EXHIBIT 3

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KRAMER LEVIN NAFTALIS & FRANKEL LLP
Kenneth H. Eckstein
Philip Bentley
Philip S. Kaufman
Jeffrey S. Trachtman
1177 Avenue of the Americas
New York, New York 10036
Telephone: (212) 715-9100
Facsimile: (212) 715-8000

Counsel for the Official Committee of Unsecured Creditors

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	:	Chapter 11
RESIDENTIAL CAPITAL, LLC, et al.,	:	Case No. 12-12020 (MG)
Debtors.	:	Jointly Administered

OBJECTION OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS TO THE DEBTORS' MOTION PURSUANT TO FED. R. BANKR. P. 9019 FOR APPROVAL OF THE RMBS TRUST SETTLEMENT AGREEMENTS

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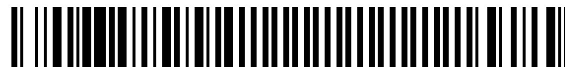
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estate and third-party claims against Ally based on a capped settlement payment of $750 million. In exchange for this support, the Debtors agreed to an Allowed Claim some *$4 billion more* than the highest value they had ever publicly attributed to their R&W liability, the effect of which would be to swamp the Debtors' unsecured creditor classes. The evidence shows little effort by the Debtors to advocate independently for the interests of their other constituents by establishing an appropriate but not inflated Allowed Claim amount. Instead, the Debtors took a back seat and allowed the negotiations to be led by their corporate parent, which had little to lose by giving a large allowed claim against its bankrupt subsidiaries in return for a cap on its own contribution to the estates.

Discovery regarding negotiation and approval of the RMBS Trust Settlement has confirmed three critical facts: first, Ally directed the negotiations from the Debtors' side; second, Ally, in negotiating the settlement on behalf of the Debtors, was primarily (if not solely) motivated by its desire to obtain a release; and third, the ResCap Board rubber-stamped the Ally-negotiated settlement based on an analysis that was both extraordinarily cursory and fundamentally flawed. We summarize here only some of the evidence that will be presented at trial:

1. Ally directed the negotiations

- In October 2011, Kathy Patrick contacted William Solomon, General Counsel to *Ally*, to demand a meeting to discuss her clients' purported repurchase and servicing claims. Exh. F. Mr. Solomon responded with a letter that denied any liability on Ally's part and suggested that Ms. Patrick reach out to Tammy Hamzehpour, General Counsel for the Debtors. Exh. G. Kathy Patrick responded that her clients believed that Ally bore the liability associated with the repurchase and servicing claims. Exh. H; *see also* Hamzehpour Tr. 28 (Exh. I).
- Subsequently, Timothy Devine, *Ally's* Chief Counsel-Litigation, was "asked to interface with Kathy Patrick." Devine Tr. 43 (Exh. J). Despite the universal

recognition that he did not represent ResCap,[12] Mr. Devine testified that he was the one "driving a deal to conclusion. . . . [T]he deal that is represented in gross by the resolution between the ResCap estate and the RMBS claimants, both the Kathy Patrick and Talcott Franklin in the one sense and also the tripartite agreement between Ally, the ResCap entities, and the claimants." *Id.* at 248.

- *ResCap's* General Counsel, Ms. Hamzehpour, on the other hand, was largely a spectator in the negotiations, having no one-on-one calls with Ms. Patrick in 2012. Hamzehpour Tr. 90 (Exh. I). While Ms. Hamzehpour claims to have been "kept informed" of the negotiations, she admittedly did not participate in many of the discussions or meetings. *Id.* at 80-81.

- Negotiations with Ms. Patrick did not begin in earnest until April 16, 2012, three weeks before the settlement was approved by the ResCap Board. Oct. 4, 2012 Hearing Tr. 47 (Exh. K). On April 17, 2012, Mr. Devine stated in an email to Ms. Hamzehpour and Gary Lee of Morrison & Foerster that he did not believe they should share with Ms. Patrick at that point a dollar range of potential Ally contribution, but should instead focus on "the structure of the proposed outcomes, the potential for substantial contribution from AFI, fragility of the goal but *clarity of purpose for comprehensive third party releases*." Exh. L (emphasis added).

- In a series of emails on April 23, 2012, Mr. Devine urged Ms. Hamzehpour to present Ms. Patrick with a range of private label R&W claim sizes of $3 billion/$4 billion/$6 billion, representing the low/medium/high range, and to use $750 million rather than $1 billion as Ally's potential contribution. Ms. Hamzehpour replied without objection. Exh. M.

- In a decisive communication on May 9, 2012, Mr. Devine wrote to Mr. Lee that "[a]s I told you on the phone, Ally will support the $8.7 billion allowed claim. There is no new Ally money. Hard stop at 750 + 200 + 100."[13]

[12] *See, e.g.*, Devine Tr. 222-23 (Exh. J) (Ally was his client); Ruckdaschel Tr. 142 (Exh. N) ("my understanding is that in the RMBS settlement discussions that Tim was representing Ally"); Marano Tr. 239-41 (Exh. E) ("Tim Devine had been present but he did not represent ResCap. . . . Mr. Devine was there as a representative of Ally I believe."); Hamzehpour Tr. 27 (Exh. I) (Mr. Devine was representing Ally).

[13] Exh. P. The Committee understands that this refers to $750 million in cash; $200 million in credit for Ally's $1.6 billion bid for the HFS portfolio of loans (which Ally alleged was worth only $1.4 billion); and $100 million in credit relating to the Debtors' ongoing origination and subservicing relationship with Ally. As we now know, the proposed additional credits were illusory: the HFS portfolio was ultimately sold to Berkshire Hathaway for more than $1.6 billion, and the ongoing agreements between the Debtors and Ally required the Debtors to pay tens of millions of dollars to Ally Bank (for the benefit of Ally) in connection with certain loan modifications being performed in connection with the DOJ/AG settlement – something Ally appears not to have considered when determining that the ongoing agreements would benefit the Debtors by $100 million.

2. **Ally's primary – or sole – motivation was to obtain a release**

- Ally made clear to Kathy Patrick that it would support the Settlement only if Ms. Patrick would agree to support Ally's release as part of the plan. As Mr. Devine testified, "[w]hat I communicated to Kathy Patrick was that in connection with the settlement agreement she was trying to reach with the debtor, for which she sought Ally's support and assurance that Ally wouldn't object to it, Ally would seek a release – Ally would seek the support of her clients of the plan that was being negotiated between ResCap and Ally at the time." Devine Tr. 98 (Exh. J).

- On May 7, 2012, Mr. Devine asked Mr. Lee and attorneys from Kirkland & Ellis, Ally's outside counsel, "what percentage of R&W claimants do we need to be able to cram down or otherwise neutralize the AIGs or other likely objectors." Exh. O.

- The amount that Ally would be paying for the releases from ResCap and third parties was of primary importance to Ally. Devine Tr. 145 (Exh. J). Ms. Hamzehpour conceded that "[i]t was clear to everyone internally" that "third-party releases would be required in order to achieve a substantial contribution from AFI." Hamzehpour Tr. 50 (Exh. I).

- In an email dated May 10, 2012, the day after the Board approved the Settlement (see below), Mr. Devine explained to Morrison & Foerster that the tripartite agreement had been structured to release claims against Ally even though the RMBS Trust Settlement Agreement itself technically did not:

> The circle is squared at the Plan. KP can only get us the "everything-but-securities" settlement release because that is the full extent of her representation. She has been clear about that. Same as in her BoA/BoNYM work. Etc.
>
> But notice: though her clients don't release securities claims, they sign Plan Support Agreements, and the Plan includes very simple comprehensive releases, which of course include third party release of all claims, which of course includes securities claims. Presto.
>
> So while she can't represent parties in giving up their securities claims, clients face a choice: either sign up with the settlement to make sure your trust receives monies under the waterfall, in which case you need to sign the Plan Support Agreement and support the Plan. And the Plan wipes out all their claims of any sort. This is the beauty of it.

  Exh. T.

- In a May 12, 2012 email from Noah Ornstein of Kirkland & Ellis to Morrison & Foerster regarding the Ally release, Mr. Ornstein wrote:

> Spoke with T. Devine this morning. He is adamant that Ally get a release from Trusts in the settlement agreement. Notwithstanding that Ally is not a party to that agreement, I think we can get there. Consider a third party beneficiary provision running to Ally that is a full release of Ally upon the Effective Date . . . .

Exh. Q.

- In an email dated May 12, 2012, Mr. Devine wrote to Morrison & Foerster and Kirkland & Ellis that he "Had call with KP. We told her PSA support – whole hog – is drop dead." Mr. Devine explained that he had informed Ms. Patrick that Ally would insist – as much as it was able to insist – on her support of the Plan. Exh. R; *see also* Devine Tr. 281-82 (Exh. J).

3. The Board rubber-stamped the Settlement after reviewing only a cursory and deeply flawed analysis

- Ally's Form 10-Q, filed April 27, 2012, stated:

> We currently estimate that ResCap's reasonably possible losses over time related to the litigation matters and potential repurchase obligations and related claims described above could be between $0 and $4 billion over existing accruals.

Exh. S at 73. The same Form 10-Q disclosed a reserve of $811 million. *Id.* at 69. No one has questioned the accuracy of this disclosure.[14]

- A presentation by Mr. Devine to ResCap's Audit Committee on May 1, 2012 summarized the "estimated top-end of the range of reasonably possible losses for ResCap over time related to litigation, repurchase obligations, and related claims over existing reserves as of 1Q 2012" at $4.041 billion. Exh. U at 3.

- A week later, the ResCap Board was asked to approve a settlement nearly *double* that amount. The $8.7 billion settlement was presented to the Board the same day that Ally's counsel Mr. Devine declared that Ally would support that number but was enforcing a "hard stop" at the $750 million base amount for Ally's plan contribution. ResCap went along with this deal even though ResCap Chairman and CEO Thomas Marano had expressed to the ResCap Board that "it probably would take something close to $2 billion to settle this" and that "no one was going to do a deal for 750." Marano Tr. 93-94 (Exh. E). In fact, ResCap's claims against Ally were initially estimated to be $8 or $9 billion. Mack Tr. 131 (Exh. V); Exh. W.

[14] John Mack, a ResCap board member on the audit committee, believed that this estimate was accurate and that "$4 billion was the upper end of the range," including securities claims. Mack Tr. 57-60 (Exh. V). *See also* Devine Tr. 199 (Exh. J) (disclosures in 10-Q "were accurate and appropriate and lawful at the time and they stand the same today.").

- Mr. Marano received the May 9, 2012 board materials – a two-page handout provided by counsel – 22 minutes before the scheduled 3 pm telephonic board meeting. Prior to the May 9 meeting, he was aware of "general concepts," but stated that the settlement discussions with Ms. Patrick were "fluid" until the meeting. Marano Tr. 146-48 (Exh. E); *see also* Mack Tr. 62-63 (Exh. V) (Mack not informed before meeting that deal had been reached); Whitlinger Tr. 24-27 (Exh. X). The Board was provided with no expert opinion as to the fairness of the settlement, no estimate of the likely outcome of actually litigating the claims, and no meaningful legal or factual analysis that in any way supported the huge leap in the amount of the allowed claim. Mack Tr. 67 (Exh. V) (board not told what number would be if claim actually litigated rather than settled); *see also* Whitlinger Tr. 119-20 (Exh. X). It nevertheless approved the settlement, after spending less than an hour on the subject. Marano Tr. 164-67 (Exh. E); Exh. Y; Exh. BB.

- The two-page handout on which the Board based its approval (which stated on its cover that it was prepared by Ally as well as ResCap) contained the barest analysis imaginable of the merits underlying the proposed $8.7 billion settlement. The analysis did not address any litigation defenses, nor did it consider any data derived from actual loan file reviews (since none had been conducted). Exh. Y. Instead, the presentation noted that the proposed settlement embodied a 19.72% "defect" rate (that is, the $8.7 billion settlement amount comprised 19.72% of the Trusts' $44 billion in estimated lifetime losses), which it purported to justify by comparing two other purported rates – namely, the 35% and 36% defect rates supposedly associated with the RMBS claims asserted in the Lehman bankruptcy and with Bank of America's recent $8.5 billion RMBS settlement, respectively. *Id.* These two comparisons, plus a footnoted reference to a REDACTED "weighted average defect rate" supposedly derived from ResCap's "historical post fund audit" experience, constituted the presentation's *only* support for the proposed settlement amount.

- Discovery has revealed, however, that each of these comparisons was fundamentally flawed – a conclusion reached by the Debtors' own expert, Mr. Sillman, who was engaged only *after* the Board had approved the Settlement and the Debtors had executed it, Sillman Tr. 104-05 (Exh. D):

    - In his analysis of the reasonableness of the $8.7 billion Allowed Claim amount, Mr. Sillman compared the "loss share rate" that he estimated for the Debtors with the loss share rate implicit in the Lehman and Bank of America cases. (Mr. Sillman's "loss share" rate is identical in substance to the "defect" rate used in the May 9 Board presentation, namely, the settlement amount as a percentage of the trusts' estimated lifetime losses.) He concluded that the correct rates for these two settlements were 9%-14% and 14%, respectively – a fraction of the 35% and 36% rates used in the Board presentation. Initial Sillman Decl. ¶ 65; Sillman Tr. 233-34, 236 (Exh. D).

    - Without any assistance from Mr. Sillman (who had not yet been retained), the Debtors' Mortgage Risk Officer, Jeff Cancelliere, reached the same conclusion about the Bank of America settlement. Mr. Cancelliere told counsel, prior to the

May 9 Board meeting, that he had "concerns" with using a 36% defect rate. Cancelliere Tr. 205-08 (Exh. B).

  - Even the REDACTED historical "weighted average defect rate" referred to in a footnote to the May 9 Board presentation was not reliable, according to Mr. Sillman. He testified that he relied on none of the Debtors' pre-petition PLS experience in forming his opinions, because he determined that the Debtors had insufficient available information to permit a meaningful assessment of that experience, including their historical "post fund audit" experience. Sillman Tr. 142-46 (Exh. D).[15]

- Although ResCap had two independent directors supposedly responsible for negotiating at arm's length with Ally, at least one of them, Mr. Mack, appears to have been largely uninformed. He testified, among other things, that he never received an explanation of what litigation defenses might be available to ResCap against these potential claims, Mack Tr. 53 (Exh. V), and that the $8.7 billion settlement was not necessarily consistent with ResCap's potential liability, but was simply a "negotiated number." *Id.* at 66-67. He also had "no idea" that Ally was having conversations with Ms. Patrick, but stated that he "would not understand" why Ally's chief litigation counsel would have taken the lead in the settlement negotiations and negotiated material terms. *Id.* at 41, 44.[16]

In short, the RMBS Trust Settlement was not "the product of arm's length bargaining," one of the key factors that the Court must consider in approving any settlement under *Iridium*. Rather, the Settlement was negotiated principally between Ally (speaking directly through its in-house counsel or by instructing the Debtors) and Kathy Patrick, and Ally's main concern was to lock in constituencies to a Plan Support Agreement in return for the lowest possible plan contribution. This deal – at bottom, the trade-off of an excessive $8.7 billion allowed claim for an inadequate $750 million plan contribution – was sold to ResCap's board on

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[15] Board members do not remember being informed of any of the shortcomings in the analysis on which they relied to approve the Settlement. Whitlinger Tr. 43, 46-47 (Exh. X); *see also* Cancelliere Tr. 205-08 (Exh. B).

[16] Further demonstrating that the Board was not fully informed regarding the details of the Settlement, the settlement agreement that the Board approved on May 9, 2012 was *different* from the one that was ultimately executed. Mr. Lee wrote in an email to Ms. Patrick later on May 9 that he was "spooked" to learn that "the deal I sold to our board" did not include the release of securities claims. Exh. T. Mr. Mack therefore believed – and apparently still believes – that the $8.7 billion settlement he approved includes securities claims. Mack Tr. 108-09 (Exh. V). Yet, the final RMBS Trust Settlement Agreement specifically *excludes* the release of securities claims, *see* § 7.01, and for good reason: Ms. Patrick could not release such claims because she did not represent her clients with respect to those claims. *See* Exh. T; *see also* Devine Tr. 271-73 (Exh. J).

the basis of information that both the Debtors' Mortgage Risk Officer and the Debtors' own expert consider inaccurate.[17]

B. The Settlement Is Opposed By Every Major Impaired Creditor Group Besides the Plaintiffs

The *Iridium* factors relating to support for the RMBS Trust Settlement by creditors and other parties in interest further militate against approval here, particularly in combination with the lack of arm's length negotiations. The Settlement was negotiated unilaterally with Ms. Patrick and Talcott Franklin, who represent a fraction of the Trusts' investors, and it has yet to be demonstrated how widely the Settlement will be supported even within that investor class. What *is* clear is that the Settlement has provoked widespread opposition by all other major creditor groups, each of which is legitimately concerned about the potential dilution of its recovery at either the HoldCo or OpCo levels and the prospect of Ally

[17] In addition to the facts discussed above, the Settlement itself, in its various iterations, confirms that Ally engineered the process with the goal of obtaining releases and that the Debtors paid scant attention to their fiduciary obligations:

- The linkage with the Plan Support Agreement was express in the original Settlement Agreement (attached as Exhibit 2 to the original 9019 Motion, filed at Dkt. No. 320), which recited in its "whereas" clauses both Ally's settlement with the Debtors fixing its plan contribution in return for a release and the Institutional Investors' agreement to support the Plan Support Agreement. After the Committee objected to the linkage, the Debtors amended the 9019 Motion to facially sever the two agreements (*see* Supplemental Motion available at Dkt. No. 1176, page 1) – without, of course, changing the historical fact that Ally had, in the negotiation process, expressly conditioned its agreement to the $8.7 billion allowed claim on Ms. Patrick's support for the PSA.
- Ally's status as the central party in interest is confirmed by remarkable language included in the proposed order submitted in connection with the 9019 Motion, providing that neither the Settlement nor any of the factual or expert materials generated in connection with the 9019 Motion may be used in the future against *Ally* – a non-party to the Settlement. This provision is discussed below at section I.E.2.
- Additional troubling evidence of the Debtors' casual approach to their fiduciary obligations is provided by the Debtors' agreement, without any apparent Board analysis or consideration, to amend the Settlement to give the Trusts an election to assert up to $1.74 billion of their Allowed Claim against ResCap LLC, rather than against RFC and GMACM, even though no R&W claims had ever been alleged against the HoldCo. *See* Mack Tr. 168 (Exh. V) (Board never told there was any legal basis for ResCap LLC to have any liability); Hamzehpour Tr. 89 (Exh. I) (Board did not approve amendment). Then, after the Committee and creditors of ResCap LLC protested, the Debtors just as abruptly amended the agreement again to remove this "HoldCo election," although without restoring the full release that the initial Settlement Agreement had given to ResCap LLC.

back claims until after many years had passed, the real estate and other markets had crashed, and most of the loans for which put-back is sought had already been liquidated. Mr. Sillman's analysis takes no account of these crucial considerations, which have the potential to greatly reduce the Debtors' liability.

For all of these reasons, Mr. Sillman's opinion, like that of Mr. Lipps, provides no support for the conclusion that the Settlement is reasonable. The Debtors have offered no reliable evidence to support the reasonableness of the settlement amount, and on that basis alone, the Court may find that the Settlement fails the merits-review prong of *Iridium*.

2. The Committee's analysis demonstrates that a non-conflicted fiduciary likely could have negotiated a substantially lower settlement of the put-back liability

In contrast to the Debtors' approach, the Committee undertook to assess the actual merits of the put-back claims against the Debtors to determine the arguments that could have been advanced by a non-conflicted fiduciary in an arm's length negotiation. The results of this analysis are telling. The Committee's work shows that a settlement negotiated at arm's length would most likely have come out substantially lower – probably at a level more in line with the Debtors' own earlier publicly disclosed estimate of zero to $4 billion (over existing accruals).

Unlike Mr. Sillman, the Committee's experts reviewed the Debtors' actual loan files and based their conclusions on that review.[21] A team of economists led by Professor Bradford Cornell drew a random, statistically significant sample of 1500 loan files, which was reviewed and "re-underwritten" by a team of loan reviewers led by J F. Morrow, an experienced mortgage loan professional. Professor Cornell and his colleagues then analyzed the incidence of

[21] Mr. Lipps himself noted that "[t]he only reliable way to determine whether a loan in fact complies with an underwriting-related representation or warranty . . . is to review and re-underwrite the actual loan files." Lipps Supp. Decl. ¶ 47. Similarly, counsel's presentation to the Board at the May 9, 2012 meeting specifically stated that the Debtors might be overpaying "if the true defect rate is below the 19.72% based on actual loan file reviews." Exh. Y. Despite these admissions by the Debtors' counsel, neither Mr. Lipps nor Mr. Sillman reviewed a single loan file as part of their evaluation of the Settlement. Lipps Tr. 121 (Exh. Z); Sillman Tr. 125-28 (Exh. D).

material defects in the underwriting of those loans and the impact of those defects on eventual loan losses, and extrapolated from those findings to estimate the Debtors' aggregate put-back liability for the entire loan pool. *See generally* Cornell Rpt. ¶¶ 29-75; Expert Report of J F. Morrow, dated December 3, 2012, served contemporaneously with this Objection.

As a first step in his analysis, Professor Cornell concluded that the gross losses suffered with respect to loans with material defects total approximately $16.5 billion. *Id.* ¶ 68.[22] Professor Cornell then applied several different legal rules based on issues identified by Mr. Lipps and Committee counsel, concluding that the application of available defenses could have a large impact on the Debtors' put-back exposure in the event the claims were actually litigated. *Id.* ¶¶ 15, 26-27, 64-68, 72-75. The three major defenses, and the aggregate expected R&W liability estimated to be associated with the successful assertion of each, can be summarized as follows:

Defense	Potential Liability
1. Loss Causation: Assuming the availability of put-back, the Debtors are responsible only for loan losses actually caused by R&W breaches.	Approximately $3.8 billion
2. Statute of Limitations: Assuming the availability of put-back and application of the loss causation rule, the Debtors' liability is further limited by New York's six-year statute of limitations.	Approximately $2.7 billion - $3.3 billion
3. Election of Remedies: Put-back claims are unavailable with respect to mortgages that have been foreclosed.	Substantial additional reduction in liability, in an amount to be determined

[22] This figure – and not the $40 billion claim that has been threatened absent a settlement – would represent the theoretical extreme upper range of the Debtors' potential liability, if (i) the Trusts had no burden to prove loss causation, (ii) no claims were barred by statutes of limitations, (iii) the election of remedies defense was not available, and (iv) no other defenses operated to reduce the total liability.