be recoverable should a creditor pursue a claim. In the context of 11 U.S.C. § 101(47)(A)(v), the statutory provision under review, the word "damages" should have been interpreted as the damages to which the repo lender potentially would have been entitled should it have chosen to pursue its claim. *See Williams*, 529 U.S. at 404; *Rosenberg*, 274 F.3d at 141. In fact, the Third Circuit acknowledged this point: "Although probably not obvious to the layperson, every first-year law student learns to automatically connect 'damages' with what is **potentially** recoverable in court, and not necessarily an underlying loss or injury." Pet. App. 17a (emphasis added).

As the non-defaulting party, the damages potentially recoverable by a repo lender should it choose to pursue a claim—*i.e.*, a deficiency claim—include the unpaid portion of the repo debt (*i.e.*, the "shortfall" or "deficiency" in the payment of principal and interest), plus collection-related expenses such as attorneys' fees. That understanding of damages was endorsed by the Third Circuit in *In re Am. Home Mortg. Holdings, Inc.*, 637 F.3d 246, 257 (3d Cir. 2011) ("*Calyon*"), which involved a claim for damages by a repo lender under Code Section 562 in connection with traditional repo collateral in the form of whole mortgage loans. *Id*. at 248. While *Calyon* did not involve "credit enhancements" under 11 U.S.C. § 101(47)(A)(v), it did involve a repo lender's claim that the value of the repo collateral was less than the balance of the repo debt, thereby creating a shortfall. *Id*. at 249. In that context a repo lender's potential "damages" equated to the shortfall in repayment of the "debt" after valuing the mortgage collateral.

A lender's election to forgo filing of a claim does not mean that it suffered no potentially recoverable damages, it means simply that the lender elected to forgo its claim. Consider that under the Third Circuit's interpretation of the Bankruptcy Code, a lender holding additional collateral worth substantially more than the unpaid portion of its debt—such as Bear held in this case—would be incentivized to keep the collateral and forgo its claim to recover damages from a bankruptcy estate that likely has little or no ability to pay. While the Third Circuit recognized the potential for such lender "bad behavior," the court then adopted a statutory interpretation that incentivized and immunized it:

> HomeBanc does raise one concern about our approach which we consider valid: interpreting "damages" to require a deficiency claim may incentivize bad behavior. A non-defaulting party may seek to price the collateral at a level equal to the debt owed by the defaulting party, keeping any upside for itself and avoiding judicial scrutiny simply by not asserting a deficiency claim.

Pet. App. 20a.

The Third Circuit decision converted a stay relief limitation imposed upon repo lenders into a repo lender option to keep credit enhancements and evade bankruptcy safe harbor limitations by merely electing to forgo a deficiency claim. It appears that the Third Circuit reached the wrong result because it misperceived the objective of the statutory limitation contained in § 101(47)(A)(v) while interpreting it. While the clear purpose of the safe harbor limitation is to preserve estate property for the benefit of all estate creditors, the Third Circuit unnecessarily adopted an interpretation that accomplished the opposite—facilitating the repo lender's effort to "liquidate quickly":

> [D]efining "damages" as a "loss," "shortfall," or "debt" would create a problematic process for creditors seeking to quickly liquidated collateral after a default. Under HomeBanc's proposed approach, a non-defaulting party would first determine which collateral constitutes a repurchase agreement under § 101(47)(A)(i) versus a credit enhancement

> under § 101(47)(A)(v): repurchase agreements would receive the full protection of § 559 while credit enhancements would be subject to the conditions of §§ 101(47)(A)(v) and 562. Once the collateral was categorized, a creditor could liquidate only the § 101(47)(A)(i) repos. Afterwards, the non-defaulting party would determine if there was any remaining shortfall. If so, then the § 101(47)(A)(v) credit enhancements could be sold, one at a time, to fill the hole.
>
> We consider HomeBanc's approach impractical. Whether a transaction is a repurchase agreement under § 101(47)(A)(i) or a credit enhancement under § 101(47)(A)(v) is not always clear cut—the parties in this case litigated this issue for nearly a decade. Creditors often seek to liquidate quickly, but a need to differentiate between repos and credit enhancements would substantially slow this process. … Moreover, the need to differentiate between repurchase agreements and credit enhancements could eliminate the ability to buy or sell collateral via "all or nothing" bids.

Pet. App. 19a.[1]

---

[1] While liquidity concerns informed the initial safe harbor from the automatic stay for traditional repos (*see Bevill, Bresler & Schulman Asset Mgmt. Corp. v. Spencer Sav. & Loan Ass'n*, 878 F.2d 742, 748 (3d Cir. 1989)), the carve-out for credit enhancements was created many years later, when Congress amended the definition of "repurchase agreement" to include 11 U.S.C. § 101(47)(A)(v). *See* BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005, PL 109–8, April 20, 2005, 119 Stat. 23.

Characterizing the "need to differentiate between repurchase agreements and credit enhancements" as "impractical" and creating "a problematic process for creditors seeking to quickly liquidate collateral after a default," the Third Circuit decision nullifies the safe harbor limitations and treats the safe harbor protection accorded to credit enhancements as co-extensive with the safe harbor protection accorded to traditional repurchase agreements, the opposite of what the Bankruptcy Code provides. In fact, that which the court criticized as "impractical" and "problematic" is exactly what Congress intended when it limited the stay relief for credit enhancements—a protection afforded to creditors of the bankruptcy estate, not a means to grease the wheels of a repo lender's liquidation effort.[2]

The fact that repo parties may seek contractual protection against lender "bad behavior" (*see* Pet. App. 20a) provides no comfort for a statutory interpretation that eviscerates protections included for the benefit of creditors. Unlike the parties to repo transactions, creditors of a bankruptcy estate had no opportunity to negotiate contractual protections in connection with the bankruptcy debtor's pre-petition repo financing. Congress granted those protections in the Bankruptcy Code itself, and courts nationwide should enforce them.

Finally, the court's observation that "if a creditor's loss is sufficiently large, it will seek damages, even if doing so invites judicial scrutiny", misses the point.

[2] The elimination of "all or none" credit bids which lump traditional repos with credit enhancements is not a "problem," rather, it is what Congress clearly intended when it provided different safe harbor protection based on the type of collateral.

Pet. App. 20a. Bear did not file a deficiency claim because it knew that the SAI would return multiples of the relatively small deficiency. That is not what Congress intended, and the Court should grant review to consider this important question.[3]

CONCLUSION

The Court should grant the petition.

Respectfully submitted,

JOHN T. CARROLL, III
COZEN O'CONNOR
1201 N. Market St.
Suite 1001
Wilmington, DE 19801
(302) 295-2000

STEVEN M. COREN
Counsel of Record
KAUFMAN, COREN & RESS, P.C.
2001 Market Street
Suite 3900
Two Commerce Square
Philadelphia, PA 19103
(215) 735-8700
scoren@kcr-law.com

Counsel for Petitioner

June 5, 2020

---

[3] The liquidation of repo collateral must precede the filing of a deficiency claim under the Bankruptcy Code, because until collateral has been liquidated one cannot determine the existence or extent of any deficiency. Since liquidation must precede filing of a deficiency claim, it is clear error to interpret the scope of safe harbor protection for credit enhancements based on a condition which could not yet have occurred.

APPENDIX

APPENDIX A

PRECEDENTIAL

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 18-2887

In re: HOMEBANC MORTGAGE CORP., *et al*,

Debtors

WELLS FARGO, N.A., in its capacity
as Securities Administrator

v.

BEAR STEARNS & CO., INC.;
BEAR STEARNS INTERNATIONAL LIMITED;
HOMEBANC CORP.;
STRATEGIC MORTGAGE OPPORTUNITIES REIT, INC.

GEORGE L. MILLER, Chapter 7 Trustee for
the Estate of HomeBanc Corp.,

Appellant

On Appeal from the United States District Court
for the District of Delaware

Opinion Filed: December 24, 2019

District Court No. 1-17-cv-00797
District Judge: The Honorable Richard G. Andrews

Argued September 26, 2019

Before: SMITH, *Chief Judge,* McKEE, and PHIPPS, *Circuit Judges*

Francesca E. Brody
Sidley Austin
787 Seventh Avenue
New York, NY 10019

James O. Heyworth [ARGUED]
Sidley Austin
787 Seventh Avenue
New York, NY 10019

Andrew W. Stern
Sidley Austin
787 Seventh Avenue
New York, NY 10019

Counsel for Bear Stearns Co., Inc.
Bear Stearns International Ltd.
Strategic Mortgage Opportunities REIT, Inc.

John T. Carroll, III
Cozen O'Connor
1201 North Market Street
Suite 1001
Wilmington, DE 19801

Steven M. Coren [ARGUED]
Kaufman Coren & Ress
2001 Market Street
Two Commerce Square, Suite 3900
Philadelphia, PA 19103

John W. Morris
Kaufman Coren & Ress
2001 Market Street
Two Commerce Square
Philadelphia, PA 19103

Counsel for George L. Miller, Chapter 7 Trustee forthe
Estate of HomeBanc Corp.

OPINION

SMITH, *Chief Judge.*

This appeal revolves around the liquidation of defaulted mortgage-backed securities that were subject to two repurchase agreements. Following multiple rounds of litigation before the Bankruptcy and District Courts, George E. Miller, Chapter 7 trustee for the estate of HomeBanc Corp., seeks our review. On appeal, we address these questions: (1) whether a Bankruptcy Court's determination of good faith regarding an obligatory post-default valuation of mortgage-backed securities subject to a repurchase agreement receives plenary review as a question of law or clear-error review as a question of fact; (2) whether "damages," as described in 11 U.S.C. § 101(47)(A)(v), requires a non-breaching party to bring a legal claim for damages or merely experience a post-liquidation loss for the conditions of 11 U.S.C. § 562 to apply; (3) whether the safe harbor protections of 11 U.S.C. § 559 can apply to a non-breaching party that has no excess proceeds after exercising the contractual right to liquidate a repurchase agreement; and (4) whether Bear Stearns liquidated the securities at issue in compliance with the terms of the parties' repurchase agreements. Because we agree with the disposition of the District Court, we will affirm.

I

HomeBanc Corp. ("HomeBanc") was in the business of originating, securitizing, and servicing residential mortgage loans. From 2005 through 2007, HomeBanc obtained financing from Bear Stearns & Co., Inc. and Bear Stearns International Ltd. (jointly referred to as "Bear Stearns") pursuant to two repurchase agreements:[1] a Master Repurchase Agreement ("MRA") dated September 19, 2005 and a Global Master Repurchasing Agreement ("GMRA") dated October 4, 2005.[2] Transactions were accompanied by a confirmation that included the purchase date, purchase price, repurchase date, and pricing rate. HomeBanc transferred to Bear Stearns multiple securities in June 2006, June 2007, and July 2007; however, nine of the securities—the securities at issue ("SAI")—were accompanied by confirmations showing a purchase price of zero and open repurchase dates.[3]

On Tuesday, August 7, 2007, HomeBanc's repo transactions became due, requiring HomeBanc to buy back thirty-seven outstanding securities, including the nine SAI, at an aggregate price of approximately $64 million. Bear Stearns, concerned about HomeBanc's liquidity, offered to roll (extend) the repurchase deadline for an immediate payment of roughly $27 million. Bear Stearns alternatively offered to purchase thirty-six of the securities outright for approximately $60.5 million, but HomeBanc rejected this proposal. HomeBanc failed to repurchase the securities or pay for an extension of the due date by the close of business on August 7. The following afternoon, Bear Stearns issued a notice of default that gave HomeBanc until the close of business on

---

[1] A repurchase agreement, typically referred to as a "repo," is "[a] short-term loan agreement by which one party sells a security to another party but promises to buy back the security on a specified date at a specified price." *Repurchase Agreement*, BLACK'S LAW DICTIONARY (11th ed. 2019).

[2] Bear Stearns held the nine securities at issue ("SAI") in this case under the GMRA.

[3] An "open repurchase date" means that the security is payable on demand.

Thursday, August 9, 2007, to make payment in full. No funds were forthcoming. Consequently, Bear Stearns sent formal default notices to HomeBanc on August 9, 2007, and later that day, HomeBanc filed voluntary petitions for relief under Chapter 11 of the U.S. Bankruptcy Code.[4]

Upon HomeBanc's default, the MRA and GMRA required Bear Stearns to determine the value of the thirty-seven remaining repo securities. This meant that Bear Stearns, within its broad discretion, had to reach a "reasonable opinion" regarding the securities' "fair market value, having regard to such pricing sources and methods . . . as [it] . . . consider[ed] appropriate." J.A. 1038.

Bear Stearns, claiming outright ownership of the securities, decided to auction them to determine their fair market value. Auction solicitations were distributed between the morning of Friday, August 10 and Tuesday, August 14, stating that Bear Stearns intended to auction thirty-six of the securities on August 14, 2017.[5] The bid solicitations listed the available securities, including their unique CUSIP identifiers, original face values, and current factors.[6] Bear

---

[4] The bankruptcy was later converted to a Chapter 7 proceeding in February 2009.

[5] One of the thirty-seven remaining securities was excluded from the August 14, 2007 auction because J.P. Morgan had agreed with HomeBanc to purchase the security for $1 million. Ultimately, J.P. Morgan did not buy the security, and as a result, it was subsequently auctioned on August 17, 2007. Bear Stearns's mortgage trading desk submitted the highest bid, purchasing the security for $1,256,000.

[6] A CUSIP is a nine-digit numeric or alphanumeric code that identifies financial securities to facilitate clearing and settlement of trades.

Stearns's finance desk sent the bid solicitation to approximately 200 different entities, including investment banks and advisors, pension and hedge funds, asset managers, and real estate investment trusts. In some cases, multiple individuals within a single entity were solicited. The finance desk also sought bids from Bear Stearns's mortgage trading desk, implementing extra safeguards to prevent any insider advantage.

The auction yielded two bids. Tricadia Capital, LLC submitted a bid of approximately $2.2 million for two securities, and Bear Stearns's mortgage trading desk placed an "all or nothing" bid of $60.5 million, the same amount Bear Stearns had offered before HomeBanc's default. After the auction closed, Bear Stearns's finance desk determined that Bear Stearns's mortgage trading desk had won. Bear Stearns allocated the bid across the thirty-six securities on August 15: $52.4 million to twenty-seven securities and $8.1 million divided evenly among the nine SAI ($900,000 apiece).

Despite its default and the results of the auction, HomeBanc believed itself entitled to the August 2007 principal and interest payments from the thirty-seven securities; Bear Stearns disagreed. Wells Fargo Bank, administratively holding the securities, commenced this adversary proceeding by filing an interpleader complaint on October 25, 2007. HomeBanc and Bear Stearns asserted cross-claims against each other. After depositing the August 2007 payment with the Bankruptcy Court, Wells Fargo was subsequently dismissed from the proceedings. The cross-claims between HomeBanc and Bear Stearns remained.

A. HomeBanc I[7]

After HomeBanc's bankruptcy was converted to a Chapter 7 proceeding, George Miller was appointed as trustee for the estate. Miller brought several claims against Bear Stearns, including (1) conversion (for selling the SAI via auction when HomeBanc asserted that it had superior title and interest), (2) violation of the automatic bankruptcy stay (by auctioning the SAI), and (3) breach of contract (for improperly valuing the SAI in violation of the GMRA).

With respect to these three claims, the Bankruptcy Court granted Bear Stearns's motion for summary judgment. When a bankruptcy petition is filed, an automatic stay halts any actions by creditors. 11 U.S.C. § 362. However, § 559 generally allows repo participants to exercise a contractual right to liquidate securities without judicial interference. 11 U.S.C. § 559. The Bankruptcy Court held that the transactions underlying the nine SAI constituted repurchase agreements under 11 U.S.C. § 101(47)(A)(i) and (v), bringing the SAI within the safe harbor protections of § 559. Thus, Bear Stearns had the right to liquidate the securities: it did not violate the automatic bankruptcy stay or convert the securities. *See* J.A. 44-45 ("Bankruptcy Code § 559 permits liquidation of securities in accordance with a party's contractual rights, and the GMRA permits the Bear Stearns defendants to act within their discretion" to sell the securities upon default.).

The Bankruptcy Court also entered summary judgment against HomeBanc on the breach of contract

[7] There are four decisions relevant to this appeal that the parties denote as HomeBanc I, Home Banc II, HomeBanc III, and HomeBanc IV. We make reference to those decisions in like manner.

claim. Interpreting the GMRA, which is governed by English contract law, the Bankruptcy Court noted that while the agreement required Bear Stearns to rationally appraise the SAI in good faith, Bear Stearns had sizeable discretion in coming to a fair market valuation. Due to this broad discretion, the Court held that there was no dispute of material fact as to whether Bear Stearns complied with the GMRA since using a bidding process to value securities was typical practice in the industry at the time.

B. HomeBanc II

HomeBanc appealed to the District Court, arguing that the Bankruptcy Court erred by (1) determining that the transactions involving the SAI qualified as repurchase agreements entitled to the safe harbor protections of § 559; (2) interpreting the GMRA to impose a nonexistent subjective rationality standard for Bear Stearns to value the securities upon HomeBanc's default; and (3) deciding that the sale of the SAI was rational and in good faith.

The District Court affirmed on the first two issues but remanded for further proceedings as to whether Bear Stearns complied with the GMRA in good faith. First, the District Court decided that the transactions underlying the SAI did not qualify as repos under § 101(47)(A)(i) because the confirmations accompanying the transactions showed that the securities had a purchase price of zero, allowing the SAI to "have been transferred back . . . without being 'against the transfer of funds . . . .'"[8] J.A. 59-60. Instead, they were

[8] 11 U.S.C. § 101(47)(A)(i), (v) ("The term 'repurchase agreement' (which definition also applies to a reverse repurchase agreement)—(A) means—

credit enhancements under § 101(47)(A)(v).[9] "There is no doubt that the disputed transactions were part and parcel of their undisputed repo transactions. It therefore seems to me that the extra securities were plainly within the umbrella of 'credit enhancements.'" J.A. 60 (quoting 11 U.S.C. § 101(47)(A)(v)). While the nine SAI were credit enhancements rather than traditional repos,[10] the District Court still held that they received the protections of § 559.

As to HomeBanc's second claim, the District Court decided that the Bankruptcy Court correctly discerned the relevant English law, finding that the GMRA's

---

> (i) an agreement . . . which provides for the transfer of one or more . . . mortgage related securities . . . **against the transfer of funds** . . . with a simultaneous agreement by such transferee to transfer to the transferor thereof . . . interests of the kind described in this clause, at a date certain not later than 1 year after such transfer or on demand, against the transfer of funds . . . ;
>
> (v) any security agreement or arrangement or other credit enhancement related to any agreement or transaction referred to in clause (i), (ii), (iii), or (iv) . . . .) (emphasis added).

[9] Although the Bankruptcy Code does not define "credit enhancement," the term encompasses various ways that a borrower may improve its credit standing and reassure lenders that it will honor its debt obligations. *See Credit Enhancement*, OXFORD DICTIONARY OF FINANCE AND BANKING (2014). Here, the District Court held that HomeBanc engaged in "credit enhancement" by providing additional collateral to Bear Stearns with a purchase price of zero. *See Overcollateralization*, THE PALGRAVE MACMILLAN DICTIONARY OF FINANCE, INVESTMENT AND BANKING (1st ed. 2010).

[10] The District Court concluded that the other twenty-eight of the thirty-seven securities were traditional repos under 11 U.S.C. § 101(47)(A)(i).

"reasonable opinion" language equated to a "good faith" requirement.

The Court, responding to HomeBanc's last argument, held that the record created a fact question as to whether Bear Stearns acted in good faith by auctioning the SAI. Two concerns led to this decision. First, only Bear Stearns submitted a bid that included the nine SAI. J.A. 62 ("When . . . Bear Stearns was the winning bidder because it was the only bidder, I think that is indisputable evidence that the market was not working, or that there was something else wrong with the auction process."). Second, the District Court believed that the Bankruptcy Judge erroneously discounted the opinion of HomeBanc's expert witness, who stated that Bear Stearns designed the auction to dissuade outside bidders. Because of these issues, the case was remanded for further proceedings to determine if the auction complied with the GMRA.

C. HomeBanc III

Upon remand and after a six-day trial, the Bankruptcy Court ruled that the auction was fair and customary, and therefore, Bear Stearns acted in good faith accepting the auction results as the fair market value of the thirty-seven securities. In reaching this holding, the Bankruptcy Court divided the question of good faith compliance with the GMRA into "three parts: (i) whether Bear Stearns'[s] decision to determine the Net Value of the Securities at Issue by auction in August 2007 was rational or in good faith; (ii) whether the auction process utilized by Bear Stearns was in accordance with industry standards; and (iii) whether Bear Stearns'[s] acceptance of the value obtained through the auction was rational or in good faith." J.A. 76.

The Court, in addressing the first sub-question, concluded that Bear Stearns acted in good faith by determining the securities' value via an auction, despite the turbulent condition of the residential mortgage-backed securities market in August 2007. HomeBanc argued that an auction cannot provide accurate price discovery when a market is dysfunctional, and while HomeBanc presented testimony that the residential mortgage-backed securities market was non-functional in August 2007, there was substantial opposing testimony that the market, though troubled, was functioning. "[T]here was [also] no evidence of other factors that might be considered indicia of market dysfunction: asymmetrical information between buyers and sellers, inadequate information in general . . . , market panic . . . , high transaction costs, the absence of any creditworthy market participants or fraud." J.A. 86. Moreover, "there was no indication . . . when or if market prices would stabilize." J.A. 85-87. It was therefore reasonable for Bear Stearns to quickly liquidate the collateral via a sale. Because the Court found that the market was functioning in August 2007, it concluded that the auction was a commercially reasonable determinant of value.

Bear Stearns's auction process was also found to be reasonable: the procedures provided possible bidders with sufficient information to formulate a bid; the 4.5 days to place bids was more than what was typically given to sophisticated purchasers of residential mortgage-backed securities; Bear Stearns solicited many potential buyers, including its main competitors; and the rules prevented a Bear Stearns affiliate from gaining an unfair advantage in formulating its bid.

Lastly, the Court held that Bear Stearns acted in good faith when it accepted the outcome of the auction as the fair market value of the SAI. HomeBanc maintained that the auction results were egregious. Using its own discounted cash flow model, HomeBanc valued the nine SAI at $124.6 million. HomeBanc's Chief Investment Officer, however, estimated the value of the SAI at approximately $18.5 million on August 5, 2007—nine days before the auction closed—a value much closer to Bear Stearns's $8.1 million assessment on August 15, 2017. The Bankruptcy Court also highlighted that (1) HomeBanc tried and failed to find an alternative purchaser who would pay more for the thirty-seven securities, and (2) Bear Stearns paid a higher price for the thirty-seventh security than HomeBanc bargained for with J.P. Morgan.

D. HomeBanc IV

HomeBanc appealed again, initially contending that Bear Stearns did not act in good faith because the auction was held in a non-functioning market, failed to produce an actual sale, and resulted in an inexplicable valuation of the SAI. Finding that the Bankruptcy Court's good faith determination was one of historical fact and not clearly erroneous, the District Court upheld the judgment. The Court faulted HomeBanc for failing to demonstrate that the mortgage-backed securities market was dysfunctional in August 2007 or that the auction was carried out in bad faith.

HomeBanc alternatively asserted that the Bankruptcy Court erred by ignoring the safe harbor limits for credit enhancements under 11 U.S.C. § 101(47)(A)(v). Unlike the broad protections of § 559 that are available for § 101(47)(A)(i) repos, HomeBanc believed that credit enhancements under § 101(47)(A)(v) receive fewer protections under § 562. "The extent to which credit enhancements qualify as repurchase agreements entitled to bankruptcy safe harbor protection is 'not to exceed the damages in connection with any such agreement or transaction,'" which must be measured by "'commercially reasonable determinants of value.'" J.A. 116-17 (quoting 11 U.S.C. §§ 101(47)(A)(v), 562).

Based on the connection between §§ 101(47)(A)(v) and 562, HomeBanc claimed that the Bankruptcy Court failed to (1) recognize that Bear Stearns had violated the automatic bankruptcy stay and converted the securities, and (2) determine whether the auction was a "commercially reasonable determinant" of the securities' value. The District Court disagreed, holding that § 562 was inapplicable. Since Bear Stearns's liquidation of HomeBanc securities resulted in excess proceeds and Bear Stearns never asserted a claim for damages, the District Court reasoned that the broad safe harbor protections of § 559, not § 562, were relevant. HomeBanc timely appealed to this Court.

II

The Bankruptcy Court had jurisdiction over this matter pursuant to 28 U.S.C. §§ 157 and 1334, and the District Court exercised its jurisdiction under 28 U.S.C. § 158(a)(1). 28 U.S.C. § 158(d)(1) provides this Court with jurisdiction to review the District Court's final order.

This Court's "review of the [D]istrict [C]ourt's decision effectively amounts to review of the [B]ankruptcy [C]ourt's opinion in the first instance." *In re Segal*, 57 F.3d 342, 345 (3d Cir. 1995) (quoting *In re Sharon Steel Corp.*, 871 F.2d 1217, 1222 (3d Cir. 1989) (internal quotation marks omitted)). We exercise plenary review of the Bankruptcy Court's interpretation of the Bankruptcy Code and clear-error review of its factual findings. *See In re J & S Properties, LLC*, 872 F.3d 138, 142 (3d Cir. 2017); *In re Abbotts Dairies of Pa., Inc.*, 788 F.2d 143, 147 (3d Cir. 1986).

The parties dispute the standard of review that applies to the Bankruptcy Court's determination of good faith. HomeBanc asserts that a good faith determination constitutes a mixed question of law and fact that is subject to clear-error review for the underlying factual findings and plenary review for the Bankruptcy Court's "choice and interpretation of legal precepts and its application of those precepts to historical facts." *In re Trans World Airlines, Inc.*, 134 F.3d 188, 193 (3d Cir. 1998). Bear Stearns responds that only clear-error review applies because HomeBanc "sets forth 'no choice and interpretation of legal precepts' of the Bankruptcy Court to which plenary review would be appropriate." Appellee Br. at 29 (quoting *In re Montgomery Ward Holding Corp.*, 242 B.R. 147, 152 (D. Del. 1999)).

As a general matter, this Court has long considered the determination of good faith to be an "ultimate fact." *Hickey v. Ritz-Carlton Rest. & Hotel Co. of Atlantic City*, 96 F.2d 748, 750-51 (3d Cir. 1938). An ultimate fact is commonly expressed in a standard enunciated by statute or by a caselaw rule, like negligence or reasonableness, and "[t]he ultimate finding is a conclusion of law or at least a determination of a mixed question of law and fact." *Universal Minerals v. C.A. Hughes & Co.*, 669 F.2d 98, 102 (3d Cir. 1981). Consequently, factual findings are reviewed for clear-error while "the trial court's choice and interpretation of legal precepts and its application of those precepts to the historical facts" receive plenary review. *Id.* at 103.

Despite these general precepts, determining the applicable standard of review here is not so straightforward. We have previously held that whether a party filed a Chapter 11 bankruptcy petition in good faith is an ultimate fact subject to review as a mixed question of law and fact. *In re 15375 Memorial Corp. v. Bepco*, 589 F.3d 605, 616 (3d Cir. 2009). Similarly, we have concluded that whether a debtor is insolvent is an ultimate fact requiring mixed review. *See Trans World Airlines*, 134 F.3d at 193. Some District Courts, however, have held that good faith determinations under § 363(m) of the Bankruptcy Code receive clear-error review. *See In re Polaroid Corp.*, No. 03-1168-JJF, 2004 WL 2223301, at *2 (D. Del. Sept. 30, 2004); *In re Prosser*, Bankr. L. Rep. 82, 437 (D.V.I. Mar. 8, 2013).

A determination of good faith necessarily flows from consideration of an array of underlying basic facts, making it an ultimate fact. *See Universal Minerals*, 669 F.2d at 102; *Hickey*, 96 F.2d at 750-51. Yet, the distinction between basic and ultimate facts can be murky; sometimes, there are intermediate steps on the path to an ultimate fact. *See In re 15375 Memorial Corp.*, 589 F.3d at 616 (referring to basic, inferred, and ultimate facts). This opacity gives us some pause, but no intermediate steps are currently before us for review. We therefore hold that a bankruptcy court's determination of good faith regarding a mandatory post-default valuation of collateral subject to a repurchase agreement is an ultimate fact subject to mixed review.[11] A bankruptcy court's basic factual findings

---

[11] We do not (and need not) decide whether good faith is always an ultimate fact requiring mixed review.

are examined for clear-error while the ultimate fact of good faith receives plenary review.

III

On appeal, HomeBanc challenges the District Court's decision that § 559, not § 562, was controlling and that Bear Stearns did not violate the automatic bankruptcy stay. Section 559 gives parties to a repurchase agreement a safe harbor from the automatic bankruptcy stay, which normally prevents creditors from collecting, recovering, or offsetting debts without court approval.[12] Thus, § 559 generally permits a non-defaulting party to liquidate collateral, according to the terms of the relevant repurchase agreement, without seeking court approval. Section 562 also provides a safe harbor, though it is more limited. For instance, § 562 requires that "damages" be measured at a certain time and using a "commercially reasonable determinant of value." 11 U.S.C. § 562.

As to whether § 559 or § 562 applies here, the text of § 101(47)(A)(v) is dispositive. Subparagraph (v) specifies that repos include credit enhancements, but such credit enhancements are "**not to exceed the damages** in connection with any such agreement or transaction, **measured in accordance with section 562 of this title**." 11 U.S.C. § 101(47)(a)(v) (emphasis

---

[12] Section 559 states in part: "The **exercise of a contractual right** of a **repo participant** or financial participant **to cause the liquidation** . . . of a repurchase agreement . . . **shall not be stayed**, avoided, or otherwise limited by . . . order of a court or administrative agency . . . [and] **any excess of the market prices received on liquidation** of such assets . . . over the sum of the stated repurchase prices and all expenses in connection with the liquidation of such repurchase agreements **shall be deemed property of the estate** . . . ." 11 U.S.C. § 559 (emphasis added).

added). While the protections of § 559 are generally available, the safe harbor does not encompass a recovery beyond the "damages" claimed. We therefore must define "damages," as found in 11 U.S.C. § 101(47)(A)(v), to determine if § 562 applies to the nine SAI—each of which is a credit enhancement.

HomeBanc asks this Court to interpret "damages" as meaning a "shortfall," "loss," "deficiency," or "debt." This would mean that when a repo participant liquidates a credit enhancement after default, any amount obtained in excess of the actual deficiency suffered, as measured according to § 562, is subject to the automatic bankruptcy stay, even if the surplus took years to develop. Conversely, Bear Stearns argues that if there is no claim for damages, then § 562 is inapplicable: The definition of "damages" must include a legal claim.

"Damages" is not defined within Title 11, but we hold for several reasons that the term refers to a legal claim for damages rather than a "loss," "shortfall," "deficiency," or "debt." First, "damages" is a term of art. Although probably not obvious to the layperson, every first-year law student learns to automatically connect "damages" with what is potentially recoverable in court, and not necessarily an underlying loss or injury.[13] Damages are "[m]oney claimed by, or ordered to be paid to, a person as compensation for loss or injury." *Damages*, BLACK'S LAW DICTIONARY (11th ed. 2019); 1 DAN B. DOBBS, DOBBS LAW OF REMEDIES:

[13] At oral argument, counsel for HomeBanc inadvertently showed how "damages" are inextricably tied to a legal claim. He stated, "I think the damages are the - the recovery to which you may be entitled, if you prove some liability." Transcript of Oral Argument at 14, *In re HomeBanc Mortgage Corp.* (3d Cir. Sept. 26, 2019) (No. 19-2887).

DAMAGES-EQUITY-RESTITUTION § 3.1 (2d ed. 1993) ("The damages remedy is a judicial award in money, payable as compensation to one who has suffered a legally recognized injury or harm."). This is a plain term, and as a result, defining "damages" as a "debt" or "loss" without any associated legal claim would contradict common understanding within the legal profession.

Second, "[C]ourts must presume that a legislature says in a statute what it means and means in a statute what it says there." *Am. Home Mortg.*, 637 F.3d at 255 (internal quotation marks and citations omitted). If Congress had wanted to define "damages" in a manner different from its commonly understood meaning, such as a "loss," "deficiency," or "debt," it could have done so. These terms appear elsewhere in Title 11, yet Congress chose not to employ them here. *See, e.g.*, 11 U.S.C. §§ 703(b), 726(a)(4), 727(a)(12)(B).

Third, other parts of Title 11 support a plain legal interpretation of "damages." "Damages" is used throughout Title 11 to refer to a legal claim. *See, e.g.*, 11 U.S.C. §§ 110(h)(5)(i)(1)(A)-(i)(2), 362 (k)(1)-(2), 523 (a)(19)(B)(iii). Moreover, the text of § 502(g)(2) and the section title of § 562 suggest that "damages" means a legal claim for loss.[14]

Fourth, defining "damages" as a "loss," "shortfall," or "debt" would create a problematic process for creditors seeking to quickly liquidate collateral after a default. Under HomeBanc's proposed approach, a non-

[14] *See* 11 U.S.C. § 502(g)(2) ("A claim for damages calculated in accordance with section 562 . . . ."); 11 U.S.C. § 562 ("Timing of damage measurement in connection with swap agreements, securities contracts, forward contracts, commodity contracts, repurchase agreements, and master netting agreements").

defaulting party would first determine which collateral constitutes a repurchase agreement under § 101(47)(A)(i) versus a credit enhancement under § 101(47)(A)(v): repurchase agreements would receive the full protection of § 559 while credit enhancements would be subject to the conditions of §§ 101(47)(A)(v) and 562. Once the collateral was categorized, a creditor could liquidate only the § 101(47)(A)(i) repos. Afterwards, the non-defaulting party would determine if there was any remaining shortfall. If so, then the § 101(47)(A)(v) credit enhancements could be sold, one at a time, to fill the hole.

We consider HomeBanc's approach impractical. Whether a transaction is a repurchase agreement under § 101(47)(A)(i) or a credit enhancement under § 101(47)(A)(v) is not always clear cut—the parties in this case litigated this issue for almost a decade. Creditors often seek to liquidate quickly, but a need to differentiate between repos and credit enhancements would substantially slow this process. It is also likely that repo participants would litigate this issue because of the potential application of §§ 101(47)(A)(v) and 562. Moreover, the need to differentiate between repurchase agreements and credit enhancements could eliminate the ability to buy or sell collateral via "all or nothing" bids. Bear Stearns, in this case, would have had to conduct multiple separate auctions: an initial auction to value the twenty-eight traditional repos and subsequent auctions to individually value the nine credit enhancements to cover any shortfall. Bear Stearns could not have made an "all or nothing" bid for the remaining securities. Such an approach is unduly cumbersome. The literal application of the statute, in contrast, does not produce "an absurd result." *See Douglass v. Convergent Outsourcing*, 765 F.3d 299, 302 (3d Cir. 2014).

HomeBanc does raise one concern about our approach which we consider valid: interpreting "damages" to require a deficiency claim may incentivize bad behavior. A non-defaulting party may seek to price the collateral at a level equal to the debt owed by the defaulting party, keeping any upside for itself and avoiding judicial scrutiny simply by not asserting a deficiency claim. The nature of repos, however, provides parties with the opportunity to address this issue contractually. For example, the GMRA requires a good faith valuation, and other agreements could do likewise. Furthermore, if a creditor's loss is sufficiently large, it will seek damages, even if doing so invites judicial scrutiny. Because of the aforementioned reasons, we hold that "damages" as described in § 101(47)(A)(v) necessitates the filing of a deficiency claim.

IV

Though § 562 is inapplicable because Bear Stearns did not initiate a damages action, it appears that the auction did not yield excess proceeds. As this Court has explained, excess proceeds result when "the market prices exceed the stated repurchase prices." *Am. Home Mortg.*, 637 F.3d at 255-56. At the time of HomeBanc's default, the contractual repurchase price for the thirty-seven securities was approximately $64 million, but the auction netted only $61.756 million. That is a shortfall, not an excess.

Notwithstanding the lack of excess proceeds, we conclude that the Bankruptcy Court appropriately applied § 559. Most importantly, the text of § 559 does not require excess proceeds:

> The **exercise of a contractual right** of a **repo participant** or financial participant

> **to cause the liquidation** . . . a repurchase agreement . . . **shall not be stayed**, avoided, or otherwise limited by operation of any provision of this title or by order of a court or administrative agency . . . . In the event that a repo participant or financial participant liquidates one or more repurchase agreements . . . and under the terms of one or more such agreements has agreed to deliver assets subject to repurchase agreements to the debtor, **any excess of the market prices received on liquidation** of such assets . . . over the sum of the stated repurchase prices and all expenses in connection with the liquidation of such repurchase agreements **shall be deemed property of the estate** . . . .

11 U.S.C. § 559 (emphasis added). Section 559 states that "any excess . . . shall be deemed property of the estate." It does not say "the excess." "Any" is commonly used to refer to indefinite or unknown quantities.[15] For instance, is there any money left in the bank account? In § 559, the indefinite or unknown quantity is the excess. There may be an excess, but the text does not demand that one exists. Rather, it establishes a condition—transferring the property to the estate—*if* there are excess proceeds. The text reveals that § 559 can apply when there is an excess, shortfall, or break-even amount.

We recognize that in *American Home Mortgage* we stated that "[s]ections 559 and 562 address different

---

[15] *See Any*, MERRIAM-WEBSTER DICTIONARY, https://www.merriam-webster.com/dictionary/any#learn-more; *Any*, OXFORD ENGLISH DICTIONARY, https://www.oed.com/view/Entry/8973?redirectedFrom=any#eid.

situations. Section 559 applies **only** in the event that a . . . liquidation results in excess proceeds. . . . § 562 . . . applies when the contract is liquidated, terminated, or accelerated, and results in *damages* rather than excess proceeds." 637 F.3d at 255-56 (emphasis added). Taken out of context, this dictum could be wrongly interpreted to suggest that § 559's authorization of a repo participant to liquidate collateral applies "only" if the liquidation results in excess proceeds. This Court used the word "only" to contrast the ordinary division between § 559 with § 562, not to create a binding either/or proposition. *Am. Home Mortg.*, 637 F.3d at 255-56. Judge Rendell's concurrence implicitly supports this narrow comparative interpretation, stating that a liquidation of a repurchase agreement is exempt from automatic stay provisions, making no mention of whether an excess is necessary for the protections of § 559. *Id.* at 258 (Rendell, J., concurring). Our reading avoids any conflict with the plain text of § 559. Furthermore, the case before us involves a "loss" or "shortfall" without a claim for "damages," presenting unique circumstances not addressed in *American Home Mortgage*.

The few cases and treatises that explore this issue show that a repo participant can liquidate a repurchase agreement regardless of whether the sale results in an excess, shortfall, or a break-even amount. *See Matter of Bevill, Bresler & Schulman Asset Mgmt. Corp.*, 67 B.R. 557, 596 (D.N.J. 1986) ("Any proceeds from the sale of the securities in excess of the agreed repurchase price are deemed property of the estate."); *In re TMST, Inc.*, No. 09-17787-DK, 2014 WL 6390312, at *4 (Bankr. D. Md. Nov. 14, 2014) ("Concomitant to those rights granted to the repurchase creditor to liquidate with finality the pledged securities, in Sections 559 and 562 Congress vouchsafed to the bankruptcy estate the right to any excess market value of such securities."); 5 COLLIER ON BANKRUPTCY § 559.04 (16th ed. 2019) ("Section 559 specifies, however, that any excess proceeds or value remaining after the nondefaulting party has recovered the amounts owed to it by the debtor must be paid to the debtor . . . ."); 1 JOAN N. FEENEY ET AL., BANKRUPTCY LAW MANUAL § 7:19 (5th ed. 2019) (a repo "participant is free to offset or net out any termination value . . . ."); 4 WILLIAM L. NORTON, JR. AND WILLIAM L. NORTON, III, NORTON BANKRUPTCY LAW AND PRACTICE § 75:4 (3d ed. 2019) ("Code § 559 also contains a provision dealing with excess proceeds in the event that a repo participant liquidates . . . and the repo participant has agreed to deliver any surplus assets to the debtor. In this event, any excess . . . shall be deemed property of the estate . . . ."). Although the auction yielded no excess proceeds, the protections of § 559 were appropriately applied.

V

Section 559 generally provides an exemption from the automatic bankruptcy stay to the extent that a liquidation accords with the relevant repurchase agreement. Thus, Bear Stearns's safe harbor is contingent on its adherence to the GMRA—upon default, to honestly and rationally value the remaining securities for purposes of crediting HomeBanc's debt. The Bankruptcy Court held that Bear Stearns valued the SAI in good faith compliance with the GMRA, but HomeBanc claims otherwise.[16] We exercise plenary review over

[16] On appeal, neither party contests the Bankruptcy Court's conclusion that the GMRA includes a "good faith" standard: Bear Stearns was required to act in "good faith" when determining the

this determination of good faith and agree with the Bankruptcy Court that Bear Stearns complied with the GMRA.

First, HomeBanc contends that the auction did not provide the fair market value of the SAI because a sale never occurred. Bear Stearns simply shifted the SAI from the finance desk to the mortgage trading desk and made an internal accounting adjustment. The GMRA required that Bear Stearns reach a "reasonable opinion" regarding the securities' "fair market value, having regard to such pricing sources and methods . . . as . . . [it] consider[ed] appropriate." J.A. 1038. There was no clause that required Bear Stearns to sell the securities to an outside party. Moreover, whether an exchange of funds occurred is immaterial to establishing the securities' fair market value.[17]

HomeBanc also asserts that Bear Stearns acted in bad faith because it knew or should have known that, given the dysfunctional market for mortgage-backed securities in August 2007, an auction would not identify the fair market value of the SAI.[18] HomeBanc

---

fair market value of the securities at issue. The parties dispute whether Bear Stearns's actions met that standard.

[17] A discount cash flow model, for example, is another way to determine fair market value without an actual "sale."

[18] The parties have invoked the term "market dysfunction." Neither the briefs nor oral argument provided substantial insight into this term and its meaning. Although there seems to be no accepted definition, dysfunction likely includes low liquidity and enough instability in a market such that the routine price discovery process is not functioning properly.

Whether the securities market in August 2007 was dysfunctional is a significant question because it bears on whether Bear Stearns rationally valued the securities using an auction. In *American Home Mortgage*, this Court endorsed the view that "the highlights, among other things, that (1) several witnesses testified that the mortgage-backed securities market was in "turmoil" and "dysfunctional" in August 2007,[19] (2) Bear Stearns's American Home Mortgage auction, a week prior, failed to produce an outside bidder, and (3) Bear Stearns reduced its internal valuation of the thirty-seven securities from roughly $119 million on Friday, August 3, 2007 to approximately $68 million on Monday, August 6, 2007.

Despite this evidence, the Bankruptcy Court was correct in determining that there was good faith where the market for mortgage-backed securities was sufficiently functional to conduct an auction that complied with the GMRA. A Bear Stearns employee, an economic consultant, and an outside executive familiar with the repurchase market all testified that the market was turbulent but not dysfunctional. The record also contains substantial additional testimony to support this characterization: other traders of mortgage-backed securities stated that transactions were occurring in the summer of 2007. There is also little evidence indicative of market dysfunction, such as potential buyers lacking sufficient information to price securities and the absence of any creditworthy market participants. Here, HomeBanc mistakenly equates a

---

market price should be used to determine an asset's value when the market is functioning properly. It is only when the market is dysfunctional and the market price does not reflect an asset's worth should one turn to other determinants of value." 637 F.3d at 257.

[19] A Bear Stearns securities trader testified that the market was "dysfunctional" with "little to no liquidity," and a former Bear Stearns senior managing director testified that "we knew it was a bad market" and that the market was "illiquid." J.A. 870, 899, 1007-09.

declining market with a dysfunctional one. The residual mortgage-backed securities market was functioning adequately for Bear Stearns, in good faith, to value the SAI via an auction.

Alternatively, HomeBanc argues that the auction procedures were flawed, rendering the sale price inaccurate. One academic witness testified that the information supplied to potential bidders was inadequate, the time given to submit a bid unreasonably short, and the bidding rules intentionally designed to frighten away outside interest. This contrasted with the testimony of several securities traders who opined that the information provided in Bear Stearns's bid solicitation was sufficient to value the securities, the auction provided adequate time to formulate a bid, and the bidding rules were attractive rather than off-putting. Bear Stearns's solicitation reached many potential buyers, including several of its competitors. Additionally, the auction rules were designed to prevent Bear Stearns's mortgage trading desk from obtaining any objectionable advantage—(1) Bear Stearns affiliates had to submit their bids thirty minutes before the deadline for outside bids, and (2) Bear Stearns's legal department, which was located in a separate building from the mortgage trading desk, collected all the bids. We will not disturb the Bankruptcy Court's finding that the auction process followed proper industry practices.

HomeBanc also maintains that Bear Stearns did not value the SAI in good faith compliance with the GMRA because the post-auction value assigned to each of the nine SAI, $900,000 a piece, was arbitrary—Bear Stearns never justified why it valued each security at $900,000. The SAI were diverse, having different collateral and cash flow rules, and Bear Stearns valued each differently weeks before the auction. Thus, HomeBanc insinuates that the allocated amount had no relationship to what the securities were actually worth. "[T]he $900,00 'price' is simply what remained of Bear Stearns's total bid after subtracting the unchallenged valuations attributed to the 27 securities not at issue, neatly divided across the securities at issue." J.A. at 38-39.

The GMRA required a rational, good faith determination of the fair market value of the securities, and this requirement could be met by a reasonable all-or-nothing bid for the securities. A buyer may allocate the winning bid in a variety of ways, but the defaulting party's debt is always credited the same amount: no matter how Bear Stearns divided its bid of $60.5 million, HomeBanc's debt only decreased by that lump sum amount. We see no need to address this argument further since the post-auction allocation to individual securities says little about whether the all-or-nothing bid constituted a fair market valuation.

In spite of HomeBanc's attempts to show otherwise, Bear Stearns acted in good faith compliance with the GMRA: the market conditions were adequate to ascertain fair market value via an auction, and the auction procedures were adequate. Consequently, Bear Stearns rationally accepted the auction results as providing the fair market value of the remaining thirty-seven securities. Bear Stearns was obligated to follow the GMRA, and it did so.

VI

In conclusion, we hold that (1) a Bankruptcy Court's determination of good faith regarding an obligatory post-default valuation of collateral subject to a repurchase agreement receives mixed review. Factual findings are reviewed for clear-error while the ultimate issue of good faith receives plenary review; (2) 11 U.S.C. § 101(47)(A)(v) "damages," which may trigger the requirements of § 562, require a non-breaching party to bring a legal claim for damages; (3) the safe harbor protections of 11 U.S.C. § 559 can apply to a non-breaching party that has no excess proceeds; and (4) Bear Stearns liquidated the securities at issue in good faith compliance with the GMRA. Thus, we will affirm the judgment.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 18-2887

In re: HOMEBANC MORTGAGE CORP., *et al*,

Debtors

WELLS FARGO, N.A., in its capacity
as Securities Administrator

v.

BEAR STEARNS & CO., INC.;
BEAR STEARNS INTERNATIONAL LIMITED;
HOMEBANC CORP.;
STRATEGIC MORTGAGE OPPORTUNITIES REIT, INC.

GEORGE L. MILLER, Chapter 7 Trustee for the
Estate of HomeBanc Corp.,

Appellant

(D.C. Civ. No. 1-17-cv-00797)

SUR PETITION FOR REHEARING

Present: SMITH, *Chief Judge*, McKEE, AMBRO, JORDAN, SHWARTZ, KRAUSE, RESTREPO, BIBAS, PORTER, MATEY, and PHIPPS, *Circuit Judges*

The petition for rehearing filed by appellant in the above-entitled case having been submitted to the judges who participated in the decision of this Court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the judges of the circuit in regular service not having voted for rehearing, the petition for rehearing by the panel and the Court en banc, is denied.

BY THE COURT,

s/ D. Brooks Smith
Chief Judge

Dated: January 24, 2020
JK/cc: All Counsel of Record

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 18-2887

In re: HOMEBANC MORTGAGE CORP., *et al*,

Debtors

WELLS FARGO, N.A., in its capacity as
Securities Administrator

v.

BEAR STEARNS & CO., INC.;
BEAR STEARNS INTERNATIONAL LIMITED;
HOMEBANC CORP.;
STRATEGIC MORTGAGE OPPORTUNITIES REIT, INC.

GEORGE L. MILLER, Chapter 7 Trustee
for the Estate of HomeBanc Corp.,

Appellant

On Appeal from the United States
District Court for the District of Delaware

District Court No. 1-17-cv-00797

District Judge: The Honorable Richard G. Andrews

Argued September 26, 2019

Before: SMITH, *Chief Judge*,
McKEE, and PHIPPS, *Circuit Judges*

JUDGMENT

This cause came on to be considered on the record from the United States District Court for the District of Delaware and was argued on September 26, 2019.

On consideration whereof, it is now hereby ADJUDGED and ORDERED that the judgment of the District Court entered August 15, 2018, be and the same is hereby AFFIRMED. All of the above in accordance with the opinion of this Court. Costs taxed to Appellant.

Attest:

s/ Patricia S. Dodszuweit
Clerk

DATED: December 24, 2019

Costs taxed in favor of Appellees Bear Stearns Co Inc, Bear Stearns International Ltd and Strategic Mortgage Opportunities Reit Inc.as follows:

Brief	$547.88
Appendix	$184.05
TOTAL	$758.93

[SEAL]

Certified as a true copy and issues in lieu of a formal mandate on 02/03/2020

Testee: /s/ Patricia S. Dodszuweit
Clerk, U.S. Court of Appeals
for the Third Circuit

APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

Civil Action Nos. 17-797-RGA

Bankruptcy Case No. 07-11079-KJC
Adv. No. 07-51740-KJC
BAP No. 17-24

In re: HOMEBANC MORTGAGE CORP., *et al*.

Debtors

GEORGE L. MILLER, CHAPTER 7 TRUSTEE
FOR THE ESTATE OF HOMEBANC CORP.,

Appellant,

v.

BEAR STEARNS & CO., INC.,
BEAR STEARNS INTERNATIONAL LIMITED, AND
STRATEGIC MORTGAGE OPPORTUNITIES REIT, INC.

Appellees.

August 14, 2018

John T. Carroll, Barry M. Klayman, COZEN O'CONNOR, Wilmington, DE; Steven M. Coren (argued), David M. DeVito, KAUFMAN, COZEN & RESS, P.C., Philadelphia, PA.

Attorneys for Appellant.

William P. Bowden, Karen B. Skomorucha Owens, ASHBY & GEDDES, P.A., Wilmington, DE; Andrew W. Stem (argued), James 0. Heyworth, Francesca E. Brody, SIDLEY AUSTIN LLP, New York, NY.

Attorneys for Appellees.

MEMORANDUM OPINION

ANDREWS, U.S. District Judge:

This is an appeal from the Bankruptcy Court's June 14, 2017 final judgment. (D.I. 30-2 at A512). The appeal is fully briefed. (D.I. 29; D.I. 31; D.T. 34). I held oral argument on June 22, 2018. (D.I. 40 ("Tr.")). After oral argument, I ordered the parties to produce letter briefs. (D.I. 38; D.I. 39). For the reasons set forth below, the Bankruptcy Court's judgment is AFFIRMED.

I. BACKGROUND

The parties' dispute arises in connection with an auction of securities owned by HomeBanc Corporation ("HomeBanc"), which was conducted by Appellees Bear, Stearns & Co., Inc., Bear Stearns International Limited, and Strategic Mortgage Opportunities REIT, Inc. (collectively, "Bear"). Between October 2005 and August 2007, Bear lent money to HomeBanc in a number of repo transactions made pursuant to a Global Master Repurchase Agreement ("GMRA").[1] Each individual transaction made pursuant to the GMRA was accompanied by a confirmation which identified the purchase date, the purchase price, the

[1] A repurchase agreement, or repo, is a transaction whereby one party transfers a security to another in exchange for funds along with a simultaneous agreement by the transferee to give back the security upon repayment of the funds.

repurchase date, and the pricing rate. Between 2005 and 2007, HomeBanc obtained approximately $200 million from Bear through numerous repo transactions.

This litigation involves nine Securities at Issue ("SAI"), which Bear obtained in three sets of transactions that took place in June 2006, June 2007, and July 2007. Each of the SAI was transferred to Bear along with other securities, and the confirmation corresponding to each of the SAI showed a purchase price of zero and open repurchase dates. HomeBanc's repos became due on August 7, 2007, at which point Bear offered to extend the repos if HomeBanc reduced its outstanding debt by making a payment of approximately $27 million. HomeBanc did not make the payment. On August 9, 2007, Bear issued formal notices of default. That night, HomeBanc filed chapter 11 bankruptcy petitions. The bankruptcy was later converted to a chapter 7 proceeding.

On the morning of August 10, 2007, Bear distributed auction solicitations, also known as bid lists, for the securities on repo under the GMRA, including the nine SAL The bid lists were sent to approximately 200 investors, with bids due on August 14, 2007. In addition to soliciting outside bids, the Bear repo finance desk solicited bids from the Bear mortgage trading desk. To ensure that Bear affiliates were not at an advantage, any bids from an affiliate were required to be submitted 30 minutes prior to the close of the auction. The repo finance desk received only two bids, an all or nothing bid of $60.5 million from the Bear mortgage trading desk, and a bid of $2.19 million by Tricadia Capital for two individual securities, neither of which is among the nine SAL The securities were sold to the Bear mortgage trading desk.

The Bankruptcy Court granted summary judgment in Bear's favor, holding that the SAI were subject to "repurchase agreements" under the Bankruptcy Code. *In re HomeBanc Mortg. Corp.,* 2013 WL 211180 (Bankr. D. Del. Jan. 18, 2013) (D.I. 30-1 at A313-64). More specifically, the Bankruptcy Court found that the repo transactions qualified as "repurchase agreements" under 11 U. S. C. § 101(47)(A)(i), having been transferred "against the transfer of funds." *(Id* at A333). The Bankruptcy Court alternatively held that even if the transactions did not qualify under § 101(47)(A)(i), they qualified under § 101(47)(A)(v), the catchall provision. *(Id.* at A334). Having established that the transactions were "repurchase agreements" under the Bankruptcy Code, the Bankruptcy Court found that Bear's exercise of its contractual right to sell the SAI was entitled to the safe harbor protection of § 559 of the Bankruptcy Code.[2] *(Id.* at A316). The Bankruptcy Court then considered whether Bear's auction of the SAI complied with the terms of GMRA. *(Id.* at A358). Because the GMRA gave discretion to the non-defaulting party, the Bankruptcy Court concluded that the only real question was whether the timing and manner of the auction was in good faith, given the prevailing market conditions. *(Id).* The Bankruptcy Court held that there existed no disputed fact as to whether the auction was in good faith and in accordance with industry practice, and granted summary judgment for Bear. *(Id).*

On appeal, I affirmed in part and reversed in part. *In re HomeBanc Mortg. Corp.,* 2014 WL 1268677 (D. Del. Mar. 27, 2014) (D.I. 30-1 at A365-77). In

---

[2] Section 559 prevents a court from staying, avoiding, or otherwise limiting the exercise of the contractual rights of a repo participant. *See* 11 U.S.C. § 559.

relevant part, I held that the SAI were not transferred "against the transfer of funds," and therefore did not meet the definition of "repurchase agreements" in § 101(47)(A)(i). (D.I. 30-1 at A372). Rather, I held that the SAI were "credit enhancements," which qualified as "repurchase agreements" under § 101(47)(A)(v), the catchall provision. *(Id.* at A373). I remanded the case for the Bankruptcy Court to determine "whether the auction complied with the GMRA." *(Id.* at A376). In doing so, I affirmed that the GMRA gave Bear "a certain amount of discretion in what to do with the disputed securities once HomeBanc had declared bankruptcy," cabined by good faith and rationality. *(Id.* at A373-75).

On remand, after a six-day trial, the Bankruptcy Court found that Bear's "auction of [HomeBanc] repurchase agreement collateral in August 2007 was rational, in good faith and in compliance with the [GMRA]." *(Id.* at A376; D.I. 30-2 at A471).

The Chapter 7 trustee of HomeBanc, George L. Miller (the "Trustee"), appealed the Bankruptcy Court's decision on June 21, 2017. (D.I. 1).

II. LEGAL STANDARD

The Court has jurisdiction to hear an appeal from a final judgment of the Bankruptcy Court pursuant to 28 U.S.C. § 158(a)(1). In undertaking a review of the issues on appeal, the Court applies a clearly erroneous standard to the Bankruptcy Court's findings of fact and a plenary standard to its legal conclusions. *See Am. Flint Glass Workers Union v. Anchor Resolution Corp.,* 197 F.3d 76, 80 (3d Cir. 1999). With mixed questions of law and fact, the Court must accept the Bankruptcy Court's finding of "historical or narrative facts unless clearly erroneous, but exercise[s] 'plenary review of the trial court's choice and interpretation of legal precepts and its application of those precepts to the historical facts." *Mellon Bank NA. v. Metro Commc'ns, Inc.,* 945 F.2d 635, 642 (3d Cir. 1991) (citing *Universal Minerals, Inc. v. C.A. Hughes & Co.,* 669 F.2d 98, 101-02 (3d Cir. 1981)). In other words, this Court reviews a decision of the Bankruptcy Court just the same as the Third Circuit usually reviews judgments of this Court. Should there be an appeal of this decision to the Third Circuit, the standard by which this Court reviews the Bankruptcy Court will be the same standard the Court of Appeals will use.

III. DISCUSSION

The Trustee challenges the Bankruptcy Court's final judgment in favor of Bear on two grounds. First, the Trustee argues, "The Bankruptcy Court erred in finding that Bear acted reasonably because the auction it used to value the SAI—held in a market that was not functioning properly—failed to produce an actual sale[,] and its valuation lacked an explicable, rational basis." (D.I. 29 at 6) (heading capitalization removed). Second, the Trustee argues, "[T]he Bankruptcy Court erred by refusing the consider the limitations and valuation parameters specifically applicable to credit enhancements." (D.I. 29 at 18; D.I. 38) (heading capitalization removed).

A. Rationality and Good Faith

The Trustee argues that the Bankruptcy Court's finding that "auction of repurchase agreement collateral in August 2007 was rational, in good faith and in compliance with the [GMRA]" constitutes error. (D.I. 29 at 6 (citing D.I. 30-2 at A471)). The Trustee also argues that the Bankruptcy Court's finding that the market for HomeBanc securities was not "dysfunctional" because it was "open for business" constitutes error. (D.I. 29 at 5 (citing D.I. 30-1 at A490-91)).

The Trustee argues that the "trial court's findings on the ultimate questions of reasonableness, rationality and good faith" are "conclusion[s] of law or at least . . . determination[s] of . . . mixed question[s] of law and fact." (D.I. 34 at 1 (citing *In re 15375 Mem'l Corp. v. Bepco, L.P.,* 589 F.3d 605, 616 (3d Cir. 2009)). Therefore, argues the Trustee, the Bankruptcy Court's findings of rationality and good faith are "subject to plenary review" as "essentially, . . . conclusion[s] of law." *(Id.).*

Bear, on the other hand, argues that the "issue presents a purely factual question subject to a deferential 'clear error' standard." (D.I. 31 at 1 (citing *DiFederico v. Rolm Co.,* 201 F.3d 200, 208 (3d Cir. 2000); *In re Polaroid Corp.,* 2004 WL 2223301, at *2 (D. Del. Sept. 30, 2004) (holding that the bankruptcy court's finding that asset sale conducted in good faith, by "rigorous auction process," was subject to clear error review))).

I agree with Bear, as to the applicable standard. The Bankruptcy Court saw and heard the witnesses testify, and concluded that Bear acted rationally and in good faith. As such, "good faith" is a historical fact. The Bankruptcy Court's factual determination of rationality and good faith is subject to clear error review.[3]

---

[3] Bear argues, "[The Trustee tacitly acknowledges that the Bankruptcy Court's determinations of the facts surrounding the auction and the lack of market dysfunction, as well as the finding that the auction was in good faith, rational, and in compliance with the GMRA., are subject to clear error review." (D.I. 31 at 1 n.2 (citing D.I. 29 at 7-9)). I agree with Bear's observation. The

The Trustee presents no evidence that that Bankruptcy Court committed clear error in deciding that the market was functioning, or that Bear acted rationally and in good faith when it conducted the auction. *(See* D.I. 29 at 6-18; D.I. 34 at 1-8). Furthermore, the Trustee agrees that the Bankruptcy Court did not make a clear error in deciding historical facts. (Tr. 15:17-16:4). Accordingly, I will affirm the Bankruptcy Court's findings of rationality and good faith.

B. Applicability of § 562

At summary judgment, the Bankruptcy Court accepted Bear's "bucket theory," and found that the SAI were traditional repos in accordance with subsection (i) of the Bankruptcy Code definition of "repurchase agreement." (D.I. 30-1 at A333). As a result, the Bankruptcy Court found that Bear was entitled to safe harbor protection under § 559. *(Id.).* In an alternative holding, the Bankruptcy Court found, "[T]he [SAI], even if not outright repos, clearly are credit enhancements . . . and are entitled to the benefits provided to repos in the safe harbor of Bankruptcy Code § 559." *(Id.* at A334).

However, the Trustee argues, "[The Bankruptcy Court omitted and ignored the limiting language in the catchall definition" in making its alternative holding about "credit enhancements." (D.I. 38 at 2) (emphasis omitted). The catchall definition provides that safe harbor protection for credit enhancements is "not to exceed the damages in connection with any such agreement or transaction, measured in accord-

Trustee seems to frame his arguments about the Bankruptcy Court's decision with the clear error standard in mind.

ance with section 562 of this title." 11 U.S.C. § 101(47)(v).

During the previous appeal, I held that the SAI qualified as "repurchase agreements" as "credit enhancements" under the catchall definition in § 101(47)(A)(v), rather than as "traditional repos" under section § 101(47)(A)(i). (D.I. 30-1 at A373). Then, on remand, the Trustee asked the Bankruptcy Court to "address the implications of this Court's finding that the SAI qualified as "repurchase agreements" under subsection (v), rather than subsection (i). (D.I. 38 at 3 (citing Bkr. No. 07-51740, D.I. 324 at 5-7)).[4] The Bankruptcy Court "declined the Trustee's invitation to consider a broader set of issues than what the District Court has specifically identified for [the Bankruptcy] Court to address on remand." (D.I. 30-1 at A445). In doing so, the Bankruptcy Court maintained that Bear was entitled to safe harbor protection under § 559, and that Bear's safe harbor protection was not limited by "damages in connection with any such agreement or transaction, measured in accordance with section 562 of this title." 11 U.S.C. § 101(47)(v).

The Trustee argues that the Bankruptcy Court erred in failing to consider whether my holding that the SAI were "credit enhancements" means that § 562 limits Bear's safe harbor protection. The Trustee argues that "no court has ever ruled on the 11 issue." (D.I. 38 at 4; D.I. 29 at 18-20). Thus, argues the Trustee, this Court must now make that ruling. (D.I.

---

[4] In doing so, the Trustee preserved this issue for appeal. *See, e.g., McDonough v. Horizon Blue Cross Blue Shield of NJ.,* 641 F. App'x 146, 149 (3d Cir. 2015) ("a reasonably detailed exposition of an argument in the district court is required to preserve the issue for appeal").

29 at 20). As an alleged legal error, I review *de novo* the Bankruptcy Court's determination that Bear was entitled to safe harbor protection under § 559, absent any limitation by § 562.

The Trustee argues that § 562 limits Bear's safe harbor protection in two ways that § 559 does not. First, the Trustee argues that § 562 limits Bear's safe harbor protection to $8.1 million dollars. (D.I. 38 at 4). Second, the Trustee argues that § 562 required the Bankruptcy Court to determine whether Bear had employed "commercially reasonable determinants of value," rather than just whether Bear "acted rationally, reasonably, and in good faith." *(Id.* at 4-5).

As to the Trustee's first argument, the extent to which credit enhancements qualify as repurchase agreements entitled to safe-harbor protection is "not to exceed the damages . . . measured in accordance with section 562." 11 U.S.C. § 101(47)(v). The Trustee argues, "Bear's `damages' with respect to the SAI were limited to the $8.1 million balance of the repo debt (the amount remaining after HomeBanc was credited for the value of the 27 traditional repos retained by Bear) . . . ." (D.I. 29 at 19). As a result, argues the Trustee, "Bear's safe harbor protection could not extend beyond the $8.1 million necessary to satisfy HomeBanc's remaining debt." *(Id.).* With the safe harbor protection so limited, the Trustee argues he "is entitled to judgment in his favor in the amount of $81,115,659.61, plus prejudgment interest."[5] *(Id.* at 20).

---

[5] This number is the SAI's post-auction cash flow, less $8.1 million (the amount the Trustee concedes is protected by the safe harbor). (D.I. 34 at 20 n.31).

Bear, however, notes that § 562 is titled, "Timing of damage measurement in connection with swap agreements, securities contracts, forward contracts, commodity contracts, repurchase agreements, and master netting agreements." (D.I. 39 at 3). "As that title suggests," argues Bear, "the section addresses exactly one topic that conceivably could be relevant here: the dates on which [Bear], as non-defaulting party, had it been seeking damages from HomeBanc, could have measured its damages in a claim against HomeBanc, the defaulting party." *(Id.* (citing *In re Am. Home Mortg. Holdings, Inc.,* 637 F.3d 246, 255-56 (3d Cir. 201I) *("Calyon"))).* As the Third Circuit explained in *Calyon,*

> Sections 559 and 562 address different situations. Section 559 applies only in the event that a repurchase agreement is liquidated, and the liquidation results in excess proceeds . . . . On the other hand, § 562 which covers, inter alia, repurchase agreements, applies when the contract is liquidated, terminated, or accelerated, and results in *damages* rather than excess proceeds.

637 F.3d at 255-56 (emphasis in original). As Bear articulates, "Section 562 applies only in the event that a repo default results in a claim for deficiency damages." (D.I. 39 at 4) (emphasis omitted). Bear did not seek damages arising from HomeBanc's default. Rather, Bear's liquidation of the HomeBanc securities, including the SAI, through an auction, resulted in excess proceeds. (D.I. 30-1 at A529, A92-106; D.I. 39 at 4). The $8.1 million sum highlighted by the Trustee is, by the Trustee's own admission, the "balance of the repo debt." (D.I. 29 at 19). "Debt" is not equivalent to

"damages," *Calyon,* 637 F.3d at 255-56, and the Trustee *offers* no support for the proposition that it is.

Therefore, as Bear argues, "because there are no damages to be 'measured' in accordance with Section 562 . . . , Section 562 cannot apply." (D.I. 39 at 4). Thus, I agree with the Bankruptcy Court's holding, at summary judgment, that § 562 does not apply because Bear did not seek damages. (D.I. 30-1 at A350-51).

As to the Trustee's second argument, I hold that there are no damages to be "measured" in accordance with § 562. Given my holding, I need not assess the parties' arguments about whether Bear's conduct would also satisfy § 562's "commercially reasonable" standard. (D.I. 38 at 4-7; D.I. 39 at 4-7).

IV. CONCLUSION

For the reasons set forth herein, the Bankruptcy Court's final judgment is AFFIRMED. An appropriate order will be entered.

APPENDIX E

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF DELAWARE

Bankruptcy Case No. 07-11079-KJC
Adv. No. 07-51740-KJC
BAP No. 17-24

In re: HOMEBANC MORTGAGE CORP., *et al*.

Debtors.

GEORGE L. MILLER, CHAPTER 7 TRUSTEE FOR THE ESTATE OF HOMEBANC CORP.,

Appellant,

v.

BEAR STEARNS & CO., INC., BEAR STEARNS INTERNATIONAL LIMITED, AND STRATEGIC MORTGAGE OPPORTUNITIES REIT, INC.

Appellees.

ORDER

For the reasons set forth in the accompanying opinion, IT IS HEREBY ORDERED that the Bankruptcy Court's June 14, 2017 final judgment (Bankruptcy Adv. No. 17-51740) is AFFIRMED.

Entered this 14 day of August, 2018.

/s/ Richard G. Andrews
United States District Judge

APPENDIX F

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

Chapter 7
Case No. 07-1I079 (KJC)
Adv. Case No. 07-51740 (KJC) (DI 15, 129, 134)

In Re: HOMEBANC MORTGAGE CORP., *et al*[1]

Debtors.

WELLS FARGO BANK, N.A., in its capacity
as Securities Administrator,

Plaintiff,

v.

HOMEBANC CORP., BEAR, STEARNS & CO., INC.,
BEAR, STEARNS INTERNATIONAL LIMITED, AND
STRATEGIC MORTGAGE OPPORTUNITIES REIT, INC.

Defendant.

OPINION[2]

BY: KEVIN J. CAREY, United States Bankruptcy Judge

---

[1] The related entities that filed chapter 11 petitions are: HomeBanc Mortgage Corporation, HomeBanc Corp., HomeBanc Funding Corp. II, HMB Acceptance Corp., HMB Mortgage Partners, LLC, and HomeBanc Funding Corp. (the "Debtors" or "HomeBanc").

[2] This Opinion constitutes the findings of fact and conclusions of law, as required by Fed. R. Bankr. P. 7052.

Much has been written about what has come to be known as the subprime mortgage crisis, including numerous newspaper accounts, scholarly articles, and popular books.[3] For the undersigned, it began on April 2, 2007, with the chapter 11 filing of New Century TRS Holdings, Inc., at the time, the second largest subprime lender behind Countrywide Securities Corporation and the largest chapter 11 filing of 2007. The subprime mortgage crisis was but a prelude to the collapse of the United States financial markets later in 2008.

The matter now before me involves the chapter 7 Trustee's challenge to decisions made by Bear Stearns[4] in August 2007 after HomeBanc defaulted under certain repurchase agreements and subsequently commenced a chapter 11 case. After HomeBanc's default, the Bear Stearns repo desk liquidated certain repurchase agreement assets (residential mortgage-backed securities) by means of an auction, but the highest bid received was from Bear Stearns' own trading desk. The Trustee for HomeBanc's now chapter 7 case objects to Bear Stearns' use of an auction to value the securities, claiming the market in August 2007 was dysfunctional, thereby making it impossible for a reasonable price to be obtained for these securities. Proof of this, the Trustee asserts, lies, in part, in the fact that the securities increased substantially in value after the auction.

The Bankruptcy Code recognizes the "need for speed" in connection with the enforcement of contrac-

---

[3] *See, e.g.*, Michael Lewis, *The Big Short: Inside the Doomsday Machine*, (W.W. Norton & Co. 2011).

[4] Defendants Bear Stearns & Co., Inc., Bear Stearns International Limited and Strategic Mortgage Opportunities REIT, Inc. are jointly referred to herein as "Bear Stearns."

tual rights by non-defaulting parties under certain financial contracts.[5] "Congress has enacted exceptions to the general rule disallowing *ipso facto* clauses for swaps and certain other types of financial contracts to address volatility in the financial markets which 'can change significantly in a matter of days, or even hours . . . . [A] non-bankrupt party to ongoing securities and other financial transactions could face heavy losses unless the transactions are resolved promptly and with finality.'"[6] The Bankruptcy Code offers a safe harbor allowing parties to exercise contractual rights without being impeded by the automatic stay or "otherwise limited" by any Bankruptcy Code provision or order of the Bankruptcy Court.[7]

The trial evidence showed that although participants in the market in August 2007 knew the market was "stressed," trades were, in fact, taking place. Bear Stearns followed the usual procedures for selling residential mortgage-backed securities by auction. I conclude that Bear Stearns' auction of repurchase agreement collateral in August 2007 was rational, in good faith and in compliance with the Global Master Repurchase Agreement.

BACKGROUND

On August 9, 2007 (the "Petition Date"), the Debtors filed voluntary chapter 11 bankruptcy petitions. By

---

[5] *See, inter alia*, 11 U.S.C. §§ 559-562; § 362(b)(6), (7), (17), (27).

[6] *Michigan State Housing Dev. Auth. v. Lehman Bros. Derivative Prod. Inc. (In re Lehman Bros. Holdings, Inc.)*, 502 B.R. 383, 392 (Banks. S.D.N.Y. 2013) quoting H.R. Rep. No. 101-484, at 2 (1990) *reprinted in* 1990 U.S.C.C.A.N. 223, 224 (discussing 11 U.S.C. § 560 and swap agreements).

[7] *See, e.g.*, 11 U.S.C. § 559.

Order dated February 24, 2009, the cases were converted to a chapter 7 liquidation, and on February 25, 2009, George Miller was appointed as chapter 7 trustee (the "Trustee").

On October 25, 2007, Wells Fargo Bank, N.A. ("Wells Fargo") commenced this adversary proceeding by filing an interpleader complaint against three parties: (i) HomeBanc Corp., (ii) Bear, Stearns & Co., Inc. ("BSC"), and (iii) Bear, Stearns International Limited ("BSIL").[8] Wells Fargo was securities administrator, paying agent, note registrar and certificate registrar for certain mortgage-backed certificates held by Bear Stearns. Wells Fargo filed the Interpleader Complaint because HomeBanc and Bear Stearns asserted competing claims to the principal and interest payment due on the mortgage-backed certificates for the month of August 2007 (the "August Payment"). Pursuant to an Order dated June 2, 2011, Wells Fargo deposited the August Payment with this Court and was subsequently dismissed from the adversary proceeding on June 8, 2011.

As part of the adversary proceeding, Bear Stearns and HomeBanc filed cross-claims against each other.[9]

---

[8] Wells Fargo amended the Interpleader Complaint on November 19, 2007, adding Strategic Mortgage Opportunities REIT, Inc. ("SMOREIT") as a defendant. BCS, BSIL and SMOREIT, together, are referred to jointly herein as "Bear Stearns".

[9] On December 7, 2007, HomeBanc filed an answer to the Interpleader Complaint which included affirmative defenses and crossclaims against Bear Stearns (Adv. D.I. 16). On the same date, Bear Stearns also filed an answer to the Interpleader Complaint, which included affirmative defenses and two crossclaims against HomeBanc. (Adv. D.I. 15).

After the Trustee was appointed, the Trustee filed a motion for leave to amend crossclaims (Adv. D.I. 88), which was granted by

The Trustee's amended cross-claims against Bear Stearns asserted eight counts, including Breach of Contract, Conversion, Turnover of Property of the Estate, Violation of the Automatic Stay, Unjust Enrichment, Avoidance and Recovery of a Preference, Accounting and Breach of Fiduciary Duty. Bear Stearns filed two cross-claims against HomeBanc: Breach of the Repurchase Agreement, and Unjust Enrichment.

On December 7, 2010, the Trustee and Bear Stearns filed cross-motions for summary judgment. In their papers and at oral argument, the parties focused their attention on three issues. By Opinion and Order dated January 18, 2013 (referred to herein as *HomeBanc I),*[10] I decided those three issues as follows:

(1) certain transactions between HomeBanc and Bear Stearns relating to specific securities are repurchase agreements under Bankruptcy Code § 101(47), and, therefore, Bear Stearns' exercise of its contractual rights with respect to those securities fell within the safe harbor of Bankruptcy Code § 559;

(2) the plain language of the controlling contracts, as well as previous decisions in this Circuit, provided that the August Payment should be paid to the registered certificate holder of the Interpleader Securities as of the record date, *i.e.,* HomeBanc.; and

Order dated December 18, 2009 (Adv. D.I. 126). The Trustee filed his answer and amended crossclaims (Adv. D.I. 129), and Bear Stearns filed an answer and affirmative defenses to the amended crossclaims (Adv. D.I. 134).

[10] *Wells Fargo Banla. N.A. v. HomeBanc Corp.* (*In re HomeBanc Mortg. Corp*), 2013 WL 21180 (Bankr. D. Del. Jan. 18, 2013) ("*HomeBanc I*") *aff'd, in part*, and *rev'd, in part, Miller v. Bear Stearns & Co., Inc.* (*In re HomeBanc Mortg. Corp*.), 2014 WL 1268677 (D. Del. Mar. 27, 2014).

(3) Bear Stearns' liquidation of the securities by auction in August 2007 was not irrational or in bad faith, and was permitted under the applicable repurchase agreement.

The Trustee appealed and, on March 27, 2014, the District Court issued a Memorandum Opinion affirming, in part, and reversing, in part, *HomeBanc I*.[11] The District Court reversed the grant of summary judgment on the issue of whether the auction complied with the underlying contract, deciding (in part) that the Trustee's expert report (which had not been considered), together with the fact that the winning bid was submitted by Bear Stearns' trading desk, created factual issues about Bear Stearns' good faith.[12] On remand, a six-day trial was held to consider the issue of Bear Stearns' good faith in connection with the sale of the securities by auction.

For the reasons that follow, I conclude that it was neither irrational nor bad faith for Bear Stearns to liquidate the repurchase agreement collateral by an auction in August 2007. After examining the evidence surrounding the auction process and the market conditions at the time, I conclude that Bear Stearns' auction was completed in accordance with industry standards. Because the process was fair and customary, it also was not bad faith for Bear Stearns to accept the auction results as providing the fair market value of the securities.

---

[11] *Miller v. Bear Stearns & Co., Inc.* (*In re HomeBanc Mortg. Corp.*), 2014 WL 1268677 (D. Del. Mar. 27, 2014) ("HomeBanc II").

[12] *HomeBanc II,* 2014 WL 1268677 at *5-*6.

FACTS

Prior to its bankruptcy filing, HomeBanc was in the business of originating, securitizing and servicing residential mortgage loans.[13] During the last several years of its existence, HomeBanc originated billions of dollars of residential mortgages, many of which were "securitized," *i.e.,* transferred to securitization trusts which issued securities that were sold to institutional and other investors.[14] HomeBanc routinely retained mortgage-backed securities from various securitizations, including the so-called subordinate tranches and residual interests that were created as part of the securitization process.[15]

In 2005, HomeBanc entered into two repurchase agreements with Bear Stearns:

(1) the master Repurchase Agreement dated as of September 19, 2005 between HomeBanc and BSC (the "MRA"); and

(2) the TBMA/ISMA Global Master Repurchase Agreement dated as of October 4, 2005 between HomeBanc and BSIL (the "GMRA").[16]

Between October 2005 and August 2007 HomeBanc obtained financing from Bear Stearns through numer-

---

[13] Stipulation of Undisputed Facts, ¶ 1.

[14] Stipulation of Undisputed Facts, ¶ 2.

[15] Stipulation of Undisputed Facts, ¶ 3.

[16] Stipulation of Undisputed Facts, ¶ 4. Joint Trial Exhibits 1 and 2.

ous repurchase transactions under the MRA and GMRA.[17]

The HomeBanc Default

On August 7, 2007, the terms of the repo transactions between HomeBanc and Bear Stearns expired.[18] On that date, Bear Stearns purchased outright from HomeBanc thirteen securities that had been part of the repurchase transactions at the price of approximately $121 million.[19] The remaining securities included three mortgage-backed securities that were subject to repurchase agreements between HomeBanc and BSC pursuant to the MRA, and 34 mortgage-backed securities that were subject to repurchase agreements between HomeBanc and BSIL pursuant to the GMRA (the "Remaining Securities"). Among the Remaining Securities were the nine securities at issue in this litigation (the "Securities at Issue"), which had

---

[17] "A repurchase agreement, or repo, is a transaction whereby one party transfers a security to another in exchange for funds along with a simultaneous agreement by the transferee to give back the security upon repayment of the funds." *HomeBanc II*, 2014 WL 1268677, *1, n.1. *See also* Bankruptcy Code § 101(47).

[18] Connell Tr. at 32:15-33:1. Brian Connell testified as a designated representative of the Bear Stearns defendants in depositions with the Trustee for the matters in dispute. Connell Tr. 21:9-21:21. Connell worked for ten years on Bear Stearns' fixed income finance desk (also called the repo desk) during the time in question. Connell Tr. 22:12-22:24. The page numbers for the transcripts for the entire six-day trial are numbered continuously and consecutively, rather than starting each day at page 1. Reference to the transcripts will refer to the witness, followed by the page and line number.

[19] Connell Tr. 30:13-32:14.

been transferred by HomeBanc to BSIL pursuant to the terms of the GMRA:[20]

HBMT 2004-1, Class R

HBMT 2004-2, Class R

HBMT 2005-1, Class R

HBMT 2005-2, Class R

HBMT 2005-3, Class R

HBMT 2005-4, Class B-2

HBMT 2005-4, Class R

HBMT 2006-2, Class R

HBMT 2007-1, Class R

Eight of the nine Securities at Issue were residual interests in HomeBanc securitizations (excluding HBMT 2005-4, Class B-2) that were neither rated by rating agencies, nor traded on any exchange.[21]

---

[20] Stipulation of Undisputed Facts, ¶ 9.

[21] Stipulation of Undisputed Facts, ¶ 17. At trial, Bear Stearns' expert witness described a "residual" security to the Court as follows:

> [T]he way residual mortgage-backed securities trusts work is . . . [thinking] of them almost like a little company. The asset side of the balance sheet consists of mortgage loans that are owned by the trust, and the liability side of the balance sheet consists of senior bonds and subordinated bonds that are issued by the trust.
>
> And then whatever's left over is the residual tranche. So, . . many people have described it like the equity, in that the equity is the owner of the residual cash flow in a regular company.

Attari Tr. 890:8-890:20.

Upon expiration, HomeBanc was obligated to repurchase the 37 Remaining Securities at an aggregate price of approximately $64 million.[22] Bear Stearns offered to roll (or extend) HomeBanc's due date for repurchase of the Remaining Securities at a price of approximately $27 million.[23] Bear Stearns also offered to buy 36 of the Remaining Securities outright at a purchase price of approximately $60.5 million.[24] HomeBanc rejected Bear Stearns' offer to buy the Remaining Securities.[25] By the close of business on August 7, 2007, HomeBanc neither repurchased the Remaining Securities for approximately $64 million (as required by the MRA and the GMRA), nor paid $27 million to roll the due date for the Remaining Securities.[26]

[22] Connell Tr. 33:23-34:4.

[23] Connell Tr. 33:1-33:19. The Trustee's amended crossclaims describe the August 7, 2007 $27 million demand as a "Margin Call" under the MRA or a request for a "Margin Transfer" under the GMRA. *See* Adv. D.I. 129, ¶ 98 - ¶ 107.

[24] Connell Tr. 34:20-35:21. Bear Stearns' offer to purchase 36 of the Remaining Securities also included an offer to purchase servicing rights in connection with certain securities for another $30 million. HomeBanc rejected the entire offer. Connell Tr. 35:15-35:20. *See also* Chasin Tr. 1033:11-1036:15; Joint Trial Ex. 4. Matthew Chasin worked at Bear Stearns from 1994 until 2008. Chasin Tr. 1015:14-1015:21. Chasin started as an associate on the repo desk and was promoted to more senior roles, specifically on the mortgage and credit financing side. Chasin Tr. 1016:1-1016:12. In August 2007, he was a senior managing director with overall management responsibility for the mortgage and repo trading area. Chasin Tr. 1016:13 1017:19.

[25] Connell Tr. 34:20-35:21.

[26] Connell Tr. 34:11-34:19.

By email dated Wednesday, August 8, 2007, at 5:58 pm, Bear Stearns sent a default notice to HomeBanc which read:

> We are hereby notifying you that all repurchase Transactions that Bear, Stearns & Co. Inc. and Bear, Stearns International Limited currently have with HomeBanc Corp. under the terms of the above-referenced agreements will not be "rolled", repriced or otherwise extended in any way, and as a result all such Transactions terminate on the scheduled Repurchase Date for such Transactions which is today, Wednesday, August 8, 2007. Under the terms of the MRA and the GMRA, all aggregate Repurchase Prices for all such Transactions, and all other related amounts owing by HorneBanc Corp. to Bear, Stearns & Co. Inc. and Bear, Stearns International Limited, are due and payable in full by HomeBanc Corp. by the close of business today.
>
> Notwithstanding the foregoing, and without in any way waiving any of its rights or remedies under the MRA or the GMRA or otherwise, Bear, Stearns & Co. Inc. and Bear Stearns International Limited have at the present time decided to give HomeBanc Corp. until the close of business tomorrow, Thursday, August 9, 2007, to make all such payments in full to Bear, Stearns & Co. Inc. and Bear, Stearns International Limited.[27]

HomeBanc still failed to make any payment to repurchase the Remaining Securities.[28] On August 9,

---

[27] Joint Trial Ex. 3. Connell Tr. 36:4-36:9.

[28] Connell Tr. 204:18-204:24.

2007 at 7:07 p.m., Bear Stearns sent formal default notices by email to HomeBanc.[29] HomeBanc and various related entities filed voluntary petitions for relief under chapter 11 of the U.S. Bankruptcy Code on the same day.[30]

As a result of HomeBanc's default, Bear Stearns took the position that it owned the Remaining Securities outright.[31] Management at Bear Stearns decided to auction the Remaining Securities to determine the fair market value of those securities.[32]

By emails sent between the morning of August 10, 2007 and August 14, 2007, Bear Stearns announced its intention to conduct an auction of the Remaining Securities (including the Securities at Issue) on August 14, 2007 (the "August 14 Auction). [33] The mails (the "Bid Solicitations") advised that Bear Stearns was conducting an auction of two groups of assets (one group owned by BSC and one group owned by BSIL) and attached a bid list for each group of assets that listed each security, including each individual security's unique CUSIP identifier, the original face amount of the security, and the current factor for each security.[34] The Bid Solicitations also noted that certain securities were subject to transfer restrictions and

---

[29] Joint Trial Ex. 5 and Ex. 6.

[30] The chapter 11 case was converted to chapter 7 in February 2009.

[31] Connell Tr. 36:24-37:19.

[32] Connell Tr. 211:16-212:4; Chasin Tr. 1039:22-1041:22.

[33] Stipulation of Undisputed Facts, ¶ 10.

[34] Joint Trial Ex. 7.

could only be purchased by a Real Estate Investment Trust, or REIT.[35]

Bear Stearns' sales force sent the Bid Solicitations to approximately 200 different entities and, at some entities, multiple individuals within the entity were solicited.[36] The Bid Solicitations, however, were not sent to HomeBanc, and HomeBanc was not provided with advance notice of the August 14 Auction.[37]

On August 14, 2007, Bear Stearns' mortgage trading desk submitted an "all or none" bid of $60.5 million for 36 of the Remaining Securities (including all of the Securities at Issue).[38] Tricadia Capital, LLC submitted

---

[35] The restrictions were not imposed by Bear Stearns, but were characteristics of the securities themselves and the result of particular aspects of HomeBanc's securitization of the loans underlying the securities. Chasin Tr. 1066:16-1067:19; Bockian Tr. 786:22-788:8. Bear Stearns proffered Jeffrey Bockian, a manager of the repo desk at Countrywide Securities, as an expert witness with respect to customary and industry practice related to repo transactions and related auctions of residential mortgage-backed securities in connection with termination of repo agreements. Tr. 763:18-764:6. The Trustee did not object to Mr. Bockian's designation as an expert witness. *Id.*

[36] Connell Tr. 75:7-75:14; 230:14-235:14; Bear Stearns Ex. 60-A.

[37] Stipulation of Undisputed Facts, ¶ 12.

[38] Stipulation of Undisputed Facts, ¶ 15. Joint Trial Ex. 13. One of the 37 Remaining Securities was removed from the August 14 Auction because HomeBanc and JPMorgan had agreed to a transaction in which JPMorgan would purchase the security for $1 million. Joint Ex. 4. The JPMorgan transaction was not consummated and the security was offered in a subsequent Bear Stearns auction. Bear Stearns' trading desk submitted a bid of $1,256,000 for the security. Joint Trial Ex. 18; Connell Tr. 270:11-272:5.

the only other bid in the August 14 Auction, which was a bid totaling $2,187,290 for two securities.[39]

On August 15, 2007, the prior day's lump-sum bid from the trading desk for the Remaining Securities was allocated on a security-by-security basis.[40] Bear Stearns allocated a value of $900,000 for each of the nine Securities at Issue, thereby crediting an aggregate value of $8.1 million from the total auction amount to those securities.[41] Bear Stearns and its affiliates retained possession and record title of the Securities at Issue, and have received and retained the post-August 14 Auction cash flow distributed in connection with the Securities at Issue.[42]

JURISDICTION

Congress granted jurisdiction over bankruptcy cases to the district courts in 28 U.S.C. § 1334, and then provided that "[e]ach district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district."[43] In 28 U.S.C. § 157(b)(1), Congress limited the Bankruptcy Court's authority to enter final judgment to core proceedings.

> Congress gave bankruptcy courts the power to "hear and determine" core proceedings and

---

[39] Joint Trial Ex. 12; Chasin Tr. 1126:10-1126:12. Mr. Connell testified that you had to multiply the price on Tricadia's fax by the factor and face amount to arrive at the total bid price. Connell Tr. 261:9-262:18.

[40] Stipulation of Undisputed Facts, ¶ 16.

[41] Joint Trial Exs. 15, 19.

[42] Stipulation of Undisputed Facts, ¶ 18.

[43] 28 U.S.C. § 157(a).

> to "enter appropriate orders and judgments," subject to appellate review by the district court. § 157(b)(1); see § 158. But it gave bankruptcy courts more limited authority in non-core proceedings: They may "hear and determine" such proceedings and "enter appropriate orders and judgments," only "with consent of all the parties to the proceeding." §157(c)(2). Absent consent, bankruptcy courts in non-core proceedings may only "submit proposed findings of fact and conclusions of law," which the district courts review *de novo.* § 157(c)(1).[44]

In *Stern v. Marshall,* however, the United States Supreme Court determined that "Congress violated Article III of the Constitution by authorizing bankruptcy judges to decide certain claims for which litigants are constitutionally entitled to an Article III adjudication."[45] Thus, a bankruptcy court cannot enter final judgment on a *"Stern* claim," that is, "a claim designated for final adjudication in the bankruptcy court as a statutory matter, but prohibited from proceeding in that way as a constitutional matter."[46] The Supreme Court later decided that Article III permits bankruptcy courts to enter final judgment in *Stern* claims submitted to them by consent of the parties.[47]

---

[44] *Wellness Int'l Network, Ltd. v. Sharif, U.S.,* 135 S. Ct. 1932, 1939, 191 L.Ed. 2d 911. (2015).

[45] *Id.* citing *Stern v. Marshall,* 564 U.S. 462, 131 S. Ct. 2594, 180 L.Ed.2d 475 (2011). *See also Executive Benefits Inc. Agency v. Arkison, U.S.,* 134 S .Ct. 2165, 189 L.Ed. 2d 83 (2014).

[46] *Executive Benefits,* 134 S. Ct. at 2170.

[47] *Wellness Int'l,* 135 S. Ct. at 1949.

This Court has jurisdiction to decide this matter pursuant to 28 U.S.C. § 157 and § 1334. While some of the Trustee's claims are core proceedings pursuant to 28 U.S.C. § 157(b)(2)(E), (F) and (O), other claims by the Trustee, as well as cross-claims by Bear Stearns, are non-core, related-to claims for breach of contract, conversion and unjust enrichment.[48] It is undisputed that the parties consented to entry of a final order by this Court when this adversary proceeding started.[49] The Supreme Court has since confirmed that, due to the parties' consent, I have authority to enter final judgment on all of the claims before me.[50]

DISCUSSION

The Trustee filed amended cross-claims against Bear Stearns alleging, in part, that Bear Stearns disposed of the Securities at Issue through an auction that did not comply with the terms of the GMRA because it was not conducted in good faith or in a commercially reasonable manner. In *HomeBanc I,* I examined the language of the GMRA and determined that, after HomeBanc defaulted, the GMRA granted Bear Stearns discretion in choosing a rational manner to determine the Net Value of the Remaining Securi-

---

[48] "[R]elated to" jurisdiction applies when "the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate." *Opt-Out Lenders v. Millennium Lab Holdings II, LLC (In re Millennium Lab Holdings II, LLC),* 2017 WL 1032992, *2 (D. Del. Mar. 17, 2017) citing *Paco, Inc. v. Higgins,* 743 F.2d 984, 994 (3d Cir. 1984).

[49] *See* Tr. 4/29/2014 at 12:15-12:19 (Adv. D.I. 321).

[50] *Wellness Int'l,* 135 S. Ct. at 1949.

ties (including the Securities at Issue).[51] The GMRA defined Net Value as:

> the amount which, in the reasonable opinion of the non-Defaulting Party, represents [the Remaining Securities'] fair market value, having regard to such pricing sources and methods . . . as the non-Defaulting Party considers appropriate, less, . . all Transaction costs which would be incurred in connection with the . . . sale of such Securities."[52]

The Trustee appealed *HomeBanc I* to the District Court, which agreed that the language of the GMRA granted Bear Stearns discretion to determine Net Value, and also agreed that the word "reasonable" modifying Bear Stearns' discretion added a "rationality" requirement, obligating Bear Stearns to act in good faith.[53]

However, the District Court did not agree that it was appropriate to grant summary judgment on the issue of whether Bear Stearns' auction complied with the GMRA, deciding that the Trustee's expert report explained why he thought the Bear Stearns' auction suffered from a number of serious flaws, raising

---

[51] *HomeBanc I,* 2013 WL 211180 at *14-*16.

[52] *HomeBanc I*, 2013 WL 211180 at *15 citing GMRA, § 10(d)(iv). In short, calculating the Net Value allows the parties to set off or net the Net Value of the Remaining Securities against the amount HomeBanc owed Bear Stearns to determine whether Bear Stearns held a deficiency claim against HomeBanc or, alternatively, whether Bear Stearns owed monies to HomeBanc if the value of the Remaining Securities exceeded the HomeBanc claim.

[53] *HomeBanc II*, 2014 WL 1268677 at *5.

a factual issue about Bear Stearns' good faith.[54] The District Court affirmed *HomeBanc I,* except with regard to the issue of whether the auction complied with the GMRA.[55] The trial on remand focused on this issue, which will be explored in three parts: (i) whether Bear Stearns' decision to determine the Net Value of the Securities at Issue by auction in August 2007 was rational or in good faith; (ii) whether the auction process utilized by Bear Stearns was in accordance with industry standards; and (iii) whether Bear Stearns' acceptance of the value obtained through the auction was rational or in good faith.

1. Was it a good faith/rational decision of Bear Stearns to determine fair market value of the Securities at Issue by an auction in August 2007?

The Trustee argues that Bear Stearns' decision to value the Remaining Securities through a "buyer-less auction in a dysfunctional market" was irrational, arbitrary, in bad faith and a breach of the GMRA. The Trustee asserts two propositions: (i) that there is no market for residual securities such as the Securities at Issue and, therefore, the only reasonable way to value such assets is by using a model such as the discounted cash flow model (the "DCF Model); and (ii) even if there is a market for residuals, the timing of Bear Stearns' auction was irrational and in bad faith because the market in August 2007 was dysfunctional.

---

[54] *Id.* at *6.

[55] *Id.* Also, as discussed *infra.,* the District Court partially affirmed, and partially rejected, my conclusion that the Securities at Issue were "Repurchase Agreements" as defined in Bankruptcy Code § 101(47)(A).

(a) Bear Stearns' use of an auction to value the Securities at Issue

The Trustee claims that there is no organized market for the Remaining Securities, especially with respect to the Securities at Issue which, he argues, were "bottom of the stack" residuals and were not liquid. An expert witness for the Trustee, Dr. Steven V. Mann, opined that, as securities get less liquid and more complicated, models, such as the DCF Model, should be used to determine value, especially for residential mortgage-backed securities which have value because they are cash-flow producing assets.[56] In July 2010, the Trustee's expert issued a report valuing the Securities at Issue at $124.6 million by using a DCF Model that calculated the present value of the projected cash flow from August 2007 to maturity.[57] For reasons explained more fully *infra,* Bear Stearns criticized many of the assumptions underlying the Trustee's expert report, including a failure to consider significant events and similar market transactions occurring in and around August 2007. Of course, to the extent assumptions in a model are wrong, the model may prescribe a value that is too low or too high.

Bear Stearns agrees that a discounted cash flow model would have been one way to determine the value of the Securities at Issue.[58] However, an alternative valuation method, perhaps the most obvious one, is to enter the marketplace and see what someone is

---

[56] Mann Tr. 450:13-455:21. Dr. Steven V. Mann was admitted, without objection, as an expert witness on fixed income securities. Mann Tr. 438:22-439:8.

[57] HomeBanc Ex. 67.

[58] Connell Tr. 46:21-48:10.

willing to pay for the securities.[59] Repo participants often rely on the markets to value securities. As discussed by Bear Stearns' expert, Mr. Bockian:

> [W]hat I would view to be market value for any security, not necessarily just the securities at issue, is what buyers and sellers will really transact in the marketplace.
>
> For a repo trader, that's the benchmark. It doesn't matter if a security is worth 60 and I think it's going to 80. I don't finance it based on 80. I finance it based on 60.
>
> A cash trader might buy it for 60 because he thinks it's going to 80, but for repo market participants, the game is about providing financing at the current market value of a security which we generally look at as . . . where would that bond transact in the marketplace, particularly . . . where could I liquidate the bond if, heaven forbid, I had to.[60]

After HomeBanc's default, a group of senior managers at Bear Stearns met with their counsel to determine the most appropriate way to address the situation.[61] The situation was not unique for Bear Stearns because, just prior to HomeBanc's default, another client—American Home Mortgage—defaulted on its repurchase financing transaction and Bear Stearns also used an auction to sell securities that were similar to the Remaining Securities, including

---

[59] *Id.*

[60] Bockian Tr. 881:23-882:17.

[61] Chasin Tr. 1028:11-1028:24; 1039:22-1040:18; 1106:15-1109:13.

residuals like the Securities at Issue.[62] Bear Stearns executives decided that the best measure of value, especially in a turbulent, volatile market, was to seek prospective bidders for securities.[63]

The Trustee's expert agreed that these securities were traded in an "over-the-counter market" and that prices could be obtained by a dealer.[64] Bear Stearns demonstrated that residential mortgage-backed securities, including residuals like the Securities at Issue, were sold through an auction method known as "BWIC" or "bids wanted in competition," which is a "commonly used . . . auction technique to gain interest and actually buy and sell securities among institu-

---

[62] Chasin Tr. 1048:24-1052:2. Connell Tr. 215:13-216:19; 253:20-254:13. Like the HomeBanc auction, the Bear Stearns repo desk sold some residual securities from the American Home Mortgage auction to the Bear Stearns trading desk. Chasin Tr. 1149:6-1149:15.

[63] Connell Tr. 215:9-215:12.

[64] Q: Are there any recognized markets or exchanges for the trading of residuals?

> A: If by "market" you mean organized exchange, no, there is not. There is an over-the-counter market in which these securities trade, which is the connection . . . between computers and telephones between various dealers throughout the world.
>
> . . . .
>
> Q: Is there any place to go to get a price quote for a security like that?
>
> A: You would have to call a dealer and there's no magic board as to those prices, those buy-and-sell interests.

Mann Tr. 449:2-450:12. Mr. Connell also testified that the securities were not traded on an organized exchange, but were traded over-the-counter "through voice brokers . . . via telephone, via fax machine, by email." Connell Tr. 77:2-77:23.

tional buyers and sellers."[65] The deposition testimony of several witnesses who were active in the market in August 2007 confirmed that, in and around 2007, it was common in the industry for a seller of residual mortgage-backed securities to solicit buyers on a daily basis through email announcements of BWICs.[66]

Mr. Connell testified that Bear Stearns used an auction, rather than a model, to determine the fair market price of the securities because "models don't buy bonds," and

> [A] model . . . has a bunch of assumptions baked in, and that might not reflect what the true market value is. For us . . . the paramount way to decipher true market value is what . . . someone else [is] going to pay for it.[67]

Mr. Chasin explained that Bear Stearns chose the BWIC method to get a fair market price because the process was:

> similar to the process that Bear or similar financial institutions would do if they were selling similar portfolios of securities. . . . We went to other financial institutions to try to see if they had a larger or different network of potential buyers, all to try to create as many potential bidders as we could, and that was something which we believed was in the

[65] Bockian Tr. 771:8-771:17; 810:6-811:15.

[66] Andrews Dep. 89:22-92:10; Ha Dep. 41:8-43:8; Herr Dep. 19:5-22:3, 52:10 -53:13; Makhija Dep. 20:3-21:10, 45:24-46:19; Torres Dep. 15:19-19:10. The deposition designations were docketed at Adv. D.1.380.

[67] Connell Tr. 213:21-214:7.

> best interest of trying to get fair market value.[68]

Mr. Chasin also explained that Bear Stearns did not want to use computer generated values for the securities because:

> sometimes the matrix price, different pricing methods, we had would be very good proxies, but sometimes they weren't. Markets could get distressed, different situations could happen and the market price that we needed to have were actually prices where somebody would bid the securities.[69]

The Trustee claims that the DCF Model is the "gold standard" for valuing securities. While there are a number of ways to value the securities,[70] the issue before me is not which is the *ideal* valuation method, but, rather, whether Bear Stearns' decision to use a BWIC auction to value the Securities at Issue was irrational or in bad faith. Based upon the evidence before me, I conclude that residential mortgage-backed securities—even residuals, like the Securities at Issue—were often sold through BWICs and, therefore, Bear Stearns' decision, made contemporaneously with the HomeBanc default, to value the securities by determining what someone in the market was willing to pay for the Securities at Issue was not irrational or in bad faith.

(b) The timing of Bear Stearns' auction

Alternatively, the Trustee contends that even if it is reasonable to value securities through a BWIC, the

---

[68] Chasin Tr. 1041:3-1041:22.

[69] Chasin Tr. 1042:3-1042:14.

[70] Connell Tr. 47:10-53:4.

timing of Bear Stearns' decision was irrational and in bad faith because the market was clearly "dysfunctional" in August 2007. The Trustee relies on the *American Home Mortgage* decisions,[71] in which the Court of Appeals for the Third Circuit analyzed language in Bankruptcy Code § 562 and determined that a discounted cash flow analysis was an acceptable type of "commercially reasonable determinants of value" for calculating a damage claim under Bankruptcy Code § 562.[72]

In *American Home Mortgage,* the debtors and the bank were parties to a repurchase agreement.[73] After the debtors defaulted, the bank exercised its acceleration rights under the repurchase agreement on August 1, 2007, triggering the debtors' obligation to repurchase the mortgage loans held by the bank.[74] The debtors filed chapter 11 bankruptcy petitions on August 6, 2007 and the bank commenced litigation seeking a declaratory judgment (and the Court so held) that the repurchase agreement fell within the definition of a "repurchase agreement" under Bankruptcy Code § 101(47) and that the bank's rights "were not stayed, avoided, or otherwise limited with respect to ownership of the Loan Portfolio."[75]

Later, the bank filed a claim for damages under § 562, and the debtors objected to the bank's claim,

---

[71] *In re Am. Home Mortg. Holdings, Inc.,* 411 B.R. 181 (Bankr. D. Del. 2009) *("AMH I"), aff'd but criticized* 637 F.3d 246 (3d Cir. 2011) ("*AMH II").* This case is also sometimes referred to as *"Calyon."*

[72] *AMH II,* 637 F.3d at 255-58.

[73] *AMH I,* 411 B.R. at 184.

[74] *Id*.

[75] *Id.* at 185.

commencing the litigation that brought the issue before the Bankruptcy Court. The bank argued that the only appropriate valuation methodology for measuring damages is the price obtained by selling the loans on the market and, on August 1, 2007 the date of acceleration), the bank could not obtain a commercially reasonable price because "the market was distressed and the Loan Portfolio suffered from a number of deficiencies."[76] The bank argued that the earliest date on which there existed a commercially reasonable determinant of value was over a year later on August 15, 2008.[77] The debtors argued in response that at least two different methodologies were available on the acceleration date to determine commercially reasonable values for the Loan Portfolio—a discounted cash flow analysis and a market analysis obtained by the bank outside the context of litigation.[78]

The Bankruptcy Court held that the bank did not meet its burden of demonstrating that "no commercially reasonable determinants of value" existed on the acceleration date because the debtors' discounted cash flow analysis is a commercially reasonable methodology for determining the value of the Loan Portfolio.[79] On appeal, the Court of Appeals agreed that the discounted cash flow analysis was a commercially reasonable determinant of value for measuring damages under Bankruptcy Code § 562.[80] The Third Circuit noted that "if Congress had intended § 562 to be limited to market or sale price, it would have said so.

---

[76] *Id.* at 186.

[77] *Id.*

[78] *Id.*

[79] *Id*. at 198.

[80] *AMH II,* 637 F.3d at 258-59.

It did so in § 559."[81] Judge Rendell also noted in her concurring opinion to *AHM H* that the language of Bankruptcy Code § 562 clearly uses the plural, referring to "commercially reasonable *determinants* of value," so that sale price should not be viewed as the exclusive method for determining value.[82] Under the same reasoning, a DCF Model also is not the exclusive method for determining value.

In *HomeBanc I,* I determined that the *American Home Mortgage* decision did not apply here because Bear Stearns acted under § 559, and was not seeking a damage claim under § 562. The Trustee argues, however, that Bankruptcy Code § 562 now applies based on the District Court's decision in *HomeBanc II* There, the District Court rejected my conclusion in *HomeBanc I* that the Securities at Issue fell within the Bankruptcy Code's definition of "repurchase agreement" pursuant to § 101(47)(A)(i), but agreed with my alternative conclusion and decided that the disputed securities qualified as repurchase agreements under § 101(47)(A)'s catchall provision:

> It seems to me that the only possible reading of this provision is that it is designed to encompass some sorts of transactions that do not fall neatly within the first four subsections. There is no doubt that the disputed

---

[81] *AMH II,* 637 F.3d at 258.

[82] *AMH II,* 637 F.3d at 259. Judge Rendell also noted that the bank in *American Home Mortgage* retained the loans and received the cash flow and, therefore, using a DCF would appear to be the most reasonable determinant of value. *Id* Here, Bear Stearns sold the collateral through an auction proceeding, the result of which transferred ownership to the Bear Stearns trading desk. Although Bear Stearns ultimately owned the Remaining Securities, it did so only after following a sale process.

> transactions were part and parcel of their undisputed repo transactions. It therefore seems to me that the extra securities were plainly within the umbrella of "credit enhancements." I conclude the disputed securities were repo agreements within the meaning of § 101(47)(A)(v).[83]

Bankruptcy Code § 101(47)(A)(v) provides:

> The term "repurchase agreement" (which definition also applies to a reverse repurchase agreement)—
>
> (A) means—
>
> . . . .
>
> (v) any security agreement or arrangement or other credit enhancement related to any agreement or transaction referred to in clause (i), (ii), (iii) or (iv) . . . , *but not to exceed the damages in connection with any such agreement or transaction, measured in accordance with section 562 of this title . . .*[84]

Bankruptcy Code § 562 provides in pertinent part:

> (a) If the trustee rejects a . . . repurchase agreement . . . or if a . . . repo participant . . . liquidates, terminates, or accelerates such contract or agreement, damages shall be measured as of the earlier of—
>
> (1) the date of such rejection; or

---

[83] *HomeBanc II,* 2014 WL 1268677 at *4.

[84] 11 U.S.C. § 101(47)(A)(v) (emphasis added).

(2) the date or dates of such liquidation, termination, or acceleration.

(b) If there are not any commercially reasonable determinants of value as of any date referred to in paragraph (1) or (2) of subsection (a), damages shall be measured as of the earliest subsequent date or dates on which there are commercially reasonable determinants of value.[85]

The Trustee argues that, because Bankruptcy Code § 562 applies, the *American Home Mortgage* decisions also apply. In *AMH II,* the Court of Appeals agreed with the Bankruptcy Court's determination that:

> [T]he market price should be used to determine an asset's value when the market is functioning properly. It is only when the market is dysfunctional and the market price does not reflect an asset's worth should one turn to other determinants of value.[86]

While there are similarities between the matter before me and *American Home Mortgage (i.e.,* a default under a repurchase agreement in August 2007), there are also striking differences that weigh against the use of a DCF Model here. In *American Home Mortgage,* the parties all *agreed* that the market for mortgage loans (not mortgage-backed securities) was dysfunctional in August 2007. Here, the issue of whether the market for residential mortgage-backed securities was dysfunctional—and what exactly that means—is a matter

[85] 11 U.S.C. § 562.

[86] *AMH II,* 637 F.3d at 257.

of an energetic dispute.[87] Further, the bank in *American Home Mortgage* did not try to sell the mortgage loans after the default and acceleration in August 2007, but, instead, held the collateral. Bear Stearns also remained in possession of the Remaining Securities after default, but it did so only after it held a BWIC auction. Accordingly, I must examine the Trustee's claim that an auction should not have been used as a "commercially reasonable determinant of value."

The Trustee points to comments of many witnesses about the distressed state of the markets, but particularly relies on the deposition testimony of a Bear Stearns' mortgage trader stating that the market for residential mortgage-backed securities in August 2007 was "very dysfunctional," and having "little to no liquidity."[88] The Trustee's expert agreed, noting that "market dysfunction" was "not a term in economics," but he defined it as:

> low liquidity and . . . chaos in the market such that the normal price discovery process is not functioning properly. During those episodes, prices can be detached from their true fundamental values and diverge considerably."[89]

In contrast, Bear Stearns asserts that the complete testimony of witnesses who were active in the residen-

---

[87] The burden of proof standard of Bankruptcy Code § 562(c) applies when damages are not measured as of the liquidation, termination or acceleration date and one party objects to using a different date. Here, both parties use the liquidation date, but argue whether an auction or the DCF Model is a better commercially reasonable determinant of value.

[88] Adv. D.I. 380, Van Lingen Dep. 10:10-12:06.

[89] Mann Tr. 469:18-470:7.

tial mortgage-backed securities market in August 2007 shows that the market was volatile and market prices were declining, *but* the market was functioning and transactions were occurring.[90] Mr. Chasin testified:

> Yes, it was a bad market. Market prices were failing . . . It doesn't mean that the market wasn't functioning. We know that in times of stress, you have asset prices which fall. It happens in markets all over the place. And sometimes markets crash. And there are bad markets and there's bad days, but that doesn't mean things don't trade. . . . So from our perspective, we knew it was a bad market, but we were still there making bids for clients like we did for Homebanc.[91]

Further, Mr. Bockian, who managed the repo desk at Countrywide Securities at the time, described the market as follows:

> [D]uring the period of time in question, which is this August 2007 time frame, we were observing market participants, . . . both buyers and sellers, . . . hedge funds, REITs, Wall Street companies, insurance companies, all kinds of professional pricers of mortgage-backed securities, which were contingent on . . . the anticipated expected cash flows of the

[90] Chasin Tr. 1044:10-1047:7; Connell Tr. 164:18-164:21 ("I don't think the market was dysfunctional. I think the market was repriced."); Adv. D.I. 380 Torres 49:22-50:13 ("There was a market for mortgage-backed securities in the summer of 2007. . . . In my opinion, it got more volatile from the beginning of the year toward the end of the year and continued so into '08. Certain products were less liquid than others.").

[91] Chasin Tr. 1129:1-1129:18.

> securities, were being marked down precipitously, not just HomeBanc deals.
>
> [T]he market as a whole had [a] . . . come-to-Jesus moment about . . . everything we've built, all these securitizations, all these many, many hundreds of billions of dollars of outstanding securities which had relatively thin margins between elevated default rates and other poor characteristics in terms of how the loans performed, that that margin was, in retrospect, thin and looked like it might get thinner.[92]

Mr. Bockian also recalled that:

> [D]uring July and August and September of 2007, what I saw was a market that was certainly depressed, particularly from a pricing and liquidity point of view, but that in my observation was functioning. There were bonds being traded. I was able to present bonds to my cash traders. They were able to price it for repo purposes. Being an observer on the floor and sitting close to some of these desks there were trades being done.
>
> So I certainly would not deny that that was a very rough period and that was a distressed period in the market. You know, I think the way I viewed it [was] that somewhere in August of 2007 the market reached a tipping point and a lot of stress did come in and prices deteriorated.

---

[92] Bockian Tr. 878:22-879:22.

> But I saw trades taking place, and that's—that's where it is a little difficult to—for me to call the market dysfunctional.[93]

Moreover, there was no evidence of other factors that might be considered indicia of market dysfunction: asymmetrical information between buyers and sellers, inadequate information in general (transparency of recent transactional prices), market panic (as in the market immediately after the Lehman Brothers September 15, 2008 bankruptcy filing), high transaction costs, the absence of any creditworthy market participants or fraud.

The facts adduced here show a repo counter-party acting in real time and in accordance with industry standards to liquidate securities in a volatile market. The Trustee faults the Bear Stearns repo desk for considering that "time was of the essence" in disposing of the Remaining Securities in August 2007, rather than holding them.[94] But Bear Stearns sought to determine fair market value at the time of default, rather than at an indeterminate point in the future, especially due to its view that time *was* of the essence, given that there was no indication in August 2007 when or if market prices would stabilize, and every

---

[93] Bockian Tr. 850:21-852:4.

[94] Mr. Connell explained: "We were not in that business. We were financiers. We were not in the business of taking principal risk against the residual and subordinate mortgage-backed securities. . . . [O]ur function is to finance clients, to lend money and then . . . get paid back. To the extent we end up with securities, we wanted to . . . eliminate exposure as quickly as possible and get paid back and settle up and move on." Connell Tr. 214:8-214:20.

indication that the market might continue to decline. Mr. Bockian testified:

> [I]n August 2007 it, candidly, felt like things weren't going to get better. It was really becoming hard to view housing prices which were starting to accelerate in terms of depreciation and the knock-on effects to the underlying mortgages as defaults rose.
>
> It was very hard to see how, the period we're in, the moment we're in in August 2007 was going to be a natural stopping point for that activity. It felt much more like we're at the beginning of the cascade, we're at the beginning of the waterfall and still had time to travel. And I think, in fact, that was borne out by continued downward pressure on home prices, continued knock-on effects in the underlining loans' performance and then the creation of government programs that not only were designed to help homeowners stay in their homes and bring some stability to the underlying mortgages, but then . . . the wholesale bailout of the banking sector because of its exposure to mortgage-backed securities. [95]

Parties trading at the time could see that the market was unsettled, but trades were occurring. People were making decisions in real time and had no guarantee about when or if prices would bounce back or continue to decline. After HomeBanc's default, Bear Stearns proceeded to liquidate the Remaining Securities as permitted by the terms of the GMRA and as allowed by the Bankruptcy Code. Bear Stearns chose to auction the Remaining Securities to discover what a

---

[95] Bockian Tr. 874:20-875:20.

willing buyer would pay for the Remaining Securities in the marketplace. The Bear Stearns trading desk submitted a bid in accordance with the bid procedures. Viewing the facts and circumstances in this case in light of the events as they were unfolding in August 2007 shows that this auction was a commercially reasonable determinant of value for Bear Stearns.

I conclude that Bear Stearns' decision to determine the value of the Securities at Issues by an auction in August 2007 was not irrational or in bad faith.

2. Was the auction process utilized by Bear Stearns in accordance with industry standards?

The Trustee posits that the auction process utilized by Bear Stearns was deficient and designed in a way to discourage bidding. Bear Stearns replies that the auction process was a "thoughtful, good faith attempt to generate outside bidding for the HomeBanc Securities, and in every respect complied with or exceeded industry custom."[96]

The Trustee's expert, Mr. Scott Calahan of Boston Portfolio Advisors, pointed out what he thought were various flaws in the process that he perceived would prevent other parties from bidding on the Securities at Issue.[97] First, Mr. Calahan claimed that the Bid

[96] Adv. D.1.379, Bear Stearns' Post-Trial Brief at 13.

[97] Scott Calahan was offered as an expert witness on the valuation and sale of mortgage-backed securities and, in particular, residuals. Tr. 586:16-591:15; 595:14-595:18. Bear Stearns' objection to qualifying Mr. Calahan as an expert on the *sale* of such collateral was overruled; although I noted that weight of Mr. Calahan's testimony would be affected by the type of his sales experience. Tr. 597:11-607:18.

Solicitation did not provide potential bidders with sufficient information to formulate a bid.[98] I disagree.

The Bid Solicitations listed the 37 Remaining Securities subject to auction, including security description, each individual security's unique CUSIP identifier, the original face amount of the security, and the current factor for each security.[99] The Bid Solicitation also advised potential bidders that if they wanted more information *(i.e.,* remittance reports and loan tapes), they could contact Lisa Marks, an officer in Bear Stearns' FAST Group, who was familiar with the Remaining Securities and what was needed to price them.[100] It was not practical for Bear Stearns to attach other documents and data related to the Remaining Securities (such as remittance reports or prospectus supplements) to the Bid Solicitation because doing so would significantly increase the size of the email, which would prevent it from reaching its intended recipients.[101] However, data needed to prepare a bid for securities with cash flows was available on third-party analytic software that was ubiquitous in the finance industry, such as Bloomberg or Intex.[102]

Several industry witnesses agreed that the information in the Bid Solicitation allowed potential bidders to access documentation and other information necessary to evaluate the Remaining Securities, including the Securities at Issue, for the purpose of

---

[98] HomeBanc Ex. 67 at 21.

[99] Joint Ex. 7.

[100] Joint Ex. 7. Chasin Tr. 1058:22-1059:11.

[101] Chasin Tr. 1059:12-1060:11; Adv. D.J. 380 Hoffman Dep. 55:25-56:20.

[102] Attari Tr. 900:14-903:4; Chasin Tr. 1059:12-1060:17; Adv. D.I. 380 Andrews Dep. 42:6-42:25; Hoffman Dep. 50:1-50:11.

formulating a bid.[103] The process and information needed to evaluate the residual Securities at Issue is no different from the process and information needed to evaluate the more senior tranche Remaining Securities.[104] The weight of the evidence demonstrated that the Bid Solicitation contained sufficient information for potential bidders to evaluate whether to submit a bid and to formulate a bid.

Second, Mr. Calahan claimed the Bid Solicitation did not provide adequate time for responses, since potential bidders had only three business days or less to submit irrevocable bids on complicated securities that required considerably longer to evaluate.[105] Here, potential bidders were provided two and one-half business days, as well as two full weekend days, to

---

[103] Bockian Tr. 789:10-793:14 (Q: [L]ooking at this page in its entirety, the descriptions of the securities, the information provided, in your view, sir, was there anything missing from this list that is customarily provided? A: No. This is complete.); Adv. D.I. 380 Herr Dep. 22:12-22:22 (Q: If you received an email bid solicitation for the sale of mortgage-backed securities, what information would you need to evaluate whether Credit Suisse is interested in purchasing that security? A: A lot—I mean, pretty much the information that's listed on this bid solicitation is, you know, pretty much market standard. You give the security name, the CUSIP, the original face, which is the amount they're looking for a bid on. And the factor, obviously, is helpful."); *see also* Andrews Dep. 41:17-42:25; Tones Dep. 21:19-22:2, 25:14-26:16; 60:10-61:22).

[104] Attari Tr. 899:16-900:13; Chasin Tr. 1062:2-1062:15. *See also* Calahan Tr. 612:22-615:10 (describing the information needed to value residual securities and agreeing that information for public deals like the Securities at Issue was available from the third-party programs, such as Bloomberg, or from the seller).

[105] HomeBanc Ex. 67 at 21. Calahan Tr. 625:12-627:10.

assess their interest and formulate a bid.[106] Several witnesses testified that this amount of time was more than what was typically provided to buyers of residential mortgage-backed securities in a BWIC process, and was more than enough time for sophisticated participants in the market to evaluate and price securities for the purpose of bidding in an auction.[107]

Based on their experience in the industry and in consultation with counsel, senior managers at Bear Stearns indicated that the auction timeline would balance the need to provide adequate time for potential bidders to formulate a bid, but protect against the risk of further market decline.[108] Mr. Chasin explained:

> [W]e were trying to strike a balance. We were trying to think about what was . . . enough time for investors to take this information which we were ready to give them relative to

---

[106] Joint Ex. 7.

[107] Adv. D.I. 380 Andrews Dep. 49:21-50:12; Ha Dep. 43:9-43:24; Torres Dep. 28:25-29:16; Makhija Dep. 25:21-27:10; Bockian Tr. 780:13-781:16; Attari Tr. 900:18-901:16. *See also* Mann Tr. 511:3-511:9 ("Q: And you agree, sir, don't you, that Wall Street investment banks and asset management firms have models that are readily available to them to project cash flows and determine values of residual interests in mortgage-backed securities? A: That's true.")

[108] Connell Tr. 236:22-238:12. *See also* Bockian Tr. 777:6-777:21 ("You know, it's very important to allow sufficient time for the bidders to evaluate their interest and price the collateral in the event they have interest in participating. At the same time, it's very important to not allow excess time, particularly in August 2007, given that market conditions were, you know, certainly deteriorating by the week and at times were deteriorating by the day. So that you'd want to allow sufficient time, but you wouldn't want to allow more than sufficient time.")

> the risk of the market continuing to fall. . . Pin Tuesday the client had failed to pay us the pare-off amount when the trade was rolled. . . . [W]e didn't default them until Thursday. We sent the bid out Friday to conduct an auction the following Tuesday. That to us felt like, you know, a lot of time for the market, where the market was certainly not getting any better.[109]

The record demonstrates that the BWIC provided potential bidders with adequate time in accordance with industry standards to formulate a bid.

Next, Mr. Calahan claimed that the manner in which the Bid Solicitation was distributed failed to target buyers in an appropriate fashion because the email "blast" was likely to be ignored as spam.[110] In response, Bear Stearns submitted testimony of Mr. Bockian who worked in the market in August 2007 and explained that distribution of the BWIC lists for the Remaining Securities was:

> in keeping with industry standard methods in terms of how salespeople generally communicate with customers. So while it's certainly - I mean, I can understand on some level the use of the word "spam" because you're sending it to a lot of different entities, but that is the nature of the business. If you're a salesperson, and certainly a sales team as large as Bear Stearns' sales team, you would send out

---

[109] Chasin Tr. 1056:11-1057:16.

[110] HomeBanc Ex. 67 at 19.

> e-mails to many recipients all at once. . . . [T]his was the best way to do it.[111]

The Bid Solicitation was sent to at least 197 different entities via email and/or the Bloomberg messaging system.[112] The Bid Solicitation was sent to a wide variety of institutions that were active in the marketplace for residential mortgage-backed securities, including over 40 that were (or could transact on behalf of) a real estate investment trust (or REIT).[113]

Among the recipients of the Bid Solicitation were other broker dealers at Deutsche Bank, Royal Bank of Scotland and UBS, who were competitors of Bear Stearns and could utilize their sales forces to distribute widely the Bid Solicitations.[114] Bear also utilized its own sales force to send the bid solicitation emails to its own clients because:

> We wanted . . . to go through our sales force to reach out to all the investors because this was the most efficient way to do it. Our salespeople were the best people to talk to about the assets. They knew exactly who to go to with their clients. If the clients received an email from them, they would know that it was

---

[111] Bockian Tr. 776:9-777:5. Adv. DI 380 Hoffman Dep. 63:4-64:3; Herr Dep. 18:24-19:151; 30:4-31:5.

[112] Joint Ex. 14; Connell Tr. 225:4-226:5; Bear Stearns Ex. 60(A); Connell Tr. 230:14-235:14.

[113] Bear Stearns Ex. 60(A); Bockian 802:1-803:23.

[114] Connell Tr. 218:19-220:10; Chasin Tr. 1052:3-1053:3; Joint Ex. 7.

> most likely related to buying or selling the mortgage securities.[115]

Moreover, the sales force was rewarded based on "the amount of transactions . . . [and] the amount of sales" they completed, "so they were incentivized to go out and do so."[116] Mr. Bockian testified that it is industry custom for a large broker-dealer like Bear Stearns to capitalize on the experience and contacts of its sales force, which often interacts with its customers daily and knows its customers' areas of focus and interest.[117] Further, it was appropriate for Bear Stearns to solicit other broker/dealers who may have customer networks unknown to Bear Stearns and which would increase the likelihood of getting bids.[118] After the auction, Bear asked the sales force to compile a list of the people and entities who received the Bid Solicitation.[119] Bear Stearns' evidence supports the conclusion that it distributed the Bid Solicitations widely and in accordance with industry standard.

Mr. Calahan also opined that the auction was deficient because its unreasonable rules required outside bidders to submit irrevocable bids, while Bear Stearns was permitted to remove securities, extend the bidding deadline and/or cancel the auction.[120] Bear Stearns countered that many of the items criticized by Mr. Calahan were procedural safeguards included in

---

[115] Chasin Tr. 1068:5-1068:14. *See also* Connell Tr. 220:11-223:11; Bear Stearns Ex. 19.

[116] Connell Tr. 222:12-223:11.

[117] Bockian Tr. 803:24-804:19.

[118] Bockian Tr. 804:20-806:2.

[119] Connell Tr. 223:12-223:21; 225:4-225:24; Chasin Tr. 1068:19-1070:8; Joint Ex. 14.

[120] HorneBanc Ex. 67 at 20.

the BWIC to protect the integrity of the auction and encourage bidding. The Bid Solicitation provided that bids were irrevocable for a three-hour period after the 3:00 p.m. bid submission deadline.[121] Bear Stearns explained that the irrevocability period provides Bear Stearns with adequate time to assess any competing bids, resolve any questions, and determine the winning bids on a security-by-security basis.[122] The purpose of the provision allowing Bear Stearns to withdraw any securities from the auction or extend the bidding deadline is to ensure that Bear Stearns would not have to accept any unreasonably low bids that did not reflect fair market value.[123] None of these provisions were unusual or would prevent bidders from bidding. [124]

The Bid Solicitation also provided that an affiliate of Bear Stearns reserved the right to submit a bid 30 minutes prior to the bidding deadline for non-Bear Stearns affiliated bidders.[125] Mr. Bockian testified that it was not uncommon for broker/dealers to reserve the right to bid at their own auction.[126] The purpose of requiring early submission for an affiliate's bid was to communicate to potential bidders that any Bear Stearns affiliate could not access other bids and use that information to top the highest bid as of the close

---

[121] Joint Ex. 7.

[122] Connell Tr. 238:14-239:4.

[123] Connell Tr. 242:16-243:11; Chasin Tr. 1058:9-1058:21.

[124] Bockian Tr. 794:23-796:2 (a three-hour irrevocable period is very common), 796:3-797:4 (ability to withdraw securities from bidding or extend the bidding deadlinc is common). *See also* Adv. D.I. 380 Herr Dep. 37:5-37:15; Makhija Dep. 39:8-40:8.

[125] Joint Ex. 7.

[126] Bockian Tr. 797:19-798:19.

of the auction.[127] The Bid Solicitation also required bids to be submitted to an attorney in Bear Stearns' legal department, whose office was located in a different building from the repo desk and the trading desk.[128] This "wall" was not typical in BWIC auctions, but was a prudent and helpful measure to limit the information that would be available to the trading desk in preparing its bid.[129]

It is inescapably obvious that review of this auction sale from one Bear Stearns desk to another calls for particularly close scrutiny, but the evidence before me shows that there was nothing unusual about the Bid Solicitation procedures and nothing to indicate that the procedures were designed to—or did—discourage bidding on the Remaining Securities. Instead of "favoring the house," the procedures protected bidders by preventing a Bear Stearns affiliate from gaining an advantage in formulating its bid. I find no merit in Mr. Calahan's criticisms of the process used by Bear Stearns to conduct the BWIC auction. Fuss as he may, the Trustee was unable to offer credible evidence of any untoward conduct by Bear Stearns in either its decision to conduct an auction or in the conduct of the auction itself. Accordingly, there is nothing in the record to support a conclusion that Bear Stearns conducted the auction in an irrational manner or without good faith.[130]

---

[127] Chasin Tr. 1064:15-1065:6

[128] Joint Ex. 7; Connell Tr. 249:29-251:16.

[129] Bockian Tr. 798:20-800:18.

[130] The Trustee relies upon *Gatz Properties v. Auriga Capital Corp.,* 59 A.3d 1206 (Del. 2012) as a comparable case in which the court awarded damages to minority members after insiders purchased their interests in the limited liability company at an

3. Was it a good faith/rational decision of Bear Stearns to accept the outcome of the auction as the fair market value of the Securities at Issue?

On August 14, 2007, prior to the deadline in the Bid Solicitation, the Bear Stearns trading desk submitted an "all-or-none" bid of $60.5 million for 36 of the 37 Remaining Securities, including all of the Securities at Issue.[131] Tricadia Capital, LLC submitted the only other bid for two securities for a total bid of $2,187,290.[132]

One of the Remaining Securities had been withdrawn from the August 14, 2007 auction because Bear Stearns understood that HomeBanc had arranged to sell the withdrawn security to JP Morgan.[133] Since Bear Stearns owned the security, it solicited JP Morgan for a separate auction on the security held on August 17, 2007.[134] JP Morgan did not submit a bid,

auction in which no competing bids were received. That case is distinguishable on a number of levels and has no relevance here. In particular, the court determined that the auction was a "sham," that was not marketed or advertised properly and conducted on onerous terms. The court wrote, "[b]y failing for years to cause [the company] to explore its market alternatives, [the insider] manufactured a situation of distress to allow himself to purchase [the company] at a fire sale price at a distress sale." *Id.* at 1215 quoting *Auriga Capital Corp. v. Gatz Properties,* 40 A.3d 839, 875 (Del. Ch. 2012). Here, I have determined that Bear Stearns' auction procedures were usual and fair.

[131] Stipulation of Undisputed Facts, ¶ 15. Joint Trial Ex. 13. Connell Tr. 54:10-55:13; 262:19 -265:12.

[132] The two securities were HMBT 2004-1 2B ($1,786,470) and HMBT 2004-1 1B ($400,820). Joint Trial Ex. 12. Connell Tr. 261:6-262:18.

[133] Connell Tr. 265:13-267:1; 270:11-271:8.

[134] Joint Trial Ex. 16. Connell Tr. 270:11-271:8.

and the security was sold to the Bear Stearns trading desk for a bid of $1.265 million—more than HomeBanc had believed JP Morgan was willing to pay for the security.[135]

As the highest bidder, the Bear Stearns trading desk purchased the 37 Remaining Securities, including the Securities at Issue, for a total bid of $61,756,000.[136] After the August 14 Auction was completed, Bear Stearns allocated the auction proceeds across the individual securities for purposes of Bear Stearns' intra-company accounts.[137] Bear Stearns allocated value of $900,000 to each of the nine Securities at Issue, for a total of $8.1 million.[138]

The Trustee argues that even if the auction process was fair and in accordance with industry standards, Bear Stearns could not rationally or in good faith accept that the bid received from the Bear Stearns trading desk represented the fair market value of the Remaining Securities, or, in particular, the Securities at Issue. The Trustee claims that his experts' discounted cash flow analysis shows that the Securities at Issue had a fair market value in August 2007 of approximately $124.6 million, rather than Bear Stearns' assigned value of $8.1 million. Bear Stearns argues in response that the assumptions and hindsight analysis included in the Trustee's DCF Model inflated the value of the Securities at Issue to an

---

[135] Joint Trial Ex. 18. Connell Tr. 271:9-272:5.

[136] Joint Trial Ex. 19. Connell Tr. 272:6-272:19.

[137] Stipulation of Undisputed Facts, ¶16. Joint Trial Ex. 15, 19. Connell Tr. 267:2-268:12.

[138] Joint Trial Ex. 15, 19.

unrealistic figure, considering the market volatility in August 2007.

The Trustee maintains that a model, such as the DCF Model, should be used to value mortgage-backed securities which have value because they are cash-flow producing assets.[139] A DCF Model for this type of security makes assumptions about matters affecting the underlying mortgages' cash flows, such as prepayments, default risks, delinquency rates and loss severity rates.[140] Other assumptions reflecting the time value of money and the risks for these securities determine the rate used to discount the cash flow generated by the mortgages over time back to present value.[141]

The Trustee's three experts prepared and reviewed the DCF Model to value the Securities at Issue. Mr. Calahan constructed the original DCF Model "and then Dr. DeRosa's staff . . . took the model apart piece by piece . . . [and] replicated the model that Mr. Calahan did the heavy lifting on."[142] Drs. Mann and DeRosa said that they tested the reasonableness of the valuation assumption and suggested changes when appropriate.[143] The experts claimed to use only historical information that would have been available to someone in August 2007.[144] Once the team was satisfied with the assumptions and the discount rate, the DCF Model was used to project the cash flow for

---

[139] Mann Tr. 450:13-455:21.

[140] Mann Tr. 452:23-454:4.

[141] *Id.*

[142] Mann Tr. 457:6-457:10.

[143] Mann Tr. 456:15-457:15.

[144] Mann Tr. 457:16-458:8. HomeBanc Trial Exhibit 77.

the Securities at Issue, which were then discounted to present value.[145] Based on the DCF Model, the Trustee's team of experts opined that the aggregate value of the Securities at Issue as of August 2007 was $124.6 million.[146]

Bear Stearns criticized the Trustee's DCF Model because it did not consider the significant market events occurring in and around August 2007, including bankruptcy filings of HomeBanc and American Home Mortgage. The Trustee, however, claims that any market dysfunction occurring in August 2007 did not impact the value of the Securities at Issue because, as stated by his expert Mr. Calahan:

> [T]he value of the residuals is based on expected cash flows, and expected cash flows are driven by mortgage loan performance by individual borrowers mailing in their checks to the servicer, and they were . . . light years apart from the trouble that was going on in New York and London.[147]

The Trustee's expert, Dr. Mann, also testified that the bankruptcy remote structure of the securities prevented the bankruptcy of the issuer, HomeBanc, from having any negative impact on the value of those securities, explaining:

> The whole structure of securities do not depend in any way on the credit risk of the original issuer . . . . The sheer act of bank-

---

[145] Mann Tr. 457:16-465:19.

[146] Mann Tr. 467:21-468:4. HomeBanc Trial Ex. 78 allocated the total $124.6 million value among the individual Securities at Issue.

[147] Calahan Tr. 619:13-614:14.

> ruptcy wouldn't have any impact on the securities' value. So American Home Mortgage goes bankrupt, HoraeBanc goes bankrupt, the securities depend on assets in the special purpose vehicle and not on HomeBanc or American Home Mortgage.[148]

On its own, the issuer's bankruptcy may not have had a significant impact on the securities' value, but the market turmoil was not limited to HomeBanc's troubles. Dr. Attari, Bear Stearns' expert witness on the valuation of residential mortgage-backed securities, testified that a DCF Model must be "anchored" to "some market price or some form of price at which people are either trading or willing to trade."[149] DCF Models, like other valuation models, are, after all, only artificial constructs, or proxies, for market value. Bear Stearns asserts that the bankruptcy filings of HomeBanc and American Home Mortgage, together with stagnant or falling real estate values and other volatility in the market, necessarily would affect the assumptions in the Trustee's DCF Model about delinquencies, default rates and loss severity rates which, in turn, would decrease the cash flows for mortgages underlying the securities.[150] I agree.

---

[148] Mann Tr. 479:21-480:21.

[149] Attari Tr. 898:9-898:18. Bear Stearns proffered, without objection, Dr. Mukkarram Attari as an expert witness on the valuation of residential mortgage-backed securities. Tr. 892:12-892:19.

[150] Attari Tr. 923:8-932:22. Dr. Attari opined, for example, that the mortgage lenders' bankruptcies limited the availability of credit and prevented borrowers from being able to refinance their mortgages on better terms, leading to possible defaults. *Id* at 927:22-928:10.

The Trustee also argues that his DCF Model was a better predictor of the actual cash flow of the Securities at Issue. Bear Stearns assigned a value of only $8.1 million for the Securities at Issue as a result of the auction, but the Trustee asserts that the Securities at Issues' actual post-petition cash flow between August 9, 2007 and May 31, 2014 reached approximately $89.2 million.[151]

Dr. Mann testified that he and the other experts did not use the actual cash flow information available in 2010, but relied on information that would have been available in August 2007.[152] Bear Stearns maintains, however, that the cash flow in the Trustee's DCF Model aligned closely with the *actual* cash flow through July 2010, and after that date, the projected cash flow varied significantly from the actual cash flows:

- For the period August 2007-May 2010 - the DCF Model predicted cash flows of $90 million, and the actual cash flows were $76 million.
- For the period June 2010-September 2014, the DCF Model predicted cash flows of $76.2 million, and the actual cash flows were $13.2 million.
- For the period October 2014 onward, the DCF Model predicted cash flows of $99.7 million, while actual cash flows for the

[151] HomeBanc Trial Ex. 106; HomeBanc Trial Ex. 132; Calahan Tr. 647:8-649:9.

[152] Mann Tr. 541:2-544:23.

> Securities at Issue ended before July 2012.[153]

The Trustee's DCF Model predicted that future cash flow from the Securities at Issue would exceed $265 million. Although the actual cash flow reached $89.2 million as of May 31, 2014, the parties agreed that the securities were unlikely to have any additional cash flow after that date.[154] The DCF Model's predicted cash flows are largely overstated.

Bear Stearns also argues that the Trustee's DCF Model fails to account for or consider contemporaneous mark-to-market valuations of the Securities at Issue that were calculated by both Bear Stearns and HomeBanc in the time period preceding HomeBanc's default and the subsequent auction.[155] The Trustee's experts admitted that they did not adjust the DCF Model to account for prices from transactions between market participants that took place on or about the August 2007.[156] Bear Stearns contends that the critical

---

[153] Mann Tr. 540:14-555:9.

[154] *Id.*

[155] Calahan Tr. 709:7-710:1. The United States Commodity Futures Trading Commission's Glossary defines Mark-to-Market as:

> Part of the daily cash flow system used by U.S. futures exchanges to maintain a minimum level of margin equity for a given futures or option contract position by calculating the gain or loss in each contract position resulting from changes in the price of the futures or option contracts at the end of each trading session. These amounts are added or subtracted to each account balance.

http://www.cftc.gov/ConsumerProtection/EducationCenter/CFTCGlossary/index.htm#M, last accessed May 8, 2017.

[156] Mann Tr. 529:16-530:11. Calahan Tr. 717:9-721:21.

valuation metric for repo securities was the daily market value. The parties agree that the repo business is a daily mark-to-market business, meaning that the parties will calculate the value of the collateral subject to the repo on a daily basis based on current market conditions "to make margin calls if the collateral value has gone down or to pay back margin if the market value has gone up."[157] The parties also agree that either could make a margin call on the other if it believed that, owing to market conditions or otherwise, the market value of the securities underlying the repurchase transactions had increased or decreased such that more or less repo funding was appropriate.[158]

Consequently, the Bear Stearns repo desk reviewed the market value for each security subject to the repurchase transactions, including the HomeBanc securities, in its daily Exposure Reports.[159] A look at the Bear Stearns Exposure Reports' valuations at the end of July and beginning of August 2007 shows the following:[160]

	Exposure Report 7/27/2007	Exposure Report 8/3/2007	Exposure Report 8/6/2007
Securities at Issue	$20,960,348.00	$ 20,044,216.00	$ 12,674,495.00
All Remaining Securities	$120,171,126.00	$118,936,450.00	$ 67,710,026.00

---

157 Connell Tr. 167:13-167:23; Kubiak Tr. 360:3-361:14.

158 Chasin Tr. 1021:9-1023:12; *See generally* Joint Trial Ex. 1 at 9-11 (§4).

159 HomeBanc Trial Ex. 119; Chasin Tr. 1074:11-1074:24 ("The exposure rcports were reports which we looked at on a daily basis which showed us what the market value was of the securities which we were leaning against . . . [W]e would make decisions as to making margin calls or not");

160 Bear Stearns Ex. 78.

The Trustee points to the "disappearance" of $51.2 million of value in the Remaining Securities in one business day (8/3/2007 was a Friday; 8/6/2007 was a Monday) as evidence of bad faith by Bear Stearns. He asserts that Bear Stearns artificially reduced the value of the Remaining Securities in the Exposure Reports by $51.2 million, knowing that if HomeBanc defaulted on its obligation to repurchase the Remaining Securities on August 6, 2007 and Bear Stearns took possession of those Remaining Securities, then Bear Stearns would have to pay HomeBanc any amount in excess of the debt under the netting obligations in the GMRA.[161]

Bear Stearns counters that the significant decrease in the market value of the Remaining Securities between August 3, 2007 and the close of business on August 6, 2007 that was reflected on the Exposure Reports was due to events in the market, rather than any nefarious purpose. General market stress was causing prices to decrease sharply leading up to and during this time.[162] HomeBanc's competitor, American Home Mortgage, defaulted on its repurchase obligation to Bear Stearns shortly before August 3, 2007 and filed for bankruptcy protection on August 6, 2007.[163] Mr. Chasin testified that the default and bankruptcy of American Home Mortgage signaled to market participants that securities comparable to the Remaining Securities likely would be auctioned or otherwise sold into the marketplace, which would cause increased

[161] *See* Connell Tr. 124:2-125:23.

[162] Kubiak Tr. 374:21-375:12; Bockian Tr. 819:7-820:4, 876:6-881:11.

[163] Chasin Tr. 1141:19-1142:7; Connell Tr. 177:4-177:12 (stipulation that American Home Mortgage filcd chapter 11 on August 6, 2007).

supply in a generally declining market and, consequently, further decrease prices.[164]

The Trustee also contends that Bear Stearns formed a real estate investment trust ("SMOREIT") on August 1, 2007 to facilitate its becoming the registered holder of repo collateral of HomeBanc. Bear Stearns explained credibly that, as the markets got choppy in the summer of 2007, it recognized the need to take various steps to manage the risk associated with the securities it was financing and ensure that it was prepared in the event of a default. Establishing a REIT was one aspect of "trying to get its ducks in a row" if it had to liquidate collateral. [165]

At the same time, HomeBanc also maintained an internal mark-to-market spreadsheet reflecting the market value prices obtained by Bear Stearns on the Remaining Securities so it could track how much Bear Stearns was willing to finance based on the securities.[166] On or about August 5, 2007, Mr. Kubiak (HomeBanc's Chief Investment Officer) prepared a spreadsheet of his "rough cut" estimate of what he expected someone in the market might bid on the Remaining Securities, including the Securities at Issue.[167] Mr. Kubiak testified that he believed the securities were worth more, but he was calculating what "the market would bid on those securities."[168] In his analysis on August 5, 2007, he estimated that the

---

[164] Chasin Tr. 1084:3-1085:10.

[165] 165Chasin Tr. 1136:15-1141:18; Connell Tr. 188:6-189:12.

[166] Bear Stearns Ex. 8. Kubiak Tr. 364:8-371:2.

[167] Bear Stearns Ex. 10.

[168] Kubiak Tr. 389:4-393:13.

market would value the Securities at Issue at roughly \$18.5 million.[169]

Bear Trial Exhibit 78 shows the gap between the contemporaneous exposure report valuations in the summer of 2007 and the valuations in the Trustee's DCF Model.

Series [Securities at Issue]	Bear Stearns' 7/27/07 exposure report	HomeBanc's 8/5/07 MBS/Repo Position Sheet	Bear Stearns' 8/6/07 exposure report	Auction Proceeds 8/14/07	DCF Model Valuation
HMBT 2004-1 R	\$ 436,675	\$1,457,666	\$1,000,000	\$900,000	\$3,282,803
HMBT 2004-2 R	\$2,500,000	\$1,710,319	\$1,000,000	\$900,000	\$10,087,833
HMBT 2005-1 R	\$1,500,000	\$1,744,506	\$1,000,000	\$900,000	\$22,421,435
HMBT 2005-2 R	\$1,000,000	\$566,531	\$1,000,000	\$900,000	\$4,056,449
HMBT 2005-3 R	\$1,500,000	\$1,762,478	\$1,500,000	\$900,000	\$24,734,083
HMBT 2005-4 R	\$2,750,000	\$2,309,071	\$2,750,000	\$900,000	\$34,630,664
HMBT 2005-4 B2	\$3,123,673	\$2,649,519	\$924,495	\$840,450	\$2,977,801
HMBT 2006-2 R	\$6,750,000	\$4,315,181	\$2,500,000	\$900,000	\$22,369,508
HMBT 2007-1 R	\$1,400,000	\$2,053,142	\$1,000,000	\$900,000	
Total	\$20,960,348	\$18,568,413	\$12,674,495	\$ 8,040,450	\$124,560,576

I agree with Bear Stearns that the Trustee's DCF Model value is far removed from what anyone in the market was willing to pay for the Securities at Issue in August 2007. Instead, the Trustee's DCF Model erroneously reflects the value of the Securities at Issue as of July 2010, when the expert report was issued, rather than a fair market value as of August 2007.

Bear Stearns maintains that it relied rationally on the market to value the Remaining Securities. After a thorough review of the language of the GMRA in *HomeBanc 1,* I concluded that Bear Stearns had the contractual right to exercise discretion in choosing a rational manner in which the Net Value of the securities should be determined.[170] I concluded:

> Because the GMRA grants the non-Defaulting party (in this case, the Bear Defendants) contractual discretion with respect to post-

[169] Bear Stearns Ex. 10. Kubiak Tr. 392:4-392:9.

[170] *HomeBanc I,* 2013 WL 211180 at *16.

> default valuation of the securities, the circumstances in which this Court should intervene with the Bear Defendants' exercise of discretion to value the Securities at Issue are limited. This is especially true given the sophistication of the parties. The Bear Defendants' exercise of discretion must not be arbitrary or capricious, but made honestly and in good faith.[171]

Bear Stearns points to several independent factors to support the rationality and good faith of its valuation: (1) the bid reflects the fair market value of the Securities at Issue because the auction process was fair and in accordance with industry standards; (2) the bid reflected the contemporaneous estimates of value for the Securities at Issue as shown on the Bear Stearns Exposure Reports and the "rough cut estimate" of market value prepared by HomeBanc; (3) the Bear Stearns trading desk's individual bid for the last security auctioned on August 17, 2007 was actually higher than the price that HomeBanc thought JP

[171] *Id.* The GMRA provides that it is to be "governed and construed in accordance with the laws of England" (Joint Ex. 1, § 17). Therefore, I relied upon English case law deciding that "[i]t is very well established that the circumstances in which a court will interfere with the exercise by a party to a contract of contractual discretion given to it by another party are extremely limited." *Id.* at *15 quoting *Socimer Int'l Bank Ltd v. Standard Bank London Ltd.,* [2008] EWCA (Civ) 116 [¶ 62] (Court of Appeal) (Eng). The *Socimer* Court further noted, "This is the world of sophisticated investors, not that of consumer protection. These merchants in the securities of emerging markets have made an agreement which speaks of the need for a spot valuation, not of the more leisurely process of taking reasonable precautions, such as properly exposing the mortgaged property for sale, designed to get the true market price by correct process." *Socimer,* at ¶ 22.

Morgan had agreed to pay for it; and (4) HomeBanc, itself, did not and could not find another repo counterparty that would finance the repo collateral or outright purchase the securities for an amount great than the aggregate repurchase price, which was approximately $63.8 million at the time of the default.[172]

Bear Stearns' expert, Dr. Attari, opined that "[t]he results of a properly conducted auction give you the value of the security, give you the highest amount that someone is willing to pay for that security."[173] When asked if the market could price a security inaccurately, he answered:

> After the fact, the people have pointed back and said our market was pricing securities incorrectly. But rarely has it been possible in real time. In fact, one of the things that the Fed has pointed out repeatedly is that it's almost impossible to identify bubbles, which is when security prices are too high in real time. And, you know, because bubbles cause great harm to the economy after the fact, [o]ne of the things they like to be able to do is identify bubbles and make sure they don't occur, but it's almost impossible to identify them.[174]

Bear Stearns rationally accepted the highest bid by its trading desk as the value of the Securities at Issue in August 2007.

---

[172] Kubiak Tr. 354:24-358:18; *see also* Connell Tr. 183:3-185:1.

[173] Attari Tr. 903:9-903:12.

[174] Attari Tr. 903:16-904:4.

Conclusion

Courts must (1) determine facts based solely on the record made at trial, (2) identify relevant legal principals, and (3) apply governing law. Therefore, based on the record before me and addressing the issue remanded by the District Court, I conclude that Bear Stearns acted rationally, in good faith, and in accordance with the GMRA when it determined the fair market price of the Remaining Securities, including Securities at Issue, by holding a BWIC auction in August 2007. The evidence showed that there was a difficult, but functioning, market for selling the Securities at Issue and that Bear Stearns' Bid Solicitations complied with all the usual and customary standards for holding a BWIC auction.

The parties will be directed to confer and submit a form of order addressing each of the Trustee's amended crossclaims and Bear Stearns' crossclaims consistent with this Opinion, *HomeBanc I,* and *HomeBanc II*.

An appropriate order follows.

BY THE COURT:

/s/ Kevin J. Carey
KEVIN J. CAREY
United States Bankruptcy Court

DATED: May 31, 2017

APPENDIX G

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 18-2887

In re: HOMEBANC MORTGAGE CORP., *et al*,

Debtors,

WELLS FARGO, N.A., in its capacity
as Securities Administrator

v.

BEAR STEARNS & CO., INC.;
BEAR STEARNS INTERNATIONAL LIMITED;
HOMEBANC CORP.;
STRATEGIC MORTGAGE OPPORTUNITIES REIT, INC.

GEORGE L. MILLER, Chapter 7 Trustee for
the Estate of HomeBanc Corp.,

Appellant.

On Appeal from the United States District Court
for the District of Delaware
District Court No. 1-17-cv-00797
District Judge: The Honorable Richard G. Andrews

Argued September 26, 2019

JUDGMENT

Before: SMITH, *Chief Judge*, McKEE, and PHIPPS, *Circuit Judges*

This cause came on to be considered on the record from the United States District Court for the District of Delaware and was argued on September 26, 2019.

On consideration whereof, it is now hereby ADJUDGED and ORDERED that the judgment of the District Court entered August 15, 2018, be and the same is hereby AFFIRMED. All of the above in accordance with the opinion of this Court. Costs taxed to Appellant.

Attest:

s/ Patricia S. Dodszuweit
Clerk

DATED: December 24, 2019