AMERICAN BANKRUPTCY INSTITUTE

2019 Delaware Views from the Bench

Ask the Judges

Prof. Bruce Grohsgal, Moderator
Widener University Delaware Law School; Wilmington

Hon. John T. Dorsey
U.S. Bankruptcy Court (D. Del.); Wilmington

Hon. Kevin Gross
U.S. Bankruptcy Court (D. Del.); Wilmington

Hon. Karen B. Owens
U.S. Bankruptcy Court (D. Del.); Wilmington

Hon. Brendan L. Shannon
U.S. Bankruptcy Court (D. Del.); Wilmington

Hon. Laurie Selber Silverstein
U.S. Bankruptcy Court (D. Del.); Wilmington

Hon. Christopher S. Sontchi
U.S. Bankruptcy Court (D. Del.); Wilmington

Hon. Mary F. Walrath
U.S. Bankruptcy Court (D. Del.); Wilmington

Delaware Views from the Bench 2019 – "Ask the Judges"

Hotel Dupont – Thurs., October 17, 2019, 9:15-10:30 a.m.

Questions for C.J. Sontchi and Judges Walrath, Gross, Shannon, Silverstein, Dorsey and Owens

Prof. Bruce Grohsgal - Moderator

1. I recall that Henry David Thoreau wrote "beware of all enterprises which require new clothes." What was the most striking difference that you perceived between being a lawyer and being a judge when you first took the bench?
2. Do you think that your approach from the Bench has changed or evolved over time? If so in what ways?
3. Things move quickly in chapter 11. What do you expect to see in a pleading that requests shortened notice? (Local Rule 9006-1 (eff. 2/1/19))
4. Delaware's 1st bankruptcy judge, Helen Balick instituted chapter 11 "first-day" orders in her court in the 1980s. The practice has been criticized over the years, including on the grounds that some payments under first-day orders are priority-skipping and that there is no express basis for them in the Code. Yet the Supreme Court in *Jevic* recently approved the practice, albeit in *dictum*, noting that "one can generally find significant Code-related objectives that the[se] priority-violating distributions serve." What is your view regarding the effect that local procedures, such as first-day hearings in chapter 11, can have on bankruptcy practice and, eventually, substantive bankruptcy law?
5. Delaware's 2nd bankruptcy judge, Judge Peter Walsh, gave Delaware's bankruptcy bar a "does and don'ts" list about 20 years ago, for what should or shouldn't be included in a first day DIP financing order. Yet the "golden rule" continues to apply – the one with the gold to a great extent makes the rules. Are you concerned with some of the terms that

you see in first day DIP orders? (Letter from U.S.B.J. Peter J. Walsh to Delaware Bankruptcy Counsel dated April 2, 1998 attached; Local Rule 4002-1 (eff. 2/1/19) attached)

6. Judge Kevin Carey, who recently earned the distinction of being just the 3rd Delaware bankruptcy judge ever to retire, was often heard to say that a secured lender in a chapter 11 case had to pay the rent on his courtroom – meaning if it wanted to use the Code to maximize going concern value and thus its own recovery, there had to be something in it for other creditors. What are your thoughts on this?
7. Pre-packaged plans have become more common over the past few years. Most of these cases move quickly to confirmation by providing that the unsecured creditors do not vote on the plan because the plan provides that they will be paid in full. Are you running into cases in which the unsecured creditors, nonetheless, are *not* paid post-confirmation?
8. What do you expect from counsel at a hearing or trial?
9. Are your expectations different for Delaware counsel?
10. What do you expect counsel, in a case assigned to you, to be doing or not doing when they're *not* in court?
11. What advice might you give to young bankruptcy lawyers entering the practice today?
12. A large number of chapter 11 cases file in Delaware – fewer than in the S.D.N.Y. but still about 9% of chapter 11 cases filed nationwide. Consumer cases also file in Delaware though, and we have a very active consumer bar and standing chapter 13 trustee. What are some of the hardest issues in consumer cases today?
13. Do you think that bankruptcy judges should be Article III judges?

14. If you could change one provision of the Bankruptcy Code, what provision would you change and why?
15. Delaware had one bankruptcy judge originally – who actually was half-judge/half-magistrate at first. The court then had two bankruptcy judges, and then six. There soon will be eight of you. Predictability is a fundamental goal of any legal system. Do you think that predictability might be affected by this increase in the size of the court?

Delaware Local Rule 9006 (eff. 2/1/19)

Rule 9006-1 Time for Service and Filing of Motions and Objections.

(a) Generally. Fed. R. Bankr. P. 9006 applies to all cases and proceedings in which the pleadings are filed with the Clerk.

(b) Discovery-Related Motions. All motion papers under Fed. R. Bankr. P. 7026-7037 and 9016 shall be filed and served in accordance with Local Rule 7026-1.

(c) All Other Motions.

(i) Service of Motion Papers. Unless the Fed. R. Bankr. P. or these Local Rules state otherwise, all motion papers shall be filed and served in accordance with Local Rule 2002-1(b) at least fourteen (14) days prior to the hearing date.

(ii) Objection Deadlines. Where a motion is filed and served in accordance with Local Rule 9006-1(c)(i), the deadline for objection(s) shall be no later than seven (7) days before the hearing date. To the extent a motion is filed and served in accordance with Local Rule 2002-1(b) at least twenty-one (21) days prior to the hearing date, however, the movant may establish any objection deadline that is no earlier than fourteen (14) days after the date of service and no later than seven (7) days before the hearing date. Any objection deadline may be extended by agreement of the movant; provided, however, that no objection deadline may extend beyond the deadline for filing the agenda. In all instances, any objection must be filed on or before the applicable objection deadline. The foregoing rule applies to responses/replies to (A) any Objection as defined in Local Rule 3007-1(a) (i.e., an objection to claims asserted by more than one claimant) and (B) any objection to a single claim or multiple claims filed by the same claimant.

(d) Reply Papers. Reply papers by the movant, or any party that has joined the movant, may be filed by 4:00 p.m. prevailing Eastern Time the day prior to the deadline for filing the agenda. If a motion for leave to file a late

reply is filed, unless otherwise ordered by the Court, a motion to shorten notice shall not be required. The Court will consider the motion for leave at the hearing on the underlying motion papers and any objections to the motion for leave may be presented at the hearing. The foregoing rule applies to replies to Omnibus Objection to Claims. Del. Bankr. L.R. 3007-1.

(e) Shortened Notice. No motion will be scheduled on less notice than required by these Local Rules or the Fed. R. Bankr. P. except by order of the Court, on written motion (served on all interested parties) specifying the exigencies justifying shortened notice. The motion requesting shortened notice shall include an averment of Delaware Counsel for the moving party that a reasonable effort has been made to notify at least counsel to the debtor, counsel to the United States Trustee, counsel to any official committee appointed in the case and any chapter 7, 11 or 13 trustee and whether such party objected to the relief sought, or not, or the basis for the moving party not making such an effort. Unless otherwise ordered, failure to so aver may result in denial of the motion to shorten. The Court will rule on such motion for shortened notice promptly without need for a hearing.

Delaware Local Rule 4001-2 (eff. 2/1/19)

Rule 4001-2 Cash Collateral and Financing Orders.

(a) Motions. Except as provided herein and elsewhere in these Local Rules, all cash collateral and financing requests under 11 U.S.C. §§ 363 and 364 shall be heard by motion filed under Fed. R. Bankr. P. 2002, 4001 and 9014 ("Financing Motions").

(i) Provisions to be Highlighted. All Financing Motions must (a) recite whether the proposed form of order and/or underlying cash collateral stipulation or loan agreement contains any provision of the type indicated below, (b) identify the location of any such provision in the proposed form of order, cash collateral stipulation and/or loan agreement and (c) justify the inclusion of such provision:

(A) Provisions that grant cross-collateralization protection (other than replacement liens or other adequate protection) to the prepetition secured creditors (i.e., clauses that secure prepetition debt by postpetition assets in which the secured creditor would not otherwise have a security interest by virtue of its prepetition security agreement or applicable law);

(B) Provisions or findings of fact that bind the estate or other parties in interest with respect to the validity, perfection or amount of the secured creditor's prepetition lien or the waiver of claims against the secured creditor without first giving parties in interest at least seventy-five (75) days from the entry of the order and the creditors' committee, if formed, at least sixty (60) days from the date of its formation to investigate such matters;

(C) Provisions that seek to waive, without notice, whatever rights the estate may have under 11 U.S.C. § 506(c);

(D) Provisions that immediately grant to the prepetition secured creditor liens on the debtor's claims and causes of action arising under 11 U.S.C. §§ 544, 545, 547, 548 and 549;Provisions that deem prepetition secured debt to be postpetition debt or that use postpetition loans from a prepetition secured creditor to pay part or all of that secured creditor's prepetition debt, other than as provided in 11 U.S.C. § 552(b);

(E) Provisions that provide disparate treatment for the professionals retained by a creditors' committee from those professionals retained by the debtor with respect to a professional fee carve-out;

(F) Provisions that prime any secured lien without the consent of that lienor; and

(G) Provisions that seek to affect the Court's power to consider the equities of the case under 11 U.S.C. § 552(b)(1).

(ii) All Financing Motions shall also provide a summary of the essential terms of the proposed use of cash collateral and/or financing (e.g., the maximum borrowing available on a final basis, the interim borrowing limit, borrowing conditions, interest rate, maturity, events of default, use of funds limitations and protections afforded under 11 U.S.C. §§ 363 and 364).

(b) Interim Relief. When Financing Motions are filed with the Court on or shortly after the petition date, the Court may grant interim relief pending review by interested parties of the proposed Debtor-in-Possession financing arrangements. Such interim relief shall be only what is necessary to avoid immediate and irreparable harm to the estate pending a final hearing.
In the absence of extraordinary circumstances, the Court shall not approve interim financing orders that include any of the provisions previously identified in Local Rule 4001-2(a)(i)(A)-(F).

(c) Final Orders. A final order shall be entered only after notice and a hearing under Fed. R. Bankr. P. 4001 and Local Rule 2002-1(b). Ordinarily, the final hearing shall be held at least seven (7) days following the organizational meeting of the creditors' committee contemplated by 11 U.S.C. § 1102.

UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

JUDGE PETER J. WALSH

824 MARKET STREET
WILMINGTON, DE 19801
(302) 573-6272

April 2, 1998

RE: First Day DIP Financing Orders

Dear Delaware Bankruptcy Counsel:

This is a follow-up to our session of March 11, 1998, where, at the prompting of Judge McKelvie, we discussed the need for improving the DIP financing orders being submitted at first day hearings. At that meeting, I gave a number of examples of provisions in several orders that I thought were either unnecessary, overreaching, or just plain wrong. In an effort to improve the content of first day DIP financing orders, I volunteered to comment in writing on the forms and to identify a number of terms or provisions in those orders that I believe should be avoided.

The following items, in no particular order of priority (except as to the first item), are not intended as immutable rules that I have on the matter, and certainly I have no authority to speak for the other judges on these matters, but I thought if we could shorten and eliminate some of the more objectionable features of proposed first day DIP financing orders, we could improve the first day proceeding. Needless to say, however, I think it is not practicable to have a blanket set of prohibitions, given the numerous variations in the lending arrangements and the prepetition relationships between the debtor and the lender(s).

1. Many of the proposed orders are just too verbose and cover unnecessary matters. It is not necessary for the order to recite, even in summary fashion, the major provisions of the loan documents. For example, the following is a portion of a paragraph included in a recent DIP financing order, which obviously paraphrases what the loan document says on this particular matter:

> All advances and other extensions of credit and financial accom[m]odations shall be made solely on the terms and conditions of, and pursuant to, the Postpetition Loan Agreement and the other Postpetition Loan Documents, shall be evidenced by the Lenders' books and records, and shall be due and payable as provided in those agreements. The Lenders shall have no commitment to make any advances or other extensions of credit or financial accom[m]odations, and may, at any time, refuse to make advances, extensions of credit, or other financial accom[m]odations and may exercise their rights and remedies pursuant to the Prepetition Loan Agreement, the Postpetition Loan Agreement, and this Order upon an Event of Default as provided in the Postpetition Loan Agreement, including, without limitation, the incurrence by the Debtors of any liabilities above those approved in the "Budget" (as defined herein) appended hereto as Exhibit B.

If the DIP financing order authorizes the debtor to enter into the financing pursuant to the loan documents, it is simply not necessary for the order to restate a lot of the major terms of the financing. (Indeed, most of the above-quoted statement states the obvious for the type of loan transaction that we see on the first day.) The motion itself should spell out the terms that are essential to an understanding of the deal: maximum borrowing, interim borrowing limit, borrowing conditions (e.g., percentage of inventory value), interest rate, maturity, events of default, use of funds limitations, collateral, and/or priority, etc.; but I do not see that it is necessary to get into a lot of details on these

in the order. Of course, the order should identify those sections of the Bankruptcy Code designed to protect the estate and/or creditors generally that are being limited or abridged in any manner by the terms of the loan documents.

2. Do not incorporate into the order specific sections of the loan documents without a statement of the section's import. In a recent case the proposed order contained a decretal paragraph regarding events of default that specifically referenced about a dozen particular sections of the loan agreement and tied them into the issue covered by the decretal paragraph. It is simply unrealistic to expect that I can fully read and digest all the provisions of the loan documents in the few hours those documents are in my possession leading up to the first day hearing. Reciting specific ties between the terms of the order and particular terms or provisions of the loan agreement is something that under most circumstances on the first day I cannot comfortably append my signature to.

3. Given the limited amount of time we have to review the first day motions prior to the hearing and given the substantial amount of paperwork presented, particularly the DIP financing motion with the loan documents and the related order, it is not realistic to have a provision in the order that recites that the Court has "examined" all the loan documents, or that the Court "approves" all the terms and provisions of the loan documents, or language of similar import. An egregious example in this regard reads: "The provisions of the Postpetition Loan Agreement and other Postpetition Loan Documents are hereby approved and by this reference incorporated herein as a part of this Order." Remember, the Court is authorizing the debtor to borrow money on basic terms that appear reasonable under the expedited circumstances; it is not placing its imprimatur on the multiple terms and conditions of the loan documents.

4. Many of the proposed orders contain lengthy recitations of findings that are preambles to the decretal portion of the order. Given the fact that at most first day hearings only the debtor is heard, it is somewhat presumptuous, and in many cases unduly aggressive, for counsel to hand up an order that sets forth detailed, and in many cases nonessential, findings by the Court

regarding prepetition deals, relationships, and understandings of the parties. Most of these findings are based on lengthy recitations in the motion papers. It seems to me, given the limited nature of the first day hearing, that most of these "findings" would better be recited under a heading of "stipulations" between the debtor and the lender. Please note, if the stipulation approach is used, do not put further back in the order a decretal statement that says something to the effect that all the terms and provisions of the subject order constitute an order of the Court. By its nature the order will be acknowledging the stipulations, and of course, appropriate court findings will be a part of the order.

5. The order should not state that parties in interest have been given "sufficient and adequate notice" of the motion. Nine times out of ten this is simply not true. Rule 4001(c)(2) contemplates an expedited hearing with little or no notice (at least not the type of notice that would be sufficient to prepare for an effective participation by third parties). Consequently, the order should simply recite that the hearing is being held pursuant to the authorization of Rule 4001(c)(2) and recite to whom and when the notice was given.

6. Given the limited nature of the hearing on the first day, the findings that are necessary for the § 364(e) protection afforded the lender can appropriately be expressed in language such as: "Based on the record presented to the Court by the Debtor, it appears that . . . ."

7. Absent exigent circumstances, neither the loan documents nor the order should give the lender a lien position on avoidance actions.

8. While, in order to give the prepetition/postpetition creditor protection typically demanded, it is appropriate for the debtor to acknowledge the validity, perfection, enforceability, and nonavoidability of the prepetition indebtedness and perhaps waive any lender liability claims, this provision should preferably be in the form of a stipulation and should be limited to the debtor so that it is not binding on the estate, the committee, or a trustee.

As discussed below, a time limit with respect to nondebtor challenges to the prepetition secured position may be appropriate.

9. Where a DIP financing facility includes the use of the prepetition creditors' cash collateral, adequate protection in the form of a substitute lien on postpetition collateral is appropriate to the extent there is a diminution in the value of the prepetition collateral, but such a provision should not include language such as the following: "[T]he Debtors' use of cash collateral pursuant to this Order or otherwise is hereby deemed to result in a dollar-for-dollar decrease in the value of the Prepetition Collateral . . . ."

10. The debtor's obligation to reimburse the lender for costs and expenses, including attorneys' fees, etc., should be expressed in terms of "reasonable" costs and expenses and such reimbursement obligation should not apply to the lender's defense to challenges by a committee to the lender's prepetition security position.

11. Carveouts for professional fees should not be limited to the debtor's professionals, but should include the professionals employed by any official committee. While the carveout for professionals of any official committee may appropriately exclude work related to the prosecution of an objection to the prepetition secured position of the lender, that exclusion should not encompass any prechallenge investigative work by the professionals.

12. The carveout for committee professionals and the limited period to challenge the lender's prepetition secured position is important. In my view it is the price of admission to the bankruptcy court to obtain the benefits of preserving the assets of the estate, which preservation typically first benefits secured parties.

13. The period of time during which the creditors' committee should have the right to challenge the lenders' prepetition position should generally be at least sixty days from the appointment of the committee. Unless the case is on a fast track, this period should be ninety days.

14. The following provision is patently objectionable:

> Nothing contained in this Order shall be deemed a finding with respect to adequate protection (as that term is described in Section 361 of the Code) of the interest of the Lenders in the Prepetition Collateral, but shall [sic] the Lenders' and security interests in the Prepetition Collateral require adequate protection, Lenders shall be deemed to have requested and shall be deemed to have been granted such adequate protection as of the Petition Date or such later date when such liens or security interests first were not adequately protected. [Emphasis added.]

15. The following provision is also patently objectionable:

> Notwithstanding anything to the contrary contained in this Order or in any of the Postpetition Agreements, the commitment of the Lenders to make loans, extend credit, and grant other financial accommodations to the Debtors shall terminate immediately and automatically, without notice of any kind, upon the institution by any person or entity of any action seeking to challenge the validity or priority of (or to subordinate) any of the Lenders' liens or security interests on any of the Prepetition Collateral. [Emphasis added.]

16. I know of no basis for including in a financing order a finding (recently proposed) such as the following: "The Debtor's other secured creditor(s) is/are adequately protected from any adverse consequences which might result from the consummation of the proposed post-petition secured financing between the Debtor and Lender."

17. In reciting the protection afforded the lender by § 364(e), verbose and redundant provisions such as the following are to be avoided. Furthermore, in the following quoted material the underscored language suggests to me that prepetition debt was intended to be afforded the § 364(e) protection. No such effect would be proper.

> If any or all of the provisions of this Order or the DIP Financing Agreement are hereafter modified, vacated or stayed by subsequent order of this Court or by any other court, such stay, modification, or vacation shall not affect the validity of <u>any debt</u> to Lender that is or was incurred pursuant to this Order <u>or that is or was incurred prior to the effective date of such stay, modification, or vacation</u>, or the validity and enforceability of any lien, security interest or priority authorized or created by this Order or the DIP Financing Agreement and notwithstanding such stay, modification, or vacation, any obligations of the Debtor pursuant to this Order or the DIP Financing Agreement arising prior to the effective date of such stay, modification or vacation shall be governed in all respects by the original provisions of this Order and the DIP Financing Agreement, and the validity of any such credit extended or lien granted pursuant to this Order and the DIP Financing Agreement is subject to the protections afforded under 11 U.S.C. § 364(e). [Emphasis added.]

18. Provisions that operate expressly or as a practical matter to divest the debtor, or any other party in interest, of any discretion in the formulation of a plan are not viewed with favor. I believe the lender can appropriately protect itself without attempting to dictate what may happen with respect to a plan. For example, the lender can certainly include a loan provision calling for repayment in full on the plan's effective date.

19. I often find that the record established at the hearing, either by affidavit or live testimony, is rather thin relative to the detailed findings that the Court is called upon to make. It is important that the affidavit or the live witness (either by testimony or, if appropriate, by proffer) offered in support of the motion be specific and complete regarding the findings required with respect to §§ 364(c) and (e) and Rule 4001(c)(2).

20. The lifting of the § 362 automatic stay upon the event of a default should be conditioned upon providing three to five business days' notice to the debtor, the U.S. Trustee and any official committee.

21. The order should be worded in a manner that makes it clear that, whatever the terms of the interim order, the Court is not precluded from entering a final order containing provisions inconsistent with or contrary to any of the terms of the interim order, subject, of course, to the lender's § 364(e) protection with respect to monies advanced during the interim period. Just by way of example, should the Court deem it appropriate, given a strong showing at the first day hearing, to allow a waiver of § 506(c), if the subsequently appointed committee presents a persuasive argument, the Court should revisit the matter and be guided by what it hears at the final hearing.

The items discussed above are not intended to be a complete list of the matters that need to be addressed on the issue of first day DIP financing orders. For the most part, they are derived from the latest four or five first day DIP financing orders that I have had before me. If I were to go back over the last few years and review other such orders, I am sure that I could pick out additional provisions that could be considered objectionable.

In any event, I hope that this communication will serve to give counsel sufficient incentive to make the proposed DIP financing orders more palatable while at the same time preserving those elements of the orders that the lending institutions

reasonably believe are essential. Perhaps further dialogue on the matter would be appropriate at a gathering similar to that of the March 11 session.

Very truly yours,

Peter J. Walsh

PJW:vw

cc: Chief Judge Joseph J. Farnan, Jr.
Judge Sue L. Robinson
Judge Roderick R. McKelvie
Patricia A. Staiano, United States Trustee