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PROPOSED COUNSEL FOR THE COMMITTEE OF UNSECURED CREDITORS

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

In re:	§	**Chapter 11**
Northwest Senior Housing Corporation, *et al.*,[1]	§	**Case No. 22-30659 (MLV)**
Debtors.	§	**Jointly Administered**

OBJECTION OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS TO THE DEBTORS' POST-PETITION FINANCING MOTION
[Relates to Docket Nos. 35 and 112]

The Official Committee of Unsecured Creditors (the "**Committee**") of the above-captioned debtors and debtors in possession (the "**Debtors**"), hereby files this objection (the "**Objection**") to *Debtors' Motion for Entry of Interim and Final Orders (I) Authorizing the Use of Cash Collateral, (II) Authorizing Post-Petition Financing, (III) Granting Adequate Protection, (IV) Modifying the Automatic Stay, (V) Scheduling the Final Hearing and Approving the Form and Method of Notice Thereof, and (VI) Granting Related Relief* [Docket No. 35] (the "**Post Petition**

[1] The Debtors in these chapter 11 cases (the "**Chapter 11 Cases**"), along with the last four digits of each Debtor's federal tax identification number, are Northwest Senior Housing Corporation (1278) and Senior Quality Lifestyles Corporation (2669). The Debtors' mailing address is 8523 Thackery Street, Dallas, Texas 75225.

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Financing Motion" or "**DIP Motion**").[2] In support of the Objection, the Committee respectfully represents as follows:

I.
PRELIMINARY STATEMENT

A. Edgemere

1. As the Court is aware, the Debtor[3] operates a 504-unit continuing-care retirement community (the "**Edgemere**") at the corner of Northwest Highway and Thackery in Dallas, Texas that provides independent living, assisted living, memory care, and skilled nursing care to residents (the "**Residents**"). Approximately 370 Residents currently reside at the Edgemere across the four levels of care.

B. Ground Lease

2. The Debtor leases real property from Intercity Investment Properties, Inc. (the "**Landlord**") pursuant to a 55-year real-property lease (the "**Ground Lease**") that began in 1999 and runs through 2054. The Committee understands that all permanent improvements on the property become the property of the Landlord upon termination of the Ground Lease, and the Landlord has an option to purchase all other personal property used in the operation of Edgemere upon termination of the Ground Lease.

C. Secured Indebtedness

3. The Debtor owes UMB Bank, as bond trustee (the "**Lender**" or "**Trustee**") approximately $111.7 million in pre-petition indebtedness, allegedly secured by properly perfected first priority pre-petition liens on most of Edgemere's assets, other than:

- Commercial torts, and

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[2] Capitalized terms used but not defined herein shall have the meanings ascribed to them in the DIP Motion.

[3] For the purposes of this Response, the "Debtor" means Northwest Senior Housing Corporation, lessee on the Ground Lease (defined below).

- Resident escrow accounts (the escrow funds are not property of Edgemere while in the escrow accounts).

4. The Committee is still in the process of investigating the extent, validity, and priority of UMB's asserted liens.

5. While Edgemere's interest in the Ground Lease is pledged to secure the Lender's pre-petition indebtedness, a termination of the Ground Lease will, of course, extinguish the Lender's pre-petition lien on the then-terminated Ground Lease.

6. The pre-petition indebtedness is not a traditional asset-based loan with a revolving advance rate tied to eligible collateral such as inventory or receivables, but is rather structured similar to term loans secured primarily by the Debtor's going concern value, i.e. its ability to operate and generate operating revenue. The Lender's ability to be repaid is dependent on the Debtor's ability to continue operations and to continue to generate cash available for debt service, after the payment of operating expenses, including Ground Lease payments. The Debtor has been unable to generate significant cash available for debt service for many years and, accordingly, the Lender is significantly "undersecured" as of the Petition Date. Nevertheless, the Lender is highly motivated to ensure the Debtor continues operating in order to preserve the going concern value and to provide the Lender with an opportunity to recover as much as possible of its outstanding indebtedness.

D. Proposed DIP Financing

7. The Lender has, accordingly, agreed to provide $10.1 million in post-petition financing to allow the Debtor to continue its operations during these bankruptcy proceedings, subject to complex terms and conditions outlined in the Post-Petition Financing Motion (the "**DIP Loan**").

8. The Committee does not oppose the DIP Loan in principle, and recognizes that the Debtor requires additional post-petition financing to assure the timely payment of its

administrative expenses. The Committee does, however, have concerns over the amount and proposed uses, and prohibited uses, of the DIP Loan proceeds, and has objections to certain proposed terms of the DIP Loan.

E. Liquidity Concerns

9. The Committee is concerned that $10.1 million may be insufficient to pay the Debtor's post-petition operating expenses and other administrative expenses during these proceedings. The Debtor's draft "Long Term Cash Flow Budget", attached hereto as **Exhibit A** (the "**Budget**")[4], currently projects only [redacted] of remaining liquidity by year-end, and that is after accruing [redacted], accruing [redacted].

10. Accordingly, to provide the estate with desperately needed additional liquidity, and to ensure the health and safety of the residents, the Committee has filed an objection to the Debtor's "Escrow Motion" [Docket No. 18] and has requested the Court to deny the Debtor's request to refund certain pre-petition resident refund claims (estimated to aggregate [redacted] this year), and to instead require the Debtor to re-direct those funds:

(i) to increase the budget for Committee professionals from [redacted] to [redacted]; and

(ii) to reserve the balance in an emergency liquidity fund to protect the health and welfare of the residents and to ensure Edgemere has sufficient liquidity

[4] The Long Term Cash Flow Budget attached hereto as **Exhibit A** is through [redacted], and appears to have been used to project revenue and expenses through [redacted] in order to determine the required amount of the DIP Loan. The Budget was marked confidential when provided to the Committee and, accordingly, this Objection is being filed under seal. A shorter term budget is proposed to be attached to the final DIP order.

to fund its operations during these bankruptcy proceedings.

F. Limited Objections to DIP Financing

11. The Committee also objects to the following proposed terms of the DIP Loan:

(i) Liens on any currently unencumbered assets[5] including, but not limited to:

(a) Entrance Fee Escrow Accounts, including the Debtors' contractual contingent rights to disbursements from the Escrow Accounts;

(b) Chapter 5 Causes of Action; and

(c) Commercial Tort Claims, including the pending claims against the Landlord.

(ii) Disguised Cross-Collateralization Provisions:

The Committee objects to the ability of the Lender to apply proceeds from its post-petition collateral to pay down its undersecured pre-petition indebtedness, thereby leaving its post-petition secured, super priority administrative expense DIP Loan unpaid.

(iii) Improper Ability to Amend, Reforecast or Extend Budget without Committee Consent or Court Approval

The Committee objects to the ability of the Debtor to amend and/or extend the budget with only approval of the Lender, in its sole discretion. The Committee requests that any amendment or extension of the budget be subject to Committee approval or Court order.

(iv) Additional Normal and Customary Committee Objections:

The Committee also asserts the following normal and customary Committee objections to the following proposed terms of the DIP Loan:

(a) global release of Lender;

(b) waiver of §506(c) surcharge rights;

(c) waiver of marshalling remedy;

(d) stipulation to Lender's good faith under §364(e);

(e) the 53-day Committee challenge period; and

[5] Herein, the "**Unencumbered Assets**".

(f) providing the Lender an irrevocable right to credit bid.

II.
STATEMENT OF FACTS

A. General Background

12. On April 14, 2022 (the "**Petition Date**"), the Debtors each filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code. The Debtors are operating their businesses and managing their properties as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

13. As of the date hereof, no request for the appointment of a trustee or examiner has been made.

14. On April 28, 2022, the United States Trustee for the Northern District of Texas appointed the Committee in these Chapter 11 Cases, as amended on April 29, 2022 and May 2, 2022.

15. The Debtor's prepetition capital structure is set forth in detail in the Motion and in the Harshfield Declaration. The contents of the same are hereby incorporated herein by reference as if fully recited verbatim. *See* Fed. R. Civ. P. 10(c).

B. The Proposed DIP Facility

16. The Motion was filed on the Petition Date. Pursuant to the Motion, the Debtor seeks authority to: (i) enter into the DIP Facility – a senior secured superpriority debtor-in-possession credit facility in an aggregate principal amount not to exceed $10,100,000, including $2.0 million that was approved on an interim basis (the "**DIP Facility**" or "**DIP Loan**"), and (ii) use Cash Collateral of the Trustee (i.e., the prepetition lender) in accordance with the Budget and certain Bankruptcy Milestones.

17. The major operative terms, covenants, and conditions of the DIP Facility are summarized on pages 9-16 of the Motion. As consideration for the DIP Facility, the DIP Lender

will receive a commitment fee of 2.00% of the DIP Commitment. The interest rate for all loans under the DIP Facility is 10% per annum, which accrued and unpaid interest shall be due and payable on the Maturity Date. All interest shall be computed on the basis of a 360-day year for the actual number of days elapsed in the period during which it accrues. The default rate under the DIP Facility is an additional 2.00% per annum.

18. The DIP Facility will mature on **December 31, 2022** (as contemplated by the latest draft of the Final Order provided to the Committee) or earlier if certain events occur, such as an Event of Default. Notably, the Maturity Date must work in conjunction with the Bankruptcy Milestones referenced below, which if amended, could push the Plan's effective date beyond the DIP Facility's Maturity Date. In this instance, the Maturity Date should automatically be extended to ensure the Debtor has sufficient funding to finance operations through the Plan's effective date. The Debtor's ability to utilize the DIP Facility is at all times subject to an acceptable Budget and Variance. The Debtor will be obligated to provide periodic financial and operational reporting to the DIP Lender/Trustee, and should do the same for the Committee.

19. The DIP Facility will be secured by Post-Petition Liens on the Post-Petition Collateral, as defined in the Interim Order, with the priorities set forth therein. Other than Charitable Assets (as defined in the Interim Order), any and all assets of the Debtor that were unencumbered as of the Petition Date are included in the Post-Petition Collateral. The Post-Petition Collateral consists of all real and personal property of each of the Debtors, and upon entry of the Final Order, the Avoidance Actions, commercial tort claims, causes of action and Escrow Funds. The Post-Petition Liens are senior to all other liens, claims, mortgages and security interests, except for the Carve-Out and Permitted Liens. Most significantly, the Unencumbered Assets are not excluded or carved out of the broad sweeping, all-encompassing grant of the Post-Petition Collateral.

20. Adequate protection is provided to the Trustee in the form of a superpriority administrative expense claim as well as Rollover Liens and Supplemental Liens on the Post-Petition Collateral to secure any diminution in value of the Trustee's Pre-Petition Collateral – including any diminution attributable to or caused as a result of the DIP Loan. As additional adequate protection, certain fees and expenses of the DIP Lender will be paid, and the Debtor is required to pay the DIP Lender its monthly reasonable and documented fees, costs and expenses, including, without limitation, legal and other professional fees and expenses.

21. The DIP Facility is subject to the following Milestones:

Bankruptcy Milestones	
Provide drafts of Plan and Disclosure Statement to DIP Lender and Trustee	June 28, 2022
Filing of Plan and Disclosure Statement	July 13, 2022
Approval of Disclosure Statement and Solicitation Procedures	August 27, 2022
Begin Solicitation of Plan	September 3, 2022
Entry of Confirmation Order	October 11, 2022
Plan Effective Date	November 10, 2022

22. The DIP Facility contemplates a broad-ranging waiver of all surcharge claims under section 506(c) of the Bankruptcy Code, which would insulate the DIP Lender/Trustee from any claims of the estates for the cost of preserving the lender's collateral. Also, the Debtor proposes that the "equities of the case" exception under section 552(b) of the Bankruptcy Code would not apply to the Trustee with respect to proceeds or profits of any of the Pre-Petition Collateral. Yet, the Budget makes no provision for the payment of all accrued administrative expense claims.

23. If an Event of Default occurs, the DIP Lender/Trustee would be entitled to exercise remedies following a short five (5) day notice period during which time the Debtor or the Committee could rush into this Court only to challenge whether an Event of Default has occurred.

24. The Final Order includes, subject to Challenge, all-encompassing admissions, stipulations, releases, and other extraordinary relief in favor of the Trustee with respect to the Pre-

Petition liens and Bond Claim of the Trustee. The Committee is given only 53 days following formation to assert a challenge and its investigation budget is limited to $25,000. The Budget (as currently contemplated) fixes the Committee's professional fees at [redacted] for the entirety of the Chapter 11 Cases, whereas Debtor's and DIP Lender's/Trustee's professionals have an aggregate budget exceeding [redacted].

25. The Court entered the Interim Order approving the Motion on an interim basis on April 20, 2022 [Docket No. 112]. Subsequently, the Court approved the Motion on a second interim basis at a hearing on May 11, 2022. The Final Hearing on the Motion is currently set for May 26, 2022 at 9:30 a.m. CT. The Committee's response deadline to the Motion is currently set for May 19, 2022 at 4:00 p.m. CT.

III.
ARGUMENT

26. First, the Committee objects to the improper restrictions on the use of DIP Loan proceeds imposed by the Lender in the proposed DIP Financing Order. The Committee objects to the Lender's control over the administration of these Chapter 11 Cases by dictating that DIP Loan proceeds be: (i) used to prefer and repay one select group of pre-petition resident refund claimants; and (ii) limited Committee professionals fees to [redacted] (including a $25,000 investigation cap), thereby attempting to significantly marginalize the participation of the Committee (whose constituents include over 400 current and former residents and more than a hundred trade creditors). As discussed in the Executive Summary, the Committee strongly believes these funds (estimated to aggregate [redacted] this year) must be used for working capital to ensure the continuing safety, health and welfare of the current residents, and to properly fund Committee professionals. The Debtors' Budget projects cash available of just [redacted] at year-end. [redacted]

[redacted]. [redacted]. The Court should preserve the [redacted] budgeted for refunds and redirect those dollars to (i) increasing the budget for Committee professionals, and (ii) to fund an emergency liquidity fund.

27. Second, the Committee objects to liens and superpriority claims that would have recourse to, or would be payable from, previously unencumbered estate assets, particularly: (i) the Entrance Fees on deposit in the Regions Bank escrow accounts, including any contractual contingent rights of the Debtors to future disbursement of any such funds on deposit in the Escrow Accounts ("**Escrow Funds**")[6]; (ii) Chapter 5 avoidance actions and proceeds thereof; and (iii) certain commercial tort claims and proceeds thereof, expressly including (without limitation), the Debtors' claims and causes of action against the Landlord ("**Landlord Claims**"). Such liens and superpriority claims would have the effect of further diminishing the position of general unsecured creditors in a case where potential recoveries are already highly speculative and uncertain. Just based on the Committee's initial review, there are at least three (3) categories of unencumbered assets that could have material value, including the Escrow Funds, certain commercial tort claims (including the Landlord Claims), and Chapter 5 avoidance actions, and the proceeds thereof (together, the "**Unencumbered Assets**").

28. As of the Petition Date, the Unencumbered Assets were available for distribution to unsecured creditors. Under the DIP Facility and through the grant of adequate protection, the Unencumbered Assets would be assimilated into the DIP Lender's/Trustee's collateral package. At a minimum, the proceeds of avoidance actions should be carved out of the Post-Petition

[6] The nature of the Escrow Funds is detailed by the Harshfield Declaration at pp. 29-30.

Collateral and any liens or super-priority claims on the remaining Unencumbered Assets should be limited to the DIP Facility, and not attributable at all to any portion of the Pre-Petition Bond Claim. Further, the DIP Lender/Trustee should be required to marshal such that they must turn to the Trustee's other collateral first before attempting to recover on any of their remaining claims from the Unencumbered Assets.

29. Third, the opening sentence of the vague, indistinct paragraph 32(b) of the proposed Final Order is troubling to the Committee. The potentially concerning terms are buried on page 28 in an ambiguous, nondescript paragraph in the middle of a dense, 35-page order.

> *"The DIP Lender and Trustee shall be entitled to apply the payments or proceeds of the Post-Petition Collateral or the Pre-Petition Collateral as they deem appropriate…"* (herein, the "**Disguised Cross-Collateralization**").

In this way, the DIP Lender/Trustee are granted discretion under the DIP Facility to apply the proceeds of the Post-Petition Collateral asset dispositions to reduce the balance of the Prepetition Bond Claim rather than the priming DIP Facility. The effect of this provision is a hidden cross-collateralization and pseudo "roll-up" of the Trustee's Prepetition Bond Claim. Proceeds of asset sales that may be realized by the Debtor outside the ordinary course should be applied against the DIP Facility – it is in first position after all – or such proceeds should be retained by the Debtor as working capital.

30. Out of an abundance of caution, it must be clarified that under no circumstances shall any provision of the Final Order be construed to grant the DIP Lender/Trustee "roll-up" rights to pay down its Prepetition Bond Claim with any Post-Petition proceeds. Furthermore, in the same vein, out of an abundance of caution, it must be clarified that under no circumstances shall any provision of the Final Order be construed to grant the DIP Lender/Trustee cross-collateralized liens

to secure each of the Pre-Petition Bond Claim and the DIP Facility with all of the Debtor's Pre-Petition and Post-Petition assets.[7]

31. Although the Committee understands that there are material risks associated with the DIP Facility in these cases, the DIP Lender is not making these advances out of the goodness of its heart, as addressed above. It is understandably trying to preserve the value of its collateral/investment. Under these circumstances, the Committee submits that any cross-collateralization and/or roll-up provisions in any fashion are inappropriate. If the Court approves any form of the requested cross-collateralization or roll-up, the Debtors will lose significant leverage over the Trustee at this early stage of these cases, potentially leaving little, if any, assets to be realized for the unsecured creditors.

32. Fourth, more troubling is the DIP Facility's attempt to eliminate the possibility of any disruption from the Committee performing even its most basic statutory function. This is demonstrated by the restrictions on the Committee's funding and the illusory challenge process. The proposed Final Order (and Budget) seeks to cap Committee professional fees and expenses at [redacted][8] of the size of the budget allocated to the Debtor's professionals. With respect to the Committee's limited challenge rights, the Committee should be granted: (a) more time than 53 days[9] from Committee formation[10] for the challenge period, (b) more than $25,000[11]

[7] *See* Debtors' Checklist at Docket Number 35, p. 62, ¶ 3 (a), (b). Although the Checklist explicitly states there is no cross-collateralization, it further states that post-petition liens secure pre-petition debts. The terms of the Final Order could be construed to be contradictory and misleading on the issue of cross-collateralization. It must be clarified that line-items ¶ 3 (a), (b) in the Checklist concern only Replacement Liens as adequate protection for the use of cash collateral on the Pre-Petition Bond Claim only to the extent of diminution in value of the Pre-Petition Collateral during the pending of the Chapter 11 Cases.

[8] The budget for Committee professional fees of [redacted] for the entirety of the Chapter 11 Cases is woefully inadequate, especially compared to the [redacted] budgeted for Debtor ([redacted]) and lender professionals ([redacted]) for this same time period.

[9] The draft Final Order sets June 20, 2022, as the expiration of the Investigation Period.

[10] The Committee was officially formed on April 28, 2022. *See* Docket Number 135.

[11] The draft Final Order caps the Committee's investigation budget at $25,000.00.

to conduct an investigation of the Trustee's liens and claims, and (c) tolling to the extent that any motions for standing or disputed Rule 2004 motions are required to be filed to conduct the investigation and/or pursue any viable claims that may exist against the DIP Lender/Trustee. The Committee is the only party with an incentive to unlock value for unsecured creditors, and the Court should ensure that the Committee is empowered to acquit its fiduciary duties.

33. Fifth, the DIP Lender's unfettered discretion over the Budget is unacceptable. In Paragraph 6 on page 12, the proposed Final Order (filed at Docket Number 243-1) reads:

> "…which Budget may be amended at the request of the Debtors and with the written consent of the DIP Lender and incorporated herein by reference (as it may be amended, supplemented, replaced or otherwise modified from time to time solely with the consent of the DIP Lender in its sole discretion, the 'Budget')…"

Further, the second to last sentence in Paragraph 21(i) on page 20 reads:

> "The Debtors may, at any time, amend or reforecast the Budget, either for the period covered by the Budget or for any period thereafter, and the DIP Lender and Trustee [Bond Trustee] may approve or not approve such amendment in their sole and absolute discretion."

The Committee objects to these provisions and any similar terms permitting the Budget to be amended, extended or modified in any way without the Committee's prior written consent or Court order after notice, hearing and an opportunity for the Committee to object.

34. Sixth, against this backdrop, there is no basis for the Court to grant the proposed waivers of (a) the Debtor's right to surcharge the DIP or prepetition collateral pursuant to section 506(c) of the Bankruptcy Code, (b) the "equities of the case" exception under section 552(b) of the Bankruptcy Code, and (c) the equitable doctrine of "marshaling" and other similar doctrines with respect to the DIP Facility and prepetition collateral. As drafted, the DIP Facility is objectionable by proposing to grant waivers of the estates' surcharge, marshaling, and equities of the case rights in favor of the DIP Lender/Trustee without making any provision for the payment of all administrative expenses. At a minimum, any waiver or release in favor of the DIP Lender/Trustee

must be subject to the Committee's Challenge and Investigation Period. The Budget also needs to take into account the payment of all administrative expenses prior to the final approval of such waivers and releases in favor of the DIP Lender/Trustee. As to the proposed marshalling waiver, as noted above, the DIP Lender/Trustee should be required to marshal away from any Unencumbered Assets that may become encumbered, which would allow general unsecured creditors to potentially retain some residual value in these assets.

35. Seventh, the DIP Lender's/Trustee's rights to credit bid (if any) must be subject, in all respects, to 11 U.S.C. 363(k) and its progeny, and to the Committee's Challenge.

36. The Committee has other miscellaneous issues with the DIP Facility as outlined at the conclusion of this Objection. In sum, the Committee recognizes that the DIP Facility is necessary and appropriate under the circumstances here, subject to certain critical changes that need to be made in order to protect the interests of unsecured creditors.

IV.
OBJECTIONS

37. The Debtor has failed to satisfy the standard for approval of the DIP Facility, as currently proposed. A debtor seeking approval of postpetition financing must demonstrate that (1) the financing arrangement is necessary to preserve assets of the estate and (2) the arrangement is otherwise fair and reasonable. *In re Premier Entm't Biloxi LLC*, No. 06-50975 (ERG), 2007 Bankr. LEXIS 3939, at *7 (Bankr. S.D. Miss. Feb. 2, 2007) (citing *In re Crouse Grp., Inc.*, 71 B.R. 544, 546 (Bankr. E.D. Pa. 1987), *modified on other grounds*, 75 B.R. 553 (Bankr. E.D. Pa. 1987)); *see also In re N. Bay Gen. Hosp., Inc.*, No. 08-20368 (JB) (Bankr. S.D. Tex. July 11, 2008) (order approving postpetition financing on the basis that the terms of the financing were "fair and reasonable" and "supported by reasonably equivalent value" and "consideration"); *In re Futures Equity L.L.C.*, No. 00-33682 (BJH), 2001 Bankr. LEXIS 2229, at *14 (Bankr. N.D. Tex. Apr. 11, 2001) (same); *In re Republic Airways Holdings Inc.*, No. 16-10429 (SHL), 2016 WL 2616717, at

*11 (Bankr. S.D.N.Y. May 4, 2016) (evaluating similar factors, including whether the terms of the transaction are fair, reasonable, and adequate given the circumstances of the debtor and the proposed lender); *In re L.A. Dodgers LLC*, 457 B.R. 308, 312 (Bankr. D. Del. 2011) (same) (citation omitted).

38. A court should only approve a proposed debtor in possession financing if such financing "is in the best interest of the general creditor body." *In re Roblin Indus., Inc.,* 52 B.R. 241, 244 (Bankr. W.D.N.Y. 1985) (*citing In re Vanguard Diversified, Inc.*, 31 B.R. 364, 366 (Bankr. E.D.N.Y. 1983); *see also In re Tenney Village Co., Inc.*, 104 B.R. 562, 569 (Bankr. D. N.H. 1989) ("The debtor's prevailing obligation is to the bankruptcy estate and, derivatively, to the creditors who are its principal beneficiaries"). Moreover, the proposed financing must be "fair, reasonable, and adequate." *In re Crouse Group, Inc.*, 71 B.R. 544, 546 (Bankr. E.D. Pa. 1987).

39. Postpetition financing should not be authorized if its primary purpose is to benefit or improve the position of a particular secured lender. *See, e.g., In re Aqua Assocs.*, 123 B.R. 192, 195-98 (Bankr. E.D. Pa. 1991) ("[C]redit should not be approved when it is sought for the primary benefit of a party other than the debtor."); *In re Ames Dep't Stores, Inc.*, 115 B.R. 34, 37 (Bankr. S.D.N.Y. 1990) ("[A] proposed financing will not be approved where it is apparent that the purpose of the financing is to benefit a creditor rather than the estate."); *Tenney Village,* 104 B.R. at 568 (debtor in possession financing terms must not "pervert the reorganizational process from one designed to accommodate all classes of creditors and equity interests to one specially crafted for the benefit of the secured creditor").

40. Indeed, the law has long acknowledged the unequal bargaining power inherent in negotiations leading to proposed postpetition financing, as well as the very significant harm that can befall creditors if the proposed financier is permitted to exploit its leverage position. *See, e.g., In re FCX, Inc.,* 54 B.R. 833, 838 (Bankr. E.D.N.C. 1985) ("[T]he court should not ignore the

basic injustice of an agreement in which the debtor, acting out of desperation, has compromised the rights of unsecured creditors."). The DIP Facility should not simply become a tool for the Trustee to enhance its collateral position at the expense of unsecured creditors. *In re Ames Dept. Stores,* 115 B.R. at 38-39 ("[A] proposed financing will not be approved where it is apparent that the purpose of the financing is to benefit a creditor rather than the estate").

41. As of the Petition Date, several potentially significant sources of recovery were available to satisfy the claims of unsecured creditors in these cases, including the estates' Escrow Funds, Avoidance Actions and other Unencumbered Assets. As proposed, the DIP Facility would encumber all such Unencumbered Assets in favor of the DIP Lender (including a potential roll-up of the Trustee's under-secured Pre-Petition Bond Claim) and, to the extent of any diminution, the Trustee, without any commitment with respect to anticipated recoveries by unsecured creditors. The DIP Facility also imposes onerous limitations on the Committee's ability to investigate the liens and claims of the DIP Lender/Trustee and any potential claims that the estates may have against such parties. The DIP Facility seeks to declare an absolute, unfettered right in favor of the DIP Lender/Trustee to credit bid without any limitation or investigation by the Committee. Finally, the DIP Facility waives the estates' surcharge, equities of the case, and marshaling rights without adequately taking into account all accrued and unpaid administrative expenses of these Chapter 11 Cases. Under these circumstances, the DIP Facility should not be approved in its present form.

A. <u>Improper Restrictions on Use of DIP Loan Proceeds</u>

42. The Budget currently projects the use of [redacted] in liquidity to prefer one class of pre-petition unsecured creditors over other classes of unsecured creditors. Indeed, the Debtors propose to pay [redacted] from operating revenue to residents in-place as of the Petition Date subsequently claiming triggered entrance fee refund obligations during the pendency of these

Chapter 11 Cases. In this way, the Debtors propose to burn precious liquidity on disbursements outside the ordinary course of business and contrary to a principal tenet of the bankruptcy process – no similar priority class of creditor can be preferred to another. The consequences of this inequitable and unlawful preference are: (i) the threatened health, safety and welfare of the remaining residents; (ii) the potential administrative insolvency of the estates; and (iii) the marginalized interests of the Committee to perform its fiduciary duties.

43. The Debtors have failed to demonstrate that the DIP Loan Budget is fair and reasonable. *See In re Premier Entm't Biloxi LLC*, No. 06-50975 (ERG), 2007 Bankr. LEXIS 3939, at *7 (Bankr. S.D. Miss. Feb. 2, 2007) (citing *In re Crouse Grp., Inc.*, 71 B.R. 544, 546 (Bankr. E.D. Pa. 1987), *modified on other grounds*, 75 B.R. 553 (Bankr. E.D. Pa. 1987)); *see also In re N. Bay Gen. Hosp., Inc.*, No. 08-20368 (JB) (Bankr. S.D. Tex. July 11, 2008) (order approving postpetition financing on the basis that the terms of the financing were "fair and reasonable" and "supported by reasonably equivalent value" and "consideration"); *In re Futures Equity L.L.C.*, No. 00-33682 (BJH), 2001 Bankr. LEXIS 2229, at *14 (Bankr. N.D. Tex. Apr. 11, 2001) (same).

44. Likewise, the Court should not approve the DIP Loan Budget because such financing is not in the best interest of the general creditor body. *See In re Roblin Indus., Inc.*, 52 B.R. 241, 244 (Bankr. W.D.N.Y. 1985) (*citing In re Vanguard Diversified, Inc.*, 31 B.R. 364, 366 (Bankr. E.D.N.Y. 1983); *see also In re Tenney Village Co., Inc.*, 104 B.R. 562, 569 (Bankr. D. N.H. 1989) ("The debtor's prevailing obligation is to the bankruptcy estate and, derivatively, to the creditors who are its principal beneficiaries"). Moreover, the proposed financing must be "fair, reasonable, and adequate." *In re Crouse Group, Inc.*, 71 B.R. 544, 546 (Bankr. E.D. Pa. 1987).

45. Instead, the [redacted] should be redirected: (i) to adequately fund the Committee's professionals; and (ii) to be held in an emergency reserve account to ensure continuing liquidity to protect the health, safety and welfare of the residents through the Debtors'

exit of these Chapter 11 Cases. These two goals serve the best interests of the estates, and this proposed solution is fair, reasonable and equitable to all parties in interest.

B. Unencumbered Assets Should Remain Unencumbered and Free of Any Superpriority Claims For the Benefit of Unsecured Creditors

46. The DIP Facility would impose liens and superpriority claims in favor of the DIP Lender/Trustee on every previously Unencumbered Asset of the Debtor's estates, including commercial tort claims, the Landlord Claims, avoidance actions, the Escrow Funds and the proceeds thereof. There may be nothing of value left for unsecured creditors if the Unencumbered Assets are pledged to the DIP Lender/Trustee in this way.

47. Avoidance actions (and the proceeds thereof), in particular, are uniquely for the benefit of general creditors of the estate, not secured creditors, and should not be encumbered in favor of secured lenders. Avoidance actions are statutory rights designed to ensure equitable distributions of a debtor's estate. *See, e.g., Cullen Ctr. Bank & Tr. v. Hensley (In re Criswell),* 102 F.3d 1411, 1414 (5th Cir. 1997) (noting that avoidance powers under the Bankruptcy Code were created to "facilitate[e] the prime bankruptcy policy of equality of distribution among creditors of the debtor"). Indeed, avoidance powers are intended to allow a debtor in possession or other party with standing to gain recoveries for the benefit of all unsecured creditors. *See Buncher Co. v. Official Comm. of Unsecured Creditors of GenFarm Ltd. Partn. IV*, 229 F.3d 245, 250 (3d Cir. 2000). Accordingly, bankruptcy courts often restrict a debtor's ability to pledge avoidance actions and their proceeds as collateral. *See, e.g., Gaudet v. Babin (In re Zedda)*, 103 F.3d 1195, 1203 (5th Cir. 1997) ("A trustee's avoidance powers are intended to benefit the debtor's creditors, as such powers facilitate a trustee's recovery of as much property as possible for distribution to the [unsecured] creditors."); *McFarland v. Leyh (In re Tex. Gen. Petrol. Corp.)*, 52 F.3d 1330, 1335–36 (5th Cir. 1995) ("[T]he proceeds recovered in an avoidance action satisfy the claims of priority and general unsecured creditors before the debtor benefits."); *In re Excel Maritime Carriers, Ltd.*,

No. 13-23060 (RDD) (Bankr. S.D.N.Y. Aug. 6, 2013) (ECF No. 133) (excluding avoidance actions and proceeds thereof from scope of adequate protection liens and property that could be used to pay super-priority administrative expense claims); *In re Sapolin Paints, Inc.*, 11 B.R. 930, 937 (Bankr. E.D.N.Y. 1981) ("[N]either a trustee . . . nor a debtor-in-possession, can assign, sell or otherwise transfer the right to maintain a suit to avoid a preference.").

48. Under the circumstances here, there is no basis for the DIP Lender/Trustee to take liens and superpriority claims on Unencumbered Assets, especially the Landlord Claims, Escrow Funds and Avoidance Actions, when unsecured creditors stand to receive potentially nothing. Specifically regarding the Escrow Funds, the money on deposit in the Debtor's Regions Bank Escrow Accounts was not subject to the Trustee's liens prior to the Petition Date. Those funds were held on deposit in a segregated account, not subject to the Trustee's possession or control, and earmarked for payment to unsecured creditors due a refund on their Entrance Fees. If the Escrow Funds become encumbered by the Post-Petition Liens, the Trustee would be permitted to inequitably elevate its pre-petition collateral position and deplete one of the few remaining sources of recovery for unsecured creditors. There is simply no justification provided to expand additional assets not previously included in the Trustee's Pre-Petition Collateral, especially considering the consequences facing the unsecured creditors.

49. Alternatively, and at the very least, any liens or superpriority claims against the Unencumbered Assets should be limited to the DIP Facility and not pledged to secure any portion of the Trustee's Pre-Petition Bond Claim. Further, to the extent that any of the Unencumbered Assets are ultimately pledged in favor of the DIP Lender/Trustee, it must be required to exercise commercially reasonable efforts to recover from the Trustee's Pre-Petition Collateral first before turning to the Unencumbered Assets.

C. Any Potential for Cross-Collateralization or Roll-Up of Prepetition Secured Indebtedness Should Be Stricken

50. The Disguised Cross-Collateralization provision in the proposed Final Order has the potential effect of securing the Trustee's Pre-Petition Bond Claim with liens on previously Unencumbered Assets (including the Escrow Funds and Avoidance Actions) and affording such debt administrative expense status, which must be paid in full in cash to emerge from chapter 11. Among other consequences, given that the DIP Facility is creating over $10 million of additional postpetition secured indebtedness, the DIP Facility could render these estates administratively insolvent by rolling-up over $111 million of the Trustee's Pre-Petition Bond Claim.

51. There is no justification for affording such favorable treatment to the Trustee's Bond Claim while leaving unsecured creditors with potentially nothing. Cross-collateralization clauses and roll-up provisions are generally disfavored because they provide no benefit to the estate while favoring certain prepetition creditors over others. *See, e.g., In re Saybrook Mfg. Co., Inc.*, 963 F.2d 1490, 1494–96 (11th Cir. 1992) (noting that postpetition cross-collateralization is an "extremely controversial form of Chapter 11 financing" before holding it was not authorized by Section 364); *In re Bruin E&P Partners, LLC,* Tr. of Hr'g at 67:9-10, Case No. 20-33605 (Bankr. S.D. Tex Jul. 17, 2020) (finding that roll-ups are "heavily disfavored under the Bankruptcy Code"); *In re Tenney Village Co., Inc.*, 104 B.R. 562, 568 (Bankr. D.N.H. 1989) (debtor-in-possession financing terms must not "pervert the reorganizational process from one designed to accommodate all classes of creditors and equity interests to one specially crafted for the benefit" of the secured creditor).

52. For example, cross-collateralization and roll-ups harm unsecured creditors in at least three ways. First, they provide the prepetition debt that is being secured by and rolled up into unavoidable liens over existing collateral. Second, they enhance the lenders' collateral package by providing liens over the Unencumbered Assets – assets that would otherwise be available to

unsecured creditors. Third, to the extent of the Trustee's Pre-Petition Superpriority Claim, the Bankruptcy Code requires this debt to be repaid in full and in cash in order for a debtor to successfully emerge from chapter 11, 11 U.S.C. § 1129(a)(9)(A), thereby precluding the debtor from treating the prepetition debt in accordance with section 1129(b)(2)(A) of the Bankruptcy Code.

53. Even when cross-collateralization and roll-ups are approved, it is usually because substantial new money financing is being provided that is roughly equivalent to the amount of prepetition debt to be paid down with post-petition collateral or rolled-up. *See In re Constar Int'l Holdings LLC,* Hr'g Tr. 87:20-25, 88:1-4, Case No. 13-3281 (CSS) (Bankr. D. Del. Jan. 16, 2014) (discussing the benefits of a lower roll-up percentage—*i.e.,* percentage of the full facility that represented rolled-up debt—and noting it was the "driving factor" behind the Court's approval of a 20% DIP roll-up over an alternative 40% DIP roll-up); *In re Vanguard Natural Resources, Inc.*, Docket No. 241 at 2-3, Case No. 19-31786 (Bankr. S.D. Tex. April 30, 2019) (approving roll-up of $65 million with a $65 million new money DIP); *In re Sheridan Holding Company II, LLC,* Docket No. 146 at 2, Case No. 19-35189 (Bankr. S.D. Tex. Oct. 15, 2019) (approving roll-up of $50 million with a $50 million new money DIP).

54. Here, the DIP Lender is providing up to $10.1 million of new money financing. As partial consideration for this new money, under the vague, ambiguous wording of Paragraph 32(b) of the Final Order, they seek to potentially exercise the discretion to elevate any portion of the Trustee's $111 million Pre-Petition Bond Claim. By exercising the discretion to "*apply the payments or proceeds of the Post-Petition Collateral or the Pre-Petition Collateral as they deem appropriate*",[12] the DIP Lender is effectively seeking to cross-collateralize an unlimited amount

[12] *See* Final Order, p. 28, ¶ 32(b) (i.e., the Disguised Cross-Collateralization provision).

of additional prepetition debt through the Post-Petition Collateral package. By potentially requiring the Debtor to repay the Pre-Petition Bond Claim from proceeds of asset dispositions, including sales of Unencumbered Assets, this has the effect of rolling up the prepetition obligations and affords any such prepetition obligations the benefits of Post-Petition Liens and administrative priority status.

55. Courts also generally refuse to grant a cross-collateralization or roll-up of prepetition debt that is undersecured because it has the effect of elevating an unsecured deficiency claim to a secured claim. *See, e.g., In re Saybrook Mfg Co.,* 963 F.2d 1490, 1495 (11th Cir. 1992) (holding postpetition financing arrangement *per se* impermissible where undersecured prepetition lender provided postpetition financing in exchange for a security interest in debtor's postpetition property to secure its prepetition debt); *In re FCX, Inc.*, 54 B.R. 833, 840 (Bankr. E.D.N.C. 1985) ("[I]f an undersecured creditor can obtain unencumbered assets as security for all of its prepetition claims, that creditor is being preferred to the detriment of other unsecured claimants.").

56. In the Debtor's Checklist attached as Exhibit B to the Motion at Docket Number 35, page 62, paragraph 2(g), the Debtor affirmatively confirms that the Trustee is undersecured on the Pre-Petition Bond Claim. The Trustee has not provided any evidence or made any representations that the Pre-Petition Bond Claim is oversecured. Hence, the DIP Facility and the Disguised Cross-Collateralization provision will have the effect of converting prepetition unsecured deficiency claims into senior secured administrative expenses.

57. Based on the foregoing, the Committee submits that the Disguised Cross-Collateralization provision should be stricken from the Final Order, and the Final Order should explicitly clarify that no portion of the Pre-Petition Bond Claim may be paid with any DIP Facility proceeds or payments received by the DIP Lender during the pendency of these Chapter 11 Cases. Further, the Final Order should explicitly clarify that no provisions of the Final Order may be

interpreted, construed or enforced to give effect to any cross-collateralization of either the Pre-Petition Bond Claim or the DIP Facility. The Final Order should explicitly clarify that the liens securing the Pre-Petition Bond Claim are limited to replacement liens of the same nature, kind and character only to the extent of any diminution in value, subject to the Challenge, the Carveout and only to the same validity, perfection, priority and extent in existence as of the Petition Date. The Final Order should clarify that the liens securing the DIP Facility are limited to the Debtor's assets owned as of the Petition Date and acquired thereafter, except and specifically excluding any Unencumbered Assets.

D. The Lien Validation and Challenge Provisions are Too Strict

58. The DIP Facility would circumscribe the Committee's ability to exercise its statutory duties. The Committee is given a marginal investigation budget of $25,000 (under the proposed Final Order) and a mere 53 days after formation to investigate the validity of the Trustee's liens and claims and any possible affirmative claims the estates may have against such lenders. It is apparent that the restricted budget seeks to limit the Committee's ability to discharge its statutory duties while improperly shielding the prepetition secured parties from potential claims. *See, e.g.*, *In re Ames Dep't Stores*, 115 B.R. at 40 ("[F]ailure to provide a reasonable sum for professionals has, in other cases before this Court, left estates, creditors' committees and trustees without the assistance of counsel and the Court without the adversary system contemplated by Congress."); *see also In re Channel Master Holdings, Inc.*, No. 03-13004 (MFW), 2004 Bankr. LEXIS 576, at *8–9 (Bankr. D. Del. Apr. 26, 2004) (disregarding a cap on the official committee's professional fees where the compensation allocated to committee's professionals was disproportionate relative to the allocation for Debtor's professionals). This investigation cannot (and should not) be rushed. The Committee should be permitted to thoroughly investigate the prepetition relationship between the Debtor and the Trustee to determine whether any claims exist.

59. At a minimum: (a) the Challenge Deadline should be extended to 90 days after Committee formation, (b) the Committee's investigation budget should be increased to $300,000, and (c) the Challenge Deadline should be tolled in the event that the Committee files a motion seeking standing to assert a Challenge until such motion is determined by the Court and/or files a contested motion for examination under Rule 2004. Further, express provision should be added that the Committee may seek a further extension of the Challenge Deadline by the Court upon a showing of cause.

60. Under section 1103 of the Bankruptcy Code, the duties of a statutory committee include "investigat[ing] the acts, conduct, assets, liabilities, and financial condition of the debtor and any other matter relevant to the case and perform[ing] such other services as are in the interest of those represented." 11 U.S.C. § 1103. Given the releases included in the Debtor's stipulations for the DIP Lender/Trustee, the timeline of these cases, and the volume of potential claims and causes of action that may inure to the benefit of unsecured creditors, the proposed investigation budget is inadequate. The Committee's ability to investigate the Debtor's stipulations relating to, inter alia, the Pre-Petition Bond Claim and all aspects of the DIP Lender's/Trustee's interaction and business relationship with the Debtor should not be dictated by the DIP Lender/Trustee (which is seeking to insulate itself), but rather, by the duties imposed on the Committee by the Bankruptcy Code.

61. Moreover the investigation budget is off-market when compared to other recently approved investigation budgets. *See, e.g., In re Strike, LLC*, No. 21-90054 (DRJ) (Bankr. S.D. Tex. Jan. 4, 2022) [Docket No. 348] (providing a $175,000 cap for the investigation budget); *In re Speedcast Int'l Ltd*., No. 20-32243 (MI) (Bankr. S.D. Tex. May 20, 2020) [Docket No. 239] (providing a $250,000 cap for the investigation budget); *In re Sanchez Energy Corp*., No. 19-34508 (MI) (Bankr. S.D. Tex. Jan. 22, 2020) [Docket No. 865] (same); *In re Westmoreland Coal*

Co., No. 18-35672 (DRJ) (Bankr. S.D. Tex. Nov. 15, 2018) [Docket No. 520] (providing a $150,000 cap for the investigation budget); *In re EXCO Res., Inc.*, No. 18-30155 (MI) (Bankr. S.D. Tex. Feb. 22, 2018) [Docket No. 348] ($250,000 cap for the investigation budget); *In re CJ Holding Co.*, No. 16-33590 (DRJ) (Bankr. S.D. Tex. Sept. 25, 2016) [Docket No. 497] (providing a $500,000 cap for the investigation of liens and claims); *In re Midstates Petrol. Co.*, No. 16-32237 (DRJ) (Bankr. S.D. Tex. June 30, 2016). [Docket No. 324] (providing a $150,000 cap for the investigation budget).

62. In light of the foregoing, the Committee requests that, to the extent the Court is inclined to impose any cap on the Committee's Investigation Budget, it increase such cap to $300,000 to ensure that the Committee is able to properly discharge its statutory duties and investigation rights in these Chapter 11 Cases. The requirement for Court approval of estate professionals' fees will provide the necessary control.

63. Additionally, the Final Order should expressly provide that the Committee's professionals shall be entitled to seek allowance and payment of any amounts expended in excess of the investigation budget as administrative expenses, and that no party shall be permitted to object on the ground that the expenses exceeded the contemplated budget; provided that the administrative expenses in respect thereof shall be subordinate in all respects to the Carve-Out. *See, e.g., In re S. Foods Grp., LLC*, No. 19-36313 (DRJ) (Bankr. S.D. Tex. Dec. 23, 2019) [Docket No. 608] (providing that amounts incurred by the committee's professionals in excess of the investigation budget constituted, subject to court approval, allowed administrative expenses); *In re iHeartMedia, Inc.*, No. 18-31274 (MI) (Bankr. S.D. Tex. Jun. 7, 2018) [Docket No. 918] (same); *In re Sandridge Energy, Inc.*, No. 16-32488 (DRJ) (Bankr. S.D. Tex. July 5, 2016) [Docket No. 464] (same); *In re Aegean Marine Petroleum Network Inc.*, No. 18-13374 (MEW) (Bankr. S.D.N.Y. Jan. 15, 2019) [Docket No. 290] (same); *In re Breitburn Energy Partners LP*, No. 16-

11390 (SMB) (Bankr. S.D.N.Y. Aug. 19, 2016) [Docket No. 431] (same); *In re Chemtura Corp.*, No. 09-11233 (REG) (Bankr. S.D.N.Y. Apr. 29, 2009) [Docket No. 281] (same).

E. The Full Range of Adequate Protection Proposed for the Prepetition Lenders is Excessive Under the Circumstances

64. There has been no showing that adequate protection in favor of the Trustee is needed to the extent proposed in the Motion. The Bankruptcy Code only requires debtors to provide a secured creditor with adequate protection to the extent that the automatic stay, the debtors' use of property, or a priming lien "results in a decrease in the value of such entity's interest in such property." 11 U.S.C. § 361(1). The purpose is to protect a secured creditor from diminution in the value of its collateral during the use period. *United Sav. Ass'n v. Timbers of Inwood Forest Assoc.*, 484 U.S. 365, 368 (1988); *In re 495 Central Park Ave. Corp.*, 136 B.R. 626, 631 (Bankr. S.D.N.Y. 1992) (goal is to "safeguard the secured creditor from diminution in the value of its interest"); *Lincoln Nat'l Life Ins. Co. v. Craddock-Terry Shoe Corp. (In re Craddock-Terry Shoe Corp.)*, 98 B.R. 250, 255 (Bankr. W.D. Va. 1988) (finding that what needs to be adequately protected is the decrease in value attributable to the stay arising on the petition date).

65. "[T]he initial burden of showing the need for adequate protection [is] upon the creditor having an interest in the property being used by the debtor. In order to meet this burden, the secured creditor must demonstrate that such relief is required by showing a likelihood that the collateral will decrease in value or establishing some other basis for the relief. The burden then shifts to the debtor to show that adequate protection is not needed or can be provided in a different manner." *Zink v. Vanmiddlesworth,* 300 B.R. 394, 402-03 (N.D.N.Y. 2003) (citations omitted); *see also In re Gunnison Ctr. Apartments,* 320 B.R. 391, 396 (Bankr. D. Colo. 2005) ("The secured creditor 'must, therefore, prove this decline in value—or the threat of a decline—in order to establish a *prima facie* case.'") (quoting *In re Elmira Litho, Inc.*, 174 B.R. 892, 902 (Bankr. S.D.N.Y. 1994)); *In re Continental Airlines, Inc.*, 146 B.R. 536, 539 (Bankr. D. Del. 1992) ("Post-

Timbers courts have uniformly required a movant seeking adequate protection to show a decline in value of its collateral.").

66. Absent diminution, no adequate protection is needed. So, where the lenders' collateral is not diminishing as a result of its use, nothing further is required for adequate protection. *Save Power Ltd. v. Pursuit Athletic Footwear (In re Pursuit Athletic Footwear),* 193 B.R. 713, 716 (Bankr. D. Del. 1996). And, diminution is not equivalent to cash collateral use. A prepetition lender is "not entitled to an adequate protection claim on a dollar-for-dollar basis for cash collateral used during the case." *Official Comm. v. UMB Bank, NA (In re Residential Capital, LLC),* 501 B.R. 549, 596-97 (Bankr. S.D.N.Y. 2013).

67. The Committee does not oppose adequate protection to the Trustee to the extent of any evidentiary supported diminution to the Pre-Petition Collateral securing the Bond Claim in the form of replacement liens in the Debtor's assets of the same nature, kind and character perfected and in existence as of the Petition Date with the same extent, priority, and validity as existed on the Petition Date. The Debtor, however, proposes to grant the Trustee vastly more, including:

- Rollover Liens on all Post-Petition Collateral, including the Unencumbered Assets;
- Supplemental Liens in all assets of the Debtor of any kind or nature whatsoever whether acquired or arising before or after the Petition Date, exclusive of the Charitable Assets and Avoidance Actions;
- Superpriority claims payable from all assets of the estate, including the Unencumbered Assets;
- Discretion to enforce the Disguised Cross-Collateralization provision and repay the Trustee's Pre-Petition Bond Claim ahead of the DIP Facility out of the proceeds of asset dispositions;
- Payment of the fees and expenses of various professionals of the DIP Lender/Trustee;
- Validation of the prepetition liens and claims of the Trustee and broad-ranging releases, subject to a shortened challenge period of 53 days from the date of Committee formation and a modest investigation budget of $25,000;
- Section 506(c) surcharge waivers for the cost of maintaining and disposing the Post-

Petition Collateral for the duration of these cases; and

- Imposition of various Bankruptcy Milestones.

68. This adequate protection package goes well beyond what is necessary and appropriate under the current circumstances of these Chapter 11 Cases. The proposed adequate protection and other lender protections greatly enhance the Trustee's Pre-Petition Collateral position at the expense of unsecured creditors, who are prejudiced by the grant of security interests and superpriority claims payable from the Unencumbered Assets, among other provisions. The payment of the Trustee's costs, expenses and legal fees is also inappropriate in a case where the Trustee's Pre-Petition Bond Claim is clearly undersecured. And as noted previously, the Disguised Cross-Collateralization provision is discrete and indirect form of the prohibited cross-collateralization and roll-up of the prepetition claim that should not be approved under the circumstances. The proposed adequate protection package under the Motion is therefore unbalanced and improper.

F. The Proposed Section 506(c), Equities of the Case, and Marshaling Waivers are Inappropriate Without Taking Into Account Unpaid Administrative Expenses

69. The Debtor proposes to grant complete waivers of section 506(c) surcharge, marshaling, good faith challenge under 364(e), and equities of the case rights under 552(b) as to the DIP Lender/Trustee. Through the section 506(c) waiver, the Debtor would irrevocably waive the estates' rights to charge certain costs or expenses incurred in the administration of these cases against the Post-Petition Collateral and the Trustee's Pre-Petition Collateral, including administrative expense claims that are not currently in the Budget. The surcharge waiver should not be approved unless and until adequate provision has been made for payment of all accrued and unpaid administrative expenses that may be allowed.

i. 506(c) Waiver is Premature and Should be Subject to the Committee's Challenge

70. The effect of the proposed section 506(c) waiver is to eliminate a further avenue of recovery for the Debtor's estates and to create the risk of administratively insolvency, particularly in these cases where the Debtor has admittedly not budgeted for payment of all administrative expenses. This result contravenes the essential purpose of section 506(c). *See Precision Steel Shearing v. Fremont Fin. Corp. (In re Visual Indus.),* 57 F.3d 321, 325 (3d Cir. 1995) ("[S]ection 506(c) is designed to prevent a windfall to the secured creditor . . . The rule understandably shifts to the secured party . . . the costs of preserving or disposing of the secured party's collateral, which costs might otherwise be paid from the unencumbered assets of the bankruptcy estate . . .") (internal citation omitted); *see also In re Codesco, Inc.*, 18 B.R. 225, 230 (Bankr. S.D.N.Y. 1982) ("The underlying rationale for charging a lienholder with the costs and expenses of preserving or disposing of the secured collateral is that the general estate and unsecured creditors should not be required to bear the cost of protecting what is not theirs.").

71. Neither the Committee nor this Court has any assurance as yet that there will be sufficient unencumbered funds available to pay all administrative claims against the Debtor's estates. As other bankruptcy courts have recognized, DIP financing that contains an inadequate budget coupled with a surcharge waiver should not be approved unless modified to provide for payment of administrative claims. *See NEC Holdings Corp.,* Hearing Tr. at 108:1-5 [Docket No. 224],Case No. 10-11890 (PJW) (Bankr. D. Del. Jul 13, 2010) ("I need some evidence that there's a probability that admin claims are going to be paid in full, including 503(b)(9) claims or I won't approve the financing."); *Hartford Fire Ins. Co. v. Northwest Bank Minn. (In re Lockwood Corp.),* 223 B.R. 170, 176 (8th Cir. B.A.P. 1998) (holding that provision in financing order purporting to immunize the postpetition lender from section 506(c) surcharge was unenforceable); *In re Colad Group, Inc.*, 324 B.R. 208, 224 (Bankr. W.D.N.Y. 2005) (refusing to approve postpetition financing agreement to the extent that the agreement purported to modify statutory rights and

obligations created by the Bankruptcy Code by prohibiting any surcharge of collateral under section 506(c)).

ii. Waiver of Marshaling Remedy is Not Justified and Should be Subject to the Committee's Challenge

72. The proposed Final Order also would restrict this Court's ability to implement equitable marshaling as to the DIP Lender/Trustee. The waiver of any marshaling requirements is prejudicial because the lenders should be required to exhaust remedies from the Trustee's Pre-Petition Collateral before turning to any other assets. Marshaling "prevent[s] the arbitrary action of a senior lienor from destroying the rights of a junior lienor or a creditor having less security." *Meyer v. United States*, 375 U.S. 233, 237 (1963). The application of the marshaling doctrine is available to benefit unsecured creditors in bankruptcy since the bankruptcy estate can assert this state-law doctrine by virtue of the strong-arm powers under section 544(a), which grant the estate the status of a judicial lien creditor. *See, e.g., Kittay v. Atl. Bank of N.Y. (In re Global Serv. Grp. LLC)*, 316 B.R. 451, 463 (Bankr. S.D.N.Y. 2004) ("The trustee has standing to invoke marshaling because he has the status of a hypothetical lien creditor."); *Official Comm. of Unsecured Creditors v. Judson United Bank (In re America's Hobby Ctr., Inc.)*, 223 B.R 275, 287 (Bankr. S.D.N.Y. 1998) (same). Official committees can stand in the shoes of the debtor in possession to pursue marshaling rights on behalf of the estate for the benefit of all unsecured creditors. *See, e.g., America's Hobby Ctr.*, 223 B.R. at 287 & n.6 (citing *Unsecured Creditors Comm. of Debtor STN Enters., Inc. v. Noyes (In re STN Enters)*, 779 F.2d 901 (2d Cir. 1985)).

73. Marshaling may be a key remedy in ensuring that unsecured creditors do not bear the brunt of the expense of these cases while having no certainty as to their own distributions under the Plan. *See Official Comm. v. Hudson United Bank (In re America's Hobby Center)*, 223 B.R. 275, 287 (Bankr. S.D.N.Y. 1998); *Ramette v. United States (In re Bame)*, 279 B.R. 833 (8th Cir. B.A.P. 2002) (marshaling doctrine invoked against taxing authorities to benefit estate's unsecured

creditors). Further, marshaling could prove valuable in ways that cannot currently be predicted. It may, for instance, assist unsecured creditors in realizing value from avoidance actions or asset sales. Waiving the doctrine at the outset of these cases is unwarranted. Based on the case timeline imposed by the Bankruptcy Milestones, the rationale for marshaling may become apparent in the near-term. Unsecured creditors should not be prejudiced in the meantime, and their right to seek marshaling as a potential remedy should not be waived.

iii. Equities of the Case and Good Faith Have Yet to be Determined and Should be Subject to the Committee's Challenge

74. Finally, the Debtor proposes that the "equities of the case" exception under section 552(b) not apply to the Trustee and that the DIP Lender be afforded irrevocable good faith status under 364(e). Both of these forms of relief should be expressly subject to the Committee's Challenge. These forms of relief hinge entirely on the equitable conduct of the DIP Lender/Trustee, but the Committee has not yet been afforded an opportunity to conduct its statutory right to investigate the DIP Lender/Trustee to confirm the same. The "equities of the case" exception in section 552(b) of the Bankruptcy Code allows a debtor, committee, or other party in interest to exclude postpetition proceeds from the Trustee's Pre-Petition Collateral on equitable grounds, including to avoid having unencumbered assets fund the cost of a secured lender's foreclosure. "'The purpose of the equity exception is to prevent a secured creditor from reaping benefits from collateral that has appreciated in value as a result of the trustee's/debtor-in-possession's use of other assets of the estate (which normally would go to general creditors) to cause the appreciated value.'" *In re Muma Servs.,* 322 B.R. 541, 558-559 (Bankr. D. Del. 2005) (quoting *Delbridge* v. *Prod. Credit Ass'n & Fed. Land Bank,* 104 B.R. 824, 826 (E.D. Mich. 1989)).

75. The "equities of the case" exception exists to "prevent secured creditors from receiving windfalls and to allow bankruptcy courts broad discretion in balancing the interests of

secured creditors against the general policy of the Bankruptcy Code." *In re Cafeteria Operators, L.P.*, 299 B.R. 400, 409 (Bankr. N.D. Tex. 2003) (quoting *In re Patio & Porch Sys. Inc.*, 194 B.R. 569, 575 (Bankr. D. Md. 1996)); *In re Muma Servs.*, 322 B.R. 541, 558-59 (Bankr. D. Del. 2005) (quoting *Delbridge v. Prod. Credit Ass'n & Fed. Land Bank*, 104 B.R. 824, 826 (E.D. Mich. 1989)) ("The purpose of the equity exception is to prevent a secured creditor from reaping benefits from collateral that has appreciated in value as a result of the trustee's/debtor-in-possession's use of other assets of the estate to cause the appreciated value.").

76. A prospective waiver of the "equities of the case" exception contained in section 552(b) of the Bankruptcy Code is inappropriate where—as is the case here—unsecured creditor recoveries are uncertain. The Court should not approve the waiver of the exception as to the Committee. *See In re Metaldyne Corp.*, No. 09-13412 (MG), 2009 WL 2883045, at *6 (Bankr. S.D.N.Y. June 23, 2009) (holding, in the context of a proposed Bankruptcy Code section 552(b) waiver, that "the waiver of an equitable rule is not a finding of fact and the Court, in its discretion, declines to waive prospectively an argument that other parties in interest may make"); *see also In re iGPS Co. LLC*, No. 13-11459 (KG) (Bankr. D. Del. July 1, 2013) [Docket No. 225] (no waiver of the "equities of the case" exception with respect to creditors committee).

77. There is no reason to waive such rights here, especially given that the value of the Trustee's Pre-Petition Collateral is substantially underwater, and the Debtor's postpetition services (as opposed to sales of inventory) generate the bulk of the Debtor's revenues. *See, e.g., In re Metaldyne Corp.*, 2009 WL 2883045, at *6 (Bankr. S.D.N.Y. June 23, 2009) ("[T]he Court, in its discretion, declines to waive prospectively an argument that other parties in interest may make. If, in the event, the Committee or any other party [in] interest argues that the equities of the case exception should apply to curtail a particular lender's rights, the Court will consider it."); *Sprint Nextel Corp. v. U.S. Bank Nat'l Ass'n (In re TerreStar Networks, Inc.)*, 457 B.R. 254, 272-73

(Bankr. S.D.N.Y. 2011) (request for section 552(b) waiver was premature because factual record not fully developed).

78. In *In re Sports Authority Holdings, Inc.*, Hr'g Tr. at 195:6-16, Case No. 16-10527 (MFW) (Bankr. D. Del. Apr. 26, 2016), the debtors requested approval of a DIP facility that rolled up the entire prepetition secured debt, proposed to pay off the prepetition lenders immediately upon an expedited sale, granted the DIP lenders a surcharge waiver, and did not adequately fund the payment of administrative and priority claims, including rent and 503(b)(9) claims. In denying the surcharge waiver, Judge Walrath ruled:

> But in a case where the landlords and other administrative claims are clearly not budgeted or being paid while the landlord—excuse me, while the secured lenders' collateral is being liquidated and their secured claim is being paid, I have a serious problem with that. And I think the fix is no 506(c) waiver for anybody. And to the extent that administrative claims are not paid at the end of this case, there will be a claim against the lenders for those costs under 506(c) to the extent they were necessary for the preservation or realization of their collateral.

Id.

79. Similarly here, it is unreasonable to ask unsecured creditors to fund any shortfall in the Budget through the estates' waiver of important creditor protections. At least one court has even refused to enforce such waivers after they were granted. *Hartford Fire Ins. Co. v. Norwest Bank Minn. (In re Lockwood Corp.),* 223 B.R. 170, 176 (BAP 8th Cir. 1998) (holding that provision in financing order purporting to immunize the postpetition lender from section 506(c) surcharge was unenforceable). In sum, the proposed waiver of section 506(c), marshaling, the equities of the case rights under 552(b), and the irrevocable grant of good faith status under 364(e) pursuant to the DIP Facility are inappropriate without adequately taking into account estate remedies and where, as here, no provision has been made for payment of all accruing administrative expenses against the Debtor.

G. Other Objections

80. The Committee has various additional objections to the proposed DIP Facility:

- ***Credit Bid Rights***. The Trustee's and DIP Lender's rights (if any) to credit bid on the sale or other disposition of their collateral must be conditioned expressly on the provisions, limitations and parameters contained in 363(k) (including the case law progeny of the same) and be subject to the Committee's Challenge.

- ***Budgets and Committee Reporting Rights***. The Committee must be granted notice of any new budgets and provided concurrently with all financial reporting delivered to the DIP Lender/Trustee. Further, the Committee should have access to an Excel working model of the Budget, including all supporting schedules and underlying assumptions.

- ***Lender Remedies***. The remedies notice period of five (5) days is too short and must be extended to at least fifteen (15) business days. Further, the Debtor's authority to use Cash Collateral should not be terminated immediately upon the occurrence of an alleged Event of Default. The Debtor should be authorized to continue to pay ordinary course budgeted expenses during the remedies notice period. There also should be no limitation on what issues may or may not be raised at an emergency hearing by the Debtor or the Committee if an alleged Event of Default occurs. It should also not be an Event of Default in the event a Challenge is brought. The Trustee should not be able to deter the Committee from conducting a legitimate and comprehensive investigation and bringing any potential Challenge by threatening to shut the case down through terminating the funding of the DIP Facility in the event the Committee is required to fulfil its fiduciary duty to the estate. This is an inequitable attempt to chill the Committee's investigation.

- ***Budget / Carve Out for Committee Fees***. The line item for Committee professional fees in the Budget [redacted] must be increased substantially, commensurate with the professional fees of Debtor and DIP Lender/Trustee professionals. Additionally, the post-Termination Date professional fee cap should be increased from $300,000 to $800,000. Finally, no changes should be made to the Budget without prior approval of the Committee or Court order.

- ***Debtor Stipulations***. The Debtor's stipulations in the Final Order should be made expressly subject to the Committee's Challenge.

- **Disgorgement/Challenge**. All rights of the Committee should be specifically preserved to challenge the liens and claims of the Trustee with respect to the DIP Facility and, in the event of a successful challenge, to unwind such roll-up or to seek disgorgement of any amounts paid to the Trustee by the Debtor.

- ***DIP Amendments***. The Committee should be provided with advance notice of and an opportunity to object to any amendments to the terms of DIP Loan Documents, including the Budget.

- ***Diminution in Value***. The Final Order contains a sentence that should be deleted to the effect that the funding of the DIP Loan and use of Cash Collateral constitutes a diminution in value of the Trustee's Pre-Petition Collateral. All rights should be reserved with respect to any potential diminution claim that may be asserted in the future by the Trustee.

- ***Standing and Discovery***. In light of the expedited timeline for these cases and the shortened Investigation Period, it is inappropriate to require the Committee to obtain standing before contesting the Debtor's stipulations or require the Committee to undergo a contested Rule 2004 motion proceeding. The Court,

therefore, should require the Debtor to provide the Committee with the authority to conduct discovery commensurate with the scope of the investigation and standing on behalf of the estates to pursue claims and causes of action related to the Debtor's stipulations.

- ***Maturity Date***. To the extent the Bankruptcy Milestones are subsequently amended and the Plan's effective date is extended beyond the DIP Facility's current Maturity Date of December 31, 2022, the Maturity Date should automatically be extended to ensure the Debtor has sufficient funding to finance operations through the Plan's effective date.

V.
RESERVATION OF RIGHTS

81. The Committee expressly reserves all rights, claims, defenses, and remedies, including, without limitation, to supplement and amend this Objection (with such supplements and/or amendments relating back to the date this Objection was originally filed), to raise further and other objections to the Motion and the form of Final Order, including any additional authorities and/or factual allegations, and to introduce evidence prior to or at the Final Hearing in the event that the Committee's objections are not resolved prior to such hearing. Specifically, the Committee is continuing to review and consider the Bankruptcy Milestones and the economics underlying the DIP Facility.

VI.
CONCLUSION

82. For the foregoing reasons, the Committee respectfully requests that the Court deny the Motion and decline to enter the Final Order in the form presented unless and until the Committee's objections set forth herein have been adequately addressed.

[Signature page to follow]

Dated: May 19, 2022

Respectfully submitted,

FOLEY & LARDNER LLP

/s/ Thomas C. Scannell

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PROPOSED COUNSEL FOR THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served electronically by the Court's PACER system on May 19, 2022.

/s Thomas C. Scannell
Thomas C. Scannell

Long Term Cash Flow Budget

[redacted]