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FIRST DAY MOTIONS AND ORDERS IN LARGE CHAPTER 11 CASES: (CRITICAL VENDOR, DIP FINANCING AND CASH MANAGEMENT ISSUES)

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I. INTRODUCTION

This article discusses typical "**first day**" issues arising in larger **Chapter 11** bankruptcy cases. **First day** issues are generally those that require immediate attention at the beginning of a case to allow a debtor to continue to operate its business and preserve its going concern value. In the absence of such **first day** relief, a business filing for **Chapter 11** protection may experience significant disruptions during the beginning of its case. Thus, it is very important to be prepared to file the necessary **first day motions** immediately or very shortly after filing **Chapter 11** petitions.

This article first discusses some of the steps necessary to preparing a large **Chapter 11** case, including a summary of the due diligence necessary to prepare the appropriate petitions and **motions**. It next discusses the preparation of bankruptcy petitions and typical **first day motions**, including certain relevant statutes and caselaw supporting such **motions**. Although **first day motions** vary depending upon a company's particular requirements, typical **first day motions** pertain to the following topics:

a. Case administration;

b. Utility providers;

c. Employee payroll and benefit programs;

***60** d. Cash management system;

e. Payment of certain taxes;

f. Payment of certain necessary prepetition vendor claims;

g. Reclamation procedures;

h. Use of a company's cash collateral; and

i. DIP financing.

It then discusses certain recent developments in **first day motions**. This article does not provide legal advice, and should not substitute for consultation with experienced bankruptcy counsel on these matters. Additionally, this article gives only a summary of the items to be addressed in preparing a **Chapter 11** filing.

II. CHAPTER 11 PREPARATION

Prior to filing **Chapter 11** petitions, a company's counsel and other advisors should perform a significant amount of due diligence concerning the company and its operations. A thorough due diligence process may take weeks or months, time permitting. It is often the case, however, that events require a **Chapter 11** filing on an accelerated schedule. In addition to due diligence, counsel to the company must prepare the company's officers, director, and employees for the transition into bankruptcy, and the obligations associated with such a filing. What follows is a highlight of certain typical due diligence for large companies. This illustration, however, is by no means exhaustive.

A. Typical Due Diligence

1. Corporate and Capital Structure

One of the first things counsel and advisors to a company must understand is the company's organizational and capital structure. This information is necessary to decide which entities must or should file for bankruptcy. If a company consists of multiple subsidiaries, partnerships, and joint ventures, a complete organizational chart detailing the levels of subsidiaries and the company's ownership thereof is often helpful.

Counsel and advisors of a company must also understand the capital structure of the company, including its credit facility, outstanding notes, outstanding trade debt, and equity. A significant element of this structure is often the company's primary credit facility. These lending facilities are typically with lending institutions or, in larger companies, a syndicate of lending institutions. These facilities may be secured by some or all of the ***61** company's assets or, in certain situations, a facility may be unsecured. Counsel must understand the nature of these facilities, the collateral securing such obligations, the maturity of any loan obligations, the covenants associated with the facility, and whether the company's cash on hand is collateral of such lending institutions. It is also important to understand the company's relationship with its lenders as such lenders may provide debtor in possession (DIP) financing to fund the company through its reorganizational process.

With respect to the company's outstanding note obligations, counsel must ascertain whether such notes are secured by collateral, the priority of such notes, and whether any notes are structurally or contractually subordinated to other obligations of the company. It is also important to understand the concentration of ownership of any notes and whether the holders of notes have organized any “ad hoc” committees. Entities that hold a large amount of notes or committees representing a large portion of notes may wield certain influence during a **Chapter 11** bankruptcy. For example, it is not uncommon for noteholders to hold seats on the committee of unsecured creditors formed after a **Chapter 11** case is filed. This committee generally exercises a great deal of influence during the bankruptcy.

2. Cash Management

Counsel and advisors to the company must also understand its cash management system. This includes how receivables are collected, how cash is transferred between and among affiliated entities, how funds are held in the short and long term, and how funds are ultimately disbursed. The cash management systems of many companies

involve a complex network of accounts, including lockbox accounts, concentration accounts, investment accounts, disbursement accounts, zero balance accounts, stand alone petty cash accounts, and other types of accounts. It is imperative to understand how these accounts connect to each other and who controls such accounts. It is also important to understand how transactions between affiliated entities are recorded.

Some items of interest in a cash management system include accounts held by a company's lending institution, which may have the right of setoff against funds in those accounts. The funding needs of joint ventures, non-wholly owned affiliates, and foreign subsidiaries is important, as these entities are not typically included as debtors in a **Chapter 11** filing, and special authorization from the court (and possibly lenders) may be necessary to continue funding these entities postpetition. Finally, how the ***62** company's cash on hand is held will be important in meeting or seeking a waiver of the requirements of 11 U.S.C. § 345.

3. Employee Programs

Uninterrupted payment of employee salaries and wages and the seamless continuation of employee benefits programs are often very important to a company. To allow for as little disruption to employee programs as possible, counsel and advisors to a company must understand how the company pays its employees, its workers' compensation and disability programs, and its health, pension, and other benefits programs. It is also important to keep in mind that the Bankruptcy Code limits the amount of prepetition wages, salaries, and other employee benefits entitled to priority. [1] A good bankruptcy planning strategy is to ensure that on the petition date, no employee is owed more than the statutory limit imposed by the Bankruptcy Code on such payments.

4. Major Litigation

Counsel and advisors to the company must also understand the nature and magnitude of any significant litigation. For example, if a company and its officers and directors are defendants in securities litigation, counsel should understand the company's director and officer insurance policies and the company's obligations to defend and indemnify such officers and directors. If a company is subject to tort litigation related to exposure to asbestos, it may wish to seek the protection of certain aspects of the Bankruptcy Code that provide for the resolution of both prepetition and postpetition asbestos-related clams. [2] It should be noted that if a company is faced with the mere possibility of litigation but is otherwise a financially healthy company, it may wish to consider the possibility that a filing may be viewed as being done in bad faith. [3]

5. Major Contracts and Leases

Counsel and advisors to the company should review and understand the company's major contracts and leases to evaluate the effect of a bankruptcy on such agreements. For example, certain types of contracts, including patent licenses and government contracts, cannot be assumed in certain jurisdictions without the consent of the other party. [4] Additionally, agreements with affiliates of the company should be reviewed for “cross-default” provisions to gauge whether the filing of one entity may cause defaults in contracts with non-filing entities.

*63 6. Other Due Diligence

To appropriately prepare for a **first day** hearing, a company should compile a schedule of all known or possible creditors with their addresses. This list will be used to provide notice of the bankruptcy. It is important to provide all potential creditors with this notice so that they are bound by its terms. Other due diligence includes obtaining a schedule of the company's utility companies [5] and ordinary course professionals [6] to be used in other **motions** filed shortly after the **Chapter 11** filing.

B. Jurisdictional Issues

Although many cases continue to be filed in Delaware and New York, it is not uncommon to file large **Chapter 11** cases in other jurisdictions. Large cases, for example, were recently filed in Illinois, Virginia, Nevada, Texas, and other states. Local Rules may vary greatly from jurisdiction to jurisdiction, and these should always be consulted before making a venue decision. The law of the district and circuit courts of these jurisdictions should also be consulted, as they also vary greatly. Examples of the issues treated differently in different jurisdictions include the assumption of intellectual property agreements, the payment of prepetition critical vendor claims, and the treatment of claims under severance or collective bargaining agreements.

III. FIRST DAY HEARINGS AND PAPERS

When a company files for **Chapter 11**, it is prohibited by federal law from taking certain actions and paying certain claims. Prohibited actions include, inter alia, incurring secured debt, paying prepetition trade claims, using cash collateral without consent, paying employees for prepetition services, and paying certain tax obligations. Because these disruptions could be detrimental to most large **Chapter 11** debtors, it is common to ask for certain "**first day**" relief from the Bankruptcy Court to allow for a smooth transition into bankruptcy.

This section details the documents a company should prepare to commence a **Chapter 11** case, including the petitions necessary to commence a case and typical **first-day motions** and related documents.

A. Petitions

To commence a bankruptcy case, the company and its co-debtor affiliates must file petitions for relief. The petition is Official Form No. 1 of the Official and Procedural Bankruptcy Forms. If the company is required to file reports with the Securities and Exchange Committee, it must attach an Exhibit A to the petition, which details certain information ***64** about its publicly-held securities. If only one entity files for bankruptcy, it must attach a schedule of its 20 largest unsecured creditors. If multiple entities file at the same time, it is typical to attach a consolidated list of the top 40 or 50 unsecured creditors. The petition must also contain a list of affiliated debtors and a resolution authorizing the company to file for bankruptcy.

B. First Day Hearings

Generally, a debtor will file "**first day**" **motions** immediately after filing its petition for relief, with the hope of having such **motions** heard on, or shortly after, the **first day** of its bankruptcy case. It is common to share confidential drafts of **first day motions** with key constituencies before filing for **Chapter 11** protection. These parties include the company's current lender, the company's proposed DIP lender (if different from the prepetition lender), any informal noteholder or litigation claimant committee and the United States Trustee. In

some jurisdictions, the local rules require that drafts of **first day motions** be provided to the United States Trustee within a certain time period before a **first day** hearing. [7]

C. Notice of Filing and First Day Hearing

To provide as much due process as possible under the circumstances, a company should be prepared to send notice (usually by facsimile) to known key parties upon the filing of its petitions. These parties include the United States Trustee, the company's lenders, any informal committee, and the largest unsecured creditors listed on the company's petition. As soon as the Court schedules a **first day** hearing, notice of the time and location of such hearing should be sent to the same key parties.

D. The First Day Affidavit

The **First Day** Affidavit provides the evidentiary support for the **first day motions**. All of the facts contained in any **first-day motion** should be in the **first day** affidavit, including the general background of the company, the events leading to the **Chapter 11** filing, the company's corporate and capital structure, the general terms of the company's current and proposed lending facilities, a description of the company's cash management system and employee payroll and benefits programs, the need to pay certain critical vendors, and the need to enter into DIP financing. If one person is not prepared to attest to all of these facts, multiple affiants may be necessary. All affiants should be prepared to give live testimony during a **first day** hearing should the Court or other parties in interest so require.

*65 E. Administrative Motions

A company may wish to file certain **first day motions** to assist in the administration of its **Chapter 11** case or cases. If the company is filing multiple affiliated entities, a **motion** providing for the joint administration of all related cases under one case number is generally desirable. [8] Joint administration, while not having a substantive effect on the debtors, will allow for pleadings filed in one case to apply to all related debtors.

A company may wish to employ a claims and noticing agent to receive and catalog proofs of claim, send and receive ballots, and mail and publish other notices in the bankruptcy cases (including notice of the initial meeting of creditors and the bar date). Courts generally prefer that a claims and noticing agent be employed under 28 U.S.C. § 156(c) in large **Chapter 11** cases, and in some instances require that such be employed. [9] A company may also wish to file a **motion** to establish scheduling and notice procedures during the **Chapter 11** cases.

F. Utility Motion

Utilities are prohibited from suspending or altering service during the first 20 days of a bankruptcy case under 11 U.S.C. § 366(a). Following this period, a utility may terminate service if a debtor has not provided adequate assurance of payment. The term “utility” is not defined in the Bankruptcy Code, and in certain instances the question of exactly who is a utility is subject to debate. A **first-day** utility procedures **motion** may extend the 20-day period proscribed by section 366(a), and specify a procedure by which utility companies must make requests for adequate assurances of payment. This **motion** must be served on all of the company's utility providers, thus

the need to ascertain their identities during the due diligence period. In some instances, courts have determined that security deposits, which are commonly requested by utilities, are not required. [10]

G. Employee Motion

Generally, companies pay their employees' salaries and wages in arrears and reimburse expenses after they are incurred by employees. Depending upon how far in arrears a company pays its employees, and when during a pay cycle a company files, many employees may hold considerable prepetition claims for unpaid salaries or wages. A strict adhesion to the Bankruptcy Code precludes a company from paying any prepetition debts, including salaries and wages incurred prior to the petition date. Because the continued support of a company's employees is critical to sustaining its going concern value, a **motion** authorizing the payment of salaries ***66** and wages and the continuation of employee benefits programs is very important. Because an interruption in wages and salaries could have a drastic effect on employee morale, possibly leading to the resignation of certain of the company's workforce, debtors generally request authority to make such payments in the ordinary course of business. The authority to make such payments comes from at least two sources, the doctrine of necessity and the priority afforded such expenses under the Bankruptcy Code.

1. Doctrine of Necessity

Courts in many jurisdictions have recognized a debtor's ability to pay certain prepetition claims "when such payment is needed to facilitate the rehabilitation of the debtor." [11] This equitable common law principle "was first articulated by the United States Supreme Court in *Miltenberger v. Logansport, C. & S.W. R. Co.*, 106 U.S. 286 (1882) and is commonly referred to as either the 'doctrine of necessity' or the 'necessity of payment' rule." [12] Under the doctrine of necessity, a bankruptcy court may exercise its equitable power to authorize a debtor to pay certain critical prepetition claims, even though such payment is not explicitly authorized under the Bankruptcy Code. [13] In *In re Just For Feet, Inc.*, [14] Judge McKelvie held that "[t]he necessity of payment doctrine recognizes that paying certain pre-petition claims may be necessary to realize the goal of [**C]hapter 11** — a successful reorganization." [15]

Thus, under the doctrine of necessity, courts may authorize the payment of certain prepetition claims, including claims related to a company's employees. The rationale is that the continued payment of employees is necessary to preserve the company's going concern value.

2. Priority under 11 U.S.C. § 507(a)(3)

Unsecured claims up to $4,650 [16] for each individual for wages, sales, and commissions earned within 90 days of the filing of the bankruptcy are given priority under 11 U.S.C. § 507(a)(3). Debtors argue that because such wages are entitled to priority, and will most likely be paid in a **Chapter 11** case in full at some point, it makes sense to pay such claims at the beginning of the case to allow for the uninterrupted payment of wages and salaries. It is recommended that no employee be owed more than $4,650 on the petition date, in the event that the court refuses to allow prepetition payments in excess of this amount.

***67 3. Description of Employee Programs**

A **first** **day** Employee **Motion** should also contain a description of the employee programs the company is seeking to continue and an express request for authority to continue such programs. A **motion** should detail the method by which the company pays its employees (check, direct deposit, etc.) and its payroll cycle (including how far in arrears employees are paid). The **motion** should also state the total amount of prepetition claims the company is seeking authority to pay and whether any individual employee is owned more than $4,650 in prepetition employment compensation. In addition, the **motion** should describe employee benefits programs, including workers' compensation programs, medical and dental plans, 401(k) plans, pension plans, bonus plans, and any other employment-related programs.

H. Cash Management Motion

United States Trustee guidelines typically require that, among other things, a debtor shall close its prepetition bank accounts, establish new DIP accounts, and maintain separate DIP accounts for cash collateral. The United States Trustee guidelines may also require that all checks used by the debtor postpetition have “DIP” and the bankruptcy case number printed on them. [17] Finally, the Bankruptcy Code precludes a debtor from making payments on account of prepetition claims, which may prohibit certain transfers between and among debtors and their non-debtor affiliates. These restrictions may cause serious complications if both debtors and non-debtors utilize a consolidated cash management system.

The primary purpose of a cash management **motion** is to allow the company to maintain its existing cash management system. A large company may have a highly automated and complex cash management system, with a significant number of interconnected accounts. Forcing a company to close all of its bank accounts and establish a new cash management system would likely create confusion and seriously disrupt the company's receipts and disbursements while such system is being established.

A cash management **motion** should describe the company's cash management system in reasonable detail, including a listing and description of all bank accounts (including account numbers). The **motion** should describe how cash receipts and disbursements are traced through the company's cash management system, how such transactions are reflected in the company's books and records, the controls established on disbursements, and how excess cash is held during the day and overnight. The ***68** **motion** should also describe how cash is moved between and among debtor and non-debtor affiliates (e.g., joint ventures, foreign subsidiaries, etc.).

If a cash management system allows for the transfer of funds between debtor entities, and the debtors are not substantively consolidated, the **motion** should detail how such transactions are reflected in the company's books and records. Additionally, if non-debtor affiliates have anticipated funding needs during the course of the bankruptcy, court authority for such transactions should be requested.

I. Investment Guidelines Motion

Bankruptcy Code section 345 proscribes how a debtor may invest or deposit its funds. [18] These proscriptions which generally provide that all funds must be secured by the United States of America or a bond in favor of the United States are generally more restrictive than the typical investment guidelines established by large companies. Bankruptcy Code section 345(b) also provides that such restrictions may be excused “for cause.” If the

company's prepetition investment and deposit guidelines are sufficiently conservative, yet do not fall within the strict requirements of section 345, the company may consider requesting a waiver of the section 345 guidelines.

J. Sales and Use Tax Motion

Large companies often collect sales, use, and other taxes from third parties and make periodic payments of such funds to various taxing authorities. Examples include the collection of a state sales tax on the sale of goods or withholding taxes from employee payrolls. The caselaw generally provides that such "trust fund" taxes are not property of the debtor's estate and are held in trust for the benefit of the various taxing authorities. [19] Moreover, section 507(a)(8) of the Bankruptcy Code gives priority to certain unsecured claims of governmental units. Finally, certain states hold officers and directors personally liable for failing to pay certain taxes. [20] There are therefore many justifications to allow a debtor to pay all sales, use, and other "trust fund" type taxes. This is generally desirable because failure to pay such taxes may result in actions being filed against the officers and directors of a debtor.

*69 K. Motions Authorizing the Payment of Prepetition Claims Related to Shipping Charges, Warehouse Charges, Mechanics' Liens and Customs Charges

Although these **motions** come in different variations and forms, they have one common theme: they seek authority to pay prepetition claims that would otherwise give rise to liens on the company's property. When companies file for **Chapter 11** protection, it is common to have certain tangible goods either in transit or stored at certain locations. Examples include goods being delivered by truck, rail, or boat, and goods being held at ports or warehouses. State law generally gives shippers, haulers and warehousemen possessory liens on property in their possession to secure payment of their fees. [21] Under Bankruptcy Code section 362(b)(3), perfection of such liens or interests, to the extent consistent with section 546(b) of the Bankruptcy Code, is expressly excluded from the automatic stay of section 362(a). [22] Consequently, notwithstanding the automatic stay, shippers, warehousemen, and/or distributors could perfect and assert liens or interests against a debtor's property if their prepetition claims are not paid.

These **motions** seek authority under the doctrine of necessity [23] to authorize the payment of such claims because (i) failure to pay such claims may cause shippers, haulers and warehousemen to retain possession of the company's property and (ii) such creditors are likely to be paid in full at the end of the case as secured creditors. [24] It is advisable to state the amount of prepetition claims the company estimates it will be required to pay shippers, haulers, and warehousemen.

L. Motions to Pay Prepetition Claims of Critical Vendors

This **motion** seeks authority to pay certain prepetition claims of critical vendors. Generally, this **motion** seeks authority to pay those creditors that hold some type of advantage over the company or could otherwise create difficulties with the company's reorganizational efforts. For example, certain vendors may be sole source suppliers to a company, offering unique or customized goods that cannot be obtained elsewhere within a reasonable amount of time. A company's practice of keeping low inventory would obviously compound this problem. The result is that a vendor could refuse to continue supplying a company with the unique or customized good and cripple the company's reorganizational efforts.

In *Just For Feet*, [25] for example, the debtors sought authority to pay the claims of certain suppliers, including Nike, New Balance, Fila, Reebok, ***70** Adidas, Asics, K-Swiss, and Converse. Judge McKelvie held that the debtor, which owned a chain of stores specializing in name-brand athletic footwear, "cannot survive unless it has name brand sneakers and athletic apparel to sell in its stores." [26] It should be noted that critical vendors need not be sole source suppliers. Other factors to examine include the effect of nonpayment on the vendor. In certain situations where the vendor is a small company, failure to pay its prepetition claims may force that vendor into bankruptcy as well.

Courts may require that the identity of vendors receiving critical vendor funds be provided to a limited number of key parties, including the United States Trustee. Courts also often require that vendors receiving critical vendor fund agree to continue to provide the debtor with trade credit during the course of the bankruptcy case, something **Chapter 11** debtors generally have a difficult time obtaining.

M. Motions to Establish Reclamation Claims Procedures

Outside of bankruptcy, reclamation rights generally are governed by section 2-702(2) of the Uniform Commercial Code ("UCC"). That section allows a seller of goods, upon discovering that the buyer has received goods on credit while insolvent, to reclaim the goods upon a demand made within ten (10) days of the buyer's receipt of the goods. If a written misrepresentation of the buyer's solvency has been made to the seller within three (3) months before the delivery of the goods, the 10-day limit does not apply.

Bankruptcy Code section 546(c) preserves a seller's reclamation rights under section 2-702 of the UCC, subject to certain significant limitations. [27] Among other things, section 546(c) imposes the additional requirements that (i) the sale must be in the ordinary course of the seller's business, (ii) the reclamation demand must be in writing, and (iii) the reclamation demand must be made within ten (10) days after the debtor's receipt of the goods or, if the 10-day period expires after the commencement of the bankruptcy case, within twenty (20) days after such receipt. [28] Section 546(c) also provides a debtor with the right to continue to use goods subject to valid reclamation claims in the ordinary course of business, if the reclaiming seller is granted an administrative claim for the value of such goods or, alternatively, a lien to secure such claim.

A company that receives large quantities of goods is typically deluged with reclamation demands within the first few weeks of its bankruptcy case. Without a **motion** establishing procedures for dealing with these demands, vendors' attempts to reclaim their goods may cause significant ***71** disruption to the debtor's operations. The goal of a reclamation claim procedures **motion** is to prevent vendors from attempting to reclaim goods by granting them an administrative claim equal to the value of their valid reclamation claim. A reclamation claims procedure should also set forth a time table by which the debtor must respond to reclamation demands and establish a procedure for resolving disputes. Because a debtor may receive a large number of reclamation demands, any time table should allow the debtor sufficient time to analyze these claims.

N. Cash Collateral/DIP Financing Motions

1. Use of Cash Collateral

Perhaps one of the most important orders to be entered on the **first day** is the cash collateral/DIP financing order, which authorizes the use of the company's cash collateral [29] and the incurrence of a postpetition debt. The need for the use of cash collateral arises when a company's sources of cash (e.g., receivables, inventory, and rent) are subject to prepetition security interests that provide that proceeds of those sources are also collateral. [30] Bankruptcy Code section 363(c)(2) provides that the debtor may not use, sell, or lease cash collateral unless "(A) each entity that has an interest in such cash collateral consents; or (B) the court, after notice and hearing, authorizes such use, sale, or lease in accordance with the provisions of this section."

Bankruptcy Code section 363(c) provides for either the consensual or nonconsensual use of cash collateral. If a debtor obtains an agreement with its lenders for the consensual use of cash collateral, it must provide notice in accordance with Bankruptcy Rule 4001. If a debtor does not obtain an agreement for the consensual use of cash collateral, the Court may authorize such use, after notice and a hearing, if the debtor can demonstrate that a secured party's interest in cash collateral is "adequately protected." [31]

Although the Bankruptcy Code does not define "adequate protection," courts will generally condition a debtor's use of cash collateral on certain protections against the diminution in the value of a lender's interest in cash collateral. [32] Bankruptcy Code section 361 provides a non-exhaustive list of methods by which a debtor may provide adequate protection, including making periodic cash payments or providing replacement liens. [33] Adequate protection is often decided on a case-by-case basis, [34] with the focus being the protection of the value of lender's interest in cash collateral. [35]

***72 2. DIP Financing**

In addition to requiring the use of its cash on hand, many debtors require additional financing to support their operational and liquidity requirements through the reorganizational process. These needs may include funding payroll, purchasing inventory, paying rent, or funding the costs associated with selling assets. Bankruptcy Code section 364 authorizes a debtor to obtain postpetition financing under certain circumstances. [36] A company often seeks an agreement with a lender to provide postpetition financing before it files for **Chapter 11** protection. The postpetition lender may be the company's prepetition lender, which is therefore incentivised to extend postpetition credit to the company to protect its prepetition claim. Alternatively, the postpetition lender may be a different lender from the lender that extended prepetition credit.

Postpetition lenders are generally afforded considerable protections under the Bankruptcy Code, including superpriority administrative claims, liens on unencumbered property, and in some instances, liens that prime existing liens. The debtor must first attempt to obtain postpetition unsecured credit allowable as an administrative expense under Bankruptcy Code section 503(b)(1). [37] If the debtor is unable to obtain such financing — which is typically the case — the debtor may obtain postpetition credit secured by a superpriority administrative claim, liens on unencumbered property, or junior liens on encumbered property. [38] If the debtor is unable to obtain postpetition credit secured by those methods, it may seek financing secured by liens of equal or greater priority than existing liens, or "priming liens." [39] If the debtor seeks to prime existing liens, it bears the burden of proving that the existing liens are adequately protected. [40]

The granting of priming liens is an extraordinary measure.[41] To prove that the interests of those holding existing liens are adequately protected, the Court must find that the proposed financing will provide the prepetition secured creditor with the same level of protection it would have had if there had not been a post-petition financing.[42] An "equity cushion" in the collateral may provide sufficient adequate protection, depending upon the size of such cushion.[43] Priming litigation, however, is likely to be protracted and expensive, and should be avoided if possible.

When a debtors' prepetition lender becomes its postpetition lender, the lender may request cross-collateralization or a rollover lending arrangement. Cross-collateralization is securing a prepetition debt with postpetition collateral. Whether the court will approve this type of security is an ***73** open question.[44] A rollover arrangement provides that postpetition proceeds are used to pay down prepetition claims.

Local Rules should be consulted when preparing, filing and serving **motions** to obtain DIP financing. Some local rules, for example, require that certain types of relief be highlighted.[45] These provisions include: cross-collateralization; waivers of rights to surcharge collateral; liens on avoidance actions; rollover arrangements; professional fee carveouts; and priming liens. All of these provisions in a DIP financing may be controversial, and may meet resistance from creditors' committees and the Court.

O. Other First Day Motions

All companies are unique and **first**-**day** **motions** that apply to one company do not necessary apply to another. Additionally, companies with special needs or circumstances may require additional or tailored **first**-**day** **motions**. When preparing **first**-**day** papers, counsel should consider the impact a bankruptcy will have on all aspects of a company and create innovative ways to prevent disruption to the company and strengthen its going concern value.

IV. MORE RECENT DEVELOPMENTS

The following is a summary of selected recent developments that affect **first** **days** **motions** and the type of relief a company may seek at its **first**-**day** hearing. Because these issues vary from circuit to circuit, they may affect a company's decision regarding an appropriate venue for a **Chapter** **11** filing. The issues discussed in this article include a recent decision striking down the doctrine of necessity, **motions** related to foreign vendors, recent issues relating to DIP financing, recent decisions affecting professional retentions, and issues regarding the trading of the company's securities and related tax issues.

A. Critical Vendor Motions in the Wake of Kmart

Courts from many jurisdictions have routinely authorized debtors to pay certain prepetition claims under the "doctrine of necessity."[46] Recently, however, in *Capital Factors, Inc., v. Kmart Corporation*,[47] the District Court for the Northern District of Illinois held that "it is clear that however useful and practical these payments [to prepetition creditors] may appear to bankruptcy courts, they simply are not authorized by the Bankruptcy Code." The District Court noted that, although many Courts recognize the "doctrine of necessity" as inherent in the Court's equitable powers granted by 11 U.S.C. § 105(a), there is simply no express statutory ***74** authority to allow a debtor to pay prepetition debts other than under a plan.[48] The *Kmart* court relied upon other courts that

concluded the payment of prepetition debts prior to confirmation is inappropriate. [49] The *Kmart* court declined to examine the need for making such payments, or whether such payments would benefit the estate.

This decision, which is currently on appeal to the Seventh Circuit, [50] may cast doubts on a company's ability to pay certain prepetition claims. On one hand, this may work to the benefit of some debtors, who are generally inundated with requests from their vendors to be placed on the "critical vendor list." As creditors become more and more sophisticated, they are learning how to make themselves "critical." If there were no such list, requests may cease. [51]

On the other hand, the doctrine of necessity is a tool utilized to accomplish many valuable results beyond the payment of "critical vendors." For one, the payment of prepetition employee wages and salaries, which are afforded priority under Bankruptcy Code section 507(a)(3), are also justified under the doctrine of necessity. Additionally, the payment of certain taxes, which are generally not property of the estate, are similarly justified under the doctrine of necessity. Without this doctrine, the alternative justifications behind many typical **first day motions** may receive additional scrutiny.

Another potential consequence is that a debtor may be required to assume executory contracts under 11 U.S.C. § 365 sooner in a case than it would have otherwise had it been able to rely on the doctrine of necessity. Because a debtor is required to pay the prepetition claims of the non-debtor party to an executory contract upon assumption of the contract, [52] such contract parties may insist on an assumption of their executory contract before providing goods and services. If the debtor is forced to assume such contracts near the beginning of its case, it will lose a great deal of control over its reorganization.

Some courts have held that the payment of certain prepetition claims may be authorized by Bankruptcy Code section 364(b). Judge Federman of the Western District of Missouri held that Bankruptcy Code section 364(b) grants the Court broad authority to approve borrowing agreements that are critical to the continued operation of the debtor. [53] The Court stated "the bare promise of a priority administrative expense claim, subject to the senior claims of lienholders [would be an inadequate inducement to vendors]. Therefore, if the debtor is to obtain credit, it may well need to offer something else to its suppliers." [54] The court held that payment of ***75** a prepetition claim could be the "something else" needed to secure credit from a vendor.

More recently, the Bankruptcy Court for the Northern District of Texas granted an interim order authorizing the compliance with preprepetition forward contracts, commodity contracts and swap agreements in *In re Mirant Americas Energy Marketing, L.P.* [55] The interim order authorized, inter alia, the payment of certain prepetition obligations under these agreements and the granting of super-priority administrative claims to secure certain other obligations. The Court justified such payments under, inter alia, Bankruptcy Code section 364. The Court did not use Bankruptcy Code section 105 or the doctrine of necessity as the exclusive statutory authority.

B. Foreign Vendor Motions

Motions to pay certain prepetition claims come in many varieties, including **motions** to pay the claims of employees, taxing authorities, shippers and haulers, holders of mechanic's liens, critical vendors, and foreign vendors. One **motion** that plays a central role in companies with a global presence is the **motion** to pay the claims of foreign vendors. The typical argument is that foreign creditors, including foreign governmental units, may

not be bound by the automatic stay imposed by 11 U.S.C. § 362(a). In the absence of this protection, a debtor's failure to pay foreign creditors may lead to the seizure of its overseas assets, the institution of criminal actions against its foreign employees abroad, and even the imprisonment of such employees. In some cases, the amount of prepetition claims sought to be paid under these **motions** can be staggering, even when compared to the amounts paid to traditional "critical vendors." [56]

As the economy continues to globalize, the likelihood that domestic companies will interact with foreign vendors and taxing authorities increases. Likewise, the amount of prepetition obligations owed by a company to foreign vendors and taxing authorities upon the filing of a **Chapter 11** petition will increase, making **motions** to pay foreign vendors and taxing authorities even more important in the future.

C. Cash Collateral/DIP Financing Issues

1. Liens on Avoidance Actions

Lenders, in a continuing effort to secure their postpetition loans, may request liens in avoidance actions of a debtor, including preference and fraudulent transfer actions. In other instances, lenders do not seek a lien on the avoidance actions themselves, but in the "proceeds" of any avoidance ***76** action. [57] In *In re WorldCom, Inc.*, [58] for example, the final DIP financing order did not grant the debtors' lenders a lien on avoidance actions, but did granted the debtors' lenders a lien in proceeds of avoidance actions. The order further provided, however, that the lenders were to look first to proceeds of the lenders' collateral before recovering proceeds from avoidance actions. A similar final DIP financing order was entered in *In re Enron Corp.* [59] Other courts have held that avoidance actions belong only to the debtor or to the trustee, and therefore, cannot be given as security to a lender. [60]

Liens on avoidance actions, however, may prove to be an empty security. In *In re Mellon Bank N.A. v. Dick Corp.* and *In re Mellon Bank N.A. v. GE Supply Co.*, [61] the Bankruptcy Court initially granted the debtors' secured lenders liens on avoidance actions. When Mellon attempted to pursue those actions, however, the Bankruptcy Court determined that it did not have standing to bring such actions because it was not for the benefit of the debtors' estates. [62]

2. DIP Provisions Related to 363 Asset Sales

In certain cases, the object of a **Chapter 11** bankruptcy is the rapid sale of all or substantially all of the debtor's assets. In these situations, it is not uncommon for the company to execute an asset purchase agreement prior to filing for bankruptcy, subject a possible auction and Bankruptcy Court approval. The proposed purchaser then becomes the "stalking horse" in any auction for the assets, generally entitled to a "break up" fee in the event the stalking horse does not prevail at the auction. [63]

In at least two larger cases, the stalking horse was also the debtor's DIP lender, and funded the debtor's **Chapter 11** bankruptcy cases until such time as a sale agreement could be approved by the Bankruptcy Court. In *In re Trans World Airlines, Inc.*, [64] American Airlines executed an asset purchase agreement with TWA prior to TWA's **Chapter 11** bankruptcy. American Airlines was also TWA's postpetition lender. Certain parties argued that this type of arrangement granted American Airlines an unfair advantage in purchasing TWA's assets. These parties also asserted that the conditions established in the asset purchase agreement, including the requirement of a rapid

auction and sale procedure, would make it difficult, if not impossible, for an entity other than American Airlines to purchase TWA's assets. Notwithstanding these objections, the Court approved the proposed DIP financing and related bid procedures order, and American Airlines was the ultimate purchaser of TWA's assets.

***77** In *In re Peregrine Systems, Inc.*, [65] the debtors executed an asset acquisition agreement with BMC Software, Inc. ("BMC") just prior to Peregrine's bankruptcy filing, subject to higher and better offers in the bankruptcy cases. BMC also provided the debtors with DIP financing to fund the debtors' operational and administrative expenses until the Bankruptcy Court could consider the proposed sale. The interim DIP financing expired upon, inter alia, the debtors' failure to obtain an order from the Bankruptcy Court approving certain bidding procedures in which BMC was the "stalking horse" bid by a particular deadline. The Court ultimately approved the DIP financing and the sale of assets to BMC.

D. Indemnification of Financial Advisors After *United Artists*

Although no longer a typical "**first** **day**" **motion**, issues related to the retention and employment of professionals continue to emerge. In *United Artists Theatre Co. v. Walton*, [66] the Third Circuit upheld a retention agreement between the debtors and their financial advisor that provided for indemnification of the advisor by the debtors in the event the advisor committed negligence.

In the wake of the settlement reached in connection with the litigation surrounding the bankruptcy case of *Merry-Go-Round Enterprises, Inc.*, [67] financial advisors started including provisions in their standard engagement agreements that provide for indemnification under certain circumstances, including against the advisor's own negligence. [68] This type of indemnification started to become common in the market and became a common request in bankruptcy retention applications. [69]

When United Artists Theatre Company and affiliates ("United Artists") filed for **Chapter** **11** protection, they requested that the District Court [70] approve the retention of its financial advisors, Houlihan, Lokey, Howard & Zukin Capital ("Houlihan"). Houlihan's retention agreement contained a clause providing for indemnification by United Artists under certain situations, including Houlihan's own negligence (but not gross negligence). The District Court approved the retention agreement as reasonable, and the United States Trustee appealed. The United States Trustee believed that indemnification against an advisor's own negligence was per se inappropriate, and contrary to the Bankruptcy Code. The Third Circuit disagreed, and determined that the retention agreement was reasonable. In making such a determination, the Third Circuit borrowed certain tenets from Delaware Corporate law regarding the appropriate standard of conduct, analogizing the actions of directors of a corporation to financial advisors of a debtor.

***78** E. Payments to Professionals Prior to Bankruptcy After *Pillowtex*

Bankruptcy Code section 327(a) provides that a debtor in possession may retain certain professionals to assist in carrying out its duties, provided that such professionals do not hold an interest adverse to the estate and are "disinterested persons." In *In re Pillowtex, Inc.*, [71] the Third Circuit held that when it appears that debtor's counsel may have received a substantial preferential payment prior to the petition date, its retention as 327(a) counsel cannot be approved until a determination is made as to whether it did in fact receive a preference.

Prior to its bankruptcy, Pillowtex, Inc. ("Pillowtex") retained counsel to assist with its contingency planning and bankruptcy preparation. [72] During the one-year period leading to its bankruptcy, Pillowtex paid its counsel over $2 million. After it filed for bankruptcy, Pillowtex requested that the District Court approve the retention of its bankruptcy counsel. The United States Trustee objected to the retention, claiming that because such counsel may have received a preferential transfer, it was not qualified to serve as section 327(a) bankruptcy counsel. The District Court, over the objection of the United States Trustee, approved the retention on the condition that if it was ever determined that the debtor's counsel received a preferential transfer, it would return the transfer and waive any unsecured claim by virtue thereof. [73] The Third Circuit reversed the decision of the District Court, holding that counsel's receipt of a possible preferential transfer made it impossible for the District Court to properly evaluate whether debtor's counsel was properly qualified. The Third Circuit remanded the case for a hearing on whether debtor's counsel actually received a preference.

As described in this article, the appropriate amount of time needed to prepare a **Chapter 11** filing may be several months, circumstances permitting. During this period, the client is generally financially distressed. The lesson to be learned from *Pillowtex* is to pay close attention to billing practices during this time period, and to assume that a record of payments may be scrutinized by the United States Trustee, creditors, and even the Court.

F. Motions for Orders Limiting Trading of Claims and Equity Securities

A **first day motion** with increasing popularity is one that enables a debtor to preserve its net operating losses ("NOLs") — often a valuable asset of the estate — by limiting trading activity. Internal Revenue Code section 172 provides that a corporation may carry forward its NOLs, reducing ***79** federal income taxes on future income. The Internal Revenue Code, however, significantly limits a company's ability to carry forward NOLs in the case of an "ownership change." [74] Although corporations experiencing ownership changes resulting from a confirmed **Chapter 11** plan may be exempt, [75] similar ownership changes arising from transfers prior to the effective date of a reorganization plan are not similarly protected. It is thus of great importance to a debtor with significant NOLs to be able to control changes in ownership of claims and interests in the company.

A debtor may limit changes in ownership by filing a **motion** to limit the transfer of and trading in its claims and equity securities. In *In re US Airways Group, Inc.* [76] and *In re Conseco, Inc.*, [77] for example, the Court authorized a procedure generally requiring persons or entities that are, or become, substantial holder of either claims or equity interests in the debtors to file and serve a notice of such status. The procedure further provided that substantial claim and equity holders must provide the court and debtors with advance written notice of any intended transfer of claims or equity securities. The debtors then had an opportunity to object to the transfer. All such transfers were subject to Bankruptcy Court approval and void if effected without such approval.

Footnotes

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1 See 11 U.S.C. § 507(a) (3), (4).

2 See 11 U.S.C. § 524(g).

3 See, e.g., In re SGL Carbon Corp., 200 F.3d 154, 163, 35 Bankr. Ct. Dec. (CRR) 116, 43 Collier Bankr. Cas. 2d (MB) 668, Bankr. L. Rep. (CCH) P 78084 (3d Cir. 1999), on remand to, 249 B.R. 615 (D. Del. 2000) (finding that the company's **Chapter 11** filing was in bad faith because it faced no "immediate financial difficulty").

4 See, e.g., Perlman v. Catapult Entm't, Inc. (In re Catapult Etm't, Inc.), 165 F.3d 747, 750-51, 33 Bankr. Ct. Dec. (CRR) 1058, 41 Collier Bankr. Cas. 2d (MB) 858, Bankr. L. Rep. (CCH) P 77886 (9th Cir. 1999) (prohibiting the assumption of certain agreements without the consent of the other party); Matter of West Electronics Inc., 852 F.2d 79, 18 Bankr. Ct. Dec. (CRR) 287, Bankr. L. Rep. (CCH) P 72351, 34 Cont. Cas. Fed. (CCH) P 75526 (3d Cir. 1988); Breeden v. Catron (In re Catron), (158 B.R. 629, 633-38 (E.D. Va. 1993) (same), aff'd mem., 25 F.3d 1038 (4th Cir. 1994). But see, Institut Pasteur v. Cambridge Biotech Corp., 104 F.3d 489, 30 Bankr. Ct. Dec. (CRR) 221, 37 Collier Bankr. Cas. 2d (MB) 588, 41 U.S.P.Q.2d (BNA) 1503, Bankr. L. Rep. (CCH) P 77242 (1st Cir. 1997) (allowing for the assumption of similar agreements without consent).

5 See 11 U.S.C. § 366 (providing for certain rights and obligations for utility providers).

6 See 11 U.S.C. § 327(a), (e).

7 See, e.g., Bankr. D. Del. Local R. 9013-2(c) (providing that draft **first day motions** must be served on the United States Trustee 24 hours before a **first day** hearing).

8 Joint administration is authorized by Rule 1015 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"). See Fed. R. Bankr. P. 1015(b).

9 See Bankr. D. Del. Local R. 2002-1(f) (requiring the employment of a claims agent in cases with more than 200 creditors).

10 See Virginia Elec. & Power Co. v. Caldor, Inc., 117 F.3d 646, 650-51 (2d Cir. 1997), 30 Bankr. Ct. Dec. (CRR) 1228, 38 Collier Bankr. Cas. 2d (MB) 128, Bankr. L. Rep. (CCH) P 77510 (2d Cir. 1997); In re Adelphia Bus. Solutions, Inc., 280 B.R. 63, 66-67 (Bankr. S.D.N.Y. 2002).

11 In re Ionosphere Clubs, Inc., 98 B.R. 174, 175, 19 Bankr. Ct. Dec. (CRR) 149, Bankr. L. Rep. (CCH) P 72706, 112 Lab. Cas. (CCH) P 11293 (Bankr. S.D. N.Y. 1989).

12 Ionosphere Clubs, 98 B.R. 174 at 175-76.

13 See In re C.A.F. Bindery, Inc., 199 B.R. 828, 835, 29 Bankr. Ct. Dec. (CRR) 807 (Bankr. S.D. N.Y. 1996), corrected, (Sept. 4, 1996) (Bankr. S.D.N.Y. 1996) (recognizing that payment of prepetition claims may be authorized where such payment is "'critical to the debtor's reorganization"') (citation omitted); In re Columbia Gas Sys. Inc., 136 B.R. 930, 939, 22 Bankr. Ct. Dec. (CRR) 986 (Bankr. D. Del. 1992) (citing In re Lehigh & New England Ry. Co., 657 F.2d 570, 581 (3d Cir. 1981)); In re Structurlite Plastics Corp., 86 B.R. 922, 931, 17 Bankr. Ct. Dec. (CRR) 808, 19 Collier Bankr. Cas. 2d (MB) 1, Bankr. L. Rep. (CCH) P 72584 (Bankr. S.D. Ohio 1988), ("[A] bankruptcy court may exercise its equity powers under § 105(a) [of the Bankruptcy Code] to authorize payment of pre-petition claims where such payment is necessary to 'permit the greatest likelihood of survival of the debtor and payment of creditors in full or at least proportionately."') (citation omitted); Burchinal v. Central Washington Bank (In re Adams Apple, Inc.), 829 F.2d 1484, 1490 (9th Cir. 1987) (the unequal treatment of pre-petition debt is permitted in order to preserve the debtor-in-possession's potential for rehabilitation); Gordon v. Hines (In re Hines), 147 F.3d 1185, 1191, 32 Bankr. Ct. Dec. (CRR) 1132, 40 Collier Bankr. Cas. 2d (MB) 684, Bankr. L. Rep. (CCH) P 77743 (9th Cir. 1998) (recognizing the "doctrine of necessity").

14 242 B.R. 821, 43 Collier Bankr. Cas. 2d (MB) 476 (D. Del. 1999).

15 See In re Just For Feet, Inc., 242 B.R. 821, 825-26.

16 This amount is adjusted every three years. See 11 U.S.C. § 104(b).

17 At least one court has held that this requirement is unenforceable See, e.g., In re Gold Standard Baking, Inc., 179 B.R. 98, 105-106, 26 Bankr. Ct. Dec. (CRR) 1038, 33 Collier Bankr. Cas. 2d (MB) 330 (Bankr. N.D. Ill. 1995) (holding that the requirement that checks state "DIP" is unenforceable).

18 11 U.S.C. § 345 provides:
§ 345. — Money of estates
(a) A trustee in a case under this title may make such deposit or investment of the money of the estate for which such trustee serves as will yield the maximum reasonable net return on such money, taking into account the safety of such deposit or investment.
(b) Except with respect to a deposit or investment that is insured or guaranteed by the United States or by a department, agency, or instrumentality of the United States or backed by the full faith and credit of the United States, the trustee shall require from an entity with which such money is deposited or invested -
(1) a bond -
(A) in favor of the United States;
(B) secured by the undertaking of a corporate surety approved by the United States trustee for the district in which the case is pending; and
(C) conditioned on -
(i) a proper accounting for all money so deposited or invested and for any return on such money;
(ii) prompt repayment of such money and return; and
(iii) faithful performance of duties as a depository; or
(2) the deposit of securities of the kind specified in section 9303 of title 31; unless the court for cause orders otherwise.
(c) An entity with which such moneys are deposited or invested is authorized to deposit or invest such moneys as may be required under this section.

19 See, e.g., Shank v. Washington State Dep't of Revenue, Excise Tax Div. (In re Shank), 792 F.2d 829, 830, 14 Bankr. Ct. Dec. (CRR) 893, Bankr. L. Rep. (CCH) P 71197 (9th Cir. 1986) (sales tax required by state law to be collected by sellers from their customers is "trust fund" tax); DeChiaro v. New York State Tax Comm'n, 760 F.2d 432, 433-34, 12 Collier Bankr. Cas. 2d (MB) 938, Bankr. L. Rep. (CCH) P 70510 (2d Cir. 1985) (same); see also In re Columbus Gas Sys. Inc., 136 B.R. 930, 935, 22 Bankr. Ct. Dec. (CRR) 986 (Bankr. D. Del. 1992) (refunds required to be collected by federal law created trust fund that was not property of the debtor's estate); Begier v. IRS, 110 S. Ct. 2258, 110 L. Ed. 2d 46, 20 Bankr. Ct. Dec. (CRR) 940, 22 Collier Bankr. Cas. 2d (MB) 1080, Bankr. L. Rep. (CCH) P 73403, 90-1 U.S. Tax Cas. (CCH) P 50294, 65 A.F.T.R.2d 90-1095 (1990)496 U.S. 53, 67 (1990) (trust fund taxes are not property of the estate); In re Al Copeland Enters., Inc., 133 B.R. 837, 22 Bankr. Ct. Dec. (CRR) 264 (Bankr. W.D. Tex. 1991), subsequently aff'd, 991 F.2d 233, Bankr. L. Rep. (CCH) P 75255 (5th Cir. 1993), aff'd, 991 F.2d 233 (5th Cir. 1993) (debtor obligated to pay Texas sales taxes plus interest because such taxes were "trust fund" taxes).

20 See John F. Olson, et al., Director and Officer Liability: Indemnification and Insurance § 3.04 at 3-20.27 (rel. 10-1999) (discussing same in regards to, among others, West Virginia, Louisiana, Pennsylvania and Ohio).

21 See U.C.C. § 7-307 (2003).

22 Under section 546(b), a debtor's lien avoidance powers "are subject to any generally applicable law that ... permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of perfection ...."

23 See discussion of the doctrine of necessity in part G.1, supra.

24 11 U.S.C. § 506(a) provides that a creditor is granted an allowed secured claim equal to the value of such creditor's interest in property of the estate.

25 In re Just For Feet, Inc., 242 B.R. 821, 43 Collier Bankr. Cas. 2d (MB) 476 (D. Del. 1999).

26 In re Just For Feet, Inc., 242 B.R. 821. at 826.

27 11 U.S.C. § 546(c) provides that:
(c) Except as provided in subsection (d) of this section, the rights and powers of a trustee under sections 544(a), 545, 547, and 549 of this title are subject to any statutory or common-law right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, but -
(1) such a seller may not reclaim any such goods unless such seller demands in writing reclamation of such goods -
(A) before 10 days after receipt of such goods by the debtor; or
(B) if such 10-day period expires after the commencement of the case, before 20 days after receipt of such goods by the debtor; and
(2) the court may deny reclamation to a seller with such a right of reclamation that has made such a demand only if the court -
(A) grants the claim of such a seller priority as a claim of a kind specified in section 503(b) of this title; or
(B) secures such claim by a lien.

28 See In re Reliable Drug Stores, Inc., 70 F.3d 948, 949, 34 Collier Bankr. Cas. 2d (MB) 1496, Bankr. L. Rep. (CCH) P 76740 (7th Cir. 1995) (observing that the Bankruptcy Code qualifies the scope of reclamation rights under the UCC); In re Adventist Living Centers, Inc., 52 F.3d 159, 27 Bankr. Ct. Dec. (CRR) 105, Bankr. L. Rep. (CCH) P 76464, 26 U.C.C. Rep. Serv. 2d 133 (7th Cir. 1995) (discussing limitations on sellers' rights to reclaim goods in the bankruptcy process); In re Rawson Food Serv., Inc., 846 F.2d 1343, 1346 (11th Cir. 1988) ("[s]ection 546(c) of the Bankruptcy Code provides the exclusive remedy for a seller who seeks to reclaim goods from a debtor in bankruptcy"); Archer Daniels Midland Co. v. Charter Int'l Oil Co., 60 B.R. 854, 856, 17 Bankr. Ct. Dec. (CRR) 1389, Bankr. L. Rep. (CCH) P 72343, 6 U.C.C. Rep. Serv. 2d 128 (11th Cir. 1988) (M.D. Fla. 1986); Eagle Indust. Truck Mfg., Inc. v. Continental Airlines, Inc., 125 B.R. 415, 417, 21 Bankr. Ct. Dec. (CRR) 924 (Bankr. D. Del. 1991)

29 11 U.S.C. § 363(a) 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 [the Code], whether existing before or after the commencement of a case under [the Code].

30 Jeffrey S. Sabin, Doing Business with Troubled Companies, DIP Financing, Practicing Law Institute, Commercial Law and Practice Course Handbook Series, PLI Order No. A0-00EJ, March, 2002 at 182-82.

31 Jeffrey S. Sabin, Doing Business with Troubled Companies, DIP Financing, Practicing Law Institute, Commercial Law and Practice Course Handbook Series, PLI Order No. A0-00EJ, March, 2002 at 185-86.

32 Jeffrey S. Sabin, Doing Business with Troubled Companies, DIP Financing, Practicing Law Institute, Commercial Law and Practice Course Handbook Series, PLI Order No. A0-00EJ, March, 2002 at 188.

33 Jeffrey S. Sabin, Doing Business with Troubled Companies, DIP Financing, Practicing Law Institute, Commercial Law and Practice Course Handbook Series, PLI Order No. A0-00EJ, March, 2002 at 188-89.

34 See e.g., O'Connor v. O'Connor, 808 F.2d 1393, 96-97, 15 Bankr. Ct. Dec. (CRR) 735, Bankr. L. Rep. (CCH) P 71571 (10th Cir. 1987) (courts consider adequate protection as a flexible concept that is to be decided on a case by case

basis); Martin v. United States, 761 F.2d 472, 12 Collier Bankr. Cas. 2d (MB) 974, Bankr. L. Rep. (CCH) P 70543 (8th Cir. 1985).

35 See e.g., In re Kain, 86 B.R. 506, 513, 17 Bankr. Ct. Dec. (CRR) 816, 18 Collier Bankr. Cas. 2d (MB) 1236 (Bankr. W.D. Mich. 1988); In re Beker Indus. Corp., 58 B.R. 725, 736 (Bankr. S.D.N.Y. 1986).

36 11 U.S.C. § 364 — Obtaining credit
(a) If the trustee is authorized to operate the business of the debtor under section 721, 1108, 1203, 1204, or 1304 of this title, unless the court orders otherwise, the trustee may obtain unsecured credit and incur unsecured debt in the ordinary course of business allowable under section 503(b)(1) of this title as an administrative expense.
(b) The court, after notice and a hearing, may authorize the trustee to obtain unsecured credit or to incur unsecured debt other than under subsection (a) of this section, allowable under section 503(b)(1) of this title as an administrative expense.
(c) If the trustee is unable to obtain unsecured credit allowable under section 503(b)(1) of this title as an administrative expense, the court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt —
(1) with priority over any or all administrative expenses of the kind specified in section 503(b) or 507(b) of this title;
(2) secured by a lien on property of the estate that is not otherwise subject to a lien; or
(3) secured by a junior lien on property of the estate that is subject to a lien.
(d)(1)The court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt secured by a senior or equal lien on property of the estate that is subject to a lien only if -
(A) the trustee is unable to obtain such credit otherwise; and
(B) there is adequate protection of the interest of the holder of the lien on the property of the estate on which such senior or equal lien is proposed to be granted.
(2) In any hearing under this subsection, the trustee has the burden of proof on the issue of adequate protection.
(e) The reversal or modification on appeal of an authorization under this section to obtain credit or incur debt, or of a grant under this section of a priority or a lien, does not affect the validity of any debt so incurred, or any priority or lien so granted, to an entity that extended such credit in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and the incurring of such debt, or the granting of such priority or lien, were stayed pending appeal.
(f) Except with respect to an entity that is an underwriter as defined in section 1145(b) of this title, section 5 of the Securities Act of 1933, the Trust Indenture Act of 1939, and any State or local law requiring registration for offer or sale of a security or registration or licensing of an issuer of, underwriter of, or broker or dealer in, a security does not apply to the offer or sale under this section of a security that is not an equity security.

37 See 11 U.S.C. §§ 364(a) and (b).

38 See 11 U.S.C. § 364(c).

39 See 11 U.S.C. § 364(d).

40 11 U.S.C. § 364(d)(2).

41 Peter Antoszyk, New Developments in DIP Lending and Cash Collateral, Trends in Debtor in Possession Financing, American Bankruptcy Institute, ABI Winter Leadership Conference, November 29-December 1, 2001, at *5.

42 See In re Swedeland Development Group, Inc., 16 F.3d 552, 564, 25 Bankr. Ct. Dec. (CRR) 486, 30 Collier Bankr. Cas. 2d (MB) 1034, Bankr. L. Rep. (CCH) P 75803 (3d Cir. 1994).

43 See discussion in Antoszyk, at *5-6.

44 See e.g., In re Willingham Investments, Inc., 203 B.R. 75, 29 Bankr. Ct. Dec. (CRR) 1330, 37 Collier Bankr. Cas. 2d (MB) 295 (Bankr. M.D. Tenn. 1996); In re Saybrook Mfg. Co., Matter of Saybrook Mfg. Co., Inc., 963 F.2d 1490, 23 Bankr. Ct. Dec. (CRR) 355, 27 Collier Bankr. Cas. 2d (MB) 277, Bankr. L. Rep. (CCH) P 74692 (11th Cir. 1992)

(refusing to permit cross-collateralization of prepetition debt with unencumbered estate property in the context of debtor in possession financing).

45 See, e.g., Bankr. D. Del. Local R. 4001-2(a)(i): Cash Collateral and Financing Orders.
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 of 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 loans 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. § 522(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.

46 See discussion in part G.1, supra.

47 Capital Factors, Inc. v. Kmart Corp., 291 B.R. 818, 41 Bankr. Ct. Dec. (CRR) 36 (N.D. Ill. 2003).

48 Capital Factors, Inc. v. Kmart Corp., 291 B.R. 818.

49 See, Official Committee of Equity Sec. Holders v. Mabey, 832 F.2d 299, 16 Bankr. Ct. Dec. (CRR) 1109, 17 Collier Bankr. Cas. 2d (MB) 1210, Bankr. L. Rep. (CCH) P 72013 (4th Cir. 1987); B & W Enters., Inc. v. Goodman Oil Co., Matter of B & W Enterprises, Inc., 713 F.2d 534, 11 Bankr. Ct. Dec. (CRR) 141, 9 Collier Bankr. Cas. 2d (MB) 302, Bankr. L. Rep. (CCH) P 69397 (9th Cir. 1983); Chiasson v. J. Louis Matherne & Assocs. (In re Oxford Mgmt. Inc.), Matter of Oxford Management, Inc., 4 F.3d 1329, 30 Collier Bankr. Cas. 2d (MB) 97, Bankr. L. Rep. (CCH) P 75518 (5th Cir. 1993)4 F.3d 1329 (5th Cir.1993); In re FCX, Inc., 60 B.R. 405 (E.D.N.C.1986); B & W Enters., Inc. v. Goodman Oil Co., 713 F.2d 534 (9th Cir.1983) 11 Bankr. Ct. Dec. (CRR) 141, 9 Collier Bankr. Cas. 2d (MB) 302, Bankr. L. Rep. (CCH) P 69397; Chiasson v. J. Louis Matherne & Assocs. (In re Oxford Mgmt. Inc.), 4 F.3d 1329 (5th Cir.1993), 30 Collier Bankr. Cas. 2d (MB) 97, Bankr. L. Rep. (CCH) P 75518; In re FCX, Inc., 60 B.R. 405 (E.D.N.C.1986), 14 Collier Bankr. Cas. 2d (MB) 1281 (E.D. N.C. 1986); In re Timberhouse Post & Beam, Ltd., In re FCX, Inc., 60 B.R. 405, 14 Collier Bankr. Cas. 2d (MB) 1281 (E.D. N.C. 1986) 196 B.R. 547 (Bankr.D.Mont.1996); In re FCX, Inc., 60 B.R. 405, 14 Collier Bankr. Cas. 2d (MB) 1281 (E.D. N.C. 1986)196 B.R. 547 (Bankr.D.Mont.1996).

50 Docket Nos. 03-1956, 03-1999, 03-2000, 03-2001, 03-2035 and 03-2262.

51 Joshua W. Cohen, Necessity No Longer Critical in Chicago?, 2003 No. 7 Norton Bankr. L. Adviser 3 at *2.

52 See 11 U.S.C. § 365(b).

53 See In re Payless Cashways Inc., 268 B.R. 543 (Bankr. W.D. Mo. 2001), 47 Collier Bankr. Cas. 2d (MB) 568.

54 In re Payless Cashways Inc., 268 B.R. 543 (Bankr. W.D. Mo. 2001).

55 Case No. 46591 (Bankr. N.D. Tex., July 14, 2003) (Dkt. No. 142).

56 See, e.g., In re WorldCom, Inc., Case No. 02-12522 (AJG) (Bankr. S.D.N.Y., August 13, 2002) (authorizing payment of prepetition claims of foreign vendors); In re Global Crossing Ltd., Case Nos. 02-40187 through 02-40241 (REG) (Bankr. S.D.N.Y. 2002) (same); In re Enron Corp., 300 B.R. 201 (Bankr. S.D. N.Y. 2003) (same).

57 See In re WorldCom, Inc., 296 B.R. 115, 41 Bankr. Ct. Dec. (CRR) 181 (Bankr. S.D. N.Y. 2003).

58 See Final DIP Order in WorldCom, at 9.

59 In re Enron Corp., 300 B.R. 201 (Bankr. S.D. N.Y. 2003). See Final DIP Order (Dkt. No. 4888) at 9.

60 See Mellon Bank (East), N.A. v. Glick (In re Integrated Testing Products Corp.), 69 B.R. 901, 3 U.C.C. Rep. Serv. 2d 1586 (D.N.J. 1987). In re Tek-Aids Industries, Inc., 145 B.R. 253 (Bankr. N.D. Ill. 1992).

61 Adv. Pro. Nos. 00-296 and 00-298 (Bankr. S.D. Ind. Aug 6, 2001).

62 See also Jerald I. Ancel & Marlene Reich, Dangerous Dicta for DIP Lenders: The Risk of a Valid but Valueless Replacement Lien, American Bankruptcy Institute Journal, July/August, 2002.

63 See In re O'Brien Environmental Energy, Inc., 181 F.3d 527, 34 Bankr. Ct. Dec. (CRR) 879 (3d Cir. 1999) (discussing breakup fees).

64 In Re Trans World Airlines, Inc., 2001 WL 1820325 (Bankr. D. Del. 2001).

65 Case No. 02-12740 (JKF) (Bankr. D. Del. 2002).

66 United Artists Theatre Co. v. Walton, 315 F.3d 217, 40 Bankr. Ct. Dec. (CRR) 182, 49 Collier Bankr. Cas. 2d (MB) 1434, Bankr. L. Rep. (CCH) P 78777 (3d Cir. 2003)

67 See In re Merry-Go-Round Enterprises, Inc., 244 B.R. 327 (Bankr. D. Md. 2000).

68 United Artists, 315 F.3d at 229.

69 United Artists, 315 F.3d at 229.

70 At the time this case was filed, both the District Court and the Bankruptcy Court in the District of Delaware shared jurisdiction over newly filed **Chapter 11** cases and many cases were initially assigned to District Court Judges.

71 In re Pillowtex, Inc., 304 F.3d 246, 40 Bankr. Ct. Dec. (CRR) 62, Bankr. L. Rep. (CCH) P 78744 (3d Cir. 2002).

72 In re Pillowtex, Inc., 304 F.3d 246, 248.

73 In re Pillowtex, Inc., 304 F.3d 246, 249.

74 An “ownership change” occurs when the percentage of a corporation's stock, measured by value, held by one or more 5-percent shareholders increases by more than 50 percentage points over the lowest percentage of stock owned by such shareholders at any time during the three-year testing period ending on the date of the ownership change. See IRC § 382(g).

75 See IRC §§ 382(1)(5) and (6).

76 In re U.S. Airways Group, Inc., 2002 WL 31829093 (Bankr. E.D. Va. 2002).

77 Case No. 02-49672 (Bankr. N.D. Ill. 2002).

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