



## Case Alert: In re American Home Mortgage Holdings, Inc.

### Third Circuit Recognizes Discounted Cash Flow (DCF) as Commercially Reasonable Determinant of Value for Mortgage Loans under § 562

In a unanimous, precedential opinion issued February 16, 2011, the Third Circuit Court of Appeals affirmed the Bankruptcy Court's disallowance of a \$478 million claim against American Home Mortgage (AHM) arising under a repurchase agreement. *In re American Home Mortgage Holdings, Inc.*, Case No. 09-4925 (3d Cir. Feb. 16, 2011).

The case considered a matter of first impression under § 562 of the Bankruptcy Code, which governs the timing and measurement of damages for claims arising under a repurchase (repo) agreement. Where a repo agreement is accelerated by a non-debtor party, § 562 provides that the non-debtor's claim for damages (i.e., for the debtor's failure to repurchase the assets at the contract repurchase price) is fixed at the time of acceleration, unless there are not any "commercially reasonable determinants of value" as of such date for the repo assets. In the absence of commercially reasonable determinants of value as of the acceleration date, damages are determined as of the earliest date at which there are such determinants of value. Section 562 places the burden of establishing the lack of commercially reasonable determinants of value on the party asserting the damages claim.

Calyon New York Branch and AHM were parties to a repo agreement covering approximately 5,700 mortgage loans with an original unpaid principal balance of just under \$1.2 billion. Days before AHM's chapter 11 filing in August 2007, Calyon accelerated the repo agreement. Thereafter, Calyon continued to hold the loan portfolio and, over time, received payments from borrowers that reduced the contractual repurchase price. Calyon asserted a claim against AHM for approximately \$478 million, which it calculated by deducting the fair market value (FMV) of the loan portfolio from the remaining contractual repurchase price as of the first date, post-petition, upon which Calyon asserted it could sell the loan portfolio in a commercially reasonable manner. Calyon argued there were no commercially reasonable determinants of value as of the acceleration date prepetition because the dysfunction of the secondary mortgage market, the quality of the loan portfolio, and litigation with AHM relating to the portfolio made it impossible for Calyon to sell the loans at that time. Calyon's position was that "commercially reasonable determinants of value" was limited to only the market value or sale value of the portfolio.

AHM objected to Calyon's claim, arguing that, notwithstanding the FMV of the loan portfolio, the discounted cash flow (DCF) value of the income stream generated by borrower payments actually exceeded the contractual repurchase price as of any given date. Accordingly, AHM asserted Calyon suffered no damages as a result of AHM's default under the repo agreement and had no claim.

The Bankruptcy Court (Sontchi, J.) agreed with AHM that "value" for § 562 purposes was not limited to FMV, and that "the use of the word *determinants* suggests . . . that *any* commercially reasonable valuation may be used." *In re American Home Mortgage Holdings, Inc.*, 411 B.R. 181, 192 (Bankr. D. Del. 2009). It went on to conclude that Calyon had not met its burden of proving that no commercially reasonable determinants of value existed as of the acceleration date because the Debtor had provided expert

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testimony establishing the DCF value of the loan portfolio at that time. Because the DCF value of the portfolio as of the acceleration date exceeded the contractual repurchase price, the Bankruptcy Court agreed with AHM that Calyon had suffered no damages and disallowed Calyon's claim.

The Third Circuit affirmed, finding that § 562 left open the possibility for valuations other than FMV, and that a DCF valuation was an appropriate "commercially reasonable determinant of value" for a repo agreement. Judge Rendell explained in her concurrence that the Bankruptcy Code provides special protections to repo transactions (e.g., exempting them from the automatic stay provisions, per § 559) because of their particular need for liquidity, but agreed that the statute's use of the plural "determinants" foreclosed an exclusively market-based approach. She also pointed out that the term "commercially reasonable" is usually associated with "dispositions" of property under Article 9 of the Uniform Commercial Code, which suggests a sale, but noted that the determination of what is commercially reasonable "involves a fact-intensive inquiry, dependent on the totality of the circumstances, and calls for an examination of the particular situation, which may not include a sale."

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