

Lien on Me

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Scope of Agreed-Upon Orders on the Use of Cash Collateral Limited



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In a chapter 11 case, after a debtor files its first-day motion to use cash collateral, the debtor and its secured lender will often negotiate agreed-upon interim and continuing orders providing adequate protection to the lender for the debtor's use of the lender's collateral during the bankruptcy case.

A recent decision demonstrates the difficulty in enforcing such agreed-upon orders when the broad language of the orders potentially grants a secured lender rights that the bankruptcy court later determines should not (or could not) have been granted to the secured lender as adequate protection for the debtor's use of the lender's cash collateral. Thus, lenders should ensure that the bankruptcy court understands and appreciates the full scope of the negotiated adequate protection provisions when submitting agreed-upon orders at the outset of a chapter 11 case.

For example, shortly after the filing of two jointly administered chapter 11 cases,¹ the senior secured lender agreed to the debtors' use of cash collateral in the continued operation of the debtors' business. In doing so, the debtors and secured lender negotiated and agreed on a lengthy form of order governing the debtors' ongoing use of the secured lender's cash collateral and providing the secured lender with broad adequate protection. As such, the bankruptcy court entered an agreed-upon order and numerous subsequent agreed orders for the debtors' continued use of cash collateral during the bankruptcy cases.

Each of the 21 agreed that interim and final cash-collateral orders contained provisions granting the secured lender additional and replacement liens on all of the debtors' assets for any diminution in value of the secured lenders' collateral. Specifically, the various parties agreed that cash-collateral orders contained language generally consistent with the following:

As interim adequate protection for the Lender for any post-petition diminution in value ("Diminution in Value") of the Lenders' collateral ... including but not limited to the Cash Collateral, the Lender is hereby granted, to the extent of any Diminution of Value, additional and replacement valid, binding, enforceable, and automatically

perfected post-petition security interests in and liens on, to the same extent, validity, and priority as existed on the Petition Date (the "Adequate Protection Liens"), without the necessity of the execution by the debtors (or recordation or other filing) of security agreements, control agreements, pledge agreements, financing statements, mortgages, or other similar documents, all property, whether now owned or hereafter acquired or existing and wherever located, of each Debtor and each Debtor's "estate" (as created pursuant to section 541(a) of the Bankruptcy Code), of any kind or nature whatsoever, real or personal ... (collectively, the "Collateral").

Thus, notwithstanding that the debtors only sought authority to use cash collateral during the chapter 11 cases, the language of the agreed-upon cash-collateral orders provided adequate-protection liens to the secured lender for a diminution in value of *any* of the secured lender's collateral during the bankruptcy case, not just the secured lender's cash collateral. However, when the debtors sought to confirm their liquidation plan, the secured creditor established that its real estate collateral had diminished in value by approximately \$4 million during the chapter 11 cases.²

The secured lender objected to confirmation on, among other grounds, the basis that the debtors' plan did not provide for treatment of its "diminution in value" (DIV) liens granted in the numerous agreed-upon cash-collateral orders. The debtors' liquidation plan was confirmed, thus appointing a liquidating trustee to sell the debtors' assets for distribution to creditors. However, the bankruptcy court refrained from ruling on whether the secured lender was entitled to the asserted DIV liens on any sale proceeds from its collateral or any potential unencumbered assets of the debtors.

The Secured Lender's Argument

The secured lender argued that the various agreed-upon cash-collateral orders were negotiated with the debtors and, therefore, that the terms of such orders were enforceable notwithstanding the

¹ *In re Westport Holdings Tampa LP and Westport Holdings Tampa II LP*, Jointly Administered Case No. 8:16-bk-08167-MGW, U.S. Bankruptcy Court for the Middle District of Florida. The authors are counsel to the court-appointed liquidating trustee in these cases.

² For purposes of confirmation, the debtors and secured lender agreed that the value of the debtors' real estate collateral was \$12.9 million, which was \$4 million less than the \$16.9 million that the secured lender's expert opined was the value of such property on the petition date.

fact that they dealt with more than simply the debtors' use of the secured lender's cash collateral. In particular, the secured lender pointed to the clear and unambiguous language of the cash-collateral orders for its entitlement to the "valid, binding, enforceable, and automatically perfected DIV Liens for any diminution in value of [the lender's] collateral." As such, the secured lender argued that it was entitled a DIV lien on the proceeds of the sale of the debtors' assets (including both real and personal property) with priority over all other creditors for the \$4 million diminution in value of the lender's real estate collateral.

Moreover, the secured lender asserted that it was entitled to an allowed superpriority administrative claim pursuant to § 507(b) of the Bankruptcy Code to the extent that the DIV liens were insufficient to compensate the lender for the diminution in value of its real estate collateral. Section 507(b) provides as follows:

If the trustee, under section 362, 363, or 364 of this title, provides adequate protection of the interest of a holder of a claim secured by a lien on property of the debtor and if, notwithstanding such protection, such creditor has a claim allowable under subsection (a)(2) of this section arising from the stay of action against such property under section 362 of this title, from the use, sale, or lease of such property under section 363 of this title, or from the granting of a lien under section 364(d) of this title, then such creditor's claim under such subsection shall have priority over every other claim allowable under such subsection.

The Eleventh Circuit had previously found that § 507(b) provides an almost automatic right to a superpriority administrative-expense claim when the adequate protection granted to a lender during a chapter 11 cases turns out to be insufficient to protect the lender's interest.³ Thus, the secured lender argued that inasmuch as the debtors had the benefit of the use of the lender's cash and non-cash collateral during the chapter 11 cases, the lender was entitled to the DIV liens attaching to the proceeds of the sale of all of the debtors' assets and, if such DIV liens were insufficient, an allowed superpriority administrative-expense claim in the amount of the diminution in value of its real estate collateral.

The Liquidating Trustee's Argument

The plan-appointed liquidating trustee, who was not a party to the negotiation of the 21 pre-confirmation agreed-upon cash-collateral orders, opposed the secured lender's entitlement to either DIV liens on any proceeds from the sale of estate assets or an allowed superpriority administrative expense as a result of the lender's asserted failure in adequate protection during the chapter 11 cases.

With respect to the secured lender's assertion of an allowed superpriority administrative expense due to the potential failure of the adequate protection, the liquidating trustee argued that the secured lender had failed to timely request an administrative-expense claim pursuant to the bankruptcy court's order setting a pre-confirmation deadline

for asserting administrative-expense claims. Thus, notwithstanding the ostensibly automatic nature of § 507(b)'s grant of an administrative claim to lenders in the event of a failure of adequate protection, the liquidating trustee asserted that the lender's failure to timely request an administrative-expense claim was fatal to the secured lender's assertion of a superpriority claim.

Moreover, the liquidating trustee noted that the express language of § 507(b) limits the grant of a superpriority administrative-priority claim to claims "arising from the stay of action against *such property* under section 362 of this title, from the use, sale, or lease of *such property* under section 363."⁴ Thus, if the secured lender was solely granted adequate protection for the debtors' use of *cash collateral*, it could not be entitled to a superpriority administrative-priority claim for a diminution in value in the debtors' use of its real property collateral during the chapter 11 cases.

Essentially, because the Bankruptcy Code defines "cash collateral" as cash and cash equivalents,⁵ any diminution in value arising from the debtors' use of non-cash, real property collateral could not give rise to a § 507(b) claim where the adequate protection was granted for the debtors' use of cash collateral. Notably, the liquidating trustee asserted that inasmuch as the secured lender never sought relief from the stay or adequate protection for the debtors' use of its real property collateral during the chapter 11 cases, the cash-collateral orders could not have been intended to grant the secured lender adequate protection for the debtors' use of the lender's real property collateral.

The Bankruptcy Court's Ruling

The bankruptcy court denied the secured lender's request for both the DIV liens and any superpriority administrative claim under § 507(b). In doing so, the court reasoned that there was never any showing that there was a diminution in value of the debtors' cash collateral, but, rather, only a showing of a \$4 million reduction in the value of the debtors' real estate during the bankruptcy cases. Accordingly, despite the plain language of the 21 agreed-upon cash-collateral orders, inasmuch as §§ 361 and 363 only authorized the court to grant adequate protection for the secured lender's interest in cash collateral, the cash-collateral orders did not grant the secured lender DIV liens for any diminution in value of its real estate collateral.

While the court pointed out that it encourages the resolution of disputed motions and the language of the agreed-upon cash-collateral orders was broad in scope, the court reasoned that it must nevertheless review the orders in the context of the relief requested by the debtors. Thus, the context in which the agreed orders were granted — pursuant to the debtors' request for use of cash collateral — was crucially important to the court's interpretation of the orders.

⁴ Emphasis added.

⁵ Section 363(a) of the Bankruptcy Code defines "cash collateral" 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."

³ See *Carpet Ctr. Leasing Co. v. Nalley Motor Trucks (In re Carpet Ctr. Leasing Co.)*, 991 F.2d 682, 686 (11th Cir. 1993).

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The court noted that the debtors' motion to use cash collateral at the outset of the chapter 11 cases initially proposed to grant the secured lender replacement liens on only cash collateral to the same extent, validity and priority as the lender's liens on the petition date for the debtors' use of cash collateral, which proposal the court recognized did not encompass non-cash collateral.

Moreover, the court recognized that the secured lender's written opposition to the debtors' cash-collateral motion did not oppose the use of cash collateral so long as the lender would receive "adequate protection in accordance with sections 361 and 363." As such, at the hearing on the debtors' initial motion to use cash collateral, where an agreement to its use was announced, the court "as is customary" requested that debtors' counsel prepare the agreed-upon order on the use of cash collateral.

Upon its review of the agreed-upon order, the court did not appreciate that the order was granting a replacement lien for use of the debtors' non-cash collateral.⁶ The court made particular note of the fact that it was only concerned with the debtors' request for use of cash collateral at the hearing and, had there been a request for adequate protection for use of non-cash collateral, that the court "had no intention of granting relief that neither party requested, particularly extraordinary relief like a lien against *non-cash* collateral to protect [the lender's] interest in *cash* collateral."⁷ The court stated further that had such a request been made, the court would not have granted it under the auspices of § 363 inasmuch as adequate protection under that section is typically limited to protecting the secured creditor's interest in cash collateral.⁸

Accordingly, having failed to establish that a replacement lien on non-cash collateral was necessary to protect the secured lender's interest in cash collateral or that the reduction in value of the lender's real estate collateral was attributable to the debtors' use of its cash collateral, the court denied the secured lender's request for the DIV liens. Likewise, inasmuch as the court found that the adequate protection granted was limited to the secured lender's interest in the debtors' cash collateral and there was no showing that there was any insufficiency in the replacement liens granted for the debtors' use of the lender's cash collateral, the court concluded that the lender was not entitled to a superpriority administrative claim.

Conclusion

It is customary in chapter 11 cases for a debtor and its lender to negotiate terms for the debtor's interim and continued use of cash collateral during the bankruptcy case. In many large chapter 11 cases, the agreed-upon orders can be voluminous and address many detailed aspects of the case, from adequate protection to timing for plan submission and specific, agreed-upon plan provisions. However, this case presents an important caveat to the negotiation and submission of agreed-upon orders that go beyond the scope of a debtor's motion for use of cash collateral and a lender's response in opposition thereto: The lender should specifically request adequate protection for the debtor's ongoing use of non-cash collateral, rather than relying on the broad language contained in many first-day orders.

Specifically, it makes sense for a lender to either file a motion seeking adequate protection for the debtor's use of non-cash collateral under § 362(d)(1), or seek specific approval of any stipulation on adequate protection for the debtor's use of non-cash collateral under Federal Rule of Bankruptcy Procedure 4001(d). **abi**

⁶ There is precedent for the bankruptcy court's authority to interpret adequate-protection agreements, particularly *ex parte* agreements, closely in order to ensure that a creditor does not receive more than it is entitled to receive under the Bankruptcy Code. See *Travelers Ins. Co. v. Amer. Agcredit Corp.* (*In re Blehm Land & Cattle Trust*), 859 F.2d 137 (10th Cir. 1988) (reviewing *ex parte* adequate-protection agreement); *In re Nordyke*, 43 B.R. 856, 860 (Bankr. D. Ore. 1984) ("[A] creditor should not be rewarded for carelessness, much less greed, in negotiating a stipulation for adequate protection that overstates entitlement.").

⁷ Emphasis in original. The bankruptcy court had the inherent authority to interpret its own orders and clarify the intent of its order if it could be construed to grant relief otherwise impermissible under the Bankruptcy Code. See *Travelers Indem. Co. v. Bailey*, 129 S. Ct. 2195, 2205 (2009) (bankruptcy court "plainly had jurisdiction to interpret and enforce its own prior orders"); *In re Optical Techs. Inc.*, 425 F.3d 1294, 1300 (11th Cir. 2005) ("[A] court that issued an order is in the best position to interpret it."); see also *In re Fontainebleau Las Vegas Holdings LLC*, No. 09-21481-BKC-AJC, 2009 WL 5195775, at *4 (Bankr. S.D. Fla. Dec. 30, 2009) (interpreting cash-collateral orders as to scope of adequate protection granted to secured lenders).

⁸ Other courts have noted a distinction between the adequate protection granted for use of cash collateral versus adequate protection granted for the use of other collateral by the debtor. See *Matter of Earth Life Inc.*, 9 B.R. 440, 443 (Bankr. M.D. Fla. 1981) ("Congress ... gave a special treatment to 'cash collateral' for the obvious reasons that cash collateral is highly volatile, subject to rapid dissipation and requires special protective safeguards in order to assure that a holder of a lien on 'cash collateral' is not deprived of its collateral through unprotected use by the Debtor."); but see *In re Triplett*, 87 B.R. 25, 27 (Bankr. W.D. Tex. 1988) (disagreeing with conclusion in *Matter of Earth Life Inc.* that use of cash collateral requires adequate protection beyond mere equity cushion).

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