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DEALMAKERS 2014

REVIVING RESCAP



GARY LEE

To get bankrupt mortgage servicer Residential Capital back on its feet, Gary Lee looked beyond the Second Circuit for a precedent.

By Julie Triedman

BEFORE RESIDENTIAL CAPITAL LLC, THE NATION'S FIFTH LARGEST MORTGAGE SERVICER, PROVED THAT IT COULD BE DONE, NO OTHER REGULATED FINANCIAL SERVICES COMPANY HAD KEPT ITS CORE BUSINESS GOING DURING BANKRUPTCY. USUALLY THE THREAT OF INSOLVENCY ALONE IS ENOUGH TO CAUSE CUSTOMERS TO FLEE AND

creditors to claim collateral. Assets go for pennies on the dollar in fire-sale liquidations.

By the time ResCap filed for Chapter 11 in May 2012, however, a team at Morrison & Foerster led by restructuring chair Gary Lee had been working for a year to ensure that none of those destabilizing events would occur. ResCap's creditors included thousands of underwater borrowers, investors in ResCap-sponsored residential mortgage-backed securities (RMBS), bondholders in the holding company and securitization trusts. Many had already sued ResCap and its parent, Ally Financial Inc.

Lee only had two assets to work with: the company's loan portfolio and its rights to service millions of residential mortgage loans. But the servicing rights were unsalable, saddled with

billions of dollars in litigation claims by RMBS investors who asserted that ResCap had to buy back bad loans under representation and warranty obligations in the servicing agreements.

Lee and his team knew of a Delaware precedent in a smaller bankruptcy, of American Home Mortgage Holdings Inc., where a judge had allowed the debtor to sever the servicing rights in the contracts from the obligations. Though there was no precedent in the U.S. Court of Appeals

October 2012, at a competitive auction, the assets sold for \$4.5 billion, far more than they would have without the bifurcation.

The RMBS investors' early agreement prompted other creditors to enter mediation, "because no creditor wanted to see another with an agreed-upon claim," says Lee.

Lee's team also faced enormous outside regulatory pressures. ResCap had signed consent orders related to its alleged mortgage servicing misconduct,

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for the Second Circuit, Lee was confident that the Delaware precedent was good law in New York.

The strategy "was pretty novel," says Tammy Hamzehpour, chief business officer of the ResCap estate. In the end, Lee convinced a core group of the RMBS plaintiffs to allow the contracts to be bifurcated in exchange for a prearranged claim. That, in turn, allowed ResCap to sell the servicing rights unencumbered; in

so any move to sell assets had to be vetted by government regulators and prosecutors. In addition, Lee had to hold off the government-sponsored buyers and guarantors of ResCap's mortgage loans—including Fannie Mae and Freddie Mac—who had the power to withdraw ResCap's servicing rights, fatally destabilizing the company. Lee obtained assurances from the agencies ahead of and during the bankruptcy

DEAL IN BRIEF

RESIDENTIAL CAPITAL BANKRUPTCY

DEAL VALUE *\$1.45 billion*

FIRM'S ROLE *Debtor's counsel*

PHOTOGRAPHY BY **PAUL GODWIN**

MORRISON FOERSTER



GARY LEE
Morrison & Foerster

DEAL FACT *ResCap's bankruptcy was so contentious that three judges worked on it—one to oversee the case, one as a mediator and one as an examiner.*

filing that they would not do so.

Still, ResCap faced credibility problems in negotiating with unsecured creditors. They alleged that Ally continued to exert undue control over the unit, objecting strongly to a deal that Ally struck with ResCap to pay creditors \$750 million in exchange for Ally's release from legal claims—a sum that left entire categories of unsecured creditors out. Ally's counsel, Kirkland & Ellis' Ray Schrock, credits Lee with pushing both sides into mediation, and with enlisting U.S. Bankruptcy Judge James Peck as mediator at an unusually early stage. In May, the crisis was resolved when Ally agreed to triple that payment.

Calling the matter the most complex he had ever adjudicated, Judge Glenn praised both Lee—a Brit who helped Iceland's second-largest bank through a massive insolvency in 2008 ["Ice Storm," October 2011]—and lead creditors' counsel Kenneth Eckstein of Kramer, Levin, Naftalis & Frankel.

"The global settlement that is the cornerstone of the plan of liquidation reflected creative solutions to seemingly intractable problems," Glenn said in approving the plan on Dec. 11. Though the approved reorganization plan ultimately took 18 months, 25 written opinions and countless orders resolving disputes, Lee had laid the groundwork that made a consensual deal possible. "He always had this ability to think steps ahead in the case," says Hamzehpour.

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