ARIZONA BANKRUPTCY INN OF COURT

CASH COLLATERAL PRESENTATION

NOVEMBER 10, 2011

CASH COLLATERAL MATERIALS

TAB	DESCRIPTION
1	Presentation Slides
2	Written Materials

TAB 1

Arizona Bankruptcy American Inn of Court

Cash Collateral

Soilyndra Corporation Fact Pattern

- The Debtor in this case is the Soilyndra Corporation.
- Soilyndra is the darling of the current White House administration as a developer of technology and a manufacturer of solar panels. It is held out in its promotional materials as a "green" business.
- Soilyndra is a closely held corporation based in the state of Washington. The founding partners and original incorporators of the business (Mr. Bill and Mr. Sluggo) claim to have lived down the street and spoken once or twice with Steve Jobs and Steve Wosniak. Neither has any other formal education.
- Soilyndra has its main flagship headquarters in Seattle, but also has a warehouse facility adjacent to a moth balled manufacturing facility in El Paso, Texas. It also has other closed retail facilities in Arizona, New Mexico and Florida. Those locations are currently sub let to manufactured modular home companies. The rent on the sub-leases covers the related real property taxes, but little else. It also has a long term land lease with coal mining rights in Pennsylvania. The coal mining facility is fully operational. The land lease and related mining rights is with the most recent past President of the Company, Mr. Bill. The El Paso and Pennsylvania locations also have fully operational landing strips with supporting refueling facilities and hanger space. The Company owns a private 12 seat jet, complete with full time flight crew and cabin attendants. As of the filing, the Company employs approximately 150 technicians and staff, down from a high of 350. Not all of the current employees can provide immigration documentation, although the Company swears that it has proof of documentation, somewhere.

- The Company was initially capitalized with $25 Million in venture capital money. The investors have long since converted that investment into Series A preferred stock. The remaining stock is owned primarily by friends and family of the original incorporators and founders of the Company.
- A year before filing bankruptcy, a good friend of the recently retired past president contacted a friend of a friend who knew someone who was a fraternity brother with someone who worked (past tense) in the Department of Energy. The Company president made it known that Soilyndra was on the verge of having to completely cease operations unless it was able to get $1 Billion in loans from the DOE. The Asst Director of the DOE (a frequent attendee of fraternity parties, but without any background in finance) decided that 350 employees would not be lost on her watch and authorized the Government loan to Soilyndra. Besides, the money could be used to upgrade the Company's aging, first generation manufacturing equipment by buying much better stuff from the Chinese. The DOE bought the equipment from the Chinese, and then made Soilyndra buy the equipment from the DOE (at only a small mark up over the DOE's cost from the Chinese) with proceeds of the loan, and the DOE took back a purchase money security interest in all of the updated equipment. In addition, the Government also concluded that the "green" nature of the business along with saving jobs in the Sun Belt states could certainly be used by the Government as a shining example for change and development of new jobs in the country's sagging economy. To do that, the DOE authorized Soilyndra to "spare no expense" in building a first class office campus in Seattle that could be used for photo opportunities and repeated sight inspections to monitor this burgeoning new industry. Unfortunately, cost over runs by government contractors hired by Soilyndra (at the Government's urging) left the Company with little funds to renovate the manufacturing facility in Texas. It took the DOE the better part of a year to fully document this transaction, and although the funds had been disbursed 9 months earlier, the recordation of the deed of trust on the Seattle facility, as well as UCC financing statements on all of the other hard assets of the Company, did not happen until 90 days prior to the filing of the bankruptcy. The Government also acquired a pledge by Soilyndra, as additional collateral, of all the company's deposit accounts and accounts receivable.

- The weather in Seattle was horrible the entire year, with little or no sun in Seattle for months at a time. Government scientists speculated that the cloudy and cold weather was from global warming. Others argued that it was always cloudy and rainy in Seattle. Regardless, orders for production and installation fell off dramatically (resulting in termination of almost the entire work force in Texas, and the closing of that plant). With no new manufactured product to sell, the sales facilities in Arizona, New Mexico and Florida had no product to sell or deliver. Without pay checks, hundreds of employees were either terminated or simply walked off the job. Soilyndra did not make even one payment to the Government on its $1 Billion loan.
- Calls by Mr. Bill to the friend of a friend of a frat brother at the DOE were not returned. Enraged at this poor treatment, reports have it that Mr. Sluggo enlisted the aid of one of his cousins who was a Congressman from Texas. A Congressional oversight committee was formed, and hearings were convened, subpoenas issued, and lawyers hired. Immediately thereafter, documents were shredded, memories faded and computers everywhere crashed.
- Mr. Bill couldn't take the pressure and resigned. Mr. Sluggo remembers it differently. Recently finding herself out of a job and in desperate need of a sizeable retainer, Lindsey Lohan's lawyer contacted Mr. Sluggo and urged an immediate Chapter 11 filing to block the take over and foreclosure of the Company's assets. Mr. Sluggo, with counsel's assistance, prepared a cash collateral budget for submission to the Government and the Court for approval. Counsel told Mr. Sluggo that pretty much anything you put in a budget for cash collateral will get approved, since no Court would ever want to be responsible for shutting down this once very popular alternative energy "green" business.
- The presidential candidate debates quickly seized on this media circus, and decided to make it a center piece of the next televised debate.
- You are the Debate audience.
- Cooper Anderson will act as your moderator this evening.

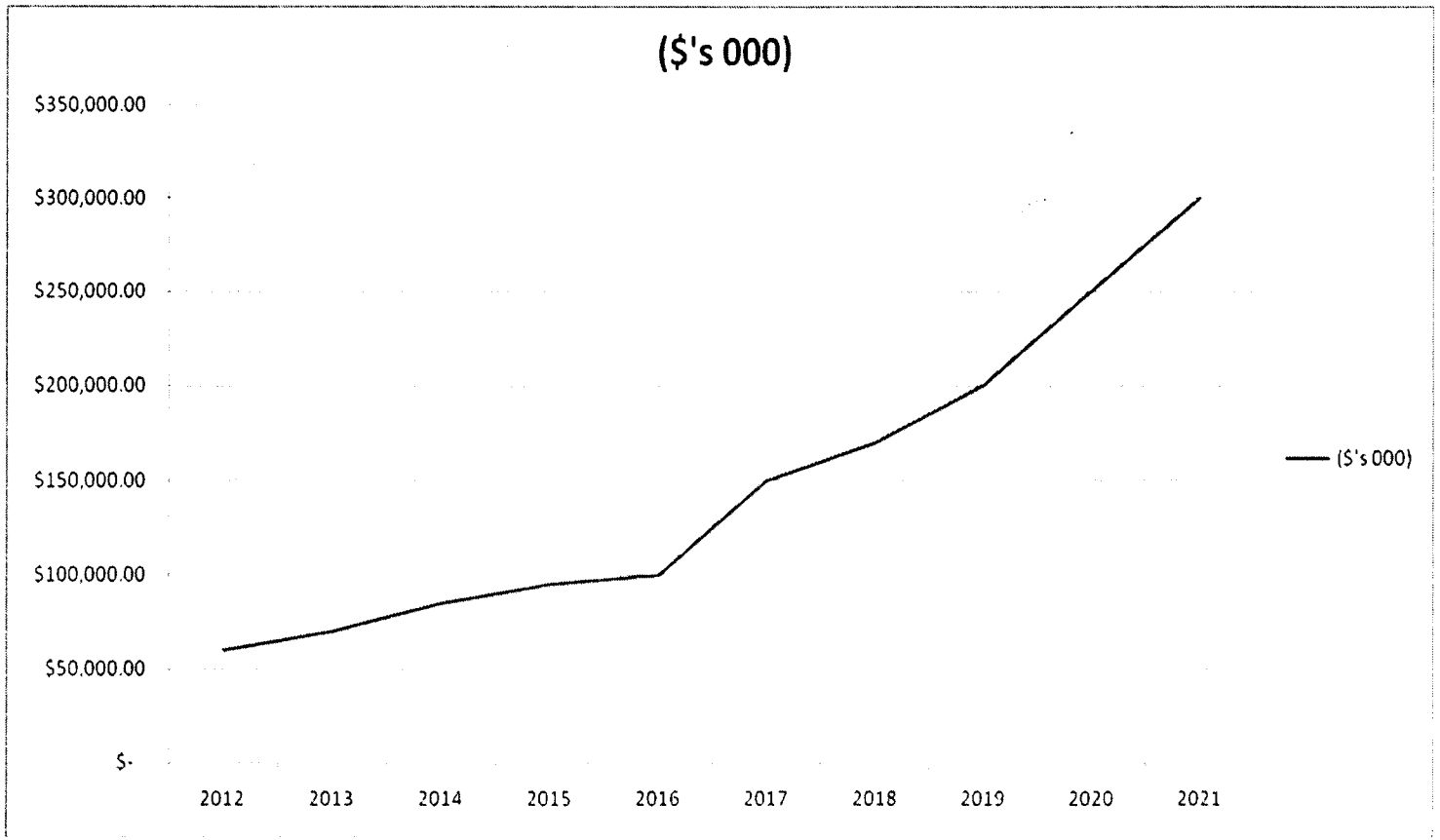
4 Debates

- 4 separate debates will be staged, each with a separate topic dealing with cash collateral issues related to this chapter 11 case.
- **First:** Gov. Chris Christie will debate Mitt Romney on the issues surrounding the content of the cash collateral budget.
- **Second**: Herman Cain and Gov. Rick Perry (if he remembers to come and remembers his talking points) will address the nature of adequate protection.
- **Third:** Ron Paul and Donald Trump will talk over and around one another about valuation of cash collateral and adequate protection.
- **Finally**: Sarah Palin and Michelle Bachman will horrify and appall us all by discussing what happens if Mr. Sluggo and his crack Hollywood attorney lose sight of the dictates of the Bankruptcy Code and any cash collateral order entered into with the Government.
- Audience participation will be needed at the conclusion of each stage to opine as to which candidate "won" each debate.

Debate #1
The Cash Collateral Budget

	November			December
	11/11/2011	11/18/2011	11/25/2011	12/2/2011
CASH COLLATERAL BUDGET				
($'s 000)				
Cash	$ 1,300.00			
Salves of Inventory	-	$ 800.00	$ 700.00	$ 600.00
Accounts Receivable	-	$ 200.00	$ 200.00	$ 200.00
Assets Sale proceeds	-	-	-	-
Total Operating Receipts	$ 1,300.00	$ 925.00	$ 900.00	$ 800.00
Operating Disbursements				
Payroll Wages and Benefits	$ 400.00	$ 380.00	$ 360.00	$ 340.00
Exectuvei Quarterly Bonuses	-	-	-	$ 500.00
Chapter 11 Fees	$ 100.00	$ 25.00	$ 25.00	$ 25.00
Utilities	$ 600.00	$ 120.00	$ 70.00	$ 70.00
Building	$ 65.00	$ 55.00	$ 45.00	$ 40.00
Warranty	$ 1.00	$ 1.00	$ 1.00	$ 1.00
Warehousing, Freight etc.	$ 60.00	$ 60.00	$ 50.00	$ 50.00
Coal (Heat)	$ 50.00	$ 50.00	$ 50.00	$ 50.00
Coal Transport	$ 75.00	$ 75.00	$ 75.00	$ 75.00
Travel Exp. / Reimbursement (Sales)	$ 80.00	$ 80.00	$ 80.00	$ 80.00
Private Jet				
Maintenance	$ 10.00	$ 10.00	$ 10.00	$ 10.00
Pilot / Crew	$ 15.00	$ 15.00	$ 15.00	$ 15.00
Fuel	$ 8.00	-	-	$ 8.00
Hangar	-	-	$ 3.00	-
Insurance	$ 50.00	$ 20.00	$ 20.00	$ 20.00
Real Property				
Real Property Taxes	$ 20.00	$ 20.00	$ 20.00	$ 20.00
Adequate Protection ABC Creditor	-	$ 75.00	$ 75.00	$ 75.00
Campaign Contributions	-	$ 10.00	-	$ 10.00
Holiday Party	-	-	$ 8.00	-
Contingency	$ 30.00	$ 30.00	$ 30.00	$ 30.00
Total Operating Disbursements	$ 1,564.00	$ 1,026.00	$ 937.00	$ 1,419.00

Soilyndra 10 Year Forecast



Debate #2
What Constitutes Adequate Protection?

- Soilyndra claims it can make periodic cash payments to the Government from the sale of both product and technology. Soilyndra also claims it can provide replacement liens from other collateral not already pledged to the Government.
- Soilyndra also believes that it adequately protects the Government because its continued operations will result in new technologies which will increase Soilyndra's profit and enable additional payment to the Government.
- The Government claims that any cash payments would be made from proceeds of the Government's own cash collateral and therefore is not adequate protection. Further, any additional or replacement lien given does not qualify as adequate protection because there is no unencumbered property. Finally, there is nothing to support the claim that continued operations protects the Government and insures the safety of the principal under the indubitable equivalence standard.
- Soilyndra seeks to use all of the Government's cash collateral to continue operations.
- Under Section 361, adequate protection may be afforded by 1) making cash payment(s), 2) giving an additional or replacement lien, or 3) other relief that results in the "indubitable equivalent" of the creditor's interest in the property.
- **The question: "Do you believe that Soilyndra can adequately protect the Government for the use of the DOE's cash collateral?"**

Debate #3
Cash Collateral Valuation

- Valuation of collateral is often a key factor in obtaining permission to use cash collateral
  - Trump – Agrees
  - Paul – Disagrees – He thinks valuation is often a key factor in obtaining permission to use cash collateral
- Roadmap – While Soilyndra has cash collateral, the ability to use cash collateral hinges on, among other things, the value of a corporate jet and certain unimproved real estate.
  - The question is not just "What is the value of each asset?"
  - But rather, "What valuation factors go into obtaining that proper value?"
    - Paul – The end result is the only question
    - Trump – I disagree, the value is the only question
- The Corporate Jet
  - Paul – Argues that the corporate jet for a bankruptcy entity is unnecessary to the business, and that it should be liquidated as soon as possible. He argues for a fire sale liquidation with all proceeds to pay down secured creditor. Corporate jets are wasteful. Paul flies Southwest – always on time and his bag flies free.
  - Trump – Disagrees – Trump knows the "value" that a corporate jet can bring to a business. Moving the officers around the world is critical to Soilyndra's ability to remain competitive. Officers need to meet with vendors and customers to calm them down. Creditors cannot expect these guys to give up everything, and Trump wouldn't fire anybody. Trump argues that the jet cannot be sold, or that it should be fully marketed for 8 months to obtain the highest value possible for the asset.
- Raw Land
  - Trump – Argues that if he knows anything at all, he knows real estate. The highest and best use of the land is to hold it for the next several years to sell. The Court cannot allow its current value to dictate use of cash collateral. Everyone knows that current values are not realistic in this economy. The market is really a market right now.
  - Paul – Why should that be the creditor's problem? Value is value, and the land's highest and best use in the foreseeable future is to sell it now.
- Miscellaneous Issues
  - Paul – Beware of arguing for too low of a value. It could dictate valuation for plan confirmation purposes.
  - Trump – Agrees. Be careful what you ask for as valuation impacts other aspects of a bankruptcy. Cash Collateral fights oftentimes happen early in a case.

Debate #4

What Happens When the Debtor In Possession Misuses Cash Collateral?

- **PALIN V. BACHMAN**
- PALIN: Drill baby drill . . . . .
- BACHMAN: Recommends using Soilyndra's cash collateral to solarize all houses of worship.
- **MISUSE:** Both Palin and Bachman recommend use of Soilyndra's cash collateral without the Government's prior consent or in violation of a cash collateral stipulation previously approved by the Court.
- **CONSEQUENCES:**
- Conversion of Chapter 11 case to a Chapter 7 liquidation matter;
- Impose personal liability on Soilyndra's corporate officers;
- Appointment of a Trustee;
- Deny Soilyndra consent to use cash collateral which in effect will terminate the Chapter 11 case since it will not be able to operate any longer;
- Impose sanctions, including punitive damages, hold Soilyndra in contempt of Court, but may allow it to pay the Government back; and
- The Unsecured Creditors Committee can file an avoidance action to avoid the transfer of the business assets to a third party.

TAB 2

USE OF CASH COLLATERAL

I. Introduction – Historical Background and Development

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I. Introduction – Historical Background and Development

Reorganization under the Bankruptcy Code often, if not invariably, involves tensions between secured creditor and debtor over use of collateral. Such tensions are not limited to reorganization cases, but more often surface in reorganization cases since the business continues to operate and this requires the debtor to use property which collateralizes a secured creditor.

This is not a new tension. It surfaced under early bankruptcy law and equity receiverships. But it came into much sharper focus with the advent of reorganizations under the bankruptcy laws beginning in the 1930's.

Primarily as a matter of case law, collateral could be used in a reorganization case if the rights of the secured creditor were protected. Probably this meant that the secured creditor must be assured of receiving the liquidation value of the collateral.[1] This assurance was permissible either by way of periodic payments or an administrative claim.[2]

The cases did not stop short of allowing the use of cash collateral. Accounts owed the debtor subject to right of prepetition offset were required to be paid to the debtor. And in Reconstruction Finance Corp. v. Kaplan,[3] the debtor was allowed to use cash collateral held by the secured creditor.

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[1] "Whatever the outer limits of the constitutional protection may be, it would seem that in the usual situation the secured creditor must be assured of ultimately receiving at least the liquidation value of his collateral as of the date of bankruptcy, less costs of repossession and sale." Rosenberg, "Beyond Yale Express: Corporate Reorganization and the Secured Creditor's Rights of Reclamation," 123 U. Pa. L. Rev. 509, 524-25 (1975). In support of his conclusion, Mr. Rosenberg cites In re New York. N.H. & H.R.R., 289 F.Supp. 451, 453-55 (D.Conn. 1968). This was the reorganization court in the New Haven-Penn Central merger. Also cited in support is a decision of a three-judge court dealing with the merger in related litigation. New York. N.H. & H.R.R. Bondholders Comm. v. United States, 289 F.Supp. 418 (S.D.N.Y. 1968). And finally, the affirmance of the New Haven inclusion cases by the United States Supreme Court is cited. New Haven Inclusion Cases, 399 U.S. 392 (1970). "The valuation, however, was considered by the Supreme Court to be an equitable one, and whether it was constitutionally mandated was specifically not considered, id. at 489-90. Thus, the parameters of the constitutional protection remain in doubt; that there is some protection is not in doubt." Rosenberg, supra, at 525, n.34.

[2] In re Yale Express, 250 F.Supp. 249 (S.D.N.Y.), rev'd., 370 F.2d 433 (2d Cir. 1966), aff'd. after remand, 384 F.2d 990 (2d Cir. 1967). See generally, Countryman, "Real Estate Liens in Business Rehabilitation Cases," 50 Am. Bankr. L.J. 303 (1976); and Murphy, "Use of Collateral in Business Rehabilitations: A Suggested Redrafting of § 7-203 of the Bankruptcy Reform Act," 63 Cal. L. Rev. 1483 (1975); Coogan, "The Proposed Bankruptcy Act of 1973: Questions for the Non-Bankruptcy Business Lawyer," 29 Bus. Law. 729 (1974); Murphy, "Restraint and Reimbursement: The Secured Creditor in Reorganization and Arrangement Proceedings," 30 Bus. Law. 15 (1974); and Coogan, Broude & Glatt, "Comments on Some Reorganization Provisions of the Pending Bankruptcy Bills," 30 Bus. Law. 1149 (1975).

[3] 185 F.2d 791 (1st Cir. 1950). Two leading cases apply differing tests based on the use of collateral or loan proceeds. In In re Third Avenue Transit Corp., 198 F.2d 703 (2d Cir. 1952), the Second Circuit required the following before cash proceeds of the sale of collateral could be used to pay operating expenses:

> That it is imperative to obtain the funds and that they cannot be obtained, on reasonable terms, first, by bank loans or second, by the disposal of certificates . . through ordinary market channels to voluntary lenders, but also that there is a high degree of likelihood (a) that the debtor can be reorganized in accordance with the Act within a reasonable time, and (b) that the secured creditors whose security is being compulsorily loaned will not be injured.

The Bankruptcy Code codified the rules that had developed over the years, with the modifications that, absent prior court order, cash collateral could not be used and an administrative claim could not serve as a substitute for collateral used. The codification did not follow the Third Avenue[4] and Jersey Central[5] tests, but instead required that the secured creditor be adequately protected.[6]

Even an order authorizing the use of cash collateral may not suffice in some cases. There may be no cash available. In such cases, the bankruptcy court can authorize a debtor to borrow -- even granting the lender a lien senior to existing secured claims.[7]

The rules relating to the use of cash collateral and borrowing are closely related in two respects: the funds must be essential to a rehabilitation and the benchmark of any order authorizing the use of cash collateral or a borrowing secured by a priming lien is adequate protection.

The Bankruptcy Code authorizes the use of cash collateral and a borrowing secured by a priming lien (assuming no consent of the secured creditors adversely affected), only after notice and hearing. Since the need to use cash collateral often arises in an emergency context, that is, the business will shut down or cease absent an order authorizing use of cash collateral, the draftsmen of the Code provided for a preliminary hearing "scheduled in accordance with the needs of the debtor."

Prior to the 1987 Amendments to the Bankruptcy Rules, Bankruptcy Rule 4001 gave little guidance as to the use of cash collateral. Rule 4001 simply provided that a motion under Rule 9014 was necessary.

The Bankruptcy Rules were amended in 1987 and Bankruptcy Rule 4001 and provide more procedural detail. Somewhat fleshing out the statutory two step hearing process, Bankruptcy Rule 4001(b)(2) provides for a final hearing no earlier than 15 days after service of the motion and an earlier preliminary hearing if so requested. Some guidance is also given as far as the parties to be served with the motion and notice of hearing.

Id. at 706-707. In the other case, the Third Circuit dealt with the use of proceeds of collateral to the extent the funds were to be used to pay for improvements:

> In addition to finding [1] that the funds are presently needed and cannot be obtained elsewhere the court need only conclude [2] that reorganization is probably feasible, [3] that the money drawn-down and expended for additions and betterments will materially contribute to the possibility of a successful reorganization and to the continuation of the transportation plant, or a substantial part thereof, as a going concern, and [4] that the interests of the bondholders are not thereby prejudiced.

Central Railroad of New Jersey v. Manufacturers Hanover Trust Co., 421 F.2d 604 (3d Cir.), cert. den. 398 U.S. 949 (1970).

[4] In re Third Avenue Transit Corp., 198 F.2d 703 (2d Cir. 1952).

[5] Central Railroad of New Jersey v. Manufacturers Hanover Trust Co., 421 F.2d 604 (3d Cir.), cert. den. 398 U.S. 949 (1970).

[6] 11 U.S.C. § 363(e) and 11 U.S.C. § 364(d)(1)(B).

[7] 11 U.S.C. § 364(d)(1).

II. Procedural Aspects of Motion

Motions seeking authority to use Cash collateral and borrow on a secured basis are contested matter proceedings under the Bankruptcy Rules. They are also core proceedings under 28 U.S.C. § 157(b)(2)(D) and (M). Thus, the bankruptcy judge may make a final determination as to such matters, subject to the right of appeal under 28 U.S.C. § 158. In any such appeal, "findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of the witnesses."[8]

Such motions are to be made in accordance with Bankruptcy Rule 9014. They are, therefore, considered contested matter proceedings. Relief is requested by motion. Bankruptcy Rule 9013 is applicable and the motion must state with particularity the grounds and relief sought. Rule 9013 further provides that the motion must be served by the moving party on the trustee or debtor-in-possession and on those entities specified by the Rules and the court.

A. Response

No response is required under Bankruptcy Rule 9014. The court can, however, order a response. It was apparently contemplated by the draftsmen of the Rules that there will be a hearing. This is in contrast to a motion seeking approval of an agreement as to the use of cash collateral as a loan; Rule 4001(d)(3) allows the court to enter an order without conducting a hearing, in the absence of an objection.

B. Notice

Bankruptcy Rule 9014 requires that reasonable notice and an opportunity for a hearing be afforded the party against whom relief is sought. Bankruptcy Rule 9006(d) provides that a written motion and notice of any hearing must be served no later than five days before the date specified for the hearing, unless a different period is fixed by the Rules or order of the court. That period can be enlarged or reduced under Bankruptcy Rule 9006.

A final hearing on a motion can take place no earlier than 15 days after service of the motion. A notice of hearing as well as a copy of the motion must be served.[9]

C. Service

Bankruptcy Rule 9013 requires that a written motion be served on the trustee or debtor-in-possession and those entities specified by the Rules and order of the court. Bankruptcy Rule 9014 requires that the motion be served in the manner of a summons and complaint under Rule 7004, and the party against whom relief is sought is to be given notice. Rule 4001(b)(1) and (c)(1) expand thereon and provide for the motion and notice to be served on any entity which has an interest in the cash collateral, any committee appointed under the Code, or, if no committee has been appointed, the creditors listed pursuant to Rule 1007(d), and on such other entities as

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[8] Bankruptcy Rule 8013.

[9] Bankruptcy Rule 4001(b)(1) and (3) and (c)(1) and (3).

the court directs. If service is accomplished by mail, Bankruptcy Rule 9006(f) provides that an additional three days is added to the prescribed period "when there is a right or requirement to do some act or undertake some proceeding within a prescribed period after service of a notice."

D. Emergency Hearing

The normal situation is for a hearing to be held no earlier than 15 days after service of the motion.[10] If there is an emergency and the matter cannot wait 15 days for resolution, Bankruptcy Rules 4001(b)(2) and (c)(2) contemplate a two step process. The court must hold an earlier hearing and authorize the use of cash collateral or the obtaining of credit to the extent necessary to avoid immediate and irreparable harm. Bankruptcy Rule 9014 nonetheless requires reasonable notice and opportunity for hearing and Bankruptcy Rule 9006(d) requires service not later than five days before the hearing.[11] This latter provision can be shortened by the court for cause shown.[12]

E. Burden of Proof

The Bankruptcy Code deals with the burden of proof as to requests for authority to use cash collateral and prime an existing lien. The trustee has the burden of proof on the issue of adequate protection in both situations.[13] The Bankruptcy Code, in the case of the use of cash collateral, imposes the burden of proof as to the validity, priority, or extent of the interest of an entity in property on the entity asserting the interest.[14] Although the borrowing provision of the Code does not specify who has the burden of proof on the issue of the validity, priority, or extent of the interest of an entity asserting an interest in property, the rules should be the same.[15] Burden of proof as used in the Bankruptcy Code means the risk of nonpersuasion, i.e., the one having the burden of proof must preponderate on the particular issue. The burden of introducing sufficient evidence to establish a prima facie case for use of cash collateral or secured borrowing, remains with the one requesting authority to use cash collateral or borrow on a secured basis.

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[10] Bankruptcy Rule 4001(b)(2) and (c)(2).

[11] The Bankruptcy Code provides for authorization of use of cash collateral "after notice and a hearing" under 11 U.S.C. § 363(c)(2)(B) as well as the authorization of borrowing secured by a senior lien "after notice and a hearing" under 11 U.S.C. § 364(d)(1). Notice and hearing is a defined term under the Bankruptcy Code; 11 U.S.C. § 102(1) defines "notice and a hearing" so as to authorize an act without an actual hearing if there is insufficient time for a hearing to be commenced before such act must be done and the court authorizes such act. The rules do not seem to contemplate an order authorizing use of cash collateral or borrowing on a secured basis which primes an existing lender without a hearing, although it might be on fairly short notice.

[12] Bankruptcy Rule 9006(c)(1).

[13] 11 U.S.C. §§ 363(p)(1) and 364(d)(2).

[14] 11 U.S.C. § 363(p)(2).

[15] The burden of proof provisions as to the use of cash collateral and borrowing vary as to each other and also as to the provisions relating to relief from the automatic stay. As to the latter, 11 U.S.C. § 362(g)(1) places the burden of proof on the issue of the debtor's equity in property on the one requesting relief from the automatic stay, while 11 U.S.C. § 362(g)(2) places the burden of proof as to all other issues on the party opposing such relief. Since one of the key issues in stay litigation will be lack of adequate protection, the trustee or debtor opposing relief will have the burden of proof on that issue.

III. Agreements Relating to Use of Cash Collateral and Credit

The 1987 Amendments to the Bankruptcy Rules added a framework for dealing with agreements concerning adequate protection, use of cash collateral, relief from stay and credit. Such agreements may have a material and perhaps adverse impact on the rights of other interested parties, and in particular unsecured creditors. The framework provides for service of the motion and agreement along with a notice of the motion and the time within which objections may be filed and served. Service must be accomplished on each appointed committee or its authorized agent or, if no committee has been appointed, on creditors listed pursuant to Rule 1007(d), "and on any other entity the court directs."

The foregoing procedure provides an opportunity for interested parties to object to improper and disadvantageous settlements. The court will often require notice to others than those expressly covered. Certainly the court should in all instances require notice be given to those who have filed a notice of appearance and request for notice. And depending on the nature of the concessions to the secured party, it will often be appropriate to require notice to all parties in interest, including creditors, indenture trustees and equity security holders.

A trustee or debtor-in-possession often is able to negotiate an agreement with a secured creditor as to adequate protection, the right to use cash collateral and the borrowing of funds from a prepetition secured creditor. The debtor-in-possession in particular is under significant pressure to do so. The need for immediate cash to continue the operation of the business as well as the need to avoid extensive and expensive litigation in the early stages of a reorganization case are compelling. The debtor-in-possession is motivated by the survival of the business and is often willing to waive preference claims and the potential of subordinating claims, in order to continue the business. The trustee is independent and more likely to consider the impact of the settlement on the rights of unsecured creditors in the event reorganization is not possible or the plan provides for less than full payment.

As a condition to consent to the use of cash collateral or an agreement to loan additional funds, an existing secured creditor will invariably require concessions. The secured creditor will insist on validation of its secured claim, both as to amount and perfection of the security. The secured creditor may also attempt to obtain a modification of the automatic stay so as to allow it to foreclose without further court order in the event the terms of the agreement are not met. Additional concessions will often include a provision precluding the modification by court order or plan of the prepetition and postpetition rights of the secured creditor, a date certain by which indebtedness must be repaid or foreclosure will result, a crosscollateralization of prepetition and postpetition debt with prepetition and postpetition collateral and a resolution of all potential claims against the secured creditor, including those that might be asserted under the avoidance provisions and §§ 552(b) and 506(b) of the Bankruptcy Code.

A. Form of the Motion

Bankruptcy Rule 4001 requires a motion accompanied by a copy of the agreement. The Advisory Committee Note to the 1987 Amendments sets out in detail what a motion for authority

to use cash collateral[16] and a motion for authority to obtain secured credit must obtain.[17] But the Committee Note is silent as to the contents of a motion for approval of an agreement. One would assume that the Committee Note is silent since the Committee intended that a motion for approval of an agreement respecting the use of cash collateral or secured borrowing track the Committee's recommendations as to such motions. That certainly would appear to be the better practice and a useful way to approach the motion, that is, to comply with the requirements of a motion for use of cash collateral or secured borrowing and in addition specify the concessions to the secured creditor under the agreement. To the extent a potential claim against a secured creditor or a basis for equitable subordination of a secured claim is waived, the motion should also satisfy the requirements of Bankruptcy Rule 9019(a). This will require that the motion be noticed to creditors and indenture trustees as provided in Bankruptcy Rule 2002(a), as well as such other entities as the court may designate. It also means that there must be a hearing, even though Bankruptcy Rule 4001(d)(3) expressly authorizes an order approving the agreement without a hearing if no objection is filed.

B. Notice

Bankruptcy Rule 4001(d)(2) requires that a notice of the motion and the time within which objections may be filed and served is to be mailed to those to be served. Subject to contrary court order, objections may be filed within 15 days of the date of mailing of the notice. Since an objection can be filed within the 15 days, it can be argued that there is a right to do some act within a prescribed period after service of a notice and therefore, if notice is served by mail, three days should be added to the prescribed period under Bankruptcy Rule 9006(f). However, the language of Rule 4001(d)(2) seems to preclude an additional three days being added since the Rule expressly provides that the objection "may be filed within 15 days of the mailing of notice." This is in contrast to the language of Rule 4001(b)(2) and (c)(2) which provide for a hearing "no earlier than 15 days after service of the motion." The reason for the difference probably is that Bankruptcy Rule 9006(f) would not apply to those provisions since no one has a right or requirement to do some act within that time period. It is merely a limitation on the ability of the court to schedule a hearing; the court must wait 15 days after service of the motion. This is in contrast to the right to object and therefore it appears that the Advisory Committee dated the 15 days from mailing rather than service so as to avoid the application of Bankruptcy Rule 9006(f).

The Advisory Committee Note to the 1987 Amendments recognizes that 15 days may be too long and, if so, suggests that it is appropriate to move for a reduction of time under

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[16] The Advisory Committee Note to subdivision (b) provides that a "motion for authority to use cash collateral shall include (1) the amount of cash collateral sought to be used; (2) the name and address of each entity having an interest in the cash collateral; (3) the name and address of the entity in control or having possession of the cash collateral; (4) the facts of demonstrating the need to use the cash collateral; and (5) the nature of the protection to be provided those having an interest in the cash collateral. If a preliminary hearing is requested, the motion shall also include the amount of cash collateral sought to be used pending final hearing and the protection to be provided."

[17] The Advisory Committee Note to subdivision (c) states that a "motion to obtain credit shall include the amount and type of the credit to be extended, the name and address of the lender, the terms of the agreement, the need to obtain the credit, and the efforts made to obtain credit from other sources. If the motion is to obtain credit pursuant to § 363(c) or (d), the motion shall describe the collateral, if any, and the protection for any existing interest in the collateral which may be affected by the proposed agreement."

Bankruptcy Rule 9006(c)(1). This should be contrasted to the Advisory Committee Note as to motions under Bankruptcy Rules 4001(b) and (c); the 15 day period after service before a final hearing can be held cannot be reduced under Bankruptcy Rule 9006(c)(2).

Bankruptcy Rule 4001(d) is silent as to the contents of the notice, as well as the motion. Nonetheless, the court has authority to regulate notices under Bankruptcy Rule 9007 and the court should require that the notice clearly set forth what the trustee or debtor-in-possession is allowed to do as far as the use of cash collateral or secured borrowing and the concessions to the lender. This should be required even though service of the motion and agreement are required as well as the notice And in those situations where the court directs that all parties in interest receive notice, the court could undoubtedly limit the mailing to the notice (rather than the notice and motion accompanied by the agreement), as to the additional parties, while requiring that notice, motion and agreement be mailed to those specified under Bankruptcy Rule 4001(d)(1).

Each of our Judges has his/her own procedures to follow concerning noticing cash collateral related hearings. A chart reflecting each specific requested procedure is attached as Exhibit A.

C. Disposition of Motion

Bankruptcy Rule 4001(d)(3) gives the court discretion as far as whether a hearing will be held in the event there is no objection filed. If no objection is filed, it is appropriate for moving counsel to submit a form of order, along with a certification that no objection was received by counsel. The certificate should also contain information as to the status of the court file.

If an objection is filed (apparently whether timely filed or not), or if the court determines a hearing is appropriate, the court is to hold a hearing on no less than five days notice to the objector, the movant, the parties on whom service is required by Rule 4001(d)(1), and such other entities as the court directs.[18] The Rule is silent as to who gives the notice. Therefore, it is incumbent on counsel for the moving party to submit a motion requesting approval of a form of notice as well as those to be served, along with a proposed form of order.

D. Shortening Time

Absent an objection, it will take at least 16 days under the Rule before an order can be entered and a minimum of 22 days if an objection is filed and the five day notice is mailed on the 16th day. This may be too long a time period; payrolls, utilities and suppliers must be paid or services will be discontinued. If the agreement must be approved at an earlier time so as to enable the business to continue, then, as pointed out in the Advisory Committee Note to the 1987 Amendments, the movant has two alternatives. The movant can seek to have the 15 day period reduced under Bankruptcy Rule 9006(c)(1) or proceed under subdivision (b) or (c) of Bankruptcy Rule 4001 and obtain earlier relief at a preliminary hearing. If the second alternative is followed, the motion should seek approval of the agreement as well as a use of cash collateral or secured borrowing and request a preliminary hearing.

[18] Bankruptcy Rule 4001(d)(3).

E. Bankruptcy Court Local Rule 4001-4

Attached as Exhibit B is a copy of Local Bankruptcy Rule 4001-4 governing all "First Day" motions which almost always involve some sort of order on use of cash collateral. Attached as Exhibit C is Judge Marlar's specific addition/modification to pleadings and proof issues concerning cash collateral.

IV. Adequate Protection

The touchstone as to the use of cash collateral or borrowing secured by a priming lien is adequate protection of the adversely affected interest.[19] What is adequate protection is left to the courts, with the exception that an administrative expense will not suffice.[20] The Bankruptcy Code does specify certain means of furnishing adequate protection, which include cash payments and replacement liens.[21] These means are not exclusive and the Bankruptcy Code expressly authorizes the court to approve other means of furnishing adequate protection so long as it will "result in the realization by such entity of the indubitable equivalent of such entity's interest in such property."[22]

It is the value of the secured creditor's collateral which must be protected. The Supreme Court has put to rest the concept that an undercollateralized secured creditor is entitled to earnings on the liquidation value of its collateral.[23] Only the value of the collateral must be statutorily[24] and constitutionally protected.[25]

A. Valuation

The Bankruptcy Code does not define value. The only guidance is that "value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest."[26] The legislative history is also indefinite; "'value' does not necessarily contemplate forced sale or liquidation value of the collateral; nor does it always imply a full going concern value. Courts will have to determine value on a case-by-case basis, taking into

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[19] 11 U.S.C. §§ 363(c) and (e) and 364(d).

[20] 11 U.S.C. § 361(3).

[21] 11 U.S.C. § 361.

[22] 11 U.S.C. § 361(3).

[23] United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assoc., Ltd., 484 U.S. ____, 108 S.Ct. 626 (1988).

[24] Id. 484 U.S. at _____, 108 S.Ct. at 630.

[25] Wright v. Union Central Life Ins. Co., 311 U.S. 273 (1940); and Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1935).

[26] 11 U.S.C. § 506(a).

account the facts of each case and the competing interests in the case."[27] Determination of value for one purpose is not determinative of value for other purposes.[28]

The cases are unclear whether liquidation value or going concern value is the appropriate standard. Which standard is used will often be determined by the nature of the collateral. For example, income producing property in a single asset case will be assigned a value based on its market value, which will most likely be based on a capitalization of earnings. Whether described as going concern value or fair market value, the result will be the same. On the other hand, the matter becomes more difficult if the collateral is a piece of machinery which is an integral part of a manufacturing process. If sold separately, it would be worth much less and presumably be assigned a liquidation value of some nature, while if it is used in the business, it will have a higher value, essentially based on replacement cost and remaining useful life. For example, a piece of machinery that has a useful life of ten years which could be replaced by a new piece of equipment having a useful life of 20 years at a cost of $100,000, would have a going concern value of at least $50,000. If the manufacturing process is unprofitable and a piece of equipment had no resale value, then its liquidation value would be nominal. But except in unusual cases, there should not be a problem in deciding between liquidation and going concern value.

B. Date of Valuation

The Code is silent as to the date of valuation of collateral.[29] The general rule is that claims are determined as of the date of the filing of the petition.[30] However, secured claims are an exception, at least as to overcollateralized secured claims which include postpetition interest and expense to the extent of the value of the collateral over and above the amount of the claim as of the date of the filing of the petition.[31]

For confirmation purposes, the Bankruptcy Code is also imprecise. Although deferred payments must have a value as of the effective date of the plan equal to the value of the collateral, there is nothing in the Code that states when the value of the collateral is to be determined. Perhaps an implication can be drawn that it is to be valued as of the date of confirmation, but this is not certain.[32] In the context of furnishing adequate protection, it is logical to conclude that collateral is to be valued either as of the date adequate protection is considered or an earlier date, such as the date of filing the bankruptcy case. It is that value which is to be adequately protected, not a value at some subsequent date. It would be inconsistent with the requirement of furnishing adequate protection to value the collateral at a subsequent date for

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[27] H. Rep. No. 95-595, 95th Cong., 1st Sess. 356 (1977).

[28] H. Rep. No. 95-989, 95th Cong., 2d Sess. 68 (1978) ("a valuation early in the case in a proceeding under §§ 361-363 would not be binding upon the debtor or creditor at the time of confirmation of the plan."); and 124 Cong. Rec. H.11095 (Daily ed. Sept. 28, 1978) and S.17411 (Daily ed. Oct. 6, 1978) ("determination for purposes of adequate protection is not binding for purposes of 'cram down' on confirmation in a case under Chapter 11.").

[29] See 11 U.S.C. § 506(a), 11 U.S.C. § 363(e) and 11 U.S.C. § 364(d).

[30] 11 U.S.C. § 502(b).

[31] 11 U.S.C. § 506(b).

[32] 11 U.S.C. § 1129(b)(2)(A)(II) and (b)(1).

purposes of determining whether there has been adequate protection. But this is probably a matter of significance only in times of rapid inflation or deflation.

C. Protection Required

As far as adequate protection is concerned, there is no dispute about two things: any physical depreciation through use must be compensated and delay in the payment to the secured creditor of the liquidation value need not be compensated, except to the extent the collateral is sufficiently valuable to do so.[33]

Beyond the foregoing, there is considerable uncertainty. Ad valorem taxes accruing postpetition which are senior to the interests of the secured creditor probably require protection. But it is uncertain whether interest and expenses accruing on a senior secured claim must be protected against as far as the junior secured claimant is concerned. Decreases in value due to passage of time, deflation and obsolescence adversely affect value, but probably are not to be protected under the Supreme Court's decision in Timbers.[34]

D. Proceeds and Offspring

If the collateral is income producing collateral or livestock which produces offspring, intriguing questions arise. If the value of the collateral is determined at the date of the petition, presumably the valuation process takes into consideration the future income or earnings of the collateral. For example, the fair market value of a registered five year old cow will have a value partially based on its ability to calve for a number of years. With each calving, the value decreases. The cow also has a residual slaughter value. Therefore, it would seem that the offspring should be considered part of the collateral and that the essential value of the collateral as of the date of the petition should not significantly increase with the birth of a calf. This means that the secured creditor is entitled to both the cow and the calf, assuming conception occurred prepetition. If the secured creditor is undercollateralized as of the date of the petition, this would mean that it would receive only the value of its collateral. If that collateral increased in value, it would be entitled to the increase in value only if the valuation date is fluid. As pointed out previously, the Bankruptcy Code is silent on this point. The implication is to the contrary, however. Therefore, if the calf is to be sold and the proceeds used, adequate protection would have to be furnished only as to the decrease in value of the cow as a result of the calving. That might or might not be equal to the proceeds of the sale of the calf.

On the other hand, if the date of valuation is fluid, then adequate protection would be based on the value of the calf and the cow. Theoretically the value should be the same as that determined at the date of petition. But it probably will not be, for the simple reason that some of the risk is gone and a cow and a calf is worth more than a pregnant cow. Taken in isolation this is not too significant. However, if a substantial breeding herd is involved, it could be significant. In a recent case decided by the Bankruptcy Court for the District of Montana, the bankruptcy judge held that the projected calf crop from a breeding herd was not part of the secured creditor's collateral. Although it is not clear from the opinion, it is probable that the calves in question

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[33] United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assoc., Ltd., 484 U.S. ____, 108 S.Ct. 626 (1988).

[34] Id.

would be conceived postpetition. The court therefore held that the security interest did not extend to the calves under the provisions of 11 U.S.C. § 552. Literally read, however, 11 U.S.C. § 552(b) does extend the security interest to calves born postpetition, since they are offspring of collateral. The court concluded to the contrary relying on cases which refused to extend the lien to crops planted postpetition.[35] Even as to calves conceived prepetition, there would have to be an adjustment in the amount of the secured claim for expenses incurred by the estate in caring for the cow and later the calf, under 11 U.S.C. § 552(b) and perhaps § 506(c).

In Matter of Kain[36], the cash proceeds of the sale of postpetition offspring of livestock which were security for a claim of a secured creditor which was not fully collateralized, were paid to the secured creditor, after deduction of an agreed amount presumably to cover some or all of the costs of maintaining the breeding herd and raising the offspring. In an opinion that is not easily understood, the Court held that the payments should be applied to reduce the deficiency, rather than the secured portion of the claim.

> "When an undersecured creditor receives proceeds from the sale of its collateral during the pendency of a case, whether or not denominated as adequate protection payments, the net effect is that such payments shall be credited to reduce its total principal indebtedness. Therefore, the unsecured portion of the creditor's claim will be reduced by the total amount of the proceeds received and the secured portion of the creditor's claim will be determined exclusive of such payments."[37]

The opinion does not discuss the date of valuation and the impact of offspring and passage of time on the value of the herd. Thus, it is quite likely that the secured creditor is treated as secured in an amount in excess of the value of its collateral as of the date of the filing of the bankruptcy case.

Probably the solution to the matter of adequate protection of a secured creditor's interest in breeding livestock is to determine the value of the livestock as of the date of the petition and the decrease in value due to ageing and calving. The secured creditor is entitled to be protected as against this decrease in value. This avoids the difficult problem of allocating expenses.

Another troublesome situation is that of income producing real property. For example, if at the date of the petition an apartment project produces $100,000 in net income, assuming a capitalization rate of ten percent the apartment project is worth $1,000,000. How much of the $100,000 is the undercollateralized secured creditor entitled to receive? A secured creditor is entitled to postpetition rents from its collateral[38]; but does that increase the secured claim? If not the trustee need only protect against any decrease in value of the collateral through e.g., economic depreciation. By way of example, if economic depreciation is $50,000 per year, then

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[35] In re Big Hoof, Land & Cattle Co., 81 B.R. 1001, 1003 (Bankr. D. Mont. 1988).

[36] 86 B.R. 506 (Bankr. W.D. Mich. 1988).

[37] Id. at _____.

[38] 11 U.S.C. § 552(b).

the secured creditor is entitled to $50,000, and $50,000 could be used by the estate, even though proceeds of collateral. The court is, of course, authorized to allow the debtor to use the rents, even though subject to the security interest of the undercollateralized secured creditor, so long as the interest of the undercollateralized creditor is adequately protected. And the only interest that must be protected is the value and so long as economic depreciation is paid, the value is maintained and the excess earnings from the property can be used by the debtor.

A decision by the Ninth Circuit suggests a contrary result.[39] In that case the Ninth Circuit held that the Supreme Court's decision in Timbers of Inwood should be retroactively applied and therefore postpetition payments to the undercollateralized secured creditor out of rental income reduce the undercollateralized secured claim. That is a correct result only if there was no economic depreciation. The matter should have been remanded to the lower court for a determination of the amount, if any, of economic depreciation. Only after rentals are applied to reimburse the secured creditor for the economic depreciation should the balance of the rentals be applied to reduce the secured claim.[40]

One other example of potential loss to a secured creditor is the situation where there is a senior secured claim which is accruing interest. In that instance, the value of the collateral of the undercollateralized junior creditor is decreasing daily. The undercollateralized junior creditor should be protected against that erosion. It has been suggested that this would lead to split loans by lenders, the senior loan being fully collateralized and entitled to interest while the junior loan being undercollateralized and not entitled to interest.[41] This would at least allow the lender to obtain some interest postpetition. It would not appear that this theoretical possibility should deter the bankruptcy courts; in such instances the court can treat the lender as having an unsecured claim, even though separately documented, and therefore it will be an undercollateralized secured claim which will not be entitled to postpetition interest. On the other hand, if there is a true separation between senior and junior ownership of secured claims, the court should recognize the erosion that takes place and require adequate protection against such erosion. This is different than requiring that interest be paid on the undercollateralized secured claim postpetition and is analogous to the postpetition accrual of ad valorem taxes which are senior to the undercollateralized secured claim.

E. Replacement Liens

Debtors often offer the secured creditor "replacement liens" in post-petition rents generated by the Chapter 11 Debtor as "adequate protection" in exchange for permission or court order authorizing use of cash collateral in day to day operations of the business. For single asset income producing properties, the secured creditor most often already has a lien on all of the rents generated by the property. Is it enough to simply grant that secured creditor a lien on all such revenues generated post-petition? The Sixth Circuit Bankruptcy Appellate Panel, in In re Buttermilk Town Center LLC, 442 B.R. 558 (6th Cir. B.A.P. 2010) says no.

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[39] Cimarron Investors v. WYID Properties, (In re Cimarron Investors), 848 F.2d 974, (9th Cir. 1988).

[40] The estate would be entitled to reimbursement for the expense of operating the apartment project under either 11 U.S.C. §§ 552(b) or 506(c).

[41] Klee, "Timbers, Ahlers and Beyond," 62nd Ann. Meeting of the National Conference of Bankruptcy Judges, 413 at 423-24 (Published by Professional Education Systems, Inc. 1988).

Debtor Buttermilk Towne Center owned and operated a commercial real estate development. Pursuant to a construction financing agreement, lender Bank of America Corp.'s predecessor loaned the debtor $34 million. These funds were used to purchase $34 million in taxable industrial revenue bonds, which were issued to fund development of a commercial real estate project.

The fee interest in the underlying real estate was conveyed to a municipality in order to maintain the tax-exempt status of the bonds. In turn, the municipality leased the property back to the debtor pursuant to a ground lease. The bonds, which were owned by the lender, were to be repaid through lease payments by the debtor to the municipality.

The underlying financing agreement was secured by a mortgage and lien on the commercial property and on the debtor's interest in the ground lease and subleases. In addition, the debtor executed an assignment of rents and subleases in favor of the lender.

Under this assignment, the debtor assigned and transferred all rents and profits derived from the property to the lender, subject to a license held by the debtor to collect and use such rents so long as the debtor was not in default of its obligations. This license was to terminate automatically and without notice upon a default by the debtor. The rents generated by the subleases were the debtor's only source of revenue

The BAP held that replacement liens on future rents in which the lender already had a security interest did not provide adequate protection to the lender. The debtor did not offer sufficient adequate protection because the debtor was merely reducing the assets to which the lender's perfected security interests had already attached. Since the lender already had a lien on the rents, the debtor had no unencumbered assets to offer as adequate protection for use of the cash collateral.

V. Rents – Assignments as Absolute or Conditional

Cash collateral is defined by 11 U.S.C. § 363(a) 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 subject to a security interest as provided in § 552(b) of this title, whether existing before or after the commencement of a case under this title." In order to determine whether cash or cash equivalents constitute cash collateral, it is necessary to determine the scope of the prepetition security agreement and its validity, enforceability and perfection.

Deeds of trust and mortgages encumbering real property generally contain a rents and profits clause or are accompanied by an assignment of rents and profits; as a result, rents and profits are encumbered. Nonetheless, under the law of many states, some further event is necessary before the secured creditor can collect rents and profits.[42]

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[42] First Federal Savings of Arkansas v. City National Bank of Fort Smith, 87 B.R. 565 (W.D. Ark. 1988) (no action necessary to perfect right to rents and profits under Arkansas law where a separate mortgage of the leasehold interest); and In re Ventura-Louise Properties, 490 F.2d 1141 (9th Cir. 1974) (absolute assignment of rents not as

The United States Supreme Court settled a controversy as to whether the state law or bankruptcy law controlled the right to rents and profits. In Butner v. United States,[43] the Supreme Court of the United States held that state law was determinative. The law of each state must, therefore, be consulted to determine whether the debtor may use rents and profits without court order or whether it is cash collateral which can be used only after a court order under 11 U.S.C. § 363.

In In re Mears,[44] Florida law controlled the need to obtain an order of sequestration or the appointment of a receiver to perfect the right to rents and profits. Such action was not possible as a result of the intervention of bankruptcy, in the absence of a modification of the stay. However, the bankruptcy court had entered an order authorizing the use of cash collateral and requiring the escrow or sequestration of the balance of any rental revenues after payment of costs of operation, with the excess to be paid to the secured creditor. The Court held that this was sufficient to perfect the interest in the rental proceeds. Florida had also recently enacted legislation which provided that an assignment of rents became absolute on the default of the mortgagor and written demand of the mortgagee. It was not clear, however, whether that statute applied retroactively and the decision was not based on that statute. The Court stated that

> The right of a secured creditor to perfect its interest in rental assignments postbankruptcy petition basis is specifically permitted under 11 U.S.C. Section 546(b). Under 11 U.S.C. Section 546(b), if the state law requires the seizure of property or the commencement of an action to accomplish perfection of a security interest, and the property has not been seized or an action has not been commenced before the date of the filing of the bankruptcy petition, the interest in the property may be perfected during the bankruptcy proceeding by the entry of a sequestration order. This procedure has been specifically recognized in various jurisdictions in numerous cases including In the Matter of Hamlin's Landing Joint Venture, supra [77 B.R. 916 (Bkrtcy. M.D. Fla. 1987)]; In the Matter of Selden, 62 B.R. 954 (Bkrtcy. Neb. 1986); In re: Casbeer, 793 F.2d 1436 (5th Cir. 1986); In re: Anderson, 50 B.R. 728 (U.S.D.C. Neb. 1985); In the Matter of Village Properties Limited, 723 F.2d 441 (5th Cir. 1984); Groves v. Fresno Guarantee Savings and Loan Association, 373 F.2d 440 (9th Cir. 1967); Florida National Bank of Jacksonville v. United States, supra [87 F.2d 896 (5th Cir. 1937)].[45]

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additional security under California law; no further action required of mortgagee). See generally, Countryman, "Real Estate Liens in Business Rehabilitation Cases," 50 Am.Bankr.L.J. 303 (1976); and Lifton, "Real Estate in Trouble: Lenders Remedies Need and Overhaul," 31 Bus.Law. 1927 (1976).

[43] 440 U.S. 48 (1979).

[44] 88 B.R. 419 (Bankr. S.D. Fla. 1988).

[45] Id. at 421.

In a decision by the United States Court of Appeals for the Eighth Circuit, the Court held that an interest in rents and profits is only perfected by the filing of a petition to sequester.[46] Of more interest, however, was the assertion by an unsecured creditor that the interest in rents and profits could be avoided under 11 U.S.C. § 544(a) since not "perfected" at the date of the petition. The Eighth Circuit did not decide this issue since it found that the unsecured creditor did not have standing to raise the issue.

In In re McCombs Properties, VI, Ltd.[47], involved a motion for authorization to use rents. The Court authorized the use of cash collateral to pay operating expenses, improve and maintain the collateral and to turn over the excess to the secured creditor. Adequate protection was offered through the use of the cash collateral and the fact that there was an equity cushion. The secured creditor was owed approximately $2,500,000 and the court found the property was worth $289,000 in excess thereof (after deducting closing costs in connection with any sale). First, the Court held that the "secured creditor has no right to the equity cushion in its collateral. It only has a right to look to the collateral for payment of its claim 'upon completion of the reorganization. It is then that he must be assured 'realization . . . of the indubitable equivalent' of his collateral.'"

The security interest was not perfected under Texas law, the location of the real property, at the date of the filing of the bankruptcy case. But thereafter, the secured creditor filed a notice under § 546(b) of the Bankruptcy Code perfecting its security interest in the rents. The Court found that this was a proper method of perfecting a security interest in rental income in the Fifth and Ninth Circuits and cited In re Casbeer[48] and In re Johnson[49]. But this was not the end of the matter; the debtor asserted that since the interest was not perfected as of the date of the filing of the bankruptcy case, it was subject to avoidance as a preferential transfer under 11 U.S.C. § 547(b). The provisions of 11 U.S.C. § 546(b) carve out an attack under the preference provisions of the Bankruptcy Code, and only insulate postpetition perfection under 11 U.S.C. §§ 544, 545, and 549. The only real question as far as the preference attack is whether the transfer was unperfected. This was not decided by the Court, since the appropriate procedure was an adversary proceeding. Although the Court did not comment on the perfection issue, it did assume that the interest was unperfected. That is a doubtful proposition. Under 11 U.S.C. § 547(e)(1)(A) "a transfer of real property . . . is perfected when a bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest that is superior to the interest of the transferee." Assuming the assignment of rents was based on the recorded deed of trust, the recording would perfect the security interest not only in the real property but also the rents and profits as against a subsequent bona fide purchaser. Furthermore, under 11 U.S.C. § 547(e)(2), the transfer takes place at the time it is perfected. Perfection occurred as a result of the recording of the deed of trust. Although conditional in the sense that the borrower has the right to utilize the rental income prior to default, that does not mean it is not perfected as that term is used under 11 U.S.C. § 547. It really is no different than the right to use proceeds of the sale of inventory under Article 9 in the

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[46] Saline State Bank v. Mahloch, 834 F.2d 690 (8th Cir. 1987).

[47] 88 B.R. 261 (Bankr. C.D. Cal 1988).

[48] 793 F.2d 1436 (5th Cir. 1986).

[49] 62 B.R. 24 (Bankr. 9th Cir. 1986).

ordinary course of business, prior to default. No one has suggested that that security interest is not perfected, even though contingent on a future event as far as the right to receive the proceeds.

For many years, if not decades, lenders have been trying to persuade courts that the lenders' rights to rents received by the borrower are not affected by a borrower's bankruptcy. See In Ventura-Louis Properties, 490 F.2d 1141 (9th Cir. 1994). Some courts have ruled that if the language of the assignment clearly indicates that the parties intended the assignment of the rents to be absolute, then such rents do not become property of the estate. Sovereign Bank v. Schwab, 414 F.3d 450 (3rd Cir. 2005).

Other courts, however, look to the underlying economic substance of the transaction and if they find that the debtor retains some interest in the rents (such as the right to receive rents upon the payment of the loan), then such rents are property of the estate of the debtor. In re Ventura-Louis Properties, supra; Cavros v. Fleet National Bank, 262 B.R. 206 (Bankr. D. Conn.. 2001); Lyons v. Federal Savings Bank, 193 B.R. 637 (Bankr. D. Mass. 1996).

Recently, the Bankruptcy Court for the Southern District of Tennessee addressed the "absolute assignment" vs. assignment but for the purpose only of additional security. In re Senior Housing Alternatives, 444 B.R. 386 (Bankr. E.D.Tenn. 2011). Despite loan and security documents heavily laden with language and terms ostensibly in support of an absolute assignment (making the ongoing rent payments not part of the bankruptcy estate), the Court instead looked to a law review article, "Still Crazy After All These Years: The Absolute Assignment of Rents in Mortgage Loan Transactions," 59 Fla. L.Rev. 487 (2007) which isolated six factors which courts have identified as reasons to hold that an assignment is one intended for security. These factors are:

1. The assignment is given in connection with (and only because of) a related real estate loan.

2. The borrower is typically permitted to collect rents before default although the borrower may be required to apply the rents for property expenses and debt service but excess rents are freely at borrower's disposal.

3. The lender is not entitled to collect rents before default.

4. The rents lender collects must be used for property expenses or debt service and are not at lender's general disposal.

5. The borrower retains the risk of nonpayment of rents by tenants.

6. The assignment of rents terminates upon the full payment of the debt.

The Court concluded that since under the assignment the borrower retained an interest in the rents upon payment of the underlying debt, such interest was sufficient to make the rents property of the estate within the meaning of 11 U.S.C. § 541.

EXHIBIT A

JUDGES PROCEDURES

RTB	GBN	SSC	JMM-P	JMM-T	CGC	RJH	EWH-P	EWH-T
Call/Email Courtroom Deputy for hearing date. Prepare notice and email ECF receipt to Courtroom Deputy.	Email Courtroom Deputy for hearing date. Note however, most cash collateral motions are sought as an emergency so a blank hearing order is lodged.	Email Courtroom Deputy for hearing date. Attorney notices. ECF receipt and notice emailed to Courtroom Deputy	Call/email for hearing date.	Call/email Courtroom Deputy for hearing date. Attorney notices. Email ECF receipt & notices to Courtroom Deputy to calendar.	Email Courtroom Deputy for hearing date/time. Prepare notice & email ECF receipt to Courtroom Deputy.	Call/email Courtroom Deputy for hearing date prepare notice.	Call/ email Courtroom Deputy for hearing date.	Call or email Courtroom Deputy for hearing date.

EXHIBIT B

RULE 4001-4

First Day Motions

(a) Advance Courtesy Copy to U.S. Trustee. Except as the Court may otherwise direct before or after the fact, and in addition to the service required by the Federal Rules of Bankruptcy Procedure, Local Rules and case law, for any motion for which an accelerated hearing is sought within the first 30 days after the filing of a chapter 11 petition (e.g., a "first day motion"), the debtor or other movant shall provide the Office of the U.S. Trustee at least 24 hours' advance notice of the nature of the case, the nature of the relief to he sought, and the proposed timing of the hearing, and shall provide the Office of the U.S. Trustee private courtesy copies of drafts of all such motions as soon as they are in substantially final form. Such advance notice and courtesy copies are required even if this means they must be provided before the petition is filed. The U.S. Trustee shall keep such advance notice and courtesy copies confidential until the case is filed.

(b) Conspicuousness Requirements for First Day, Cash Collateral and Financing Motions. In any such motion, any motion for use of cash collateral pursuant to Code § 363, and any motion for postpetition financing pursuant to Code § 364, the first or second paragraph of the motion shall conspicuously state whether any of the followings kinds of relief is sought and, if so, identify the pages of the motion and the attached exhibits that support such relief:

(1) Granting a prepetition creditor a lien or security interest in postpetition assets in which the creditor would not otherwise have a security interest by virtue of its prepetition security agreement and applicable law, other than replacement liens in the same kind of collateral as the creditor had prepetition, in order to obtain the use of that creditor's cash collateral (sometimes known as "cross-collateralization");

(2) Findings, conclusions, holdings or orders as to the amount of a secured debt or the validity, perfection and scope of the security interests securing such debt, that purportedly affect the rights of the estate or anyone other than the debtor in possession and the secured creditor;

(3) Release, waiver or abandonment of claims, setoff rights, surcharge rights, avoidance actions and subordination actions against a secured creditor, or findings or stipulations that no such rights exist, that purportedly affect the rights of the estate or anyone other than the debtor in possession and the secured creditor;

(4) Granting of liens or security interests against rights and actions arising under Code §§ 544, 545, 547, 548 or 549;

(5) The use of funds derived from postpetition financing to pay all or part of a prepetition secured debt, or a provision that deems prepetition secured debt to be postpetition secured debt, other than as permitted by Code § 552(b);

(6) Granting surcharge or "carve-out" rights to a debtor's professionals without providing equivalent treatment to professionals engaged by an authorized committee, or any restrictions on the surcharge or carve-out rights granted to such professionals other than the requirement for Court approval of the fees or expenses (e.g., a restriction against investigating or pursuing causes of action against the secured creditor);

(7) Payment of prepetition wages, salary or other compensation to an employee in an amount in excess of the Code's priority amount, payment of any severance or vacation pay earned prepetition, or payment of any officer's, director's, insider's or equity holder's prepetition wages, salaries, commissions, benefits or consulting fees; and

(8) Priming any secured creditor under Code § 364(d) without that creditor's consent.

(c) Limited Scope of Interim Relief. Absent extraordinary circumstances, the Court will ordinarily not grant such a motion that includes any of the provisions listed above on an interim or accelerated basis, and such provisions may be excluded even from "final" orders issued after 14 days' notice, unless an official creditors' committee has had sufficient time to be appointed, organize, engage professional(s), and analyze and investigate the requested relief with the advice of such professional(s).

(d) Reconsideration of Interim and First Day Orders. On any motion for reconsideration filed within 30 days of receipt of notice of the entry of the order granting such a motion on shortened notice, the burden of proof with respect to the appropriateness of the relief shall remain on the debtor or other movant notwithstanding the entry of such order, the extent of funds necessarily and irrevocably expended in reliance on such order

EXHIBIT C

CASH COLLATERAL PROCEDURES

Judge James M Marlar

Cash collateral matters are the most critical "first day" or early motions. The Court will set these matters as quickly as it can, sometimes on the same day. The moving party should provide a proposed BUDGET (short-term) for the secured creditor's review. The parties should confer on the budget, if possible, prior to the hearing. Orders concerning cash collateral will be promptly entered.