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**UNITED STATES BANKRUPTCY COURT**
**FOR THE SOUTHERN DISTRICT OF NEW YORK**

| | | |
|---|---|---|
| **In re** | ) | |
| | ) | **Chapter 11** |
| **MPM Silicones, LLC, *et al.*,**[1] | ) | **Case No. 14-22503 (RDD)** |
| | ) | **Jointly Administered** |
| **Debtors.** | ) | |
| | ) | |

**TRIAL BRIEF OF WILMINGTON TRUST,**
**NATIONAL ASSOCIATION, AS 1.5 LIEN INDENTURE TRUSTEE**

[1] The last four digits of the taxpayer identification numbers of the Debtors follow in parentheses: (i) Juniper Bond Holdings I LLC (9631); (ii) Juniper Bond Holdings II LLC (9692); (iii) Juniper Bond Holdings III LLC (9765); (iv) Juniper Bond Holdings IV LLC (9836); (v) Momentive Performance Materials China SPV Inc. (8469); (vi) Momentive Performance Materials Holdings Inc. (8246); (vii) Momentive Performance Materials Inc. (8297); (viii) Momentive Performance Materials Quartz, Inc. (9929); (ix) Momentive Performance Materials South America Inc. (4895); (x) Momentive Performance Materials USA Inc. (8388); (xi) Momentive Performance Materials Worldwide Inc. (8357); and (xii) MPM Silicones, LLC (5481). The Debtors' executive headquarters are located at 260 Hudson River Road, Waterford, NY 12188.

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## I. PRELIMINARY STATEMENT

In remanding this case for further proceedings, the Second Circuit observed that the interest rates obtained by the Debtors for their exit financings in competitive, arm's-length negotiations with some of the largest money-center banks, "if credited, would have established a market rate" for the Replacement Notes. *In re MPM Silicones, L.L.C.*, 874 F.3d 787, 800 (2d Cir. 2017) ("2d Cir. Op."). Discovery has only confirmed this truism.

Not only did the Debtors go out into the market and obtain exit financing commitments at market rates prior to (for the first liens) and shortly after (for the 1.5 liens) the petition date, JPMorgan, the lead arranger and underwriter, provided updated pricing guidance for those exit facilities in August 2014, just three days before the Court's original confirmation ruling. That pricing guidance confirmed that market conditions had changed since the original commitments, resulting in increased market rates than were previously anticipated. The new notes to be issued to refinance the 1.5 Lien Notes (the "New 2L HY Notes") were expected to clear the high-yield market at a midpoint interest rate of 8.125%, and were backstopped by the fully committed bridge facility. The New 2L HY Notes were substantially similar to the 1.5 lien cramdown notes (the "1.5L Replacement Notes"): they had the same size ($250 million), a substantially similar term (8 vs. 7.5 years), and the same collateral (a junior lien on substantially all assets). The principal economic difference was that the 1.5L Replacement Notes lacked call protection, a pricing issue that, if anything, would have required a *higher* interest rate.

The Court need not simply rely on commitment rates or pricing guidance from the arrangers and underwriters. The company itself, in connection with its fresh-start accounting, was required to value the cramdown notes at "fair value" as of the Effective Date. The company obtained an independent valuation firm, which determined that the market interest rate for the 1.5L Replacement Notes was in the range of 7.75% to 8.25% as of the Effective Date. The

company relied on this independent valuation in its SEC filings, reporting that the fair value of the 1.5L Replacement Notes was 81%, which reflects a market interest rate of 8.12%. The Debtors' market rate expert, William Q. Derrough, does not even attempt to reconcile how his concluded rates are less than the company's own independent, contemporaneous valuations used in its SEC filings. Based on these and other indicia of market rates, including a standard market rate analysis, Christopher J. Kearns, the expert for the 1.5 Lien Trustee, concludes that the market interest rate for the 1.5L Replacement Notes was in the range of 7.75% to 8.25%.

After their competitive process established market rates for the exit financing, the Debtors attempt to evade those rates by proffering an academic expert on theoretical market efficiency that has no relevance to the availability of exit financing. As set forth in the Trustees' motion in limine, the entirety of Prof. David Smith's opinions should be excluded for disregarding the legal standard mandated by the Second Circuit. Accordingly, the only issue remaining for trial should be the market rate. For the reasons set forth below, the market rate of interest for the 1.5L Replacement Notes is at the high end of the range of 7.75% to 8.25%.

## II. RELEVANT FACTUAL BACKGROUND[2]

### A. MPM's Prepetition Capital Structure

In May 2012, MPM issued $250 million of 10% Senior Secured Notes due 2020 (the "1.5 Lien Notes") into the high-yield bond market.[3] The 1.5 Lien Notes required the payment of interest semi-annually at a fixed rate of 10%, had a term of approximately 8 years (the maturity date was October 15, 2020), and were secured by a lien on substantially all of MPM's assets that was junior to the lien on the then-existing Senior Secured Credit Facilities.[4] The 1.5 Lien Notes

[2] Unless otherwise indicated, citations including page numbers for Bates-stamped documents only include the last four digits of the Bates number.

[3] Statement of Stipulated Facts, Dkt. No. 1663 ("Facts") ¶ 1.

[4] Facts ¶ 1.

had call protection, including a "make whole" premium upon redemption before October 15, 2015.[5] In October 2012, MPM issued $1.1 billion principal amount of 8.875% First-Priority Senior Secured Notes due 2020 (the "First Lien Notes").[6] The proceeds from the First Lien Notes were used to repay the company's Senior Secured Credit Facilities, leaving the First Lien Notes senior in priority to the 1.5 Lien Notes.[7]

**B. Prepetition DIP and Exit Financing Commitments**

In November 2013, MPM retained Moelis & Company ("Moelis") to evaluate strategic alternatives and financing options.[8] In February 2014, the Debtors authorized Moelis to initiate the process of securing financing to fund a potential chapter 11 filing, including debtor-in-possession ("DIP") and exit financing.[9] Moelis then engaged in "extensive, virtually non-stop, multi-track negotiations" with three of the leading providers of DIP and exit financing, Credit Suisse AG ("Credit Suisse"), JP Morgan Securities LLC / JPMorgan Chase Bank, N.A. (together, "JPMorgan"), and Citigroup Global Markets Inc. ("Citigroup") (collectively, the "Arrangers") to secure commitments for DIP and exit financing.[10] The Arrangers were "institutions that are sophisticated and highly skilled in providing financing in distressed situations that have the ability to enter into a complex financing arrangement on an expedited basis."[11] The Arrangers were not equity holders in, or otherwise insiders of, MPM.[12]

[5] Facts ¶ 1; JX1 (1.5 Lien Notes Indenture) at 0615-16.
[6] Facts ¶ 2.
[7] Facts ¶¶ 1-2.
[8] Facts ¶ 7.
[9] Facts ¶¶ 8-9.
[10] JX9 (Derrough Postpetition Financing Declaration) ¶15.
[11] *Id.* ¶12.
[12] Derrough (May 2018) Dep. Tr. 64:13-65:3, 67:17-68:4.

Each of the Arrangers made independent proposals to underwrite both the DIP and exit financing, and Moelis negotiated separately with each of the Arrangers.[13] The proposals from the Arrangers reflected a tight range of proposed interest rates and certain other key terms.[14] After discussions with Apollo Global Management, LLC ("Apollo"), MPM's equity sponsor, GE Capital, and certain of MPM's second lien lenders about potentially providing DIP and exit financing, Moelis and MPM determined that the best financing would be obtained by negotiating a joint proposal for both DIP and exit financing from the Arrangers.[15] After extensive negotiations between Moelis and the Arrangers, MPM secured commitments dated April 3, 2014 for DIP and exit financing, including a $1.0 billion first lien exit term loan facility (the "First Lien Exit Term Loan").[16] The First Lien Exit Term Loan had a minimum commitment interest rate of LIBOR + 4% (with a 1% LIBOR floor).[17] The Arrangers also negotiated for the ability to use "flex" to increase the interest rate by up to 125 bps to achieve a successful syndication (defined as the Arrangers not holding any of the First Lien Exit Term Loan).[18]

### C. The New 2L HY Notes and Incremental Facility

#### 1. Negotiations of the Incremental Facility

Shortly after the Debtors filed petitions for relief under chapter 11 of the bankruptcy code on April 13, 2014 (the "Petition Date"), the Debtors engaged in a second marketing process to arrange additional exit financing to refinance the 1.5 Lien Notes.

On or about April 22, 2014, Moelis reached out separately to each of the Arrangers for

[13] Facts ¶ 10.
[14] JX78 (Moelis March 20, 2014 DIP Financing Discussion Materials) at 3734.
[15] Facts ¶ 10.
[16] Facts ¶¶ 11-14.
[17] Facts ¶ 15.
[18] Facts ¶ 17.

proposals for a second lien exit facility (the "Incremental Facility").[19] Credit Suisse, JPMorgan, and Citi each separately provided proposals to the Debtors.[20] The initial proposals were each for 8-year facilities of at least $250 million and included an option for the issuance of high yield bonds.[21] The Citi and JPMorgan proposals were structured as second lien facilities, and Credit Suisse's proposal was for unsecured bonds with the option to add second lien security (with no change in pricing).[22] The indicative pricing was within a tight range: Citi and Credit Suisse indicated pricing around 7.5%, while JPMorgan provided an all-in yield range of 6.75-7.125%.[23]

After engaging in "extensive multi-track negotiations," Moelis and the Debtors "determined that a comprehensive agreement shared by all three institutions would provide the best option for the Debtors."[24] Indeed, in seeking approval of the Incremental Facility, Derrough represented that the negotiations "involved a significant amount of time and effort as well as the exchange of numerous drafts and give-and-take on various deal points."[25] Derrough also represented that the negotiations of the Incremental Facility "occurred at arm's-length and in good faith," concluding that the terms of the Incremental Facility, including the interest rate and fees, were "reasonable and within market norms and on a whole, the financing is the best option available to the Debtors."[26]

The record confirms Derrough's representations to the Court. The Debtors provided initial drafts of a Commitment Letter, an Engagement Letter, a Fee Letter, and a Fee Credit

[19] Facts ¶ 30.
[20] JX88 (Credit Suisse Proposal) at 0728; JX87 (JPMorgan Proposal) at 0676; JX15 (Citi Proposal) at 0686.
[21] JX166 (Moelis Comparison) at 1006; JX88 (Credit Suisse Proposal) at 0730-31; JX87 (JPMorgan Proposal) at 0679-80; and JX15 (Citi Proposal) at 0696-98.
[22] JX166 at 1006; JX88 at 0731; JX87 at 0679-80; and JX15 at 0696-98.
[23] JX88 at 0730-31; JX87 at 0679; JX15 at 0696.
[24] JX99 (Derrough Incremental Facility Declaration) ¶ 9.
[25] *Id.* ¶ 11.
[26] *Id.* ¶¶ 11-12.

Letter (the "Incremental Facility Documents") separately to each of JPMorgan, Credit Suisse, and Citi on May 9, 2014.[27] Over the next month, Moelis and the Arrangers exchanged multiple drafts of the Incremental Facility Documents.[28] These drafts involved significant changes to key terms of the Incremental Facility, including the interest rate,[29] fees payable to the Arrangers, [30] covenants and conditions precedent,[31] use of proceeds,[32] and the scope of the Arrangers engagement.[33] After over a month of back and forth negotiation, the Incremental Facility Documents were executed on June 13, 2014.[34]

**2. Terms of the New 2L HY Notes and Incremental Facility**

The Incremental Facility Documents provided that the Debtors would issue $250 million of New 2L HY Notes into the high-yield bond market, with the Arrangers serving as "joint lead bookrunning managing agents," "joint lead bookrunning managing placement agents," and "joint lead bookrunning managing initial purchasers." [35] The New 2L HY Notes were to be secured by a junior-priority lien on the collateral securing the First Lien Exit Term Loan, have a term of at least 8 years, have call protection, and were subject to an overall 9% interest rate cap.[36]

The issuance of the New 2L HY Notes was backstopped by the fully committed Incremental Facility.[37] The Incremental Facility Documents provided that the interest rate on the

[27] Facts ¶ 32.
[28] *Id.*; *see, e.g.*, JX171 (May 14, 2014 drafts); JX173 (May 20, 2014 drafts); JX236 (May 24, 2014 drafts); JX174 (May 27, 2014 drafts); JX175 (May 27, 2014 drafts); JX235 (Executed Commitment Papers).
[29] *See, e.g.*, JX171 (May 14, 2014 drafts) at 1145; JX173 (May 20, 2014 drafts) at 1279.
[30] *See, e.g.*, JX171 (May 14, 2014 drafts) at 1119; JX173 (May 20, 2014 drafts) at 1253.
[31] *See, e.g.*, JX171 (May 14, 2014 drafts) at 1147; JX173 (May 20, 2014 drafts) at 1281-84.
[32] JX236 (May 24, 2014 drafts) at 1963.
[33] JX236 (May 24, 2014 drafts) at 1927-28.
[34] JX235 (Executed Commitment Papers).
[35] JX235 (Executed Commitment Papers) at 4488.
[36] Facts ¶¶ 33-34, 36; JX37 (Rating Agency Presentation) at 8561; JX21 (Executed Fee Letter) at 4752.
[37] Facts ¶ 33; JX235 (Executed Commitment Papers) at 4443-44.

Incremental Facility, if drawn upon, would be a ratcheting interest rate, starting at a rate of LIBOR+600 bps for the first three months, with a 1% LIBOR floor, and increasing by 50 bps at the end of each three-month period thereafter through the first year of maturity, subject to a 9% cap.[38] After one year, any amounts outstanding under the Incremental Facility would automatically convert to either a senior second-priority secured term loan (the "2L Term Loan") or, at the option of the Arrangers, senior second-priority secured exchange notes (the "2L Exchange Notes").[39]

The Debtors, Moelis, and JPMorgan all fully expected that the Debtors would be able to issue the New 2L HY Notes into the high-yield bond market, and thus had no expectation of drawing on the Incremental Facility.[40] Rather, the Incremental Facility served as a backstop to "provide certainty" at confirmation that the Debtors would be able to pay in full in cash the $250 million owed to holders of the 1.5 Lien Notes.[41]

### D. Updated Pricing Guidance from JPMorgan

In preparing to syndicate the First Lien Exit Term Loan and market the New 2L HY Notes, on August 23, 2014, after the close of evidence at confirmation and just three days before the Court announced its confirmation decision, JPMorgan advised Moelis and Apollo that its "current interest rate assumptions" were 8.125% for the New 2L HY Notes and LIBOR + 450 bps for the First Lien Exit Term Loan.[42] These interest rate "assumptions" aligned with JPMorgan's internal "guidance" that the market would require 50 bps of flex for the First Lien

[38] Facts ¶ 34; JX235 (Executed Commitment Papers) at 4463-64, 4508.

[39] Facts ¶ 34; JX235 (Executed Commitment Papers) at 4464.

[40] Facts ¶ 35; *see also* Jamal (May 2018) Dep. Tr. 261:17-263:17, 299:25-301:5, 317:24-318:18; Knight (May 2018) Dep. Tr. 179:10-179:19; Tramontozzi Dep. Tr. 96:15-97:13.

[41] Jamal (May 2018) Dep. Tr. 265:3-7, 253:21-254:3, 296:17-25, 297:2-14; Derrough (May 2018) Dep. Tr. 92:25-93:6, 100:20-22; Tramontozzi Dep. Tr. 96:3-6; *see also* JX31 (Bridge Motion) ¶ 10.

[42] Facts ¶ 21; JX84 (Aug. 23, 2014 email chain) at 0846.

Exit Term Loan and that the range of market yields for the New 2L HY Notes would be from 7.75% - 8.5%.[43] JPMorgan sent its "current interest rate assumptions" to Moelis so that Moelis could update the Debtors' projected interest expense calculations for use in the lender presentation JPMorgan was then preparing.[44] JPMorgan did not provide any further interest rate assumptions or guidance to Moelis or the Debtors.[45]

**E. Confirmation of the Debtors' Plan**

On August 26, 2014, the Court issued a bench ruling confirming the Debtors' plan of reorganization (the "Plan") over the objections of the holders of the First Lien Notes and 1.5 Lien Notes.[46] Pursuant to the Plan, on October 24, 2014, (the "Effective Date"), the Debtors issued cramdown notes with a fixed interest rate of 3.88% to the holders of the First Lien Notes (the "1L Replacement Notes") and the 1.5L Replacement Notes with a fixed interest rate of 4.69% to the holders of the 1.5 Lien Notes (together, the "Replacement Notes").[47] Although the Debtors did not seek to obtain credit ratings for the Replacement Notes prior to their issuance, there was no practical impediment to doing so. Shortly after the Effective Date, Standard & Poor's and Moody's assigned the Replacement Notes the following ratings on December 19, 2014 and January 16, 2015, respectively:[48]

| Replacement Notes | Standard & Poor's | Moody's |
|---|---|---|
| **1L Notes** | B | B3 |
| **1.5L Notes** | B- | Caa2 |

[43] JX43 (Draft Lender Presentation Deck) at 8105.
[44] Notably, Apollo directed Moelis to not "footnote the rates anywhere in the presentation." JX84 at 0846.
[45] Jamal (May 2018) Dep. Tr. 239:15-240:10.
[46] Facts ¶ 61; JX52 (Confirmation Order).
[47] Facts ¶¶ 67-68.
[48] Facts ¶¶ 74-75.

### F. The Debtors' Contemporaneous Determination of the Market Interest Rates for, and Valuation of, the Replacement Notes

Following confirmation of the Plan, the Debtors were required to value their assets and liabilities as of the Effective Date for their fresh start accounting.[49] As part of this process, the Debtors engaged Valuation Research Corporation ("VRC") as an independent valuation expert to determine the "fair value" [50] of their assets and liabilities, including the Replacement Notes.[51]

VRC concluded that the 1.5L Replacement Notes had a market yield (*i.e.*, market rate of interest) as of the Effective Date of ***7.75%*** to ***8.25%***, with a midpoint of ***8.0%***.[52] In its analysis, VRC concluded that "discounts to Par are justified via the above market leverage, below market yields and poor operating history[.]"[53] To determine the market yield for the 1.5L Replacement Notes, VRC first built up a market yield for the 1L Replacement Notes of 5.75% to 6.25%, then added a "market trade-implied yield spread between the 1st and 1.5 liens" of 193 bps.[54]

MPM relied upon VRC's valuation in recording the fair value of the 1.5L Replacement Notes on its fresh start balance sheet and its public SEC filings.[55] In its third quarter 2014 Form 10-Q and its 2014 Form 10-K, MPM reflected its fair value determination of the 1.5L Replacement Notes as $202 million, or 81% of par value, as of the Effective Date,[56] which reflects a yield (*i.e.*, market interest rate) of approximately **8.12%**.[57]

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[49] JX3 (VRC Engagement Letter) at 4589; Knight (May 2018) Dep Tr. 133:12-20.

[50] Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in a hypothetical arm's length transaction. JX94 (ASC Excerpts) at 4626.

[51] JX3 (VRC Engagement Letter) at 4589.

[52] JX60 (Oct. 24, 2014 VRC report) at 2189.

[53] *Id.*

[54] JX60 (Oct. 24, 2014 VRC report) at 2192.

[55] Knight (May 2018) Dep. Tr. 79:16-80:4.

[56] Facts ¶ 79; JX65 (2014 Form 10-K); JX61 (Sept. 2014 Form 10-Q).

[57] *See* Expert Report of Christopher J. Kearns (the "Kearns Report"), Appendix D for this yield calculation.

## III. ARGUMENT[58]

The Second Circuit's guidance on remand prescribes two steps for the Court's analysis. The Court is to determine first whether the markets for exit financing were efficient and, if so, "apply it to the replacement notes." 2d Cir. Op. at 800. The Second Circuit noted that the market rates quoted by the Arrangers, "if credited, would have established a market rate." *Id.*

### A. The Evidence Clearly Demonstrates the Existence of an Efficient Market for Exit Financing for the Debtors as of the Effective Date

The Second Circuit set forth the relevant test for market efficiency in the cramdown context: "markets for financing are efficient where, for example, they offer a loan with a term, size, and collateral comparable to the forced loan contemplated under and cramdown plan," *id.* (internal citation omitted), and where that market "generates an interest rate that is apparently acceptable to sophisticated parties dealing at arms-length." *Id* at 801.[59]

#### 1. Financing with Comparable Term, Size, and Collateral to the 1.5L Replacement Notes, from Sophisticated Parties Dealing at Arms-Length, Was Available on the Effective Date

The Debtors cannot credibly dispute that an efficient market existed under the Second Circuit's standard. The undisputed evidence demonstrates that the Second Circuit's efficient market test is easily met. Moreover, Prof. Smith, the Debtors' proffered expert on efficiency, admits that he offers no opinion under the Second Circuit's test.[60]

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[58] The 1.5 Lien Trustee hereby joins and incorporates by reference all of the arguments made by the First Lien Trustee in its trial brief to the extent applicable.

[59] The parties have already briefed in detail the applicable standard for market efficiency. The 1.5 Lien Trustee incorporates by reference all arguments with respect to the standard for market efficiency set forth in the Trustees' Joint Motion in Limine to Exclude the Expert Testimony of David C. Smith, Ph.D., Dkt. No. 1644 (the "Smith Motion in Limine") and the Trustees' Joint Objection to Motion in Limine to Exclude Expert Reports and Testimony of Bradford Cornell, Ph.D. and Christopher Kearns, Dkt. No. 1661 (together, the "Trustees' Motion in Limine Briefs").

[60] Smith (July 2018) Dep. Tr. 53:18-54:2 (Exhibit A to the Devore Declaration submitted herewith).

*First*, the New 2L HY Notes had substantially the same term (8 years vs. 7.5 years), the same $250 million amount, and the same junior lien on substantially all of MPM's assets, as the 1.5L Replacement Notes.[61] There is also no dispute that the Debtors, Moelis, and JPMorgan all fully expected to be able to issue the New 2L HY Notes into the public high-yield bond market.[62] The Debtors expected they "would successfully syndicate the bonds,"[63] and their advisors similarly anticipated that the bond offering would fully clear the high-yield bond market.[64] JPMorgan, as lead underwriter for the issuance, also testified to this view,[65] which was consistent with the robust market for high-yield bond offerings around the Effective Date.[66] The high-yield bond market indisputably consisted of sophisticated third-parties dealing at arms-length.[67]

*Second*, the Debtors obtained, through a competitive, arm's-length process, the $250 million Incremental Facility to act as a backstop for the issuance of the New 2L HY Notes.[68] The Incremental Facility, including its automatic conversion to the 2L Term Loan and/or 2L Exchange Notes, had a term, size, and collateral comparable to the 1.5L Replacement Notes.[69]

*Lastly*, Kearns presents uncontroverted testimony that, at the time of the Effective Date, there was (i) an active market of sophisticated lenders extending exit financing with comparable

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[61] *See supra*, Section II.C.1; *supra*, Section II.E.

[62] Facts ¶ 35.

[63] Jamal (May 2018) Dep. Tr. 300:18-301:5.

[64] Jamal (May 2018) Dep. Tr. 299:25-300:5.

[65] Tramontozzi Dep. Tr. 96:15-97:13.

[66] Kearns Report at 29-32.

[67] Smith criticizes focus on the anticipated issuance of the New HY 2L Notes because the final terms for those notes were never set and those notes were never marketed. Smith Report ¶ 99; Smith Rebuttal Report ¶ 66. However, the relevant question for the existence of an efficient market is whether those notes could have been issued, and Smith does not argue to the contrary.

[68] *See supra*, Section II.C.1, II.C.2.

[69] *See supra*, Section II.C.2.

size, term, and collateral priority to the 1.5L Replacement Notes;[70] (ii) a robust new issuance market for high yield financing, including financing for specialty chemical companies;[71] and (iii) an active secondary market for corporate credits, including those issued by specialty chemical companies.[72] The Debtors' own expert observed that financial market conditions were "strong" and that the leveraged loan and high yield bond markets were "robust."[73]

### 2. The Debtors' Academic Standard for Identifying an Efficient Market Is Incorrect and Unreliable

The Debtors' market efficiency expert, Prof. Smith, is admirably candid that the philosophical test of market efficiency used by academics in other contexts has no relationship to the test prescribed by the Second Circuit.[74] Indeed, he testified that it was "irrelevant" whether courts had applied his standard of market efficiency.[75] As set forth in detail in the Trustees' Motion in Limine Briefs, Smith's proposed efficient market test does not reflect, and is entirely inconsistent with, the Second Circuit's standard and, thus, should be excluded.[76]

Even if the Court were to consider Prof. Smith's approach, his methodology is unreliable and should be disregarded. Smith invents a three-step market efficiency test that has no support in any academic literature.[77] Smith fails the reliability standard at his first step (identifying "key" features to identify a "reference market"). *See Daubert v. Merrell Dow Pharm., Inc.*, 509 U.S. 579, 597 (1993) (expert testimony must "rest[] on a reliable foundation" and be "relevant to

[70] Kearns Report at 33-34.
[71] Kearns Report at 29-32.
[72] Kearns Report at 34-38.
[73] Derrough Report ¶¶ 62-63.
[74] Smith Rebuttal Report ¶¶ 16-18 & n. 12, 21.
[75] Smith (July 2018) Dep Tr. 53:18 – 54:15.
[76] *See supra*, n. 59.
[77] Smith Motion in Limine at 20-21, 21 n.10.

the task at hand."). By including the absence of call protection as a "key" feature,[78] Smith conflates a pricing issue (all else being equal, a note with call protection will yield a lower interest rate) with the existence of a market. Moreover, Smith's apparent conclusion that bonds without call protection could not clear the market or effectively trade is belied by the facts in this case. Brian Tramontozzi[79] testified that JPMorgan *would* have underwritten notes with substantially the same terms as the Replacement Notes, provided there was pricing flex to compensate for the absence of call protection.[80] That is, even without standard call protection, JPMorgan expected that there still would have been a market prepared to buy those notes (depending on the price), as has been confirmed by the post-issuance trading in the Replacement Notes. But, as explained in detail in the Trustees' Motion in Limine Briefs, the question is not the efficiency of the market specifically for the Replacement Notes, but the efficiency of the market for exit financing, namely the availability of financing with comparable term, size, and collateral to the cramdown notes.[81]

These are only some of the faults in Smith's opinions. To the extent the Court does not entirely exclude Smith's opinions for failing to apply the applicable standard for market efficiency (as it should), the 1.5 Lien Trustee will further demonstrate their unreliability at trial.

### 3. Markets for Financing Available to the Debtors Were Efficient Even Under an Academic Definition of Efficiency.

Even if the Court were to consider an academic definition of market efficiency, Kearns's testimony demonstrates that the market for exit financing available to the Debtors was efficient. Kearns concludes that there is an efficient market based on the Second Circuit definition, which

[78] *Id.* at 20.
[79] Tramontozzi was JPMorgan's Fed. R. Civ. P. 30(b)(6) designee in this matter.
[80] Tramontozzi Dep. Tr. 127:25-128:17; 149:3-150:4.
[81] *See supra*, n. 59.

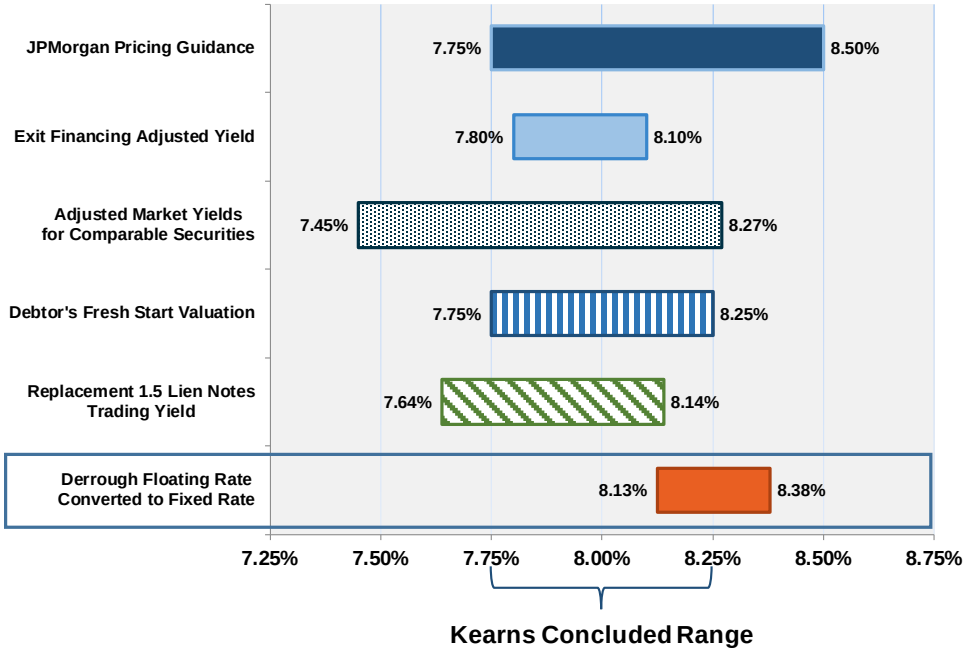
he opines is confirmed by the standard academic definition because (i) information was freely available to all market participants, and (ii) there was an active market where competition among investors supported price discovery.[82] Kearns identified eight "characteristics that are commonly present in an efficient credit market" (from academic literature by Fabozzi) applicable to MPM: (i) widespread, easily available information (transparency); (ii) numerous investors; (iii) clearly established roles for issuers, intermediaries, and investors; (iv) secondary trading; (v) established protocols for trading and distribution; (vi) standardized instruments; (vii) credit ratings and independent research available; and (viii) competitive pricing, with comparable deal pricing information widely available.[83] Although Smith argues, without any support, that "none of these characteristics constitutes a test of market efficiency as recognized by finance scholars,"[84] he acknowledges that that these characteristics constitute a textbook test of efficiency for fixed income securities.[85] Indeed, Smith regularly cites Fabozzi in his own report.[86]

### B. The Appropriate Market Rate of Interest for the 1.5L Replacement Notes Is In The Range of 7.75% to 8.25%.

Once the Court concludes that an efficient market exists, the Court must then determine the appropriate market rate. 2d Cir. Op. at 801, 806. Kearns concluded that the appropriate rate of interest for the 1.5L Replacement Notes is in the range of 7.75% to 8.25% (the "Kearns Concluded Range"),[87] resulting in a requisite Catch-Up Payment range of $26.9 - $31.6 million.[88] This concluded range is based on six different indicia of the market interest rate that

[82] Kearns Report at 34-38.
[83] *Id.*
[84] Smith Rebuttal Report ¶ 82.
[85] Smith Rebuttal Report ¶¶ 81-82; Smith (July 2018) Dep. Tr. 151:24-152:5, 152:17-21.
[86] *See* Smith Report at n. 89, 91, 97, 113, 114.
[87] Kearns Report at 54.
[88] The catch-up payment calculations set forth in the Kearns Report were based on the original $250 million principal amount of the 1.5L Replacement Notes. *See* Kearns Report at 54-55 & Ex. E. Following

all converge (with only slight variances) on the Kearns Concluded Range, many of which indicia the Debtors and Derrough do not dispute:




### 1. JPMorgan Pricing Guidance: 7.75%-8.50%

The first indicia of the market rate Kearns looks to is the contemporaneous pricing guidance provided by JPMorgan on August 23, 2014 (after the close of evidence in the confirmation trial but just three days before the Court's oral ruling).[89] JPMorgan's updated pricing guidance was 7.75%-8.5% for the New 2L HY Notes.[90] JPMorgan testified that this guidance was based on then-current "market conditions, deals in market as well as comparables, to determine a fair pricing to the market."[91]

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confirmation by the Debtors that the $48,423,000 in 1.5L Replacement Notes repurchased by the Debtors in 2015 and 2016 were cancelled, Kearns updated his calculations to reflect the current outstanding principal amount of $201,577,000, and the Catch-Up Payment figures contained herein are based on that current outstanding principal amount. These updated calculations will be filed with Kearns's trial declaration.

[89] Kearns Report at 44-45.

[90] *See* JX43 (Aug. 23, 2014 email chain attaching Draft Public-Side Lender Presentation) at 8105.

[91] Tramontozzi Dep. Tr. 61:5-64:10.

The New 2L HY Notes were to be issued with a similar term (8 vs. 7.5 years for the 1.5L Replacement Notes), the same size ($250 million), and the same collateral package as the 1.5L Replacement Notes.[92] The principal economic difference was the absence of call protection in the 1.5L Replacement Notes.[93] The absence of call protection is a pricing issue which, if anything, would require an *increased* rate as compared to the New 2L HY Notes.[94] Taking a conservative approach, Kearns did not increase the rate from this pricing guidance to reflect the absence of call protection.[95] Accordingly, the Court should look to this pricing guidance and the Kearns Concluded Range at the higher end of their respective ranges.[96]

The Debtors cannot refute JPMorgan's contemporaneous assessment of the anticipated market rate by the lead-left underwriter for the New 2L HY Notes. Instead, Derrough merely points out that the pricing guidance was for a lender presentation that was not ultimately made and that market participants would ultimately determine the market rate – points that the 1.5 Lien Trustee does not dispute.[97] But Derrough provides no basis as to why JPMorgan's contemporaneous analysis is anything but reliable, or less reliable than Derrough's own market analysis purportedly based on a similar methodology prepared for litigation purposes. Instead, Derrough only suggests that the Trustees' experts failed to consider a number of "Company-specific factors" that purportedly improved from the Commitment Date to August 2014.[98] But

[92] *Compare* Facts ¶¶ 36, 50 *with* JX37 (Aug. 12, 2014 Rating Agency Presentation) at 8561.

[93] The New 2L HY Notes were to be issued with a no-call period of up to three years and "customary make-whole and equity claw-back provisions." JX21 (Executed Fee Letter) at 4752.

[94] Kearns Report at 44-45. Derrough acknowledged at deposition that, all else being equal, weak call protection would require a higher interest rate than a similar note with strong call protection. Derrough (July 2018) Dep. Tr. 62:3-8 (Exhibit B to the Devore Declaration submitted herewith).

[95] *See* Kearns Report at 45.

[96] Using the high-end of these ranges is particularly appropriate given Derrough's conclusions on the "critical" nature of the call protection. *See* Derrough Report ¶ 39; Derrough Rebuttal Report ¶ 7.

[97] Derrough Rebuttal Report ¶ 11.

[98] Derrough Rebuttal Report ¶ 12.

all of those "Company-specific factors" were well-known to JPMorgan when JPMorgan provided the *updated* pricing guidance in August 2014 and most were, in fact, conditions precedent to the financing.[99] Also, Derrough speculates that this pricing guidance to be used in the lender presentation may have possibly strategically overstated the anticipated rate to increase investor interest.[100] Not only did JPMorgan not recall whether that strategy was to be used here,[101] but that conjecture is entirely rebutted by the fact that Apollo directed that the lender presentation ***exclude*** the updated rates.[102] There is no factual basis to suggest that JPMorgan's guidance was anything other than its best estimate of market rates.[103]

**2. Exit Financing Adjusted Yield: 7.80%-8.10%**

The second indicia of a market rate for the 1.5L Replacement Notes is the expected yield for the First Lien Exit Term Loan adjusted by a spread to reflect their relative priorities. Kearns performed a discounted cash flow analysis that calculated the expected yield of the First Lien Exit Term Loan.[104] Using JPMorgan's last pricing guidance of LIBOR + 450 bps, Kearns concludes that the First Lien Exit Term Loan was expected to yield approximately 6.80%.[105] Kearns then increased that 6.80% yield by a highly conservative range of 1.0% to 1.3%, based on

[99] Specifically, Derrough points to four "Company-specific factors": (i) "the actual financial results of the Company," which JPMorgan unquestionably had access to because they were publicly filed with the Disclosure Statement on June 23, 2014, two months before the updated pricing guidance; (ii) "reaffirmation of the $600 million equity investment," which was a condition precedent to the financing and always known to JPMorgan; (iii) "certainty around the plan," confirmation of which was a condition precedent for the financing; and (iv) "establishment of a clear separation between the Company and Momentive Specialty Chemicals from a management perspective with a shared services agreement in place," yet another condition precedent to the financing. Derrough Rebuttal Report ¶ 12; *see also* JX4 (Executed ABL, DIP, and Exit Term Loan Documents) at 2410-11, 2437.

[100] *See* Derrough Report ¶ 52, n.72.

[101] Tramontozzi Dep. Tr. 65:25-66:6.

[102] JX84 (Aug. 23, 2014 email chain) at 0846 ("Don't footnote the rates anywhere in the presentation.").

[103] The guidance was also consistent with the increasing market spreads for leveraged loans. Facts ¶ 22.

[104] Kearns Report at 45-46.

[105] Kearns Report at 45-46, Appx. A.

the historic spread between the yields to worst for the prepetition First Lien Notes and the 1.5 Lien Notes, resulting in a market rate of 7.80% to 8.10%.[106] Derrough, on the other hand, concluded that the appropriate spread was even higher, at 2%, based upon the spread between the commitment rates for the First Lien Exit Term Loan (LIBOR+400) and the Incremental Facility (LIBOR+600) because that "was a reasonable proxy for the spread."[107] Based on Derrough's higher spread, the Court should again look to the higher end of the range implied by the adjusted yield for the First Lien Exit Term Loan and the Kearns Concluded Range.

Derrough's rebuttal report has no direct critique of Kearns's First Lien Term Loan adjusted yield analysis, other than the fact that Kearns included the 50 bps of flex indicated by JPMorgan in its August 2014 guidance.[108] As noted above, the use of JPMorgan's pricing guidance is both reasonable and appropriate, and the Debtors have no factual basis to suggest that the guidance was anything other than JPMorgan's best estimate of the rate required to syndicate the loan. Moreover, given Derrough's opinion that the appropriate spread is higher than what Kearns conservatively used, the impact of excluding the 0.5% of flex is more than offset by Derrough's increase in spread (which exceeded the spread used by Kearns by 0.7% to 1.0%), further demonstrating the reasonableness of this indicia of market rate.

**3. Adjusted Market Yield for Comparable Securities: 7.45%-8.27%**

Kearns also compared the market yields of comparable securities of other issuers.[109] This methodology is the same approach used by the Arrangers in pricing their commitments and in

[106] *Id.*

[107] Derrough Report ¶ 60.

[108] Derrough Rebuttal Report ¶¶ 9-13.

[109] Kearns Report at 46-52, Appx. B, C. Kearns also prepared a summary of the comparables set forth in Appendix C of his report, which was attached to the Anker Declaration in support of the Smith Motion in Limine and will be included in Kearns's trial declaration.

providing the updated pricing guidance to the Debtors.[110] The methodology and comparable-security screening processes that Kearns used is set forth in greater detail in his reports.[111] In summary, Kearns developed a universe of comparable securities by identifying issuers with a credit rating of B+/B1 or lower, which was consistent with the expected and actual credit ratings for the Debtors at emergence, in the specialty chemical sector and from companies identified as comparable by the Arrangers and Moelis. This resulted in seven securities of issuers that had sufficiently similar business operations and credit risk for inclusion in a comparable security group.[112] Eliminating the high and low observations of the comparables resulted in a range of indicated market rate of interest of 7.45% to 8.27%.[113]

Derrough provides several critiques of Kearns's comparable securities analysis, none of which have merit, as will be demonstrated in detail at trial. For example, Derrough criticized Kearns for including three companies that have business models that his rebuttal report states are in the "commodity chemical" sector instead of the "specialty chemical" sector.[114] Derrough testified at deposition, however, that he had no understanding of how his team delineated between "specialty chemical" and "commodity chemical" companies, as many specialty chemical companies have significant commodity chemical businesses, and testified that he was not even involved in determining which issuers would be appropriate as comparables.[115] One of those three companies Derrough faults Kearns for including – Hexion – is a company that

[110] *See, e.g.*, Tramontozzi Dep. Tr. 64:5-10.

[111] Kearns Report at 46-52, Appx. B, C.

[112] *Id.* at 50-51. Kearns started with eight comparables, but excluded one from his calculations, Axalta, that was in the process of an initial public offering, the proceeds of which were expected to be used to repay material portions of that company's outstanding indebtedness.

[113] *Id.* at 52.

[114] Derrough Rebuttal Report ¶ 19.

[115] Derrough (July 2018) Dep. Tr. 216:21-219:10.

Derrough himself includes as a comparable "compan[y] in the specialty chemicals industry."[116] Derrough does not explain how Hexion is appropriate for him to use, but not for Kearns. Instead, Derrough includes Hexion as a comparable specialty chemical company, and then excludes it from his analysis because Hexion's debt had the lowest credit rating in his set of comparables.[117] Remarkably, Hexion's debt (which Derrough excluded) was the only security from his ten comparable companies with a credit rating comparable to the Replacement Notes, leaving 44 of 45 his remaining credits with *substantially higher* credit ratings for his "comparables." Moreover, Derrough could not explain at deposition (nor in his reports) why any such distinction between "commodity chemical" and "specialty chemical" companies even matters for Kearns's analysis when the three subject companies have similar credit ratings to Momentive, which credit ratings Derrough acknowledged he would expect to reflect any differences between commodity and specialty chemical sectors.[118]

**4. Debtors' Fresh Start Valuation: 7.75%-8.25%**

The fourth indicia of the market rate used by Kearns is the Debtors' own Effective Date valuation of the 1.5L Replacement Notes. Following consummation of the Plan, the Debtors' independent valuation expert, VRC, concluded that the 1.5L Replacement Notes had a below-market interest rate and, based on their valuation, had a market yield (*i.e.*, the market rate of interest) of ***7.75%*** to ***8.25%***.[119] In their SEC filings, the Debtors, relying upon VRC's valuation, determined that the notes had a fair market value of 81%, which calculates to a market yield of 8.12%.[120] Thus, the Debtors' own determination of the market rate of interest for the 1.5L

[116] Derrough Report ¶ 66.
[117] *Id.* at ¶¶ 66, 68.
[118] Derrough (July 2018) Dep. Tr. at 287:7-21.
[119] JX60 (Oct. 24, 2014 VRC Report) at 2189.
[120] See Kearns Report Appendix D for the calculation of this yield.

Replacement Notes is at the high end of the Kearns Concluded Range.

Derrough does not reference the Debtors' fresh-start valuation, nor provide any criticism in his rebuttal report of this indicia of market rate. Nor can the Debtors dismiss their own valuation of the 1.5L Replacement Notes as just "for accounting purposes." These are not book value figures that have tangential relevance to fair market valuations. The requisite standard applied by VRC for its valuation was "fair value," defined as "the price that would be received . . . to transfer a liability in an orderly transaction between market participants at the measurement date."[121] Not only did VRC determine the fair market value and market rate of interest for the 1.5L Replacement Notes, but PwC issued an unqualified opinion for the Company's balance sheet.[122] To issue that opinion, PwC was required to review the reported fair value measurement of the 1.5L Replacement Notes under the same standards it would have used for its own independent valuation. PwC's unqualified audit opinion confirms that the auditors agreed that the fair value of the 1.5L Replacement Notes was fairly presented.[123]

George F. Knight—the Debtors' treasurer at the relevant time and Rule 30(b)(6) designee—testified that the Debtors "stand behind the disclosures in the Q and the K."[124] There have been no amendments to the SEC filings. It remains to be seen if or how the Debtors will attempt to sidestep VRC's independent, contemporaneous valuation, confirmed by PwC, and incorporated by management into their SEC filings. In any event, Derrough's conclusions cannot be reconciled with the VRC valuation and the Debtors' fresh-start accounting, which align with all of the other indicia for the Kearns Concluded Range.

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[121] JX3 (VRC Engagement Letter) at 4589; JX94 (ASC Standard Excerpts) at 4626.

[122] Knight (May 2018) Dep. Tr. 80:20-81:2.

[123] The Kearns Report sets forth the applicable standards for PwC's audit opinion. *See* Kearns Report at 52-53, Appx. D.

[124] Knight (May 2018) Dep. Tr. 38:21-39:14.

**5. Post-Issuance Yield on 1.5L Replacement Notes: 7.64%-8.14%**

The fifth indicia of market rates used for the Kearns Concluded Range is the observed market yield of the 1.5L Replacement Notes in actual market transactions. During the 30 days immediately following the Effective Date, the 1.5L Replacement Notes traded between $81.0 and $83.5, indicating a yield to maturity range of ***7.64***% to ***8.14***%.[125] The calculated market rate of interest implied by trading prices for the 1.5L Replacement Notes reflected both (i) the contractual repayment terms of the notes and (ii) market expectations of the potential value of accretive litigation outcomes (i.e., pending litigation regarding the make-whole and interest rate). This is so because any benefits from such litigation would accrue to the benefit of the Replacement 1.5 Lien Notes. Thus, the calculated market yields from this trading activity understate the market rate of interest (*i.e.,* the trading price is higher than it would be without such litigation value, and a lower trading price would result in a higher yield), again confirming that the Court should look to the high-end of the Kearns Concluded Range.

Of course, actual rates agreed to by market participants (such as the rates for the exit financings in this case) are the best evidence of market rates. In lieu of such agreed rates, courts may look to market yields to determine then-current market interest rates. These standard yield calculations allow for the calculation of the current market interest rate for notes that were issued at a prior time (and thus in a different interest rate environment). In calculating such yields, there are three data points: (i) the coupon rate, (ii) the current trading price, and (iii) the maturity date.[126] The current trading price drives the calculation of market yields, which calculation is the

[125] *See* Kearns Report at Appx. E.

[126] *See* Derrough (July 2018) Dep. Tr. at 139:22-140:12. In a yield to worst calculation, the maturity date is assumed to be the first call date that is economically advantageous to the borrower and the calculation incorporates any premium expected to be paid at that call date.

foundation of comparable securities analyses used in fixed income securities, including as used by the Arrangers in their own underwriting memoranda.[127]

The 1.5 Lien Trustee understands from the March 2018 status conference that the Court has some reluctance in looking to trading prices. But looking to trading prices in determining market yields is fundamentally different from the typical attempt in bankruptcy to use trading prices to suggest solvency or insolvency, or otherwise imply enterprise valuation from the trading prices of junior debt. As described in detail in the Kearns Report, the use of trading prices for determining market yields is fundamental to the valuation of fixed income securities.[128] For example, in both Kearns's and Derrough's comparable securities analysis, both look to the "yield to maturity" (the required interest rate, assuming cash flows of the note are received through contractual maturity) or the "yield to worst" (the required interest rate, assuming cash flows are received until the first call date).[129]

Derrough's rebuttal report does not criticize the use of trading prices of the 1.5L Replacement Notes as an indicia for the Kearns Concluded Range.

**6. Derrough's Floating Rate Adjusted to Fixed Rate: 8.13%-8.38%**

Lastly, in his rebuttal report, Kearns converts Derrough's concluded floating market interest rate range for the 1.5L Replacement Notes of LIBOR + 600 to 625 to a fixed rate range of 8.13% to 8.38%.[130] As set forth below, there is no basis to depart from the terms of the Plan and the 1.5L Replacement Notes, and the market standard for high-yield notes, to change to a floating rate. Derrough's concluded range converted to a fixed rate is at the very high end of

[127] *See, e.g.*, JX241 (JPMorgan Discussion Materials) at 9318.
[128] Kearns Report at 41-43, 53-54.
[129] Kearns Report at 53-54; Derrough Report ¶ 67-68.
[130] Kearns Rebuttal Report at 27.

(and even exceeds) the Kearns Concluded Range, again confirming that the appropriate rate for the 1.5L Replacement Notes is at the high end of the Kearns Concluded Range.[131]

### C. Derrough's Analysis of an Appropriate Market Rate of Interest Is Fundamentally Flawed.

The Derrough Report opines as to the range of the market rate of interest for the 1.5L Replacement Notes as of the Effective Date based on: (i) an analysis of various factors of credit risk; (ii) identified debt instruments issued by companies sharing comparable credit characteristics to the reorganized Debtors; and (iii) an evaluation of new issuances of securities that were similar to the 1.5L Replacement Notes. While Derrough uses methodologies similar to Kearns, Derrough's analysis must be rejected. As will be demonstrated in further detail at trial, Derrough's analysis is fundamentally flawed, including for the following reasons.

#### 1. Derrough Incorrectly Concludes On a Floating Rate of Interest for the 1.5L Replacement Notes

Derrough takes the conclusory position that the Court should re-write the Replacement Notes as floating rate instruments even though the Replacement Notes have paid a fixed rate of interest for the past four years to holders that carried the risk of a fixed-rate instrument. The only proffered justification (set forth only in his rebuttal report) is that the 1.5L Replacement Notes were not issued with call protection.[132] Derrough's conclusion has no basis, and should be rejected for at least four independent reasons.

*First*, the Plan specifically provides that the Replacement Notes are fixed rate instruments. The Plan defines the Replacement Notes as "notes bearing interest at a fixed rate."[133] There is no basis to rewrite and depart from the plain language of the Plan.

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[131] Derrough Report ¶¶ 12, 75.
[132] Derrough Rebuttal Report ¶ 6.
[133] Facts ¶ 50; JX55 (Plan) §§ 1.152; 1.153.

*Second*, the New 2L HY Lien Notes were to be fixed rate, consistent with market standard for high-yield bonds. Derrough correctly recognizes that the primary economic difference in the Replacement 1.5L Notes is their lack of call protection. That pricing issue, however, would require a ***higher*** rate to reflect the interest rate risk lenders face under the freely-callable Replacement 1.5L Notes. But Kearns does not increase his concluded rates to reflect that increased risk. There is thus no basis for Derrough to use that economic distinction to retroactively rewrite the 1.5L Replacement Notes to floating rate and reduce their value even further.

*Third*, calculating the catch-up payment for the 1.5L Replacement Notes based on a retroactively assumed floating rate of interest would not make the holders of the 1.5L Replacement Notes whole. The holders received below-market fixed rate paper, and thus bore the entirety of the risk of market changes in interest rates. Retroactively imposing a floating rate—using hindsight knowledge of how interest rates actually changed over the past four years—would improperly retroactively reallocate that risk, borne by the noteholders, and deflate the appropriate 1.5L Replacement interest rate and resulting Catch-Up Payment.[134]

### 2. The "Comparable" Debt Instruments Underpinning Derrough's Analysis Are Inappropriate and Render His Conclusions Unreliable

The supposedly comparable debt instruments that Derrough selected to calculate a market interest rate are not comparable in the most critical economic respects. Derrough identified 10 chemical companies based in the U.S. with debt purportedly with "similar credit ratings to [MPM]."[135] However, Derrough excluded Hexion—the only issuer with debt rated remotely comparable to MPM's rating—leaving issuances with substantially *higher* credit ratings than the

[134] Kearns Rebuttal Report at 26-27.
[135] Derrough Report ¶ 66.

Replacement Notes. Specifically, the 1L Replacement Notes (for which Derrough focuses his comparable securities analysis and then bridges up to rates for the 1.5L Replacement Notes with a spread) were rated B/B3, considered "highly speculative" "junk" ratings.[136] After excluding Hexion, 44 of the 45 remaining debt issuances included in Derrough's analysis had *higher* credit rating than the 1L Replacement Notes.[137] Remarkably, 19 of the 45 (more than 40% of the "comparable" issuances) had *investment grade credit ratings.* Not a single one had a lower credit rating. Nor does Derrough make any adjustment to his rates in light of these disparities. Unsurprisingly, applying interest rates implied by investment grade debt to much lower-rated debt results in inappropriately low market rates for the riskier securities.

In his rebuttal report, Derrough explains for the first time that he relies more heavily (in an unquantified way) on four of those nine remaining companies: Minerals Technology, Kraton, Chemtura, and Huntsman.[138] Derrough, however, ignores (or was unaware of) fundamental problems with these "heavily weighted" comparables. Mineral Technologies had only one outstanding debt issuance, a first lien, senior secured term loan with a coupon of 5.28%.[139] Contrary to his report, this was in fact a floating rate instrument.[140] Derrough uses this floating rate in his fixed rate calculations without adjustment because, as he testified at deposition, he was unaware that it was a floating rate.[141] Two of the three remaining companies whose debt securities were central to Derrough's analysis had announced their intention to redeem the

[136] Facts ¶ 75; Derrough Report ¶ 66; Derrough Rebuttal Report ¶26.

[137] Only one of the 45 remaining credits (Kraton) had the same credit rating as the Replacement 1L Notes based on the S&P rating. Moody's, however, rated the Kraton issuance two notches higher (B1) than the Replacement 1L Notes. Derrough Report at Ex. 6.

[138] Derrough Rebuttal Report ¶ 27.

[139] Derrough Report at Ex. 6.

[140] JX243 (Minerals Technologies Sept. 2014 Form 10-Q) at 14.

[141] Derrough (July 2018) Dep. Tr. 165:18-167:13.

relevant securities as of the Effective Date, rendering them inapposite for a comparable credit analysis based on yields.[142] These are only some of the fundamental flaws in his analysis.

### 3. Derrough's Proffered Fixed Interest Rate for the 1.5L Replacement Notes Should Be Summarily Rejected

Unlike Kearns's analyses, Derrough (in both his floating and fixed rate analyses) focuses solely on the appropriate market rate for the 1L Replacement Notes, and then bridges up to the rate for the 1.5L Replacement Notes with a spread. Derrough's fixed rate analysis for the 1.5L Replacement Notes is directionally inconsistent, unprincipled, and should be rejected.

In his initial report, Derrough concluded that the 1.5L Replacement Notes should have a floating rate of LIBOR + 600 to 625 with a 1% LIBOR floor, corresponding to a minimum interest rate of 7% to 7.25%.[143] He calculated this rate by first determining a rate for the 1L Replacement Notes and adjusting upwards by a spread of 2%, the difference between the base commitment rates for the First Lien Exit Term Loan and Incremental Facility.[144] Derrough applied this 2% spread as "a reasonable proxy for the spread in rate between the 1L Replacement and the 1.5L Replacement Notes because the relative position in the capital structure of the [Incremental Facility] to the Exit Term Loan is substantially similar to the relative position of the 1.5L Replacement Notes and the 1L Replacement Notes."[145]

In his rebuttal report, Derrough concludes that if the Court were to require a fixed rate, the fixed rate for the 1.5L Replacement Notes should be 6.65% to 6.85%.[146] Inexplicably,

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[142] Derrough (July 2018) Dep. Tr. 176:9-177:12, 178:7-17. Kraton had announced that it was going to call its notes at their call premium price, and Chemtura had already announced that it was divesting assets and planned to repay all of its debt with the proceeds.

[143] Derrough Report ¶ 75.

[144] Derrough Report ¶ 60, 75.

[145] Derrough Report ¶ 60. In its fresh-start accounting, VRC used a similar spread of 193 bps between the 1.5L Replacement Notes and the 1L Replacement Notes.

[146] Derrough Rebuttal Report ¶ 25.

Derrough's fixed rate (6.65% to 6.85%) is ***lower*** than his minimum concluded floating rate (7% to 7.25%) for the 1.5L Replacement Notes.[147] This is directionally inconsistent with his rates for the 1L Replacement Notes, which have a *higher* fixed rate (5.5% to 5.7%) than his minimum floating rate (5% to 5.25%).[148] At deposition, Derrough acknowledged that it makes directional sense for the first lien fixed rate to be higher than the minimum first lien floating rate.[149] And that is, of course, because a fixed rate exposes the holder to interest rate risk, and all else being equal, the fixed rate should be higher than the minimum floating rate.[150] There is no basis for this to differ for the 1.5L Replacement Notes. At deposition, Derrough could not provide any reasoned basis as to why, unlike in his conclusions for the first liens, his fixed rate for the 1.5L Replacement Notes was *lower* than his minimum concluded floating rate:

> Q. Can you provide me any principled reason why on the one hand the replacement [first lien] notes directionally go higher from minimum floating to fixed, whereas the 1-and-a-half lien replacement go lower from floating to fixed?
>
> A. Not as I sit here right now. I'd have to think some more about it. Could be a function of the comps we are using having call protection and that ultimately impacting the relative pricing. I hadn't thought about it that way.[151]

The comparables used, of course, have no impact on how Derrough's fixed and floating rates are directionally different between the 1L Replacement Notes and the 1.5L Replacement Notes, because Derrough focused solely on the first lien rates in his analysis and then bridged up with a spread to the 1.5L Replacement Notes.

[147] Derrough Report ¶¶ 12, 75.
[148] Derrough Rebuttal Report ¶¶ 4, 8.
[149] Derrough (July 2018) Dep. Tr. at 296:7-11 ("Q: So directionally it makes sense to you that your fixed rate is higher than your minimum floating rate for the first lien replacement notes? A: Yes.").
[150] *See generally* Derrough Rebuttal Report ¶ 6.
[151] Derrough (July 2018) Dep. Tr. at 297:16-298:3.

Derrough's intellectual inconsistency is the result of cherry-picking a lower spread in his rebuttal fixed rate report. Unlike his 2% spread from his opening floating rate report, in his rebuttal fixed rate report Derrough significantly reduces the spread to 1.15%, which was the midpoint of the spread Derrough selectively chose from one component of one of Kearns's five original indicia of market rates.[152] Derrough takes this reduced spread from one component of Kearns's analysis, and applies it to his analysis *in toto*, resulting in directionally counter-logical conclusions. This result-driven analysis is not credible and should be summarily rejected. At a minimum, to preserve consistency and intellectual integrity, Derrough should have maintained his original 2% spread for his fixed rate conclusion for the first liens (5.5% to 5.7%), resulting in a minimum fixed rate for the 1.5L Replacement Notes of 7.5% to 7.7% (slightly higher than his minimum concluded floating rate of 7% to 7.25%).[153]

### D. The Catch-Up Payment for the 1.5L Replacement Notes Must Include Interest on Unpaid Interest Amounts

Kearns calculates the Catch-Up Payment for the 1.5L Replacement Notes to include interest on all unpaid interest amounts, using the market rates of the Kearns Concluded Range for such "interest-on-interest." The Kearns Concluded Range of 7.75% to 8.25% results in a range of interest-on-interest for the 1.5L Replacement Notes of approximately $3.3 million to $4.1 million.[154] Derrough, however, "on the instruction of counsel" excludes any interest-on-interest and has no opinion as to whether it is or is not proper to include interest-on-interest.[155]

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[152] Derrough Rebuttal Report ¶ 27.

[153] For all of the reasons set forth elsewhere herein and to be established at trial, even when Derrough's fixed rate is adjusted to reflect his original 2% spread, such rates continue to significantly understate the market rate for the 1.5L Replacement Notes.

[154] As noted above, *see supra*, note 88, Kearns's updated catch-up payment calculations will be filed with his trial declaration.

[155] Derrough Rebuttal Report ¶ 29; Derrough (July 2018) Dep. Tr. 32:23-34:10.

Interest-on-interest must be included in the Catch-Up Payment to satisfy the present value requirements for cramdown under section 1129(b)(2)(A)(i)(II) (requiring deferred cash payments "totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan"). Assuming an efficient market, the purpose of these proceedings is to go back in time and determine the appropriate market interest rate that, if it had been implemented on the Effective Date, would have provided the holders future cash payments with a present value *as of the Effective Date* equal to their claim amounts. While the Court can go back in time to determine the market interest rate that should have been imposed as of the Effective Date, the Debtors cannot go back in time and actually pay the amount of the interest deficiency when it would have been due to the holders on the 15th of every April and October for the past four years. Instead, in order to retroactively provide the holders with the present value of their claims as of the Effective Date, the Debtors must also pay interest on the unpaid deficiency at the market rate. Only with the payment of interest-on-interest are the holders "made whole" and retroactively provided with their full entitlement to the present value of their claims as of the Effective Date.[156] Anything less would provide a windfall for the Debtors who have benefitted—to the detriment of the holders—from the time value of such unpaid amounts.

[156] The Debtors in drafting the 1.5L Replacement Notes acknowledged this fundamental economic point. The indenture for the 1.5L Replacement Notes requires the Debtors to "pay interest on overdue installments of interest at the same rate borne by the Notes." JX1 (1.5L Replacement Notes Indenture) at § 4.01. To the extent that the Debtors contend that the "overdue interest" provision of the 1.5L Replacement Notes is not applicable or that they are otherwise not required to pay interest-on-interest at the market rate, applicable New York law would require the Debtors to pay an even *higher* 9% prejudgment interest rate. *See, e.g.*, *NML Capital v. Republic of Argentina*, 17 N.Y.3d 250 (N.Y. Ct. App. 2011) (holding where an indenture does not expressly provide for a certain rate of interest on missed interest payments, the New York 9% prejudgment interest applies).

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