Webinar | October 14, 2021

Anatomy of the Hertz Chapter 11

CLE Material

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Table of Contents

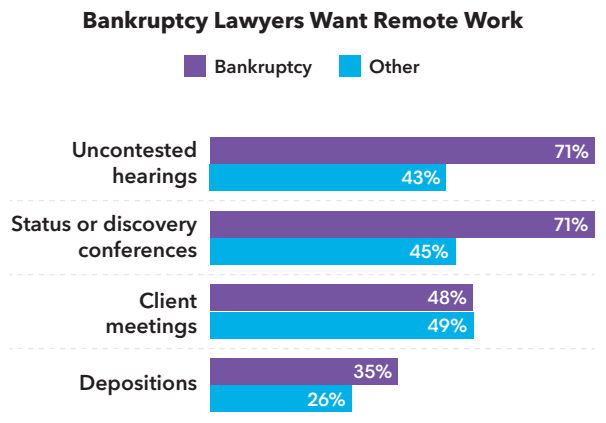
ANALYSIS:

Bankruptcy Attorneys Are in No Rush to End Remote Work

by Jacquelyn Palmer, Research and Data Analyst
Teadra Pugh, Legal Analyst
July 26, 2021

Some law firms are feeling **new pressure** to call their attorneys back into the office. If this becomes a **widespread trend**, return-to-office mandates could hit bankruptcy attorneys particularly hard.

Based on results from Bloomberg Law's Remote Practice 2021 Survey, which asked attorneys for their views on the future of remote work in the legal industry, bankruptcy practitioners seem more ready to welcome a virtual future than attorneys in other practice areas. Although fewer than half of all non-bankruptcy respondents said they want remote options to continue for uncontested hearings and status or discovery conferences, a full 71% of bankruptcy lawyers said they would like to see those tasks remain available through remote work, even after social distancing restrictions are lifted.



Source: Bloomberg Law's Remote Practice 2021 Survey. Respondents were asked which types of work they would like to continue to be offered remotely after social distancing restrictions are lifted. Respondents were shown additional options; the graphic above displays the top four options. Respondents were asked to select practice areas, and had the option to select multiple areas. The Bankruptcy group includes those who selected Bankruptcy as a practice area, and the Other group includes all others.

Why would bankruptcy lawyers find remote work a good fit? For one thing, bankruptcy, by definition, is an area of law with limited resources. Prior to the pandemic, bankruptcy courts routinely held cattle call-type hearing dates where all Chapter 11 or Chapter 13 hearings were heard. Attorneys could wait in the courtroom for hours for their case to be called. Attorneys could save time—and therefore their clients' money—by practicing remotely.

Also, bankruptcy law itself is changing. Bankruptcy attorneys have a reputation as old curmudgeons who are slow to embrace change. While that may have been true in the past, the bankruptcy bar of today is a more diverse one, with attorneys of all ages and backgrounds. In 2020, we learned that nearly **two-thirds** of bankruptcy practice groups are expanding and many are even recruiting new blood from other practice groups. Embracing change in practitioners might be fostering a coinciding embrace of a change in practice.

Finally, while there are some bad apples, bankruptcy attorneys are generally congenial in and out of the courtroom. The bankruptcy bar in most jurisdictions remains comparatively small, making for a more intimate community. Practitioners will frequently work with and across from the same attorneys and the same judges repeatedly, often all in the trenches together trying to create something from nothing. Working together so closely often fosters a sense of familiarity and trust. This unique bond in the bankruptcy bar could make bankruptcy attorneys' virtual work as effective as in-person work.

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*Bloomberg Law subscribers can find related content on our **Surveys, Reports & Data Analysis** page.*

ANALYSIS:

Summer Surge May Not Stave Off Storm of Bankruptcies

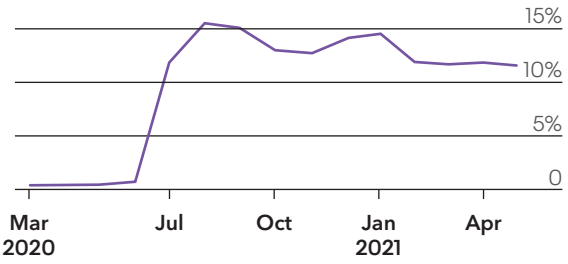
by Jeffrey P. Fuller
Legal Analyst
May 28, 2021

The hotel industry, despite being hard-hit by the pandemic, has not seen as many Chapter 11 bankruptcy filings as you might have expected. Most of the cases have been smaller, often filed by franchisee-owners. Larger companies have mostly been able to avoid a trip to bankruptcy court. Currently, cases appear to be declining, possibly in anticipation of a surge in pent-up travel demand. But while expectations of a glorious summer may be keeping hotel bankruptcy filings low for now, the more distant future might not be so bright.

Foreboding Delinquencies

Pandemic-related closures and travel restrictions have battered the hospitality sector considerably over the past several months. Bloomberg data shows that hospitality-related commercial real estate loans have been more than 90 days delinquent at a **higher rate than any other CRE type**, indicating an increased likelihood of loan defaults. This percentage has remained at or above 11% since July 2020, raising the question of whether a summer surge in bookings will be enough to reverse this situation.

Delinquency Rate for Hospitality CRE Loans Remains High
Hospitality Commercial Real Estate Loans Delinquent for 90 Days or More, March 2020-May 2021



Source: Bloomberg Terminal. Percentage for May 2021 is as of May 27, 2021.

Even though CRE hospitality loans are experiencing a sustained delinquency rate, this has not translated into a high number of large hotel bankruptcies—at least not yet. You'd expect that many of these delinquent loans will be in default and that, of those, many will culminate in Chapter 11 bankruptcy cases. However, the filing data tells a different story.

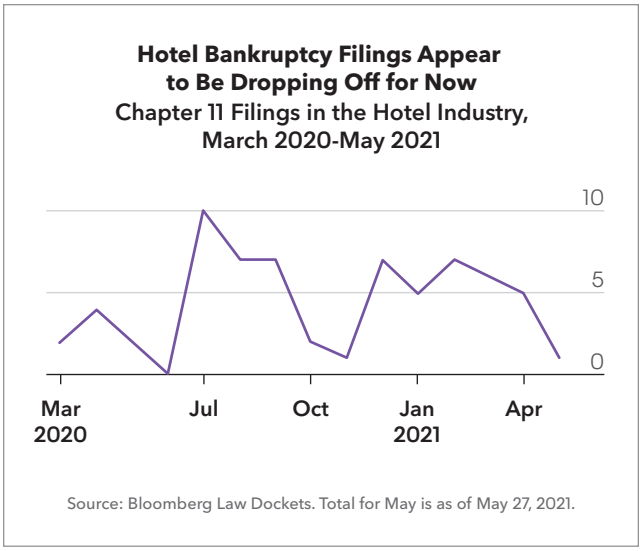
A review of Chapter 11 hotel bankruptcies (including Subchapter V) filed since March 2020 reveals that most of the debtors have been smaller companies, often hotel franchisee-operators. Fewer than 10% of the cases filed have more than $100 million in liabilities. And more than half of the hotel cases filed have between $1 million and $10 million in liabilities.

It is not completely clear why there haven't been as many larger hotel bankruptcies as predicted. Here are some possible explanations: Companies and their lenders are engaging in forbearance, workouts, and out-of-court restructurings. Lenders may be willing to wait and see what will happen after the anticipated surge in travel before resorting to default remedies. Lenders may also be hoping for better values for their loans and/or collateral in the future.

Riding the Wave

Chapter 11 hotel bankruptcies overall have gone through a couple of waves since March 2020, and it's unclear why filings declined last fall. One possible explanation is that the initial wave included hotels that had existing defaults or problems prior to the pandemic and that needed to file despite government relief or a desire to wait for reopenings. Hotels and their lenders also might have wanted to wait and see what holiday bookings would do for their financial situation.

The second wave of filings shows an increasing pace in late 2020 through early 2021, but a dramatic dropoff within the last month. There has only been a single Chapter 11 hotel case filed in May thus far: **Hospitality Investors Trust Inc.**, a real estate investment trust that indirectly owns or has an interest in 100 hotels nationwide.



The increase in hotel bankruptcies in late 2020 and early 2021 might be due to fear that a window was about to close for some debtors to file Chapter 11 cases under **Subchapter V**. Smaller hotel debtors may have wanted to take advantage of the relatively new Subchapter V, which has some legal and procedural advantages for small businesses that are not available in a traditional Chapter 11 case.

In light of the pandemic, Congress enabled more debtors to be eligible for this subchapter by temporarily increasing the $2,725,625 debt limit to $7.5 million. This new debt limit was originally set to expire in March, but Congress extended it for another year at the very last minute. Leading up to the extension, debtors that may have been just above the original debt limit might have chosen to move forward with a Subchapter V case rather than take their chances with a regular Chapter 11. This might explain the wave of hotel filings in late 2020 and early 2021. Paycheck Protection Program (PPP) loans and other government stimulus initiatives may also be saving these companies from bankruptcy for the time being.

While it appears that Chapter 11 hotel filings are quieting down for now, a third wave may be on its way.

Summertime Salvation?

With the availability of vaccines and the resulting elimination of social distancing and travel restrictions, the hotel industry is hoping for a summertime surge in demand and a reversal of the losses suffered during the pandemic. For some hotels, increased bookings may help bring them back to brighter days; however, others may be stuck in the eye of the storm.

Certain hotels may be vulnerable to trends that existed prior to the pandemic, in addition to the permanent changes the pandemic has likely brought to the travel economy. The challenges hotels face include the following:

- Hotels lost entire months of bookings under mandated shutdown orders and canceled events. Once the pandemic is less of a factor, lenders may lose patience with companies that are behind on their debt obligations
- Hotels located in cities where there is oversupply may have a difficult time recovering. New York City, for example, was reporting an oversupply of hotels prior to the pandemic and even quite a few hotels under construction.
- Airbnb and other vacation rental platforms remain a disruptive force, even though they too have suffered under the pandemic.
- Business travel may also be changed permanently due to the pandemic. Companies that have become accustomed to a year of videoconferencing may be impressed with the significant cost savings of a reduced travel budget. So hotels may find that business travelers won't be returning in the same numbers as they did prior to the pandemic.

Welcome to the Hotel California?

Like the classic Eagles song portends, hotels themselves may feel like living it up in this summer of increased bookings. But by early winter, we should begin to learn which hotels were saved by the summer and which ones will need Chapter 11 relief. The summer of reopening might be a time for hotels to check out and enjoy if they like, but the long-term impact of these challenges could leave them trapped in a financial nightmare that they can never leave.

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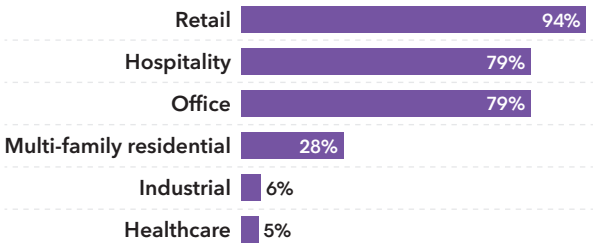
ANALYSIS:

CRE Survey Respondents Expect More Office Defaults

by Jacquelyn Palmer, Research and Data Analyst
Teadra Pugh, Legal Analyst
June 17, 2021

In Bloomberg Law's 2021 Commercial Real Estate Bankruptcy Survey, we asked attorneys which commercial real estate (CRE) property types would see the most defaults in 2021. So far this year, data on delinquent CRE loans show some similarities—and one key difference—when compared with the attorneys' predictions.

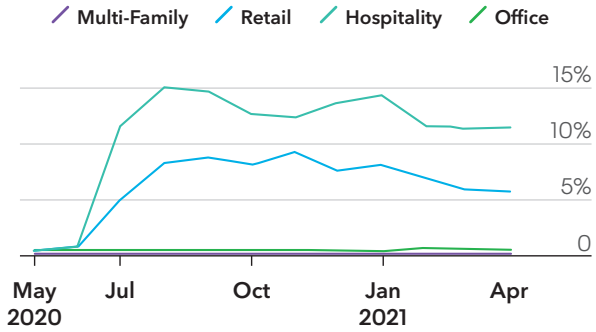
Which CRE Type Do You Anticipate Will See the Most Defaults in 2021?



Source: Bloomberg Law 2021 CRE Bankruptcy Survey (conducted March-April 2021). Respondents were asked to select the top three property types for 2021 defaults.

Respondents most often selected retail, hospitality, and office among their top three choices for 2021 defaults. The first two are not surprising, as pandemic-related distress in retail and hospitality has been high-profile in the last several months. Interestingly, an equal percentage of respondents selected office as selected hospitality for one of the top three defaulting property types. Cancellation of office leases and potential vacancies caused by permanent moves to remote work might be behind this choice.

Hospitality, Retail Have CRE's Highest 90-Day Delinquency Rates
Percentage of 90-Day Delinquencies on CRE Loans, May 2020-April 2021



Source: Bloomberg Terminal – data current through April 30,2021.

While retail was the most frequently identified property type for defaults, actual delinquency percentages tell a slightly different story. (While delinquency does not necessarily equate to default, loans more than 90 days delinquent indicate economic distress and are at an increased likelihood of default.) Analyzing the percentage of 90-day delinquencies in each CRE property type using Bloomberg Terminal data (<REDQ>) reveals that hospitality and retail are at the top of the list, although the rates for both have decreased somewhat since January. Meanwhile, the office delinquency rate has stayed far below those for retail and hospitality. For example, the highest delinquency rate for office since May 2020 was only 0.72%, in March 2021.

As 2021 continues, delinquencies in hospitality and retail might decline even further as travel and shopping return to pre-pandemic levels and properties experience better cashflow. While office doesn't show the levels of distress that the survey respondents predicted, this could change as the year progresses, especially if businesses embrace remote work and decide that they won't need as much office space in the future.

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ANALYSIS:

CAA 2021 Benefits Tenants Over Landlords, Lawyers Say

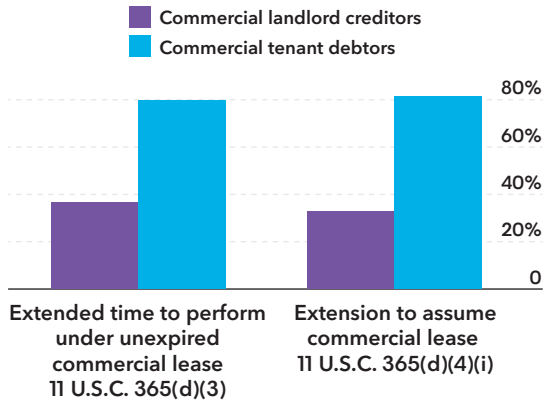
by Jacquelyn Palmer, Research and Data Analyst
Teadra Pugh, Legal Analyst
June 17, 2021

After the Consolidated Appropriations Act of 2021 (CAA 2021) was signed into law last December, bringing several new and temporary amendments to the Bankruptcy Code, some bankruptcy attorneys were **optimistic** that the provisions specifically designed to address commercial real estate (CRE) leases would be a boon to CRE landlords and tenants alike. However, **we predicted** in January that the provisions provided by the CAA 2021 would be of minimal benefit to landlords.

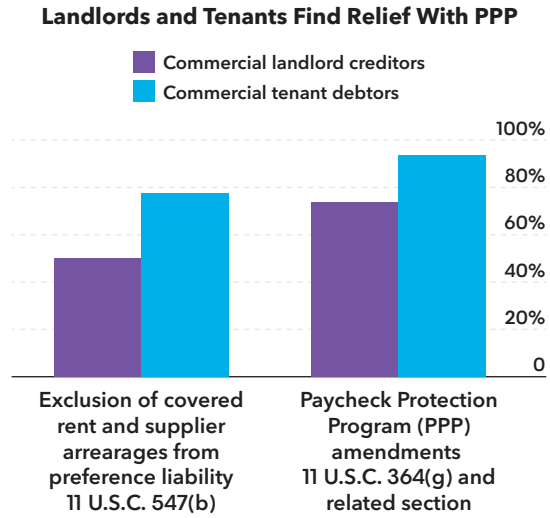
To understand how the CAA 2021 has impacted tenants and landlords, Bloomberg Law's **CRE and Bankruptcy 2021 Survey**, conducted in April, asked bankruptcy lawyers how helpful certain provisions to the CAA 2021 have been for their CRE landlord and tenant clients. Results from our survey show that, overall, the landlord creditors have benefited less from these amendments than tenants have.

In particular, bankruptcy-specific provisions of the CAA 2021 addressing assumption or rejection of CRE leases had minimal impact on landlords. Survey results illuminate a stark divide between how the provisions have affected landlord creditors and their bankrupt tenants. More than four-fifths of tenant debtors found helpful the provisions extending the time that debtors have to accept or reject their lease and the time Subchapter V small business debtors have to make lease payments. In sharp contrast, landlord creditors were less than impressed with those same amendments, with fewer than two-fifths reporting the same provisions to be helpful.

Even the provision **purporting** to be the most landlord-friendly, which excludes past-due rent payments from preference liability, had lackluster results: Only half of respondents report this exclusion was helpful to their landlord creditor clients.



Source: Bloomberg Law's Commercial Real Estate (CRE) and Bankruptcy Survey 2021. Respondents were asked to rate how helpful provisions from the Consolidated Appropriations Act (CAA) 2021 have been to each party. The data above show the percentage of respondents that reported 'Very helpful' or 'Somewhat helpul.'



Source: Bloomberg Law's Commercial Real Estate (CRE) and Bankruptcy Survey 2021. Respondents were asked to rate how helpful provisions from the Consolidated Appropriations Act (CAA) 2021 have been to each party. The data above show the percentage of respondents that reported 'Very helpful' or 'Somewhat helpul.'

The silver lining for CRE landlords might lie in non-bankruptcy-specific relief. Respondents overwhelmingly report that the amendment to **11 U.S.C. § 364(g)** and related provisions extending Paycheck Protection Program (PPP) loan eligibility to some Chapter 11 debtors exiting bankruptcy were beneficial to their tenant debtor and landlord creditor clients.

ANALYSIS:

Five Ways to Prepare for Increased Chapter 9 Filings

by Jeffrey P. Fuller
Legal Analyst
July 1, 2021

Three municipalities have filed for Chapter 9 bankruptcy within the last two months—a **county airport**, a **power authority**, and a **student housing authority**—and all cited Covid-19 as a contributing cause. That's more municipal bankruptcy filings than in the entire first 12 months of the pandemic. The economic effects of the pandemic and **increased municipal bond defaults** will likely only heighten awareness of municipal distress. Accordingly, bankruptcy attorneys might start getting approached more often by clients with Chapter 9 questions.

Below are five ways bankruptcy attorneys can prepare and strengthen their knowledge of this lesser-known chapter of the Bankruptcy Code.

1. **Determine whether Chapter 9 is even possible in your state.** For constitutional reasons, a municipality can file a Chapter 9 bankruptcy only if its state authorizes it. Only 28 states expressly authorize Chapter 9, many with stringent restrictions. 21 have no laws authorizing Chapter 9 filing, and one (Georgia) expressly prohibits it.

2. **Understand the pre-filing work needed** for Chapter 9 **eligibility requirements**. Attorneys representing potentially interested parties should understand the pre-filing work that a Chapter 9 debtor must undertake, and what must be done for the case to survive motions to dismiss.

3. **Research the differences between Chapter 9 and Chapter 11.** Chapter 9 **incorporates** many Bankruptcy Code provisions that are applicable in Chapter 11, including the automatic stay, ability to recover avoidable transfers, and plan confirmation requirements. However, other provisions are not included, often for constitutional reasons. Accordingly, municipalities often do not need court approval for actions that would otherwise require it in Chapter 11. For more, see Bloomberg Law's **Comparison Table – Chapter 11 & Chapter 9 Bankruptcy** and **Comparison Table – Chapter 11 & Chapter 9 Plan Confirmation**.

4. **Review the dockets of past Chapter 9 cases.** Take note of how the **cases developed** and which issues typically arose.

5. **Take a look at Puerto Rico.** It may be helpful to research cases under the **Puerto Rico Oversight, Management and Economic Stability Act (PROMESA)**, a federal law enacted in 2016 to address the Puerto Rico debt crisis. The law has similar statutory language to Chapter 9 of the Bankruptcy Code. Because of this, courts may use PROMESA cases to interpret similar statutory language within Chapter 9.

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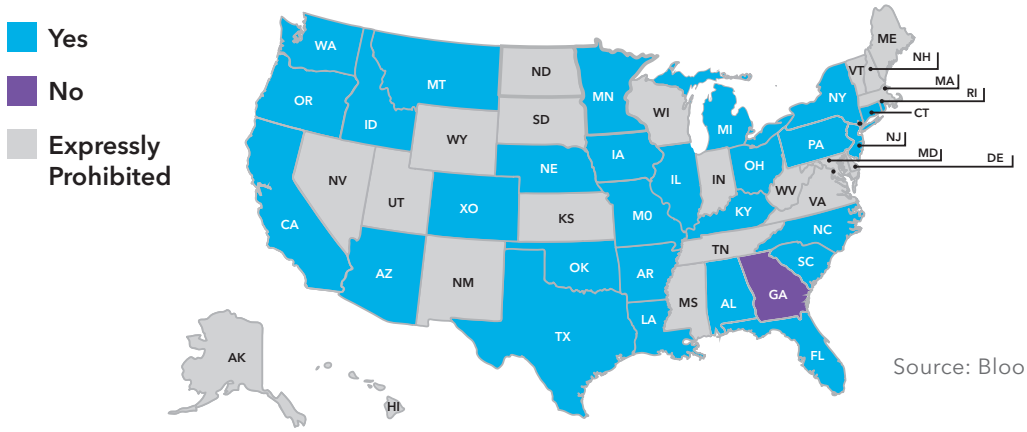
*Bloomberg Law subscribers can find related content in the Chapter 9 materials on our **Bankruptcy Practice Center** resource.*

Only 28 States Expressly Authorize Chapter 9 FIlings



Source: Bloomberg Law

ANALYSIS:

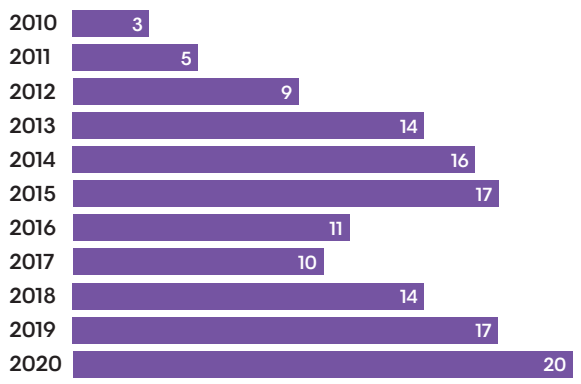
For Rural Hospitals, Stimulus Cash Might Not Be Enough

by Jeffrey P. Fuller
Legal Analyst
March 30, 2021

Rural hospitals have been closing at an alarming rate. Before last year, these hospitals were already struggling, but the Covid-19 pandemic has only made their bad financial situation worse. Although rural hospitals may currently have cash on hand from government aid, and more stimulus aid is on the way, many of them may still face closure this year unless additional help is provided. While some of these hospitals may end up turning to Chapter 11, restructuring costs may be too burdensome for others.

Pre-Pandemic Peril

Even before the Covid-19 pandemic, many rural hospitals were navigating financial distress. According to data compiled by the Cecil G. Sheps Center for Health Services Research, 136 rural hospitals closed in 2010–2020. Twenty of those occurred in 2020, a record number. But the upward trend was already in play: Seventeen rural hospitals closed in 2019, up from 14 in 2018 and 10 in 2017.



Source: The Cecil G. Sheps Center for Health Services Research.

Because of their locations, these hospitals treat fewer patients than their urban counterparts. Rural patients are more likely to be uninsured or underinsured, have chronic medical conditions, and use the emergency room for routine services. These patients are also more likely to be older, poorer, and, accordingly, more reliant on Medicare or Medicaid. Indeed, the American Hospital Association (AHA) has found that a large percentage of rural hospital revenue comes from Medicare and Medicaid. This all makes for a situation with tight margins and limited profitability.

A Bad Situation Made Even Worse

The pandemic has presented a whole new set of financial challenges for all hospitals. While hospitals may admit their share of Covid-19 patients, their elective surgeries have been canceled, removing a profitable source of revenue. The effects of the pandemic have also contributed to a decrease in emergency room traffic.

The AHA estimates that hospitals overall lost about $323 billion in revenue last year and are expected to lose between $53 and $122 billion in 2021. All of these factors have hit rural hospitals especially hard, since they often rely on elective procedures and emergency room visits for their income.

The impact of a rural hospital's closure can be devastating on its community. Not only does such an event require residents to travel further for medical care, but it also can mean a significant loss of jobs in the area as well as loss of income for area businesses that may supply goods and services to the hospital.

Temporary Relief, But Danger Ahead

The recently passed American Rescue Plan Act of 2021 will provide a measure of relief, including $8.5 billion in assistance to rural health care providers for Covid-related expenses and lost revenue and $500 million to the Department of Agriculture to provide rural hospital grants for Covid-related expenses, vaccine distribution, and telehealth improvements.

However, organizations such as the AHA wish the bill had provided more funding for the Provider Relief Fund, extended relief from sequestration-related cuts to Medicare (although this is now being addressed in a bill making its way through Congress with strong bipartisan support), and granted loan forgiveness for the accelerated payments Medicare provided to hospitals in 2020. It remains to be seen how much the latest stimulus will help prevent hospital closures.

Rural hospitals might actually be sitting on a good deal of cash right now, but this situation will not last. John Tishler, a partner at **Waller Lansden Dortch & Davis LLP**, explained to me that these funds consist of government funding, including money from the Centers for Medicare and Medicaid Services Accelerated Payment Program, which has advanced $85 billion to hospitals. Unfortunately, this positive cash situation is not going to last. Tishler observed that the hospitals have to start paying the accelerated payments back in August. The accelerated payments are a loan that must be repaid in full.

Rural Hospitals in Chapter 11: A Solution for Some

While other types of businesses turn to Chapter 11 to restructure, reorganize, or sell their company, that may be a harder road to travel down for rural hospitals.

It's true that, in the past few years, some prominent rural hospital chains have sold assets or reorganized successfully in Chapter 11. In late 2018 and 2019, hospital and nursing home operator **Promise Healthcare Group LLC** sold several of its hospitals and confirmed a plan of liquidation. More recently, **Quorum Health Corp**., a for-profit corporation that operates 23 hospitals and seven outpatient centers, confirmed a $1.3 billion restructuring plan. While Quorum filed in the early months of the pandemic, it was also fortunate enough to arrive in bankruptcy with a Restructuring Support Agreement with its lenders in hand.

But for standalone hospitals, executing a successful Chapter 11 case is a much more difficult proposition, because they cannot share restructuring costs across a network of hospitals. There have been some success stories, however. In late 2020, **Penobscot Valley Hospital**, a 25-bed critical access hospital in Lincoln, Maine, confirmed a Chapter 11 plan that restructured debt.

Things did not go as well for **Williamson Memorial Hospital** in Williamson, W.V. It filed a Chapter 11 case in 2019. The hospital was sold in a bankruptcy court-approved sale, but because of lost revenue due to the Covid-19 crisis, the debtor had to shut the hospital down prior to the closing of the sale. Fortunately, the purchaser still closed the sale and took the physical assets of the hospital, seeking to provide health care services to the community in the hospital's former location. However, even with the sale proceeds, the bankruptcy case ended up converting to Chapter 7 under the weight of administrative expenses.

Many rural hospitals simply do not have the financial wherewithal to execute a successful Chapter 11 case. A lot of these hospitals may not have interested buyers waiting in the wings. For every standalone hospital that manages to file a Chapter 11 case, many more will opt to shut down completely unless their economic situation changes.

The solution to rural hospital distress may lie instead with stronger Medicare and Medicaid reimbursement, government aid, charitable enterprise, or innovative changes that can keep these hospitals open to the communities that so desperately need them.

Legislators in Congress are recognizing that more needs to be done to help rural hospitals. For example, Congress is taking action to extend the moratorium on sequester-related cuts to Medicare in a **bill with strong bipartisan support**. Additionally, Representatives Terri Sewell (D-Ala.) and Tom Reed (R-N.Y.) have proposed the **Rural Hospital Support Act**, a bill which seeks to assist hospitals that depend on Medicare for their income. The bipartisan nature of this bill bodes well for its passage. Working together to modernize and strengthen rural healthcare may end up saving hospitals from shutting down completely and will ultimately save lives.

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*Bloomberg Law subscribers can find related content on our **In Focus: Business Closure** page.*

CHECKLIST:

Pre-Petition Creditor's DIP Finance Motion Review

Editor's Note: The terms of debtor's post-petition financing often have far-reaching implications for pre-petition creditors. Depending on the structure of the DIP financing, pre-petition creditors could see repercussions ranging from diminished potential distribution through the debtor's plan to priming of a secured pre-petition creditor's lien. See **Overview – Debtor-in-Possession Financing; Form – Motion to Approve DIP Financing**. The following is a checklist to assist creditors and creditors' counsel in reviewing a DIP financing motion to determine the impact of the post-petition debt on the pre-petition creditor's claim.

- ❑ **Hearing Date.** A DIP Financing motion may only be granted upon notice and hearing. **11 U.S.C. § 364**. Initial motions for interim relief are usually filed on an emergency basis and hearings held on extremely shortened notice, sometimes as short as one day. Refer to **local rules** throughout your review as they will often address debtor-in-possession financing motions and orders and many provide a list of acceptable and inappropriate provisions that may be included on an emergency or shortened-notice basis.

- ❑ **Interim or Final Financing.** Often debtors will initially request temporary, interim relief and set a future hearing for entry of a final, permanent order. Note the length of time of the temporary relief or whether the debtor is seeking permanent relief with the current motion.

- ❑ **Requested Relief.** **11 U.S.C. § 364** provides for the debtor obtain credit or incur debt post-petition. Depending on the structure of the financing, the debtor might request more than simply approval of a loan. If the debtor has moved for credit approval pursuant to **11 U.S.C. § 364(c)**, ensure that the debtor has met its burden as to all elements including showing that the debtor could not obtain financing under **11 U.S.C. 364(b)**.

  If the debtor seeks relief pursuant to **11 U.S.C. § 364(d)**, it must prove (i) that it could not find credit on more favorable terms and (ii) that adequate protection is provided for affected, secured, pre-petition creditors.

  For emergency motions, the debtor should also show that immediate and irreparable harm will occur without such relief.

  While the debtor may make some statements in support of these elements in the motion, most will also include additional details in an attached declaration of a party familiar with the debtor's financial affairs and the DIP loan negotiations.

- ❑ **Terms of Financing.** The debtor should include a concise statement of DIP loan's terms in the motion. **Fed. R. Bankr. P. 4001(c)(1)(B)**. Where appropriate, some debtors include a copy of the term sheet or DIP financing agreement as an exhibit to the motion. **Fed. R. Bankr. P. 4001(c)**-(d). DIP financing terms must be fair, reasonable, and extended pursuant to customary market terms.

- ❑ **DIP Lender.** Some debtors are able to obtain post-petition credit from existing pre-petition creditors. However, many debtors-in-possession turn to new lenders for post-petition financing. In either case, it is important to note if the lender is an insider of the debtor. Often these insiders will negotiate retention of their ownership in the reorganized debtor. Unless all other classes of creditors are paid in full or the insider provides "new value," this retention violates the "absolute priority" rule. **Court Opinions Search**. The practitioner should ensure that the insider lender is in fact extending new, post-petition credit (value) to the debtor with the DIP Financing motion.

  If the DIP lender is a pre-petition creditor, look out for roll-ups (rolling up the creditor's pre-petition debt into the post-petition debt or credit and using DIP funding to repay the pre-petition claim) and cross-collateralization (securing both pre-petition and post-petition debt with the new liens extended with the DIP loan). Either of these treatments would elevate the DIP lender's pre-petition claims to a better position than they were prior to extending the post-petition financing. Depending on local rules, these terms may not be approved on shortened notice.

- ❑ **Use of Proceeds.** Confirm that the debtor proposes to use the funding for appropriate expenses (e.g., supporting debtor's post-petition operations) and does not unnecessarily or unlawfully restrict use of funds. For example, the loan terms will often include carve-outs for professional fees of the debtor and creditors' committee. The carve-out may not, however, be so restricted as to prevent any appointed creditors' committee from investigating the DIP Lender. Also, confirm that the debtor does not simply propose to repay the DIP lender's pre-petition claim.

- ❑ **Liens & Collateral.** More often than not, post-petition financing is extended on a secured basis. Generally, practitioners should be wary of blanket liens and cross-collateralization and liens on proceeds of avoidance actions granted as collateral for DIP financing on shortened notice. The Bankruptcy Code does, however, provide for granting of other liens on an emergency basis. Pursuant to **11 U.S.C. § 364(c)** the court may approve post-petition financing secured by unencumbered assets or a junior lien against property already subject to a lien. Under **11 U.S.C. § 364(d)**, the court may even authorize the debtor to secure new financing with a senior or equal, pari passu, lien on property. In these cases, any creditor with existing liens on the property should ensure the debtor has met all the elements of **11 U.S.C. § 364(d)(1)**, including providing adequate protection to the existing creditor.

- ❑ **Adequate Protection.** Existing secured creditors whose liens have been primed by liens securing DIP financing should confirm that the order provides adequate protection for the existing creditor either in the form of cash payment(s), an additional lien or other allowable form of adequate protection. See **Overview –Adequate Protection**.

- ❑ **Consider a Stay Relief Motion.** If the debtor has no means of adequately protecting the lender's interest and/or no possibility of reorganizing, the pre-petition creditor should consider moving for relief from the automatic stay. See **Sample Motion – Motion for Relief from the Automatic Stay (Annotated)**.

- ❑ **Priority Claim.** If the adequate protection for a primed pre-petition secured creditor proves inadequate, your affected pre-petition creditor should insist that it be granted a super-priority administrative claim. **11 U.S.C. § 507(b); Smart Code®**.

- ❑ **Additional Relief.** The debtor will often couple a request for DIP financing with a request for use of cash collateral pursuant to **11 U.S.C. § 363**, relief from the automatic stay upon default under DIP loan pursuant to **11 U.S.C. § 362**, as well as other relief. This related or ancillary relief may not be included in the motion's caption. Note all relief requested, not just approval of the DIP loan, as it could impact your client's claim and/or recovery.

- ❑ **Waivers.** Pay careful attention to any waivers of DIP lender liability and any of debtor's claims and/or defenses against the DIP Lender. Generally, the debtor may not waive these claims on shortened notice.

- ❑ **Proposed Order.** Confirm that the proposed order does not include any prohibited provisions. In interim orders and related motions, closely review provisions that remain in effect even if final, permanent relief is denied. Pursuant to **Fed. R. Bankr. P. 4001(c)(1)(A)**, a DIP financing motion must be accompanied by a proposed order.

- ❑ **Review Perfection Status of Prepetition Liens.** While the secured lender may likely have already reviewed to ensure that its security interests are properly perfected, it is important to be aware of any potential problems or issues as early as possible.

CHECKLIST:

Secured Creditor's Review of Cash Collateral Motion

Editor's Note: Often debtors will file a first-day motion seeking authorization to use their secured lenders' cash collateral. Sometimes this is used as an alternative means of financing to obtaining credit under 11 U.S.C. § 364. See Overview – Debtor-in-Possession (DIP) Financing. The following is a checklist to assist a secured creditors' counsel in reviewing a cash collateral motion.

- ❑ Hearing Date. A cash collateral motion (without lender consent) may only be granted upon notice and hearing. 11 U.S.C. § 363(c)(2)(B). Initial motions for interim relief are usually filed on an emergency basis and hearings are held on extremely shortened notice, sometimes as short as one day.

- ❑ Local Rules. Double check local rules for requirements on cash collateral/financing motions. Sometimes these rules will require the debtor to provide certain information and summarize key terms. Often the information will be put in a grid. However, be sure to read the motion in its entirety as important information might not be in the summary and can be overlooked.

- ❑ Interim or Final Order. Often debtors will initially request temporary, interim relief and set a future hearing for entry of a final, permanent order. Note the length of time of the temporary relief or whether the debtor is seeking permanent relief with the current motion.

- ❑ Requested Relief. 11 U.S.C. § 363(c) requires the debtor to obtain court approval for nonconsensual use of cash collateral. Ensure that the debtor has met its burden as to all statutory requirements including adequate protection (see below).

  For emergency motions, the debtor must also show that immediate and irreparable harm will occur without such relief.

  Fed. R. Bankr. P. 4001(b)(1)(B) requires the debtor to provide "(1) the name of each entity with an interest in the cash collateral, (2) the purposes for the use of such cash collateral, (3) the material terms, including duration, of the use of the cash collateral; and (4) any liens, cash payments, or other adequate protection that will be provided to each entity with an interest in the cash collateral or, if no additional adequate protection is proposed, an explanation of why each entity's interest is adequately protected." The last three elements are explored in more detail below.

- ❑ **Use of Proceeds/Budget.** Confirm that the debtor proposes to use the cash collateral for appropriate expenses (e.g., supporting debtor's post-petition operations) and activities authorized by the Bankruptcy Code. Cash collateral motions should also include a budget indicating how the debtor intends to use cash collateral during the bankruptcy case. For the interim period, consider whether the proposed uses are needed on an emergency basis. Also, evaluate whether the budget is realistic based on the economic facts at hand.

- ❑ **Time Period.** Determine the length of time the debtor is intending to use cash collateral. Typical practice is to allow the debtor to use cash collateral for a limited period of time. Once that period expires, the debtor will need to obtain an agreement from the lender for an additional period. This is one way the lender can monitor the case as things develop.

- ❑ **Adequate Protection.** Existing secured creditors whose cash collateral the debtor is proposing to use should confirm that the order provides adequate protection for the existing creditor either in the form of cash payment(s), an additional lien or other allowable form of adequate protection. The debtor has the burden of proof as to adequate protection. 11 U.S.C. § 363(p)(1). See Overview – Adequate Protection. If cash payments are proposed, it may be worthwhile to examine whether the debtor can generate enough revenue to provide the proposed adequate protection.

- ❑ **The Debtor's Factual Statements.** Carefully review the debtor's first day declaration as well as any other pleadings filed in which the debtor makes factual allegations concerning its economic situation or matters that pertain to the cash collateral motion.
- ❑ **Segregation and Accounting.** The debtor must segregate and account for all cash collateral in its "possession, custody, or control." **11 U.S.C. § 363(c)(4)**. Evaluate how the debtor is complying with this requirement.
- ❑ **Consider a Stay Relief Motion.** In preparing the objection to use of cash collateral, it may become evident that the debtor has no means of adequately protecting the lender's interest and/or no possibility of reorganizing. Many of these facts are also pertinent to a motion for relief from the automatic stay, which the lender may want to consider filing in tandem with its objection. See **Sample Motion – Motion for Relief from the Automatic Stay (Annotated).**
- ❑ **Notice.** Review whether the debtor complied with the notice requirements of Fed. R. Bankr. P. **4001**. The debtor must provide notice to any entity with an interest in the cash collateral.
- ❑ **Proposed Order.** A cash collateral motion must be accompanied by a proposed order. Fed. R. Bankr. P. **4001(b)(1)(A)**. Review the proposed order to confirm that it is consistent with the motion and **local rules** requirements. Confirm that the order does not include any prohibited provisions. In interim orders and related motions, closely review provisions that remain in effect even if final, permanent relief is denied.
- ❑ **Review Perfection Status of Prepetition Liens.** While the secured lender may likely have already reviewed to ensure that its security interests are properly perfected, it is important to be aware of any potential problems or issues as early as possible.

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