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***CONSENSUAL USE OF CASH COLLATERAL,
A PRACTICAL VIEW***

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CONSENSUAL USE OF CASH COLLATERAL, A PRACTICAL VIEW

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In a bankruptcy, cash is king, and thus, a lender whose debt is secured by a lien on the debtor's cash is in a unique position to preserve, and in certain instances improve, its position during a bankruptcy case. A secured lender can be one of the most influential players in a bankruptcy case, but a lender will also be one of the most scrutinized parties in a bankruptcy, because a lender's vulnerability translates into money for unsecured creditors. Consequently, when possible, a lender can and should use a bankruptcy to protect its pre-petition liens during bankruptcy, maintain or improve its position during bankruptcy, and minimize or eliminate compromise of its liens and loan during the reorganization process, with an understanding that any negotiated agreements will themselves be scrutinized to protect any inappropriate compromise of the rights of unsecured creditors.

One of the most effective tools a lender can wield is the conditions the lender imposes on the consensual use of its cash collateral. The use of cash collateral is a manner of post-petition financing although the lender is not actually advancing "new money". Through a well-negotiated and well-drafted cash collateral agreement and order, a secured lender can insulate itself to some extent from the powerful tools that can be utilized by a debtor-in-possession or trustee to compromise a lender's position, as well as influence, to some extent, the manner in which a debtor conducts its bankruptcy case. Post-petition financing is another powerful tool that a lender can and should use as a sword and shield, when possible and appropriate for the same reasons as those regarding

the consensual use of cash collateral. A lender who can provide post-petition financing in the form of new money may consider doing so to protect itself from another lender compromising a pre-petition lender's collateral position. A debtor with cash needs greater than the funds available through use of cash collateral may need to seek new money, either from a pre-petition lender or a new lender. Often a post-petition loan is not available to the debtor, such as when the debtor has no unencumbered assets and no way to provide a current lien holder with adequate protection. Sometimes a pre-petition lender cannot provide new financing, such as a trustee in a securitized loan, which has no "new money" to provide. However, many times a lender and a debtor will negotiate an argument that includes both the use of cash collateral under 11 U.S.C. §363 and a post-petition loan under 11 U.S.C. §364.²

WHAT IS CASH COLLATERAL

Cash collateral is defined in the Bankruptcy Code³ as:

cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest and includes the proceeds, products, offspring, rents, or profits of property and the fees, charges, accounts or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties subject to a security interest as provided in section 552(b) of this title, whether existing before or after the commencement of a case under this title.

11 U.S.C. § 363(a)

Cash collateral does not include cash proceeds generated from post-petition assets, other than lease revenues from real property or hotel room rents. 11 U.S.C. §552⁴.

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² A full discussion of issues relating to post-petition financing under 11 U.S.C. §364 is beyond the scope of this paper.

If a lender has a lien on inventory and the proceeds of inventory, the pre-petition lien will attach to the proceeds of inventory that existed on the petition date. However, the pre-petition lender's lien does not attach to proceeds of sale of inventory created after the petition date.

If a lender has a pre-petition lien on hotel revenues, the lender will continue to have a lien on room rent and rent from space leased in the hotel (such as gift shops), but the lender's lien shall not continue as to other revenue generated, such as from a spa or banquet facilities.

Courts have held that "cash collateral" includes fee paid to golf course debtor from operation of a golf course on premises, In re GGVXX, Ltd., 130 B.R. 322 (Bankr. Colo. 1991) and includes crops, In re Kielhafner, 69 B.R. 51 (Bankr E.D. Mo. 1986) but does not include money to be generated from operation of a bowling alley, In re Countryside Bowling Center, Inc., 203 B.R. 765 (Bankr. M.D. Fl. 1996), tipping or dumping fees paid at a landfill, In re West Chestnut Realty of Haverford, Inc., 166 B.R. 53 (Bankr. E.D.Pa. 1993), greens fees, In re GGVXX, Ltd., 130 B.R. 322, or gate receipts from an autotrack, In re Zeeway Corp., 71 B.R. 210 (9th Cir. B.A.P. 1987). These controversies often lead to compromises in unreported cases.

³ Title 11 of the United States Code.

⁴ 11 U.S.C. Section 556 provides: "(a) Except as provided in subsection (b) of this section, property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case.

(b) (1) Except as provided in sections 363, 506(c), 522, 544, 547 and 548 of this title, if the debtor and an entity entered into a security agreement before the commencement of the case and of the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds, product, offspring, or profits acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable non-bankruptcy law, except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise."

PROCEDURES FOR THE USE OF CASH COLLATERAL

11 U.S.C. §363 of the Bankruptcy Code specifically authorizes a debtor to use a lender's cash collateral if either (a) the lender consents or (b) the court "after notice and a hearing" authorizes the use, sale or lease of the cash collateral. 11 U.S.C. §363 (c)(2). The court shall condition the use of cash collateral on the lender's adequate protection if requested by a party in interest. 11 U.S.C. §363(e). The benefit of a consensual cash collateral arrangement is the lender's ability to negotiate its adequate protection, since usually what a lender and debtor can negotiate and have approved, in a consensual cash collateral agreement, is much broader than the adequate protection a lender is likely to receive in a contested cash collateral scenario.

Although parties routinely seek court approval of cash collateral arrangements, court approval is not required if the lender consents to the use of cash collateral and the lender does not impose conditions on its use. *See In re Nilges*, 301 B.R. 321 (Bankr. N.D. Iowa 2003); *In re Trout*, 123 B.R. 333 (Bankr. D.N.D. 1990). It is not recommended that a lender allow use of its cash collateral without court approval and a debtor should not assume or rely on a lender's implied consent to use cash collateral. *Compare Freightliner Market Development Corp. v. Silver Wheel Freightlines, Inc.*, 823 F. 2d 362 (9th Cir. 1987) (Implied consent for use of cash collateral is not adequate; the debtor must affirmatively obtain lender's consent before using the cash collateral) *with In re Cross Baking Co.*, 818 F.2d 1027 (1st Cir. 1987) (where use of cash collateral was conditioned upon subsequent court approval, but lender did not get court approval, and continued to allow use of its cash collateral, debtor was justified in relying upon the initial consent, and lender would not receive adequate protection "after the fact"). Indisputedly, court

approval is required for any agreements regarding use of cash collateral and adequate protection. A lender should also not delay in getting approval of a cash collateral agreement, as the conditions for use that the lender negotiated may be compromised. *See In re Package Design & Supply Co.*, 217 B.R. 422 (Bankr. W.D.N.Y. 1998); *Freightliner Market Development Corp.*, 823 F.2d 362.

Federal Rule of Bankruptcy Procedure⁵ 4001(d) governs the procedures for approval of an agreement regarding use of cash collateral. The agreement must be attached to the motion, and absent an order of the court altering the deadlines, a party shall have 15 days from the mailing of the notice of the motion to object to the agreement. If no objection is filed, the court may enter an order without a hearing. Any hearing shall be on no less than five days notice.

However, a debtor and lender are not usually able to wait twenty (20) days for a court order, and so, they rely on the procedures of Rule 4001(b) for a motion seeking authorization to use cash collateral in the absence of an agreement.⁶ An interim order is sought, usually on an emergency basis. The Rules require service on any appointed creditors' committee, or if a committee is not yet appointed, on the twenty largest unsecured creditors as previously identified by the debtor, as well as other parties in interest, including the U.S. Trustee. Rules 1007(d); 4001(b). At an interim hearing the court "may authorize the use of only that amount of cash collateral as is necessary to avoid immediate and irreparable harm to the estate pending a final hearing." Rule 4001(b). Part of the reason for this is that the emergency nature of relief may preclude

⁵ The Federal Rules of Bankruptcy Procedure will be referred to hereinafter as Rules and individually as "Rule ____".

⁶ Local rules may modify these time frames or procedural requirements.

certain parties in interest from an opportunity to raise timely objections, all of which are then preserved for the final hearing on use of cash collateral.

Because at an initial hearing only interim relief is granted, lenders need to restrict the amount of cash available as much as possible, recognizing that the interim protections authorized by the court will be limited usually only to replacement liens (to the extent of unencumbered assets). Approval of the broader concessions and rights sought in the cash collateral agreement, more fully described in this article below, will generally need to wait until the final hearing, which is usually set within 15 to 20 days of service of the original motion.

Pursuant to Rule 4001(b) a motion to approve the use of cash collateral is a contested matter and therefore it is not unusual for the court to conduct an evidentiary hearing on the debtor's cash needs and whether offered adequate protection is, indeed, adequate. However, a hearing to approve the consensual use of cash collateral is not generally an evidentiary hearing. Whether or not evidence will be required will generally depend on whether there are any objections to factual rather than legal issues, and whether, in the absence of an objection, the presiding judge will accept the motion and agreement as an evidentiary proffer, especially with respect to a lender's good faith.

Any order approving the use of cash collateral should incorporate all the provisions of the cash collateral agreement, either expressly or by reference, with the agreement attached as an exhibit to the order. It is important that the order include specific findings as to the lender's good faith regarding the extension of credit through the use of its cash collateral (and the consequent liens granted) in order to be insulated from the effects of a reversal on appeal, 11 U.S.C. §363(m), although it is not clear what

affect such a finding will have in a cash collateral order that doesn't include other types of post-petition financing since the statutory mootness provisions of the Code do not expressly apply to cash collateral orders. 11 U.S.C. §363(m) provides that the reversal or modification on appeal of the authorization under 363(a) or (b) for the sale or lease of property to a party who leased or purchased the property in good faith will not affect the validity of the sale or lease. There is no mention of orders relating to the use of the property or the granting of liens as a condition of such use. Only one case appears to address this issue – in In re Tek Aids Industries, Inc., 145 B.R. 253 (Bankr. N.D. Ill. 1992) the court held that 11 U.S.C. §363(m) notwithstanding, the court would set aside liens in avoidance actions granted as adequate protection because the form of notice of the cash collateral hearing did not identify this as a provision of the cash collateral agreement. The court noted in a footnote that 11 U.S.C. §363(m) does not apply to the use of property but even the “spirit” of 363(m) did not protect an agreement constitutionally “void” due to lack of due process. 11 U.S.C. §364(e) doesn't apply because the provision pursuant to which the replacement liens are granted is 11 U.S.C. §361 not 11 U.S.C. §364.

THE CONSENSUAL CASH COLLATERAL AGREEMENT

A cash collateral agreement is very detailed.⁷ Some debtors and lenders draft their agreements as agreed orders, but the better practice is to prepare an agreement together with a proposed order that mirrors, or incorporates by reference, the terms of the agreement, or a short agreement that incorporates a proposed agreed order - there should be some document signed by the parties to the agreement, subject, of course, to bankruptcy court approval.

In some jurisdictions the form of the agreement, or at least its operative terms, are dictated by local rule.⁸ Courts and many practitioners favor standardization of financing agreements and orders because it provides a certainty to a process that, in the absence of standardization, depends often on the judge to whom the case is assigned. *See, eg.,* Hon. Robert C. McGuire, *Standardizing Cash Collateral and Post-petition Financing Orders*, 4 Am. Bankr. Inst. L. Rev. 535 (1996).

In the absence of local requirements, courts will review a consensual cash collateral agreement, as the court will with many motions presented in a bankruptcy case, with a view towards the exigencies of the circumstances and an eye on overreaching by the lender. *Compare* Unsecured Creditors' Committee v. Jones Truck Lines, Inc., 156 B.R. 608 (W.D. Ark. 1992) (A court approved agreement for the use of cash collateral that included a replacement lien on avoidance actions, post-petition interest payments to the lender, and had no provision for carve out for committee professionals based on the fact that the debtor was liquidating and unsecured creditors probably wouldn't receive a distribution anyway) *with* In re Tenney Village Co., 104 B.R. 562 (Bankr. D.N.H. 1989) (Court refused to approve a financing order that, in the court's opinion, effectively gave the lender complete control of the case.) Consequently, although there is no true consistency in what a court will approve in a consensual cash collateral agreement, there is a general understanding of the appropriate structure most bankruptcy judges in a particular district will approve.

⁷ A sample cash collateral order is included in the Appendix.

⁸ Jurisdictions in which local rules have adopted standards for use of cash collateral include Delaware, the Northern District of California, the Southern District of Florida, the Western District of Washington, the Western District of Pennsylvania, the Southern District of New York and the Northern District of Texas. The local rules for the Southern District of New York and the District of Delaware are included in the Appendix.

The consensual cash collateral agreement should supplement, not replace, underlying loan documents, although with respect to certain covenants and obligations, at least for the period when the cash collateral agreement is operative, its terms may supersede the underlying loan agreements. In certain circumstances, as more fully discussed below, a lender may ask the debtor to execute additional loan documents to evidence additional liens granted under the agreement, although such additional loan documents are not usually necessary.⁹

The parties to the cash collateral agreement are usually the lender and the debtor. If there are guarantors of the pre-petition debt, or parties who will execute guarantees as a condition to the lender's consent, they will generally be parties as well, or will at least be expected to sign a joinder. If a debtor has significant equity investors, such as bondholders, their consent to the agreement should be obtained if it is possible.

Because cash collateral agreements are negotiated prior to, or immediately following, the filing of a bankruptcy case, neither the committee nor any other unsecured debtor representative will have an opportunity to provide input. Based on the speed with which even a final cash collateral order may be approved, an official committee may have not yet been formed, or only recently been formed, when the interim and final orders are entered. Consequently, many cash collateral orders provide a committee with an opportunity to review and file objections to the extent, validity and priority of a lender's lien, the amount of the debt, or the existence of a setoff, or defense to the claim. The time for committee review will usually be set between thirty to sixty days after entry of the final cash collateral order. The order should specifically authorize the committee to bring an action against the lender's claim or lien, or the committee should seek such

⁹ Where a post-petition loan is extended, new or amended loan documents are recommended and advised.

authorization as soon as it has determined that an action is appropriate. See In re America's Hobby Center, Inc., 223 B.R. 275 (Bankr. S.D.N.Y. 1998) (Notwithstanding provision in a cash collateral order giving committee thirty days to challenge a lender's lien, committee was required to seek separate order authorizing the committee to bring the adversary on behalf of the estate).

Less often, but not infrequently, the court will require that the agreement allow a trustee, if one is later appointed, to conduct his or her own investigation into a lender's claim. The time for the trustee's review usually runs from the date of the trustee's appointment and would similarly be between thirty and sixty days after the appointment. A lender should insist that if a trustee is given an opportunity to review and object to a lender's lien or claim, that right should not be available if the trustee is appointed after the deadline for claim objections. The lender should not be placed in a more vulnerable position by virtue of allowing use of its cash collateral than if the lender had not so agreed. Moreover, a trustee should not have the right to review and challenge a lender's lien if the committee has already done so. However, in some districts, such as the Southern District of Florida, the local rules may require that the trustee have an opportunity to investigate a lender.

A. Protecting The Loan and Collateral Position

The cash collateral agreement should include some basic concessions from the debtor regarding the loan, such as an acknowledgement of the amount of the lender's debt as of the petition date, the nature of the lender's collateral, the status of the loan, and the operative interest rate. The debtor should also acknowledge the debtor has no claim against the lender, no right of setoff or other defense to payment. This list is not

exhaustive. The lender should insist on all the concessions to which it legitimately believes it is entitled. Consequently, a lender should review its loan documents and collateral position very carefully, beginning as soon as the lender believes the debtor is in financial trouble, so the lender can identify its vulnerabilities prior to negotiating a cash collateral agreement. At a minimum, the negotiations with the debtor about the cash collateral order will flush out any areas of dispute. As a corollary to the foregoing, lenders will usually seek, and debtors will usually agree to provide, a lender release as part of the consideration for the cash collateral use. The release will protect the lender not only from claims arising from traditional sources (such as lender liability claims) but claims that only arise by virtue of the bankruptcy filing, such as claims to recover alleged preferences or alleged fraudulent conveyances. Of course the release will be subject to review by the committee and trustee as discussed above.

B. Adequate Protection and the Indubitable Equivalent

11 U.S.C. §361 outlines what constitutes adequate protection for purposes of 11 U.S.C. §363(b). These are (1) a cash payment or periodic cash payments, but only to the extent of the decrease in value caused by the use of the cash collateral, (2) an additional or replacement lien, again, only with respect to the decrease in value in the lender's collateral or (3) any other relief, other than an administrative claim, "as will result in the realization by such entity of the indubitable equivalent of such entities interest in such property". "Indubitable Equivalent" is a catch-all phrase designed to give the court flexibility to fashion adequate protection beyond periodic payments or replacement liens. In re Swedeland Development Group, Inc., 16 F.3d 552 (3d Cir. 1994). "Indubitable equivalent", for purposes of 11 U.S.C. §361, means "relief that will result in the

realization by the protected entity of the value of its interest in the property involved.”
1984 U.S.C.C.A.N. 576.

1. Monitoring the Cash and the Case

Courts routinely approve adequate protection restrictions on the use of the cash. An approved budget, with appropriate monitoring, provides the lender with a means to control the manner in which a case will be conducted. A lender legitimately has the right to impose appropriate restrictions on the use of its cash collateral. A debtor's management must expect some belt tightening, especially at the top, and especially with respect to payment to insiders. However, the lender and debtor must be realistic. The lender must acknowledge the necessity of payment of expenses critical to maintain its collateral and the debtor's business, such as insurance, utilities and wages, including employee benefits. This does not mean carte blanche and limitations on insider salaries or management fees are expected and appropriate.

The lender and debtor will negotiate two budgets – one for the interim cash collateral order and one for the final cash collateral order. Sometimes the cash collateral agreement will provide for new budgets to be prepared and approved based on a change in circumstances (sale of significant assets) or periodically (quarterly, for example). What is in the budget, both in terms of its detail and its categories of authorized expenses, will depend on the nature of the debtor's business, and sometimes the sophistication of its management. For example, the budget for a stand alone movie theater with one tenant will be very different than the budget for a shopping center with multiple tenants or a window manufacturer with several expenses and many employees.¹⁰ The cash collateral agreement will usually provide for variances from the budget. Typically, the agreement

will authorize a small percentage variant (5% - 10%) either by category or overall amount. So long as the variances stay within the agreed upon range, the variances won't trigger a default or termination event under the cash collateral agreement. The lender and debtor should also try to agree on a mechanism for treatment of unexpected or extraordinary expenses.

If the lender and debtor are depending on a third party to prepare the budget they each must be confident of the accuracy of the information and must impress on the third party the potential penalties for budget variances. For example, if the debtor is a hotel owner whose hotel is being operated by a third party manager such as Hyatt, or Ramada, the debtor must actively participate in the budgeting process and be comfortable with the budget the third party prepares.

The cash collateral agreement, either by incorporating the underlying loan documents, or by imposing new covenants, may impose financial covenants such as debt service ratios, or the use of a lock box arrangement. Even if a lock box was not used pre-petition, the debtor and lender can agree to an appropriate control arrangement as part of the lender's adequate protection. Other covenants may include a time schedule to sell the assets or business of a company, a deadline to file a plan, the requirement that management have different financial consultants, and the requirement that the debtor bring certain actions against third parties. A debtor should make every effort to comply with all financial covenants as the debtor may have agreed to certain case dispositive remedies in the event of a material default.

As with a pre-petition agreement between a lender and borrower, a lender must be careful not to cross over the line and be treated as a control person, notwithstanding the

¹⁰ Examples of different budgets are included in the Appendix.

benefits of court approval, or to abuse its lender status post-petition. See Germain v. Connecticut National Bank (In re O'Sullivan's Fuel Oil Co.), 88 B.R. 17 (D. Conn. 1988) (Trustee sued lender for post-petition tortious interference with debtor's business which conduct, allegedly, led to destruction of the debtor's business after bankruptcy).

As a corollary to the budget, the cash collateral agreement should also include periodic reporting requirements. The frequency and nature of these reports (which in some cases, and under appropriate circumstances, may include daily cash receipt reports) will depend on the nature of the debtor's business. A lender whose cash collateral agreement is generated by a business, such as a hotel, with significant daily receipts, and expenses, may want to know the hotel's daily cash position to make sure there is no meaningful deterioration in a debtor's liquidity. At a minimum these reports should include budget variances. The lender should also carefully review the monthly debtor-in-possession reports and compare these to the reports provided to the lender under the cash collateral agreement.

If the debtor has no source of cash other than cash collateral, the debtor will seek a carve-out to pay its professional fees. A lender does not need to agree to a carve-out as part of the budget process but courts in non-consensual cash collateral scenarios have often allowed, or forced, consensual carve-outs for professional fees. Consequently, a consensual cash collateral lender should focus on negotiating a carve-out cap rather than a carve-out prohibition.¹¹ A lender should expect the carve-out will need to include not only the debtor's professionals, but also committee professionals. *But see In re Lavelle*, 1995 WL 334325, p.2 (E.D. Pa. 1995) (on appeal the committee failed to cite support that

a one-sided carve-out – for the debtor and not the committee, was a violation of the Bankruptcy Code). Debtor’s counsel should be aware of the limitations of the carve-out. At least one court has held that an attorney was not entitled to payment of its fees from a lender’s cash collateral notwithstanding a carve-out, once the cash collateral agreement had expired. In re Blackwood Associates, L.P., 187 B.R. 856 (Bankr. E.D.N.Y. 1995). Moreover, a carve-out is not the same as a consent by a lender to payment of professionals, since, in the absence of a carve-out, even approved fees can only be paid from unencumbered cash. The cash collateral agreement should expressly provide for the carve-out and the cap, if any.

Courts have also upheld agreements that preclude the use of cash collateral to sue the lender. However, a lender might prefer not to impose such a restriction on the use of its cash collateral. When there is such a restriction, debtors have been known to allow a creditor to pursue litigation against a lender on behalf of the estate at such creditor’s cost. If the creditor has a grudge against the lender, it could be worse for a lender to have the disgruntled creditor rather than the debtor pursuing the lender.

Debtors may also seek carve-outs for KERP’s (Key Employee Retention Plans), the approval of which are becoming more common, *see, eg.*, In re Montgomery Ward Holding Corp., 242 B.R. 147 (D. Del. 1999), In re Aerovox, Inc., 269 B.R. 74 (Bankr. D. Mass 2001), and In re America West Airlines, Inc., 171 B.R. 674, 678 (Bankr. D. Ariz. 1994), but a lender’s decision to permit such payments should be driven by whether such payments will benefit the lender in any way.

¹¹ A court cannot force a post-petition lender to lend new money. Accordingly, a lender of “new money” may have more leeway on the conditions it imposes on the budget in connection with its loan, including whether, and to what extent, the lender will agree to a carve-out.

Another bankruptcy specific “attack” from which a lender will seek relief in a cash collateral agreement is the debtor’s right to seek a surcharge from a lender. 11 U.S.C. §506 (c) provides that a debtor-in-possession may recover from a secured lender’s collateral “the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim”. Thus, lenders have been surcharged for expenses paid by the estate such as insurance, real estate taxes, capital repairs, brokers’ fees and other closing costs in connection with a sale, and environmental cleanup. However, if the debtor is using the lender’s cash collateral to preserve a lender’s other collateral it is not appropriate that the lender should then be surcharged, because actually the lender, not the estate, has paid the expenses.¹² At a minimum, the lender and debtor should seek agreement on appropriate areas of surcharges if an absolute prohibition cannot be negotiated, or approved. Although courts will usually agree to some limitation on surcharge, the courts will scrutinize any language that is overbroad. *See In re Ridgeline Structures*, 154 B.R. 831 (Bankr. D.N.H. 1993) (A broad and absolute prohibition on surcharge no matter what the basis is against public policy and unenforceable per se.)

2. Replacement Liens

An element of adequate protection included in the cash collateral agreement is the replacement lien, that is, a lien that “replaces” to the extent necessary, the lender’s lien on the cash or cash proceeds or the assets that generate those proceeds. By definition, the use of the lender’s cash collateral will diminish the lender’s lien on its cash even if the lender is over-secured with respect to its overall collateral position. A replacement lien

¹² If the lender receives a replacement lien on unencumbered collateral for the use of its cash collateral, however then, arguably, a surcharge might be appropriate.

becomes more critical with respect to inventory and other diminishing collateral that generates cash collateral as it is sold as the lender's underlying collateral is diminished and the proceeds are used up by the debtor. The replacement lien as adequate protection presupposes the existence of unencumbered assets or encumbered assets with sufficient equity to provide a meaningful replacement lien to protect a lender's lien position.¹³

In many cases, a debtor will not have any unencumbered assets and will only be able to offer a second lien on already encumbered collateral. The value of a second lien on an encumbered asset depends on the nature of, and the debtor's equity in, the asset. Moreover, one issue that may arise with a replacement lien on already encumbered property is a lender's ability to monetize the asset in the event of a default in the absence of an inter-creditor agreement with the first lender. A lender should try to negotiate with the primary secured lender if a second lien is offered as a part of the adequate protection.

One type of asset of the debtor that is unencumbered on the petition date consists of the claims of a debtor against third parties arising under Part V of the Bankruptcy Code – the proceeds of avoidance actions, since these are claims that only arise by virtue of the bankruptcy and therefore no pre-petition security interest could attach to them. *See In re Integrated Testing Products, Corp.*, 69 B.R. 901 (D.N.J. 1987) Although some courts have allowed replacement liens on a debtor's avoidance actions, others do not. Counsel will need to review local rules and understand the local practice.

In some instances, the court will allow a lender's replacement lien on avoidance actions other than those against the lender, *see, e.g., Unsecured Creditors' Committee v.*

¹³ Although a replacement lien necessarily secures a lender's pre-petition claim through, in some instances, post-petition collateral, it is not cross collateralization. Replacement liens are expressly authorized by the Bankruptcy Code, and therefore, are not an issue in jurisdictions such as the 11th Circuit, where cross-collateralization is prohibited.

Jones Truck Lines, Inc., 156 B.R. 608. In other instances, the court may permit a lender's replacement lien, but only on avoidance actions against the lender, in a way, a post-petition mutual right of set-off. See In re Lillie Rubin Affiliates, Inc., Case No. 96-10646, United States Bankruptcy Court, Southern District of Florida.

Replacement liens do not need to be documented¹⁴, but the better practice is to have the debtor execute, and for the lender to record, any notice documents required for perfection. This avoids the cost of any disputes down the road with third parties who may not have had notice of the bankruptcy, and who seek some kind of relief against the replacement collateral.¹⁵ The cash collateral order should specifically provide that the liens granted thereunder are automatically perfected.

3. Post-petition Payments

As with other forms of adequate protection, periodic cash payments are only appropriate to the extent necessary to make up for a diminution in value of the collateral. Where the collateral is cash, the reasoning could be circular, because cash, by its nature, is diminished when spent, and many courts do not recognize the cash, per se, as an asset that is "diminished" for purposes of adequate protection. However, most cash collateral is generated by the sale or use of an underlying "hard asset" and so, a lender's ability to receive post-petition payments should be viewed in the context of diminution in value of the underlying asset. If the underlying asset is "wasting" or deteriorating by sale or use, then the lender can receive periodic payments if the court does not believe the lender is otherwise adequately protected. The timing of, and methods relating to, valuation of the

¹⁴ See Small v. Beverly Bank, 936 F. 2d 945 (7th Cir. 1991) (A replacement lien provided as adequate protection in a cash collateral order, which according to the order, was automatically perfected, was a judicial lien, and other steps for perfection under state law were not necessary to perfect the lien.)

underlying assets is beyond the scope of this article. However, a consensual cash collateral agreement should provide for periodic payments to the lender out of cash collateral if the underlying asset is deteriorating, especially where the equity cushion is small.

Sometimes a lender will seek periodic payment of interest and costs as part of the budget process. The Bankruptcy Code make clear that only an oversecured creditor is entitled to payment of post-petition interest and costs. 11 U.S.C. §506(b). However, it is not always clear until the end of a case whether a creditor is oversecured or not. At least in the 11th Circuit, an alleged oversecured creditor is not entitled to receive periodic payments of interest until a plan is confirmed (or presumably the creditor's collateral is sold), because, until the case is "over", at least with respect to that creditor, it is not clear the creditor is oversecured. Moreover, adequate protection is only designed to protect decline in collateral value, not decline in a lender's equity cushion. Orix Credit Alliance Inc. v. Delta Resources, Inc., 54 F.3d 722 (11th Cir. 1995). *But see* Unsecured Creditors' Committee v. Jones Truck Lines, Inc., 156 B.R. 608, 613 (The court held that the creditor that consented to use of its cash collateral was entitled to receive periodic payments of interest because the lender was not receiving interest payments on account of pre-petition debt, but rather, it was receiving interest on the post-petition use of the lender's cash collateral.) Notwithstanding Orix, there are many instances, even in the 11th Circuit, in which a debtor will consent to, and the court will approve, periodic payments to a lender during a bankruptcy case.

¹⁵ A lender with a previously recorded blanket UCC-1 would not usually be concerned, but if the collateral is a piece of real property, a deposit account, securities or the like, the extra step is advisable.

If a court is inclined to authorize post-petition payments to a lender as part of the cash collateral arrangement, to the extent possible the lender and debtor should seek to resolve the application of these post-petition payments. Will the payments be applied to interest? To principal? When will the determination as to the proper application be made? This dialogue becomes more complex when the cash collateral is produced by income producing property in which the lender also has a lien. Is the cash collateral separately identified as collateral and added to the value of the underlying asset that generates the cash to determine whether a lender is over secured or is the cash generated by the asset included as an element of its value? For example, assume a lender has a lien on a shopping center worth \$18 million on the petition date. During the case, the property generates \$2 million in net revenue. Further assume the lender is owed \$19 million on the petition date. Is the lender oversecured or undersecured? The courts are split on this issue. *Compare* In re Flagler-at-First-Associates, Ltd., 114 B.R. 297 (Bankr. S.D. Fla. 1990) (post-petition adequate protection payments protected secured creditor from decline in value of its post-petition revenue collateral) *with* In re Reddington/Sunarow Ltd. Partnership, 119 B.R. 809 (Bankr. D.N.M. 1990) (post-petition income generated from creditor's income producing collateral was not included as additional collateral, and therefore the use of that cash collateral did not cause a depreciation in the value of the lender's collateral for purposes of determining the application of adequate protection payments). Of course the lender wants all payments applied to interest and costs to preserve the underlying principal amount. The debtor, or the committee, will want the payments applied to reduce the principal amount of the debt. At a minimum, the lender and debtor should try to agree in the cash collateral order to a

mechanism for resolution at the appropriate time. For example, the agreement could address the timing of the valuation of the underlying collateral (petition date, disclosure statement date)¹⁶ and how the payments will be applied depending on the valuation.

One aspect of post-petition payments less likely to occur in a cash collateral agreement with no element of new financing is the roll up. In a roll up, proceeds of disposition of pre-petition collateral are applied first to payments of pre-petition debt. New financing, or the use of excess or other cash collateral, would be applied towards post-petition expenses. Under a roll up the pre-petition debt will be paid down or paid in full, eliminating the risks a lender with a pre-petition loan could face at the time of confirmation. Because, in most instances cash collateral, including cash proceeds of pre-petition collateral, is being used to pay the pre-petition obligation there is no prohibited cross collateralization in the 11th Circuit or any other circuit that prohibits cross collateralization.

C. The Administrative Claim

The Code gives a debtor and lender tremendous leeway in fashioning adequate protection, with only one absolute prohibition – the administrative claim. 11 U.S.C. §361 makes clear that adequate protection seeks to protect a lender claim from diminution in the value of a lender's collateral due to its use. However, that diminution in value cannot be protected through the use of an administrative claim. In Bonapfel v. Nalley Motor Trucks (In re Carpet Center Leasing Co.), 991 F.2d 682 (11th Cir.), on reh'g, 4 F.3d 940 (11th Cir. 1993), the 11th Circuit observed that this proscription was developed to protect creditors and reflected Congress' concern that "undersecured creditors [would be] lured

¹⁶ 11 U.S.C. §506 provides valuation can be done a different times depending on the purpose for the valuation.

into foregoing the right to foreclose on collateral by the illusory promise of an administrative expense claim, when the estate's assets would later prove to be insufficient to make such payments." 991 F.2d at 940-941. However, Congress did believe the use of the administrative claim was an appropriate remedy if the "indubitable equivalent" proved not to be adequate. Id.

One issue addressed by the 11th Circuit in Bonapfel is whether, in order to receive a super-priority administrative claim under 11 U.S.C. §361, a lender is automatically entitled to the amount its collateral diminished in value for which the lender was not adequately protected, or whether the lender must further demonstrate the extent to which the estate was benefited by the use of the collateral. Citing cases from several districts, the 11th Circuit held the lender is entitled to an administrative claim if its collateral is used and the amount of the claim is based on the diminution of value in the collateral not otherwise adequately protected. Benefit to the estate is presumed.

D. Default, Termination and Remedies

All good things must come to an end, including the use of cash collateral. The cash collateral agreement should provide for termination on a date certain or on the happening of a bankruptcy case event such as appointment of a trustee, conversion of the case, or, proposal of a plan that doesn't meet with the lender's approval. Sometimes cash collateral agreements "roll over" on a month to month or quarterly basis, requiring an express, periodic extension of the consensual use.

Defaults under the cash collateral agreement should be tied to the debtor's covenants and agreements under the cash collateral agreement, and, to the extent not modified under the cash collateral order, the operating covenants set forth in the

underlying loan documents. Other defaults may be tied to certain bankruptcy events, similar to those that trigger termination of a lender's consent for use. However, as illustrated in the Tenney Village case, a court will not usually allow a lender to take over the bankruptcy case, and a lender should expect that certain provisions that tread too far into the debtors' ability to manage the case may not be approved. Consequently, while conversion or appointment of a trustee are considered "standard" termination provisions, the filing of a plan that doesn't meet with the lender's approval is less likely to be approved as a termination provision.

Remedies for default should include stay relief and the ability to exercise lender remedies against the lender's collateral without notice other than the filing of a notice of default with the court.¹⁷ Sometimes the court will require notice to a committee, if one has been appointed, and possibly a hearing, depending on the nature of the case, the number of other creditors and the nature of the default. If there are only a limited number of other creditors, or an active committee, a judge may authorize exercise of remedies with little or no notice and no hearing after an event of default.

Default and termination provisions should be precise and unambiguous. For example, if a projected budget shortfall outside the variance is a ground to terminate use of cash collateral that should be clearly stated in the cash collateral agreement.

Conclusion

Both a debtor and lender must be familiar with the obligations and limitations regarding the use of cash collateral, both those imposed by the Bankruptcy Code and

¹⁷ In certain instances a knowing violation of a cash collateral order by a debtor's principal or employer could result in penalties assessed against that individual. See In re Four Seasons Marine & Cycle, Inc., 263 B.R. 764 (Bankr. E.D. Tex. 2001); In re A-1 Specialty Gasolines, Inc., 246 B.R. 445 (Bankr. S.D. FL. 2000).

those imposed by the practicalities of a particular case. The ability of a debtor or lender to use the need for cash collateral as a tool in the reorganization process will depend on the size of the debtor, the relative size of the lender's loan and extent of its liens in the bankruptcy case, and whether the debtor has any alternate sources of cash. Lenders and debtors must be diligent, realistic and practical. When all three exist, the debtor can achieve necessary funding needs even in the absence of available post-petition lending and a lender can reduce, or at times eliminate, the uncertainties of the bankruptcy process.

233498.1

APPENDIX

- A. Sample Cash Collateral Agreement
- B. Guidelines for Financing Requests, United States Bankruptcy Court for the Southern District of New York
- C. District of Delaware Local Rule 4001-2 regarding Cash Collateral and Financing Orders
- D. Cash Collateral Checklist

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF FLORIDA
www.flsb.uscourts.gov

In re:

Chapter 11 Case

PICCADILLY CAFETERIAS, INC.,

Case No. 03-27976-BKC-RBR

Debtor.

AGREED FINAL ORDER (I) AUTHORIZING LIMITED USE OF
CASH COLLATERAL AND (II) GRANTING ADEQUATE PROTECTION

THIS MATTER came before the court on November 19, 2003 at 9:30 a.m. for a final hearing (the "Final Hearing") pursuant to that certain Agreed Interim Order (I) Authorizing Limited Use of Cash Collateral (II) Granting Adequate Protection and (III) Scheduling Final Hearing entered on October 31, 2003 [Court Paper No. 33] (the "Interim Order") which granted on an interim basis and scheduled the Final Hearing on the *Emergency Motion of Debtor and Debtor In Possession for Interim and Final Interim Orders (I) Authorizing The Use of Cash Collateral, and (II) Granting Adequate Protection Pursuant to 11 U.S.C. §§ 361 and 363* [Court Paper No. 8] (the "Motion") filed by Piccadilly Cafeterias, Inc., the debtor and debtor-in-possession (the "Debtor"). The Motion sought entry of the Interim Order and this final Order authorizing the limited use of "Cash Collateral" (as that term is defined in section 363(a) of the Bankruptcy Code, 11 U.S.C. §§ 101-1330 (the "Bankruptcy Code")) and granting adequate protection. Wells Fargo Foothill, Inc. (f/k/a Foothill Capital Corporation), Bank of New York ("BONY"), as Indenture Trustee (the "Trustee") on behalf of the holders of the Senior Notes (as defined below), an ad hoc Committee (the "Noteholders' Committee") of holders of the Senior Notes totaling more than 50 percent of the face value of such Senior Notes, and the Debtor have

reached an agreement regarding the Debtor's use of Cash Collateral, upon the terms and conditions contained in this Order. Based upon the record presented to this Court at the interim hearing held on October 31, 2003 and Final Hearing on the Motion, and upon review of the Motion itself and the *Affidavit of John G. McGregor, Interim Chief Executive Officer of Piccadilly Cafeterias, Inc., in Support of Certain First Day Motions* [Court Paper No. 16], it appears as follows:

A. On October 29, 2003 (the "Petition Date"), the Debtor filed the above-referenced petition for relief under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code") (the "Case"). Pursuant to sections 1107 and 1108 of the Bankruptcy Code, the Debtor remains in possession of its assets and continues to operate its business as debtor in possession.

B. Prior to the Petition Date, the Debtor entered into that certain Second Amended and Restated Credit Agreement (as amended, restated, supplemented or otherwise modified from time to time, the "Prepetition Credit Agreement") as of December 11, 2001 and that certain Amended and Restated Security Agreement dated as of December 11, 2001 (as amended, restated, supplemented or otherwise modified from time to time together with the related loan documents thereto (the "Prepetition Security Agreement") (collectively, and together with the Prepetition Credit Agreement and the Prepetition Security Agreement, the "Prepetition Loan Documents"), between and among Piccadilly Cafeterias, Inc. and Wells Fargo Foothill, Inc. (f/k/a Foothill Capital Corporation) as Lender (the "Lender") and as Collateral Agent (the "Collateral Agent") as successor in interest to and assignee of Hibernia National Bank. On or about December 21, 2000, the Debtor entered into that certain Indenture (as modified, amended or restated from time to time, the "Indenture") with BONY as Trustee for the holders of those

certain Series A and Series B Senior Secured Notes (the "Senior Notes") due 2007 and those certain Series A and Series B Term B Notes due 2007, (collectively, the "Noteholders"; together with the Lender, the Collateral Agent and the Trustee, the "Prepetition Secured Parties"). The Debtor is also a party to that certain Intercreditor Agreement and Collateral Agency Agreement dated as of December 21, 2000 (as modified, amended or restated from time to time, (the "Intercreditor Agreement") among the Debtor, the Lender, the Collateral Agent, the Trustee and the lenders under the Term Loan Credit Facility (as defined in the Intercreditor Agreement).¹

C. Pursuant to the Prepetition Loan Documents, the Indenture and the Intercreditor Agreement, the Collateral Agent, for the benefit of the Prepetition Secured Parties, claims first priority liens on, and security interests in, substantially all of the Debtor's assets for the benefit of the Prepetition Secured Parties, both tangible and intangible, real and personal, including, *inter alia*, the Debtor's accounts, inventory, machinery and equipment, real property, chattel paper, books and records, intellectual property, licenses, deposit accounts, money, negotiable collateral, securities, and general intangibles; and the proceeds and recoveries of the foregoing (collectively, the "Collateral"). As such, the Collateral Agent claims a perfected first-priority security interest in the Collateral, specifically including Cash Collateral.

D. The Debtor and the Prepetition Secured Parties assert that cash on hand as of the Petition Date and cash generated after the Petition Date constitutes the Prepetition Secured Parties' "cash collateral," as such term is used in section 363 of the Bankruptcy Code. The Official Committee of Unsecured Creditors (the "Committee") disputes that cash generated after the Petition Date constitutes "cash collateral," reserves all of its rights with respect to this issue

¹ As of the Petition Date, the Debtor has repaid all obligations under the Term Loan Credit Facility.

and, subject to Paragraph 15 of this Order, nothing herein shall constitute a determination or adjudication as to such issue.

E. Pursuant to the terms of the Prepetition Credit Agreement and the Indenture, the Prepetition Secured Parties made prepetition extensions of credit and other financial accommodations to the Debtor from time to time.

F. An immediate need exists for the Debtor to use Cash Collateral to continue to operate strictly in compliance with the budget attached hereto as Exhibit "A" (the "Budget") and this Order to, *inter alia*, pay wages and other direct operating expenses, to maintain vendor and customer support and generally conduct its business affairs so as to avoid immediate and irreparable harm to its estate and the value of its assets.

G. The Lender, the Collateral Agent, the Trustee and the Noteholders' Committee have consented to the Debtor's use of Cash Collateral only on the express terms and conditions set forth in this Order.

H. Notice of the Final Hearing on the Motion has been provided to the parties on the Master Service List in accordance with the Order Granting Motion by Debtor to Limit Notice entered on October 31, 2003 [Court Paper No. 28] (the "Notice Parties"): Such notice constitutes good and sufficient notice of the Final Hearing and Motion in accordance with Bankruptcy Rule 4001(b)(1), 4001(c) and 4001(d) and section 102(1) of the Bankruptcy Code, as required by sections 363(c), 363(e) and 364(c) of the Bankruptcy Code.

I. Good cause has been shown for the entry of this Order. Entry of this Order will, *inter alia*, minimize disruption of the Debtor's business and operating expenses and permit the Debtor to meet payroll and other operating expenses and maintain vendor support. The Cash

Collateral use arrangement authorized hereunder is vital to avoid harm to the Debtor's estate. Absent the use of Cash Collateral, the Debtor's estate would not have the necessary funds to satisfy its obligations. Allowing the use of Cash Collateral, therefore, is in the best interest of the Debtor's estate and creditors.

J. The use of Cash Collateral and adequate protection arrangements authorized hereunder have been negotiated in good faith and at arm's length, and the terms of such Cash Collateral use and adequate protection arrangements are fair and reasonable under the circumstances, reflect the Debtor's exercise of prudent business judgment, and are supported by reasonably equivalent value and fair consideration.

K. The Debtor has requested immediate entry of this Order pursuant to Rule 4001 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"). The authorization granted to the Debtor to use Cash Collateral is necessary to avoid harm to the Debtor and the Debtor's estate. The Court concludes that entry of this Order is in the best interest of the Debtor and its estate and creditors as its implementation will, *inter alia*, allow for the continued operation of the Debtor's existing business.

L. This Court has jurisdiction to consider this matter pursuant to 28 U.S.C. §§ 157 and 1334. This is a core proceeding pursuant to 27 U.S.C. §157(b). Venue is proper before this Court pursuant to 28 U.S.C. §§1408 and 1409.

ACCORDINGLY, IT IS HEREBY ORDERED, ADJUDGED, DECREED AND, AS APPLICABLE, STIPULATED:²

² Findings of fact shall be construed as conclusions of law, and conclusions of law shall be construed as findings of fact, pursuant to Bankruptcy Rule 7052.

1. The Prepetition Secured Parties have consented to the Debtor's use of a limited amount of Cash Collateral through the Expiration Date (as defined herein), pursuant to, and in accordance with, the conditions set forth in this Order, provided that, except as provided in the Budget, the net proceeds from any sale of the Debtor's assets outside the ordinary course of business (other than the proceeds from the sale of substantially all of the Debtor's assets) are to be promptly paid to, and retained by, the Collateral Agent for application in accordance with this Order, the Prepetition Loan Documents and the Intercreditor Agreement. The Debtor reserves the right on behalf of itself and its estate to request a reallocation of any payments received by, or amounts applied to, the Prepetition Secured Parties' claims if it is determined that such respective claims are undersecured.

2. Subject to the terms and conditions of this Order, the Debtor may use the Cash Collateral to pay its ordinary and necessary business expenses as set forth on the Budget, provided that such use shall not be in excess of cash on hand, collections actually received in connection with accounts, disposition of inventory, and sales of approved Collateral existing on the Petition Date and generated thereafter. The Debtor warrants and represents that the Budget includes all reasonable, necessary, and foreseeable expenses to be incurred in the ordinary course of business in connection with the operation of its business for the period set forth in the Budget. In no event shall the Debtor use any Cash Collateral to pay any items except substantially as set forth in the Budget or as may be consented to by the Lender and the Noteholders' Committee. In this regard, the Debtor shall not exceed 10% of the line item amounts set forth in the Budget. Notwithstanding the foregoing, the Debtor may (i) use line item budgeted amounts on a cumulative basis, provided, however, that the Debtor may not modify allocations by line item

within the Budget without the consent of the Lender and the Noteholders' Committee. After five (5) days notice to the United States Trustee (the "U.S. Trustee") and the Committee, and no objection by the U.S. Trustee and the Committee, Budget may be modified without further Order of this Court, and once modified, shall serve as the Budget in the Case. Upon the filing of an objection and request for a hearing by the U.S. Trustee or the Committee, the Budget may be modified as determined by the Court. The Debtor is authorized to pay, without regard to the Budget, allowed claims under the Perishable Agricultural Commodities Act ("PACA"), or any applicable state or federal statute that affords the same relief afforded a seller under PACA, to the extent authorized by separate order of the Court implementing procedures and authorizing the Debtor to pay claims under PACA.

3. The Debtor further agrees not to incur any administrative expenses other than as set forth in the Budget, exclusive of professional fees as to professionals whose engagements are approved by the Bankruptcy Court pursuant to sections 327, 363(b) and 1103 of the Bankruptcy Code or whose fees are approved pursuant to section 503 of the Bankruptcy Code, fees payable pursuant to 28 U.S.C. § 1930, and fees due to the Clerk of the Court, without the prior written consent of the Lender and the Noteholders' Committee or approval by the Bankruptcy Court after notice to the Lender, the Collateral Agent, the Noteholders' Committee, the Committee and the Trustee and a hearing.

4. The Debtor's right to use Cash Collateral commenced on the Petition Date and shall expire on the earlier of (i) [February 28, 2004], unless mutually extended by the Lender, the Noteholders' Committee and the Debtor, or (ii) the occurrence of a Termination Event as defined in Paragraph 21 of this Order (collectively, the "Expiration Date"). In no event

shall the Debtor be authorized to use the Cash Collateral for any purposes or under any terms other than those set forth herein and as set forth in the Budget; provided, however, nothing herein shall affect the Debtor's right to seek to use Cash Collateral on a non-consensual basis, pursuant to Court order, upon notice to the Lender, the Noteholders' Committee and the Committee.

5. In allowing the use of Cash Collateral as provided for herein, pursuant to the Debtor's existing cash management systems established under the Prepetition Credit Agreement, the Debtor is required to maintain accounts to which the Collateral Agent's liens and claims, for the benefit of itself and the Prepetition Secured Parties, attach with respect to collections to the extent the Debtor receives any such collections or proceeds from the Collateral. Unless and until new procedures are established as may be required by the U.S. Trustee or otherwise, the Debtor is authorized and directed to maintain its prepetition cash management system and bank account systems as same were in effect on the date of this Order subject to the Debtor establishing new disbursement accounts as may be required by the Court or consented to by the Lender and the Noteholders' Committee; provided, however, that any new disbursement accounts shall be subject to the Replacement Liens (as defined below). Notwithstanding the Debtor's compliance with this Paragraph, the Committee's reservation of rights to dispute the Prepetition Secured Parties' interest in the postpetition cash remains expressly reserved.

6. The Lender is not required to advance to the Debtor any amounts that may be available for lending under the Prepetition Credit Agreement with the Debtor. So long as the Expiration Date has not occurred, the Prepetition Secured Parties shall allow the use by the Debtor, or for the benefit of the Debtor at the Debtor's direction, such amounts of Cash Collateral as are received by the Debtor pursuant to this Order.

7. In addition to the existing rights and interests of the Prepetition Secured Parties in the Cash Collateral and for the purpose of providing adequate protection for the use of Cash Collateral, the Collateral Agent, on behalf of itself and the Prepetition Secured Parties, is hereby granted a valid, perfected and enforceable security interest and lien (the "Replacement Liens") equivalent to a lien granted under the section 364(c) of the Bankruptcy Code in and upon all post-petition assets of the Debtor which are of the same nature or type as the Collateral in which the Collateral Agent, on behalf of itself and the Prepetition Secured Parties, had an interest prior to the commencement of the Case, including without limitation, all of the Debtor's accounts receivable, contract rights, inventory, machinery and equipment, licenses, general intangibles, real property, and such other collateral in which the Collateral Agent on behalf of itself and the Prepetition Secured Parties had an interest prior to the initiation of the Case (but excluding claims or causes of action of the Debtor or the estate available through the exercise of the powers granted pursuant to sections 542, 544, 547, 548, 549, 550, 551, 552 and 553 of the Bankruptcy Code) whether such property was owned on the Petition Date or thereafter created, acquired or arising, and all improvements, additions and extensions thereto, all replacements thereof, all books and records with respect thereto and all products and proceeds of the foregoing, specifically including any proceeds of the foregoing deposited into bank accounts opened prepetition by the Debtor, the accounts opened by the Debtor after the Petition Date and the accounts themselves, which Replacement Liens shall be subject only to (a) the extent of the Carve Out (defined below) provided for in Paragraph 12 below and (b) the security interests of the Collateral Agent, on behalf of itself and the Prepetition Secured Parties, in the same order of priority as such interests existed on the Petition Date and in accordance with the terms of the

Intercreditor Agreement. Solely to the extent of any diminution in the aggregate value of the Prepetition Secured Parties' Cash Collateral and other Collateral, the Replacement Liens shall also attach to any property of the Debtor that was unencumbered as of the Petition Date and the proceeds of such unencumbered property created, acquired or arising after the Petition Date.

8. The Replacement Liens herein granted: (i) are and shall be in addition to all security interests, liens and rights of set-off existing in favor of the Collateral Agent and the Prepetition Secured Parties on the Petition Date; (ii) are and shall be valid, perfected, enforceable and effective as of the date of the entry of the Interim Order without any further action by the Debtor, the Collateral Agent or the Prepetition Secured Parties, and without the necessity of the execution, filing or recordation of any financing statements, security agreements, vehicle lien applications, filings with the United States Patent and Trademark Office, mortgages or other documents; and (iii) shall only secure the payment of indebtedness to the Prepetition Secured Parties, as the case may be, as adequate protection to the extent that the use of the Cash Collateral and any other Collateral results in a decrease in the aggregate value of the Prepetition Secured Parties' interest in such Cash Collateral and any other Collateral.

9. In addition to the Replacement Liens granted to the Collateral Agent on behalf of itself and the Prepetition Secured Parties pursuant to this Order, the Collateral Agent, on behalf of itself and the Prepetition Secured Parties, is hereby granted an administrative claim under sections 503(b)(1), 507(a), and 507(b) of the Bankruptcy Code (the "507(b) Claims") solely for the amount by which the adequate protection provided herein proves to be inadequate. Such 507(b) Claims shall be allowed and have priority over all other costs and expenses of the kind allowed pursuant to sections 105, 326, 330, 331, 503(b), 506(c), 507(a), 507(b) or 726 of

the Bankruptcy Code, subject only to the extent of the Carve Out (defined below) provided for in Paragraph 12 below. The amount of such 507(b) Claims, if any, shall be established by the Court after a hearing on notice.

10. As further adequate protection for the use of Cash Collateral and other Collateral, the Lender shall receive periodic payments in an amount equal to the interest payments due and owing under the Prepetition Credit Agreement, at the applicable non-default rate of interest on the principal amount of the obligations due and owing under the Prepetition Credit Agreement, as of the Petition Date, with such payments being due on the dates mandated for payments of interest under the Prepetition Credit Agreement (the "Interest Payments"). From the Petition Date through the Expiration Date, the Lender agrees to waive the accrual and payment of interest above the non-default rate. In addition, the Debtor will continue to pay to the Lender all other actual and reasonable fees, costs and expenses provided for under the Prepetition Credit Agreement, including, but not limited to fees associated with letters of credit issued by the Lender, on behalf of and at the direction of the Debtor, as well as actual and reasonable legal fees and costs of the Lender's counsel (the "Lender's Expenses", together with the Interest Payments, the "Lender's Adequate Protection Payments"); provided, however, that the payment of the fees and costs of the Lender's counsel shall be subject to the notice and objection procedures set forth in Paragraph 22 of this Order.

11. As adequate protection for the use of its Cash Collateral and other Collateral, the Debtor will, subject to Paragraph 22 of this Order, pay to the Noteholders' Committee, all actual and reasonable fees, costs and expenses including, but not limited to, actual and reasonable legal fees and the costs of the Noteholders' Committee's counsel (the

"Noteholder Adequate Protection Payment"). In no event shall the Noteholder Adequate Protection Payment be subject to reallocation pursuant to Paragraph 1 of this Order.

12. The Replacement Liens and the 507(b) Claims granted to the Collateral Agent, on behalf of itself and the Prepetition Secured Parties, pursuant to this Order shall be subject and subordinate to a carve out (the "Carve Out") for the payment of (a) allowed professional fees and disbursements incurred by counsel and other professionals retained by the Debtor, pursuant to sections 327(a) and 363(b) of the Bankruptcy Code, and by the Committee, in an aggregate amount not to exceed \$1,250,000 (the "Professional Fee Carve Out"); (b) quarterly fees required to be paid pursuant to 28 U.S.C. §1930(a)(6); (c) any fees payable to the Clerk of the Court; and (d) any payment made, or to be made, with respect to Pay-to-Stay Payments as defined in the Motion for an Order Authorizing the Debtor To Implement a Key Employee Retention Plan as approved by this Court, up to a maximum of \$525,000 (the "KERP Carve Out"); provided however, the Professional Fee Carve Out granted pursuant to subsection (a) hereof shall be reduced *pro tanto* by the percentage, if any, that the Court determines that any of the Debtor's postpetition cash receipts are not Cash Collateral of the Prepetition Secured Parties pursuant to section 552 of the Bankruptcy Code; provided that, notwithstanding the foregoing and the 506(c) waiver contained in Paragraph 16 of this Order, to the extent the amount of the Professional Fee Carve Out is reduced pursuant to this Paragraph 12, the Committee reserves its rights to assert that the professional fees and expenses no longer subject to the Professional Fee Carve Out, should be paid out of the Prepetition Secured Parties' Collateral pursuant to 506(c) of the Bankruptcy Code to the extent that the Court determines that such professional fees and expenses and employee-related expenses benefited the Prepetition

Secured Parties; provided, further, that the Carve Out shall not include, and no Cash Collateral shall be available to the Debtor or the Committee pursuant to this Order to pay professional fees and disbursements incurred in connection with prosecuting and asserting any claims or causes of action against the Collateral Agent or the Prepetition Secured Parties and/or challenging or raising any defense to the obligations under the Prepetition Loan Documents or the Indenture or any lien asserted by the Collateral Agent, or the Prepetition Secured Parties, including, without limitation, any challenge to whether the Debtor's postpetition cash receipts are subject to the liens of the Prepetition Secured Parties under section 552 of the Bankruptcy Code. Nothing herein shall be construed as a waiver of the right of any party to object to the allowance of any such professional fees. Notwithstanding anything to the contrary, the Professional Fee Carve Out shall be in addition to any allowed interim compensation paid to the professionals pursuant to separate order(s) of the Court or any prepetition retainers paid by the Debtor to any professionals. Further, the allowance of the Carve-Out shall survive the occurrence of a Termination Event.

13. In consenting to the continued use of Cash Collateral, the Debtor, and the Prepetition Secured Parties stipulate and agree, subject to the Committee contesting any such matter in the name of, and on behalf of, the Debtor prior to the Investigation Termination Date (as defined below), that:

- (a) the Prepetition Loan Documents and the Indenture between and among Debtor, the Collateral Agent, the Lender, the Trustee and the Noteholders are in all respects, valid and binding agreements and obligations of the Debtor;
- (b) as of the Petition Date the principal balance due under the revolving credit facility of the Prepetition Credit Agreement (the "Revolver") was \$1,805,832.04, plus interest, fees, costs and expenses and the principal

face amount of letters of credit outstanding under the Letter of Credit subfacility of the Prepetition Credit Agreement was \$14,670,571, plus interest, fees, costs and expenses (the "Letters of Credit");

- (c) as of the Petition Date, the principal balance due to the Noteholders under the Indenture was \$39,217,000, plus interest, fees, costs and expenses.
- (d) the liens and security interests held by the Collateral Agent on behalf of itself and the Prepetition Secured Parties under the Prepetition Credit Agreement, the other Prepetition Loan Documents and the Indenture, and in accordance with the Intercreditor Agreement, are valid, enforceable, properly perfected and non-avoidable; and
- (e) the Debtor (i) is not aware of any claim, counterclaim, recoupment, setoff or defense of any kind or nature which would in any way affect the validity, enforceability and non-avoidability of the obligations of the Collateral Agent or any of the Prepetition Secured Parties owing under the Prepetition Credit Agreement and the Indenture, respectively, or any of the Prepetition Secured Parties' lien claims or security interests, or, reduce or affect the obligations of the Debtor to pay any of the Collateral Agent's or any of the Prepetition Secured Parties' claims; (ii) hereby acknowledges and agrees that it has no offsets, defenses, claims, or counterclaims against the Collateral Agent, or any of the Prepetition Secured Parties, or their respective officers, directors, employees, attorneys, representatives, parents, affiliates, predecessors, successors or assigns, solely with respect to the claims under Prepetition Loan Documents or the Indenture; (iii) further acknowledges and agrees that it is not aware of any circumstances or facts that would subject the Collateral Agent or the Prepetition Secured Parties to the equitable doctrine of "marshaling" or any similar doctrine with respect to the Collateral; and (iv) further acknowledges and agrees that if the Debtor now has or ever did have, any offsets, defenses, claims, or counterclaims against the Collateral Agent or the Prepetition Secured Parties, or their respective officers, directors, employees, attorneys, representatives, parent, affiliates, predecessors, successors, or assigns, whether known or unknown, at law or in equity, from the beginning of the world through this date, solely with respect to the claims under the Prepetition Loan Documents or the Indenture, all of such claims are hereby expressly **WAIVED**, and the Debtor hereby **RELEASES** the Collateral Agent, the Prepetition Secured Parties and their respective officers, directors, employees, attorneys, representatives, parent, affiliates, predecessors, successors, and assigns from any liability thereon.

14. The stipulations set forth in Paragraph 13 of this Order shall be binding on the Debtor and any of its successors-in-interest and assigns, as permitted by law, subject to the Committee's rights in Paragraph 15 below.

15. Notwithstanding anything herein to the contrary, the Committee and a subsequently appointed Chapter 11 or Chapter 7 Trustee (collectively, a "Future Trustee") shall have allowed investigation periods as set forth below before the stipulations in Paragraph 13 shall become binding:

(a) Until January 30, 2004 (the "Investigation Termination Date"), the Committee shall be entitled to investigate the validity, perfection and enforceability of the Collateral Agent's liens held on behalf of the Prepetition Secured Parties and the obligations arising under the Prepetition Loan Documents and the Indenture or to assert any other claims or causes of action against the Collateral Agent and the Prepetition Secured Parties, including seeking a determination that the Debtor's cash receipts do not constitute the Prepetition Secured Parties' Collateral. If the Committee determines by the Investigation Termination Date, that there may be a challenge to the Collateral Agent's prepetition liens or the Prepetition Secured Parties' prepetition obligations, upon five (5) business days written notice to the Debtor and the Prepetition Secured Parties (which five (5) days are not intended to be used to seek Court intervention) the Committee shall be deemed to have standing and be permitted to file and prosecute an objection or claim related thereto (including avoidance, offsets, defenses, claims or counterclaims), and shall have only until the Investigation Termination Date to file such objection or otherwise initiate an appropriate action or adversary proceeding on behalf of the Debtor's estate setting forth the basis of any such challenge, claim or cause of action. If such

action is not filed on or before the Investigation Termination Date (or such other later date as extended by the written consent of the Debtor, the Lender and the Noteholders' Committee or by Court order), the stipulations contained in Paragraph 13 of this Order shall be irrevocably binding on all creditors and all parties in interest without further action by any party or this Court.

(b) In the event the Committee does not file an action by the Investigation Termination Date and a Future Trustee is appointed, the Future Trustee will have forty (40) days from its appointment (the "Trustee Investigation Termination Date") to review the Committee's analysis and perform an investigation of the validity, perfection and enforceability of the Collateral Agent's liens held on behalf of the Prepetition Secured Parties and the obligations arising under the Prepetition Loan Documents and the Indenture or to assert any other claims or causes of action against the Collateral Agent and the Prepetition Secured Parties. If the Committee has commenced an adversary proceeding with respect thereto, the Future Trustee shall be allowed to prosecute such action on behalf of the Debtor's estate and no separate Trustee Investigation Termination Date shall be created.

Unless the Lender, the Noteholders' Committee and the Debtor each consents in writing to an extension, the Investigation Termination Date or the Trustee Investigation Termination Date may not be extended, unless cause therefor is shown and only after notice to the Lender, the Noteholders' Committee and the Debtor and a hearing on the request to extend the Investigation Termination Date being held before the expiration of the Investigation Termination Date or Trustee Investigation Termination Date, as the case may be.

16. With the exception of the Carve Out and solely to the extent of accrued but unpaid items provided for in the Budget, no expenses of administration of the Debtor's estate shall be charged pursuant to section 506(c) of the Bankruptcy Code, or otherwise, against the Collateral or any collateral supporting the Replacement Liens. Nothing contained in this Order shall be deemed to be consent by the Collateral Agent or the Prepetition Secured Parties, whether express or implied, to any claims against the Collateral or the collateral supporting the Replacement Liens under section 506(c) of the Bankruptcy Code or otherwise.

17. The Debtor shall maintain all necessary insurance, including, without limitation, life, fire, hazard, comprehensive, public liability, and worker's compensation as may be currently in effect, and obtain such additional insurance in an amount as is appropriate for the business in which the Debtor is engaged, naming the Collateral Agent, on behalf of itself and the Prepetition Secured Parties, as an additional insured and loss payee with respect thereto; but notwithstanding being named loss payee, the Prepetition Secured Parties shall be entitled to recover from and apply the insurance proceeds to the claims of the Prepetition Secured Parties to the extent the Prepetition Secured Parties have a validly attached, properly perfected, non-avoidable lien on the asset insured. Nothing herein shall affect the Prepetition Secured Parties' rights to receive any such insurance proceeds on account of their Replacement Liens and 507(b) Claim under Paragraphs 7-9 of this Order or otherwise. The Debtor shall provide the Collateral Agent with prompt notification of any change in such coverage which may hereafter occur.

18. The Debtor shall furnish to the Prepetition Secured Parties and the Committee, or as may be more appropriate, their respective counsel or other advisors, such

financial and other information as the Lender, Noteholders' Committee or the Committee shall reasonably request including, but not limited to, the following:

a. By Thursday of each week, commencing November 6, 2003, a report that includes the following:

- i. Sales results for the week;
 - ii. Summary of cash receipts and disbursements for the current week and the cumulative debtor in possession period;
 - iii. Detailed report of cash inflows and outflows for the current week and for each previous week in the debtor in possession period; and
 - iv. Budget to Actual variance analysis for cash receipts and disbursements.
- b. On the last business day of each month, commencing November 28, 2003 for informational purposes, a reforecast for the subsequent thirteen (13) week period in a format similar to the Budget.
- c. Simultaneously with their filing, any financial information and pleadings filed with the Bankruptcy Court;
- d. All other financial information and reports prepared by the Debtor, including any financial information required by the Bankruptcy Court or by the Operating Guidelines and Reporting Requirements of the United States Trustee's Office; and
- e. All other reports and financial information required by the Prepetition Credit Agreement.

The Lender, the Noteholders' Committee, the Committee and the Trustee shall be given reasonable access to the books, records, and documents of the Debtor.

19. Upon reasonable notice to the Debtor, the Prepetition Secured Parties and the Committee, or any of them, shall have access to, and the right to examine and audit the Debtor's books and records.

20. Except as otherwise provided in Paragraph 15 herein, the provisions of this Order and any actions taken in accordance with this Order shall survive entry of any Order

that may be entered: (a) confirming any plan of reorganization, (b) converting this case to a case under chapter 7 of the Bankruptcy Code, or (c) dismissing this case. The claims and liens, including the Replacement Liens, on the Collateral shall continue in full force and effect and maintain their priority until all of the obligations owed to the Collateral Agent and the Prepetition Secured Parties under the terms of the Intercreditor Agreement, the Prepetition Loan Documents, the Indenture, respectively, and this Order are indefeasibly paid in full; provided, however, the Replacement Liens shall only secure the amounts set forth in Paragraph 8(iii) hereof.

21. Notwithstanding anything to the contrary in this Order, the Debtor's authority to use Cash Collateral pursuant to this Order shall terminate immediately and automatically (the "Termination Event"): (a) upon the fifth (5th) business day following the delivery of written notice to the Debtor by the Lender, the Noteholders' Committee or Trustee (the "Notice Period") of any breach or default by the Debtor of the terms and provision of this Order, including, but not limited to: (i) failure to furnish to the Lender, the Noteholders' Committee and Trustee those reports and information listed in Paragraph 18 of this Order; (ii) noncompliance with the Budget as defined in Paragraph 1 of this Order; or (iii) failure to pay Adequate Protection Payments, unless with respect to each of the forgoing, the Debtor has cured such breach or default within the Notice Period; and (b) without notice of any kind upon (i) the Expiration Date, (ii) the conversion of the Chapter 11 Case to a chapter 7 case or appointment of a chapter 11 or chapter 7 trustee or an examiner with expanded powers without the consent of the Lender and the Noteholders' Committee, (iii) the initiation by the Debtor of any lawsuit or adversary proceeding against the Collateral Agent or Prepetition Secured Parties, or entry of an

order that alters the validity or priority of (or to subordinate) any of the Collateral Agent's or the Prepetition Secured Parties' liens and security interests on any of the Collateral, (iv) the Debtor ceases to operate all or substantially all of its business unless consented to by the Lender and the Noteholders' Committee, (v) the Debtor has sold all or substantially all of the property of the estate, unless consented to by the Lender and the Noteholders' Committee, (vi) entry of an order of the Bankruptcy Court authorizing a lien under sections 364(c) or 364(d) on the Collateral to secure any credit obtained or debt incurred that would be senior or equal to any lien held by or granted to the Collateral Agent on behalf of the Prepetition Secured Parties, (vii) entry of an order granting any relief from the automatic stay, which allows any entity to proceed against any material assets of the Debtor that constitute the Collateral of the Prepetition Secured Parties, and (viii) the filing of a motion by the Debtor, or entry of an order to reconsider this Order, alter or amend judgment of this Order, denying the validity or extent of the Collateral Agent's liens on the Collateral or surcharging the Collateral.

22. The reasonable fees and costs of counsel to the Lender under the Prepetition Loan Documents and the Noteholders' Committee, shall be paid by the Debtor on the following terms

(i) From time to time, counsel to the Lender and the Noteholders' Committee shall serve invoices, in said counsel's usual form, without being subject to the U.S. Trustee guidelines, setting forth the fees and expenses incurred by said counsel upon the Debtor, the U.S. Trustee and the Committee.

(ii) Any objection to the reasonableness or payment of such invoices shall be filed with the Court within ten (10) business days following the date of the service of the invoice,

with service of such objection to be made on counsel for the Lender or Noteholders' Committee (as appropriate), the Debtor, the Committee and the U.S. Trustee. If any objection is filed within such period, a hearing on the objection will be held promptly thereafter. If no timely objection is filed, said fees and expenses shall be deemed allowed (without any holdback) without further order of Court, and the Debtor shall promptly pay said fees and expenses.

23. The Debtor shall promptly serve a copy of this Order upon Notice Parties. The provisions of this Order shall remain in full force and effect unless modified or vacated by subsequent Order of this Court. If any or all of the provisions of this Order are hereby modified, vacated or stayed by subsequent Order of this or any Court, such stay, modification or vacation shall not affect the validity and enforceability of any lien, priority, or benefit, or application of payment authorized hereby with respect to any indebtedness of the Debtor to the Collateral Agent and the Prepetition Secured Parties.

DEC - 2 2003

ORDERED in the Southern District of Florida on November ____, 2003.

RAYMOND B. RAY

RAYMOND B. RAY
UNITED STATES BANKRUPTCY JUDGE

Copy furnished to:

Paul Steven Singerman, Esq.

(Attorney Singerman shall mail a conformed copy of this Order upon all interested parties and file a Certificate of Service).

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In the Matter of the Adoption of :
Guidelines for Financing Requests :

X

General Order No. M-274

By resolution of the Board of Judges for the Southern District of New York, it is resolved that the Guidelines for Financing Requests, annexed hereto, are hereby adopted and are to take effect as of the date of this order.

Dated: New York, New York
September 9, 2002

/s/ Stuart M. Bernstein
STUART M. BERNSTEIN
Chief United States Bankruptcy Judge

GUIDELINES FOR FINANCING REQUESTS

The purpose of this document is to establish guidelines for cash collateral and financing requests under sections 363 and 364 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York (the "Court"). Although it is recognized that each case is different, the Guidelines are designed to help practitioners identify common material issues that typically are of concern to the Court (at least on the first day of a case and/or where there is limited notice), and to highlight such matters so that, among other things, determinations can be made, if necessary, on an expedited basis.

Substantively, these Guidelines do not purport to establish rules that cannot be varied, but they do require disclosure of the "Extraordinary Provisions," discussed below, that ordinarily will not be approved in interim orders without substantial cause shown, compelling circumstances and reasonable notice.

It will be evident that many of the following guidelines are designed to deal with debtor in possession financing requests documented with a loan agreement and (for want of a better term) a long-form financing order. However, the Court would welcome the use of simplified orders, whenever possible, particularly in smaller cases and in connection with the debtor's use of cash collateral not involving the extension of new funds.

These guidelines are intended to supplement the requirements of sections 363 and 364 of the Bankruptcy Code and Bankruptcy Rules 4001(b) and (c).

I. MOTIONS

A. MOTION CONTENT

1. Single motion

(a) A single motion may be filed seeking entry of an interim order and a final order, which orders would be normally entered at the conclusion of the preliminary hearing and the final hearing, respectively, as those terms are used in Bankruptcy Rules 4001(b)(2) and (c)(2). In addition, where circumstances warrant, the debtor may seek emergency relief for financing limited to the amount necessary to avoid immediate and irreparable harm to the estate pending the preliminary hearing, but in the usual case, only a preliminary and a final hearing will be required.

(b) If the financing is to be extended pursuant to a loan agreement or similar agreement ("Agreement"), the Agreement should be attached to the motion.

(c) The motion should also include a copy of any proposed order for which entry is sought.

(d) Motions must be double-spaced and in form comply with all applicable rules of the Court.

2. Description of use of cash collateral or the material provisions of DIP financing The motion should ordinarily contain the following disclosure relative to the use of cash collateral or the financing, either in the text of the motion or in an attached term sheet:

(a) amount of cash to be used or borrowed, including (if applicable) committed amount, maximum borrowings (if less), any borrowing base formula, availability under the formula, and the purpose of the borrowing;

(b) material conditions to closing and borrowing, including any budget provisions;

(c) pricing and economic terms, including interest rates, letter of credit fees, commitment fees, any other fees, and the treatment of costs and expenses of the lender (and its professionals);

(d) collateral or adequate protection provided to the lender and any priority or superpriority provisions, including the effect thereof on existing liens, and any carve-outs from liens or superpriorities;

(e) maturity, termination and default provisions, including events of default, effect on the automatic stay and any cross-default provisions; and

(f) any other material provisions, including any Extraordinary Provisions, as defined in Section II(A), any provisions relating to change of control, and key covenants.

3. Adequacy of Budget. Any motion for new financing or use of cash collateral must also include disclosure by the debtor as to whether it has reason to believe that any budget to which the debtor will be subject under the order will be adequate (in the context of all assets available to the debtor) to pay all administrative expenses due and payable during the period covered by the financing or the budget.

4. Extraordinary Provisions. The motion must disclose prominently whether the financing includes any of the Extraordinary Provisions set forth in section II (A) of these Guidelines, and any accompanying order must also set forth these provisions prominently and conspicuously.

5. Efforts to Obtain Financing. The motion should describe in general terms the debtor's efforts to obtain financing, the basis on which the debtor determined that the proposed financing was on the best terms available, and material facts bearing on the issue of whether the extension of credit is being extended in good faith.

6. Emergency Applications. A motion that seeks entry of an Emergency Order or Interim Order should also describe the amount and purpose of funds sought to be borrowed on an emergency or interim basis and set forth facts to support a finding that immediate or irreparable harm will be caused to the estate if immediate financing is not obtained at a preliminary hearing or on an emergency basis.

B. NOTICE

1. Notice of the hearing on (i) the Interim and (ii) the Final Order shall be given to the persons required by Rules 4001(b)(3) and 4001(c)(3), as the case may be, the United States Trustee and any other persons whose interests may be directly affected by the outcome of the motion or any provision of the proposed order. Notwithstanding the foregoing, emergency and interim relief may be entered after the best notice available under the circumstances; however, emergency and interim relief will ordinarily not be considered unless the United States Trustee and the Court have had a reasonable opportunity to review the motion, the financing agreement, and the proposed interim order, and the Court normally will not approve provisions that directly affect the interests of landlords, taxing and environmental authorities and other third-parties without notice to them.

2. Prospective debtors may provide substantially complete drafts of the motion, interim order, and related financing documents to the Office of the United States Trustee in advance of a filing, and the United States Trustee will hold such documents in confidence and without prejudice to the prospective debtor, and attempt to comment on such documents on or shortly after the filing. Debtors are strongly encouraged to provide drafts of financing requests, including proposed orders, to the United States Trustee as early as possible in advance of filing.

3. The hearing on a Final Order will not commence earlier than 15 days after service of the motion, in accordance with Bankruptcy Rules 4001(b)(2) and 4001(c)(2), and ordinarily will

not commence until there has been a reasonable opportunity for the formation of a Creditors Committee under 11 U.S.C. §1102 and either the Creditors Committee's appointment of counsel or reasonable opportunity to do so.

C. PRESENCE AT HEARING.

Except as otherwise ordered by the Court:

1. Counsel for the postpetition lender (or the entity whose cash collateral is to be consensually used) must be present at any hearing with respect to its financing or its collateral; and
2. A business representative of the debtor and lender and any party objecting to the financing, each with appropriate authority, must be reasonably available by telephone or present at the hearing for the purpose of making necessary decisions.

II. ORDERS

A. EXTRAORDINARY PROVISIONS.

The following provisions in a cash collateral or DIP financing order, or in a financing agreement to be approved under such an order, called "Extraordinary Provisions," must be disclosed conspicuously in the motion and order and justification therefor separately set forth:

1. Cross-Collateralization. Extraordinary Provisions include all provisions that elevate prepetition debt to administrative expense (or higher) status or secure prepetition debt with liens on postpetition assets that such debt would not have by virtue of the prepetition security agreement or applicable law (for the purposes of these Guidelines, "Cross-Collateralization"), unless such status and liens are limited in extent to that necessary to accord the prepetition lender in a reorganization case adequate protection against a decline in the value of its collateral during the postpetition period. In connection with a request for Cross-Collateralization, the Court will consider, among other factors:

- (i) the extent of the notice provided;¹
- (ii) the terms of the DIP financing and a comparison to the terms that would be available absent the Cross-Collateralization;
- (iii) the degree of consensus among parties in interest supportive of Cross-Collateralization;
- (iv) the extent and value of the prepetition liens held by the prepetition lender (and in particular the amount of any "equity cushion" that the prepetition lender may have), and
- (v) whether Cross-Collateralization will give an undue advantage to prepetition lenders without a countervailing benefit to the estate.

An order approving Cross-Collateralization must ordinarily reserve the right of the Court to unwind the postpetition protection provided to the prepetition lender in the event that there is a timely and successful challenge to the validity, enforceability, extent, perfection, and (where appropriate) priority of the prepetition lender's claims or liens, or a determination that the prepetition debt was undersecured as of the petition date, and the Cross-Collateralization unduly advantaged the lender.

2. "Rollups." Rollups include the application of proceeds of postpetition financing to pay, in whole or in part, prepetition debt. Determination of the propriety of a rollup will normally take into account, to the extent applicable, the factors mentioned above in connection with Cross-Collateralization, and, in addition, the following:

- (a) the nature and amount of new credit to be extended, beyond the application of proceeds of postpetition financing used to pay in whole or in part the prepetition debt;

¹ See *Otte v. Manufacturers Hanover Commercial Corp., (In re Texlon Corp.)* 596 F.2d 1092 (2d Cir. 1979).

(b) whether the advantages of the postpetition financing justify the loss to the estate of the opportunity to satisfy the prepetition secured debt otherwise in accordance with applicable provisions of the Bankruptcy Code, and the burdens on the estate of incurring an administrative claim;

(c) whether the rollup can be unwound (see below);

(d) availability under the terms of the DIP financing and a comparison to the terms that would be available in the absence of the rollup;

(e) the extent to which prepetition and postpetition collateral can, as a practical matter, be identified and/or segregated;

(f) the extent to which difficult "priming" issues would have to be addressed in the absence of a rollup; and

(g) whether the postpetition advances are used to repay a pre-bankruptcy, "emergency" liquidity facility secured by first priority liens on the same collateral as the postpetition financing, where the prepetition facility was provided in anticipation of, or in an effort to avoid, a bankruptcy filing.

An order approving a rollup must ordinarily reserve the right of the Court to unwind the paydown of the prepetition debt in the event that there is a timely and successful challenge to the validity, enforceability, extent, perfection, and (where appropriate) priority of the prepetition lender's claims or liens, or a determination that the prepetition debt was undersecured as of the petition date.

3. Waivers and concessions as to validity of prepetition debt. The Court will not consider as extraordinary the debtor's stipulation as to validity, perfection, enforceability,

priority and non-avoidability of a prepetition lender's claim and liens, and the lack of any defense thereto, provided that:

(a) the Official Committee of Unsecured Creditors (the "Committee"), appointed under section 1102 of the Bankruptcy Code, has a minimum of 60 days (or such longer period as the Committee may obtain for cause shown before the expiration of such period) from the date of the order approving the appointment of counsel for the Committee to investigate the facts and bring any appropriate proceedings as representative of the estate; or

(b) if no Committee is appointed, any party in interest has a minimum of 75 days (or a longer period for cause shown before the expiration of such period) from the entry of the final financing order to investigate the facts and file a motion seeking authority to bring any appropriate proceedings as representative of the estate; provided that

(c) the foregoing periods may be shortened in prepackaged or pre-arranged cases for cause shown.

4. Waivers. Extraordinary Provisions include those that divest the Court of its power or discretion in a material way, or interfere with the exercise of the fiduciary duties of the debtor or Creditors Committee in connection with the operation of the business, administration of the estate, or the formulation of a reorganization plan, such as provisions that deprive the debtor or the Creditors Committee of the ability to file a request for relief with the Court, to grant a junior postpetition lien, or to obtain future use of cash collateral. Notwithstanding the foregoing, and where duly disclosed, it will not be considered "extraordinary" for the debtor to agree to repay the postpetition financing in connection with any plan; for the debtor to waive any right to incur

liens that prime or are pari passu with liens granted under section 364; for a financing order to contain reasonable limitations and conditions regarding future borrowings under section 364 or cash collateral usage under section 363 (including consent of the lender, subordination of future borrowings to the priorities and liens given to the initial lender, and repayment of the initial loan with the proceeds of a subsequent borrowing); and for an order to provide that the lender has no obligation to fund certain activities of the debtor or the Committee, so long as the debtor or Committee is free to engage therein.

5. Section 506(c) waivers. Extraordinary Provisions include any waiver of the debtor's right to a surcharge against collateral under section 506(c); factors to be considered in connection with any order seeking such a waiver include whether the debtor's rights are (to the extent permitted by law) delegated to the Committee (or, if a Committee is not appointed, to any party in interest) and whether the carve-out includes expenses under section 726(b) (see below).

6. Liens on avoidance actions. Extraordinary Provisions include the granting of liens on the debtor's claims and causes of action arising under sections 544, 545, 547, 548 and 549 (but not liens on recoveries under section 549 on account of collateral as to which the lender has a postpetition lien), and the proceeds thereof, or a superpriority administrative claim payable from the proceeds of such claims and causes of action.

7. Carve-outs. Provisions relating to a carve-out that will be considered "extraordinary" include those that provide disparate treatment for the professionals retained by the Committee compared to professionals retained by the debtor or that do not include the fees of the U.S. Trustee, the reasonable expenses of Committee members, and reasonable fees and expenses of a trustee under section 726(b); however, reasonable allocations among such expenses can be proposed, and the lender may refuse to include in a carve-out the costs of litigation against it (but

not the costs of investigating whether any claims or causes of action exist). Provisions relating to carve-outs should make clear when the carve-out takes effect (and, in this connection, whether it remains unaltered after payment of interim fees made before an event of default under the facility), and any effect of the carve-out on availability under the postpetition loan.

8. Termination; Default; Remedies. Extraordinary Provisions include terms that provide that the use of cash collateral will cease, or the financing agreement will default, on (i) the filing of a challenge to the lender's prepetition lien or to the lender's prepetition conduct; (ii) entry of an order granting relief from the automatic stay (except as to material assets); (iii) the grant of a change of venue with respect to the case or any adversary proceeding; (iv) the making of a motion by a party in interest seeking any relief (as distinct from an order granting such relief); and (v) management changes or the departure, from the debtor, of any identified employees.

Clauses providing a reasonable maturity date for the postpetition debt and for termination of the loan or default of the postpetition debt (if not repaid) on dismissal of the case or on confirmation of a plan of reorganization, or on conversion to Chapter 7, or on the appointment of a trustee or an examiner with expanded powers, will not be considered to be extraordinary. Termination of the postpetition lender's commitment to continue to advance funds after an event of default will not be considered extraordinary, but the following provisions will:

(a) failure to provide at least five business days' notice to the debtor and the Committee before the automatic stay terminates and the lender's remedies can be enforced; and

(b) failure to provide at least three business days' notice before use of cash collateral ceases, provided that the use of cash collateral conforms to any budget in effect.

B. INTERIM ORDERS.

An Interim Order will not ordinarily bind the Court with respect to the provisions of the Final Order provided that (i) the lender will be afforded all the benefits and protections of the Interim Order, including a DIP lender's section 364(e) and 363(m) protection with respect to funds advanced during the interim period, and (ii) the Interim Order will not bind the lender to advance funds pursuant to a Final Order that contains provisions contrary to or inconsistent with the Interim Order.

C. FORMAL PROVISIONS OF ORDERS

1. Findings of Fact. The order should limit recitation of findings to essential facts, including the facts required under section 364 regarding efforts to obtain financing on a less onerous basis and (where required) facts sufficient to support a finding of good faith under section 364(e). Non-essential facts regarding prepetition dealings and agreements may be included under the rubric of "stipulations" between the debtor and the lender or "background." Any emergency or interim order should include a finding that immediate and irreparable loss or damage will be caused to the estate if immediate DIP financing is not obtained and should state with respect to notice only that the hearing was held pursuant to Rule 4001(b)(2) or (c)(2), that notice was given to certain parties in the manner described, and that the notice was, in the debtor's belief, the best available under the circumstances. The Final Order may include factual findings as to notice. The Order should not incorporate by reference or refer to specific sections of a pre- or post- petition loan agreement or other document without a statement of the section's import. The Order should not contain any findings or provisions extraneous to the use of cash collateral or to the DIP financing.

2. Decretal Provisions. The Order should specify, in particular: any Extraordinary Provisions; any priorities or collateral granted; any effect of the borrowing on pre-existing liens;

bankruptcy-specific events of default and the consequences thereof; any provisions relating to adequate protection; any acknowledgments or stipulations by the debtor as to the prepetition debt; the purpose for which the loan is being made, and any restrictions on use of borrowings. The Order may permit the parties to enter into waivers or consents to the DIP loan agreement or amendments thereof provided that (i) the agreement as so modified is not materially different from that approved, (ii) notice of all amendments is filed with the Court, and (iii) notice of all amendments (other than those that are ministerial or technical and do not adversely affect the debtor) are provided in advance to counsel for any Committee, all parties requesting notice, and the U.S. Trustee.

3. Conclusions of Law. The interim order should not state that the Court has examined and approved the loan or other agreement; it may say, however, that the debtor is authorized to enter into it. Normally, the Interim and Final orders are sufficient if they state that the debtor is authorized to borrow on the terms and conditions of the loan or other agreement.

4. Order to Control. The order should ordinarily state that to the extent the loan or other agreement differs from the order, the order will control.

5. Statutory Provisions Affected. The order should specify those sections of the Bankruptcy Code that are being relied on, and identify those sections that are, to the extent permitted by law, being limited or abridged.

6. Conclusions re Notice. The Final Order may contain conclusions of law with respect to the adequacy of notice under section 364 and Rule 4001.

DISTRICT OF DELAWARE

Rule 4001-2 Cash Collateral and Financing Orders

(a) Motions. Except as provided herein and elsewhere in these Rules, all cash collateral and financing requests under 11 U.S.C. §§ 363 and 364 shall be heard by motion filed pursuant to Fed.R.Bankr.P. 2002, 4001 and 9014 ("Financing Motions").

(i) Provisions to be Highlighted. All Financing Motions must (1) recite whether the proposed form of order and/or underlying cash collateral stipulation or loan agreement contains any provision of the type indicated below, (2) identify the location of any such provision in the proposed form of order, cash collateral stipulation and/or loan agreement, and (3) the justification for the inclusion of such provision:

(A) Provisions that grant cross-collateralization protection (other than replacement liens or other adequate protection) to the prepetition secured creditors (i.e., clauses that secure prepetition debt by post-petition assets in which the secured creditor would not otherwise have a security interest by virtue of its prepetition security agreement or applicable law).

(B) Provisions or findings of fact that bind the estate or all parties in interest with respect to the validity, perfection or amount of the secured creditor's prepetition lien or debt or the waiver of claims against the secured creditor without first giving parties-in-interest at least 75 days from the entry of the order and the creditors' committee, if formed, at least 60 days from the date of its formation to investigate such matters.

(C) Provisions that seek to waive, without notice, whatever rights the estate may have under 11 U.S.C. § 506(c).

(D) Provisions that grant immediately to the prepetition secured creditor liens on the debtor's claims and causes of action arising under 11 U.S.C. §§ 544, 545, 547, 548, and 549.

(E) Provisions that deem prepetition secured debt to be post-petition debt or that use post-petition bans from a prepetition secured creditor to pay part or all of that secured creditor's prepetition debt, other than as provided in 11 U.S.C. § 552(b).

(F) Provisions that provide disparate treatment for the professionals retained by a creditors' committee from that provided for the professionals retained by the debtor with respect to a professional fee carveout.

(G) Provisions that prime any secured lien, without the consent of that lienor.

(ii) All Financing Motions shall also provide a summary of the essential terms of the proposed use of cash collateral and/or financing (e.g., the maximum borrowing available on a final basis, the interim borrowing limit, borrowing conditions, interest rate, maturity, events of default, use of funds limitations, and protections afforded under 11 U.S.C. §§ 363 and 364).

(b) Interim Relief. When Financing Motions are filed with the Court on or shortly after the date of the entry of the order for relief, the Court may grant interim relief pending review by the interested parties of the proposed debtor-in-possession financing arrangements. Such interim relief is intended to avoid immediate and irreparable harm to the estate pending a final hearing. In the absence of extraordinary circumstances, the Court shall not approve interim financing orders that include any of the provisions previously identified in subsection (a)(1)(A) through (a)(1)(F) of this Rule.

(c) Final Orders. A final order shall be entered only after notice and a hearing pursuant to Fed.R.Bankr.P. 4001 and Local Rule 2002-1(b). Ordinarily, the final hearing shall be held at least ten (10) days following the organizational meeting of the creditors' committee contemplated by 11 U.S.C. § 1102.

CASH COLLATERAL CHECKLIST

A. Preparing to Negotiate

1. Review all loan documents and identify weak spots and strengths.
 - a. Are there any perfection issues?
 - b. Are there any collateral “gaps”?
 - c. Are there any defaults that trigger special lender rights?
 - d. Are there guaranty issues?
2. Identify who are all necessary parties.
 - a. Are there bondholders?
 - b. Are there lenders with priority or subordinate liens?
3. Debtors should determine how much in funds are needed. Prepare budgets for both interim and final use of cash collateral.
4. Lenders should confirm all debt amounts including the amount of any interest or other charges owing.
5. Identify available resources to provide replacement liens.

B. The Cash Collateral Agreement

1. Confirmation of the Lender’s Prepetition Claim
 - a. Acknowledge the amount of the debt as of the Petition Date
 - b. Acknowledge the validity, priority and enforceability of all prepetition liens
 - c. Acknowledge the lender’s lien on cash and identify what is cash collateral
 - d. Acknowledge value of collateral (if appropriate)
 - e. Acknowledge there are no rights of setoff, counterclaims, etc.

- f. Acknowledge the interest rate
- 2. Other Lender Protection
 - a. Lender release
 - b. Restriction on right to surcharge
 - c. Restriction on use of cash collateral to bring action against the lender.
 - d. Prohibition on placing other liens on the lender's collateral or lender's right to veto other financing with priority equal or superior to lender's rights.
 - e. Lender's "right of first refusal" to provide other lending
- 3. Conditions for use of cash collateral
 - a. Describe the term of use and conditions that trigger earlier termination including:
 - (i) Is there a particular date
 - (ii) Appointment of a Trustee
 - (iii) Conversion to Chapter 7
 - (iv) Further default under the loan documents
 - (v) Failure to file a plan by a certain date
 - b. Include interim and final budget and variance provisions
 - c. Describe defaults and default remedies
 - (i) waiver of automatic stay
 - (ii) right to terminate without notice or shortened notice
 - d. Reporting requirements
 - (i) frequency of reports

- (ii) content of reports including variance reporting
 - (iii) necessity of audited reports
- e. Include any other rights and protections including:
 - (i) Lock box requirements
 - (ii) Ability to review books and records
 - (iii) Ability to have an on-site observer
 - (iv) Right to interim payments. How will the payments be applied?
- f. Confirm continuing application of other loan obligations, or modification, such as
 - (i) obligation to maintain insurance
 - (ii) obligation to maintain debt service/equity ratios

4. Replacement Liens

- a. Describe collateral. If collateral is subject to liens seek an intercreditor agreement with the other lender.
- b. If avoidance liens are collateral, describe any limitation.
- c. Include automatic perfection language in the order.
- d. Take all necessary steps to perfect anyway.
- e. Acknowledgement of superpriority lien if adequate protection isn't adequate.

5. Third party rights

- a. Right of committee or trustee to challenge lien and releases
 - (i) When does the right terminate – within a certain amount of days? When the claims bar date has expired?
 - (ii) Describe whether additional court order is needed before the Committee can file suit

- b. Carveouts
 - (i) What is the carveout cap
 - (ii) Is there a limitation on use of the funds (e.g., cannot be used to sue lender)
 - (iii) Who is included? All professionals? Only Debtor's counsel?
 - (iv) Don't forget the U.S. Trustee fees.

6. Miscellaneous Provisions

- a. What law applies
- b. The agreement is binding on successors and assigns
- c. Agreement to sign other documents if requested
- d. Notice provisions

C. The Cash Collateral Hearing and Order

1. Preparing to file

- a. Check the local rules
 - (i) Confirm the agreement for interim and final use meets all local requirements
 - (ii) Confirm the notice and time deadlines have not modified the Federal Rules.
- b. Make sure all required parties receive notice
- c. The agreement must be attached to the motion

2. The cash collateral hearing

- a. Understand the local practice regarding proffer
- b. Have all required evidence and witnesses prepared

3. The cash collateral order
 - a. Incorporate by reference the cash collateral agreement with any court-directed modifications
 - b. Alternatively confirm the order precisely tracks the agreement, other than court-directed modifications
 - c. Include automatic perfection provisions.
 - d. Include a finding of good faith

D. After the Wedding

1. Debtors comply with the agreement
2. Lenders – watch your cash
3. Committees and Trustees – know your review deadlines. Don't wait until the last minute to ask for or receive information
4. All changes must be in writing. Provide notice to the court and in the appropriate circumstance seek court approval

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