AMERICAN BANKRUPTCY INSTITUTE

2017 Rocky Mountain Bankruptcy Conference

Documentation Issues/Proper Structuring of Transactions to Strengthen Position in Bankruptcy

Caroline Case Fuller, Moderator
Fairfield and Woods P.C.; Denver

Steven J. McCardell
Durham Jones & Pinegar; Salt Lake City

Hon. R. Kimball Mosier
U.S. Bankruptcy Court (D. Utah); Salt Lake City

Steven T. Waterman
Dorsey & Whitney LLP; Salt Lake City

CONCURRENT SESSION

2017

22nd Annual Rocky Mountain Bankruptcy Law Conference
Drafting Issues
-
POST-BANKRUPTCY SETTLEMENT AGREEMENTS AND PRE-BANKRUPTCY FORBEARANCE AGREEMENTS[1]

Steven Jack McCardell
Durham Jones & Pinegar, P.C.
Salt Lake City, Utah

I. CONTRACT LAW BACKGROUND

Forbearance agreements and settlement agreements are contracts whose formation and enforcement are subject to general principles of contract law.

A. Enforceability in general – freedom of contract. Absent defenses to contract enforcement, applicable overriding equitable principles, and statutory or regulatory restrictions on contracts, courts addressing the enforceability of contracts strongly lean toward freedom of contract. In practice this means avoiding judicial renegotiation of contract terms, steering clear of relieving parties from the effects of a bad bargain, and recognizing that parties lawfully may enter into contracts that might be objectively unreasonable or lead to hardship on one side. *See, e.g., Commercial Real Estate Investment, L.C. v. Comcast of Utah II, Inc*., 714 Utah Adv. Rep. 31, 2012 UT 49, 285 P.3d 1193 (Utah 2012).

B. Defenses to contract enforcement. Enforcement of contracts is limited or barred in cases of mistake, fraud, duress or undue influence, illegality, or unconscionability. *Commercial*

[1] This outline addresses issues in drafting post-bankruptcy settlement agreements and pre-bankruptcy forbearance agreements. It does not address (1) pre-petition settlements; (2) plan settlements (*see*, *e.g*., Bankruptcy Code § 1123(b) (plan may provide for "the settlement or adjustment of any claim or interest belonging to the debtor or to the estate")); (3) consumer issues (including regulated statutory modifications of residential mortgages); or (4) settlements providing for structured dismissals (as of December 16, 2016, the validity of structured dismissals is under submission in the United States Supreme Court in *Czyzewski v. Jevic Holding Corp*., No. 15-649, argued December 7, 2016).

Real Estate Investment, L.C. v. Comcast of Utah II, Inc., 714 Utah Adv. Rep. 31, 2012 UT 49, 285 P.3d 1193 (Utah 2012) (listing these defenses to enforceability); *see, e.g., Tolliver v. U.S. Bank*, 2012 WL 2952239 (Bankr. E.D. Ky. 2012) (forbearance agreement unenforceable if induced by fraud). In addition, enforcement of certain contract provisions may be barred by statute or public policy. *See, e.g.,* Bankruptcy Code provisions barring enforcement of *ipso facto* clauses: 11 U.S.C. §§ 363(l), 365(e), 541(c); state statutes of fraud; and state and federal consumer protection statutes.

Debtors sometimes seek to avoid forbearance agreements by claiming they were under economic duress. This claim is rarely successful. *See*, *e.g., Interpharm, Inc. v. Wells Fargo Bank, N.A*., 655 F.3d 136 (2d Cir. 2011) (under New York law, a party cannot be guilty of economic duress for failing to grant further forbearance when it has no legal duty to do so; claim of economic duress requires an unlawful threat that precluded the exercise of the debtor's free will; mere demonstration of financial pressure or unequal bargaining power is insufficient, by itself, to establish economic duress; threat to exercise a legal right is not a wrongful threat; ending forbearance after fifth and final forbearance agreement); *In re Maco Homes, Inc*., 1996 WL 511494, 96 F.3d 1439 (table) (4th Cir. 1996) (debtor's claim of duress rejected; threat of foreclosure may have pressured debtor, but lender had the legal right to threaten foreclosure; debtor may have had a weak bargaining position, but lender did not create debtor's weak financial position and debtor could have filed bankruptcy as an alternative to signing the agreement). Debtors frequently assert that their lenders owe them fiduciary duties. However, absent unusual circumstances, "a lender has no fiduciary obligation to its borrower or to other creditors of the debtor in the collection of its claims . . . . The permissible parameters of a creditor's efforts to seek collection from a debtor are generally those with respect to voidable preferences and fraudulent conveyances proscribed by the Bankruptcy Act; apart from these there is generally no objection to a lender's using [its]

bargaining position, including [its] ability to refuse to make further loans needed by the debtor, to improve the status of [its] existing claims." *Cosoff v. Rodman* (*In re W.T. Grant Co*.), 699 F.2d 599, 609 (2d Cir.), *cert. denied,* 464 U.S. 822 (1983) (citations omitted); *Sloan v. Zions First National Bank* (*In re Castletons, Inc*.), 990 F.2d 551, 559 (10th Cir. 1993) (citing *W.T. Grant*).

C. Contract interpretation. Contract interpretation starts with an assessment of the intention of the parties determined by looking within the four corners of the contract. Courts generally enforce unambiguous contracts according to their terms. In general, extrinsic evidence is admitted only when the contract is ambiguous (including contracts where, despite lack of ambiguity in terms, an ambiguity exists as to the nature and character of the contract or transaction as a whole). Avoiding ambiguity is a primary goal of contract drafting. Ambiguity does not mean simply that the parties disagree. Rather, ambiguity means that a contract or a contract term is capable of more than one reasonable interpretation, for example, because of uncertain meanings of terms, missing terms, or other facial deficiencies (*i.e*., drafting errors). *See, e.g., WebBank v. American General Annuity Service Corp*., 54 P.3d 1139 (Utah 2002) (citations omitted); *Brodkin v. Tuhaye Golf, LLC*, 355 P.3d 224, 2015 UT 165 (Utah App. 2015).

D. Contract modification. Under common law consideration requirements, contract modifications require consideration, absent some legally sufficient consideration substitute, such as a material change in position in reliance on the modification or principles of estoppel and waiver. Section 89 of the Restatement (Second) of Contracts also provides: "A promise modifying a duty under a contract not fully performed on either side is binding (a) if the modification is fair and equitable in view of circumstances not anticipated by the parties when the contract was made; or (b) to the extent provided by statute; or (c) to the extent that justice requires enforcement in view of material change of position in reliance on the promise.

E. **UCC provisions**. Many UCC sections allow parties to waive or modify otherwise generally applicable provisions. In drafting agreements governed by the UCC, consider whether to include waivers or modifications. See *Key Equip. Fin. v. Southwest Contr. Inc.,* 87 UCC Rep. Serv.2d 647 (D. Colo.) (waiver of notice allowed under Colorado UCC 4-9-624(a)), *reconsidered in part*, 2016 WL 614398 (slip op. February 16, 2016) (as to issues unrelated to the waiver).

F. **Public policy issues**. Depending on applicable nonbankruptcy law, contract provisions may be vulnerable public policy arguments limiting enforcement. Typical areas of concern (depending on applicable law) include the following: (a) jury waivers; (b) submission to jurisdiction/forum selection (especially when the selected forum has no reasonable relationship to the parties or the transaction); (c) choice of law in a forum with no substantial relationship or interest in the parties or the transaction; (d) restraints on alienation; (e) provisions in the nature of penalties; (f) waiver of punitive damages authorized by statute for conduct that manifests a knowing and reckless disregard for or indifference to the rights of others. *See also* Section VI below, Bankruptcy Clauses, certain of which have public policy implications; *see generally*, *Restatement (Second) of Contracts,* Section 178 ("When a Term is Unenforceable on Grounds of Public Policy"):

> (1) A promise or other term of an agreement is unenforceable on grounds of public policy if legislation provides that it is unenforceable or the interest in its enforcement is clearly outweighed in the circumstances by a public policy against the enforcement of such terms.
>
> (2) In weighing the interest in the enforcement of a term, account is taken of
>
> (a) the parties' justified expectations,
> (b) any forfeiture that would result if enforcement were denied, and
> (c) any special public interest in the enforcement of the particular term.
>
> (3) In weighing a public policy against enforcement of a term, account is taken of
>
> (a) the strength of that policy as manifested by legislation or judicial decisions,

(b) the likelihood that a refusal to enforce the term will further that policy,
(c) the seriousness of any misconduct involved and the extent to which it was deliberate, and
(d) the directness of the connection between that misconduct and the term.

See Salt Lake County v. Holliday Water Co., 2010 UT 45, 234 P.3d 1105, 1111 (Utah 2010).

II. POST-BANKRUPTCY SETTLEMENTS – SELECTED CASE LAW

A. Standards for approval of settlements under Rule 9019. Bankruptcy settlements require courts to evaluate the settlement and make an independent determination as to whether the settlement is fair and equitable. *See*, *e.g*., *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424-25 (1968) (bankruptcy judge must determine all facts necessary for an intelligent and objective opinion of the probabilities of ultimate success should the claim be litigation; form an educated estimate of the complexity, expense, and likely duration of the litigation, along with the possible difficulties of collecting any judgment; and all other factors relevant to a full and fair assessment; essentially, this is a cost/benefit analysis of settlement terms versus the likely outcome of litigation).

Tenth Circuit courts use a factor-based test for evaluating proposed settlements, even when there is no objection to the proposed settlement. *See In re Kopexa Realty Venture Co.*, 213 B.R. 1020, 1022 (BAP 10th Cir. 1997) (analysis of four factors: (1) probability of success of the litigation on the merits; (2) possible difficulty in collection of a judgment; (3) complexity and expense of the litigation; (4) interests of creditors in deference to their reasonable views); *In re Dennett*, 449 B.R. 139, 144–45 (Bankr. D. Utah 2011) (underlying test is whether trustee's actions are "'within the universe of reasonable actions,' not whether pressing onward might produce more funds[;]" court must determine if settlement is in the best interest of creditors after apprising itself of "all facts necessary for an intelligent and objective opinion of probabilities of ultimate success should the claim be litigated[;]" court not required to hold a mini-trial but rather to canvass "the

issues and see whether the settlement falls below the lowest point in the range of reasonableness.") (internal citations omitted).

B. Standards for settlements that include a sale of claims. When a settlement includes a sale, many courts require compliance with sale requirements. *See In re Eurogas, Inc*., D. Utah, Case No. 04-28075 (Hon. William T. Thurman) (Memorandum Decision on Motion to Approve Agreement, October 28, 2016) (whether to impose sale procedures is within the court's discretion based on particular circumstances) (citing *Rich Dad Operating Co., LLC v. Zubrod* (*In re Rich Global*), 2016 WL 3397685 at *4 (10th Cir. 2016) (unreported opinion) (quoting *Goodwin v. Mickey Thompson Enter. Grp., Inc*. (*In re Mickey Thompson Enter. Grp., Inc.),* 292 B.R. 415, 422 (B.A.P. 9th Cir. 2003)).

III. TYPICAL PROVISIONS IN POST-BANKRUPTCY SETTLEMENTS

- Recitals – context, recitation of parties and issues in dispute, along with description of claims and litigation
- Clear expression of what each party gives and receives, including specific payment terms
- Condition requiring court approval of trustee or debtor in possession entering into agreement pursuant to Fed. R. Bank. P. 9019
- Obligation of debtor or trustee to seek approval by a date certain, on appropriate notice, of counterparty not to object and of both parties to cooperate in any hearings and appeals
- Confidentiality provision, if appropriate
- Non-admission of disputed facts, claims, or liability
- Requirements for non-disparagement of counterparties
- Prohibition of evidentiary use of settlement agreement and evidence thereof, other than for enforcement of agreement
- Litigation standstill pending settlement approval, including suspension of discovery or scheduling order (interim court order may be advisable, for example if settlement is not approved and litigation must be resumed)
- Dismissal of litigation with prejudice, withdrawal of proofs of claim (if appropriate, by a specified date)
- Identify claims against non-parties that are not being settled and expressly provide that claims and litigation against non-parties are expressly preserved
- Representation and warranty that no settled claims have been assigned or transferred
- Mutual releases:

  - Timing of release delayed until after effective date of court approval and, in appropriate cases (*i.e*., counterparty not in bankruptcy but subject to bankruptcy risk), expiration of applicable preference period(s))
  - Release details: (1) who releases, (2) who is released, (3) what claims are released, (4) does release include unknown claims
- Covenant not to sue as to settled claims, indemnification and hold harmless provisions and preservation of defenses and counterclaims in case party sued
- No plan provisions inconsistent with terms of settlement (beware, however, of sub rosa plan issues; *Pension Benefit Guar. Corp. v. Braniff Airways, Inc*. (*In re Braniff Airways, Inc*.), 700 F.2d 935, 940 (5th Cir. 1983))
- Forms of proposed approval order and, if appropriate, (1) form of papers on dismissal of litigation and (2) form of withdrawal of proof of claim
- Consequences of (a) failure to obtain court approval, (b) other defaults
- Remedies – specific performance, attorney fees and costs, interest on defaulted amounts
- Forms of dismissal papers, forms of lien releases

IV. FORBEARANCE AGREEMENTS – SELECTED CASE LAW

A. Consideration. "Forbearance from exercising a right or doing an act which one has a right to do is legal consideration . . . . Before any act or forbearance, or promise to act or forbear, can constitute consideration, it must be bargained for and given in exchange for the promise. Mere forbearance to exercise a legal right, without any request to forbear or circumstances from which an agreement to forbear may be implied, is not consideration such as will support a promise." 3 Williston on Contracts § 7:44 (4th ed. 2015). See Restatement (Second) of Contracts § 71(1), (2), and (3) ("To constitute consideration, a performance or a return promise must be bargained for. A performance or return promise is bargained for if it is sought by the promisor in exchange for his promise and is given by the promise in exchange for that promise. The performance may consist of (a) an act other than a promise, or (b) forbearance, or (c) the creation, modification, or destruction of a legal relation."). *See also Master Mortg. Inv. Fund, Inc. v. Chicago Title Ins. Co.,* 34 F.3d 1076 (unpublished) (10th Cir. 1994) ("Forbearance from suit or delay in collection can provide consideration sufficient to support a contract, but only if there is an agreement between the parties for the forbearance.") (citing Kansas law); *In re 400 Walnut*

Assoc's, L.P., 454 B.R. 60, 71 (Bankr. E.D. Pa. 2011) (debtor's claim that lender breached alleged "agreement in principle" reached in a meeting, but where there was no unsigned forbearance agreement dismissed; although meeting of the minds was established, consideration was lacking—debtor's performances were already required by contract, waivers of default interest and late charges benefitted only the debtor, debtor undertook no new obligations and court could discern no benefit to the lender). However, an agreement of a party "to do what he or she is already legally obligated to do is not a sufficient consideration for the promise of another." *McGowan v. Homeward Residential, Inc*., 500 F.App'x 882, 884-85 (11th Cir. 2012) (forbearance agreement unenforceable for lack of consideration under pre-existing duty rule). Voluntary forbearance which was not requested is not consideration, *OfficeMax, Inc. v. Sapp*, 132 F.Supp.2d 1079, 1085 (M.D.Ga.2001), nor is voluntary forbearance which was not bargained for. *European Bakers, Ltd. v. Holman*, 177 Ga. App. 172, 173, 338 S.E.2d 702 (1985). Utah's statute of frauds on credit agreements (defined to include an agreement by a financial institution to "delay, or otherwise modify an obligation to repay money or to "make any other financial accommodation") expressly provides that "a debtor or creditor may not maintain an action on a credit agreement unless the agreement is in writing, **expresses consideration**, sets forth the relevant terms and conditions, and is signed by the party against whom enforcement is sought." Utah Code § 25-5-4(b)(i) (emphasis added).

B. **Forbearance as consideration for credit enhancements**. Courts generally hold that forbearance is sufficient legal consideration for a guaranty. 78 A.L.R. 2d 1414, "Forbearance as Sufficient Consideration for Guaranty." *See First Nat. Bank v. Taylor*, 38 Utah 516, 114 P. 529 (Utah 1911) (bank's 90-day extension of time for payment of a note was sufficient consideration for new guaranty). However, promises to perform existing obligations do not constitute

consideration for performance over and above the original agreement and forbearance from prosecuting a groundless claim does not constitute consideration. *Warburton v. Tacoma School Dist. No. 10*, 55 Wash. 746, 758 350 P.2d 161, 167 (Wash. 1960).

C. Valuing, for fraudulent transfer purposes, the economic benefit to the debtor of forbearance. While forbearance has been recognized as having some value for purposes of fraudulent transfer analysis, coming up with a value requires a facts and circumstances analysis. *See, e.g.*, *In re Positive Health Mgmt.,* 769 F.3d 899 (5th Cir. 2014) (debtor that was not obligated to a bank nevertheless made cash payments to the bank in exchange for its forbearance from foreclosing on the building in which the debtor operated its business; debtor's Chapter 7 trustee sued the bank to recover part of the payments as fraudulent transfers, arguing that in excess of fair market rental value of the leased premises were made without receiving reasonably equivalent value; trial court found actual intent to defraud creditors, but applied a Section 548(c) defense and held that debtor received reasonably equivalent value consisting of the use value of the property and additional value from the bank's forbearance from foreclosure; Fifth Circuit reversed, holding (under circuit precedent) that Section 548(c) is limited to and therefore requires valuation of the economic benefit the transferee gave up rather than what the debtor received).

D. Statute of Frauds. A forbearance agreement may be governed by the applicable state statute of frauds, and if so should be in writing and signed by or on behalf of the lender, but may still be enforceable under equitable principles, if applicable. *See, e.g., Secrest v. Security National Mortgage Loan Trust 2002-2*, 167 Cal.App.4th 544, 552-54, 84 Cal. Rptr.3d 275 (2008) (forbearance agreement that modifies a note and deed of trust is subject to the statute of frauds; borrowers who made a down payment under the agreement failed to establish estoppel to assert the statute of frauds); *Lueras v. BAC Home Loans Servicing*, LP, 221 Cal. App.4th 49, 163

Cal.Rptr.3d 804 (2013) (Bank of America unexecuted forbearance agreement under Fannie Mae HomeSaver Forbearance program did not modify loan documents, although mortgage payment could be deferred by up to 50% for up to 6 months and bank would suspend any scheduled foreclosure sale during the deferral period, and therefore was not governed by the California statute of frauds, but was nevertheless enforceable as a binding contract because bank accepted payments and was entitled to an incentive fee).

Some states expressly include certain forbearance agreements within the statute of frauds. *See, e.g.,* Utah Code § 25-5-4 (every "credit agreement" (defined to include an agreement by a financial institution to "delay, or otherwise modify an obligation to repay money or to "make any other financial accommodation") is void unless the agreement or some note or memorandum of the agreement is in writing and signed by the party to be charged with the agreement); Colorado Revised Statutes § 38-10-124 (no debtor or creditor may file or maintain an action or claim relating to a "credit agreement" (defined to include a contract, promise or commitment to "forbear repayment of money" or to "make any other financial accommodation") involving principal exceeding $25,000, unless the credit agreement is in writing and signed by the party against whom enforcement is sought.").

V. TYPICAL PROVISIONS IN FORBEARANCE AGREEMENTS

"Setting the stage" provisions (used as stipulations/admissions of borrower/guarantors):

- Identify the Lender, borrower(s) and guarantors.
- Identify all obligors, including any that are not signing the forbearance agreement (and, as to non-signers, include provision that signers are still bound and claims against non-signers are fully preserved and not subject to any of the forbearance terms)
- Identify the applicable loan documents (including all modifications and collateral security documents), maximum principal amounts, and current unpaid principal, interest, and fees
- Identify maturity date
- Identify applicable security agreements, deeds of trust, and other liens
- Describe the circumstances that led to the agreement, including existing defaults

- Clearly identify consideration lender is giving (especially if agreement cures defects in the loan or in loan documentation)

Forbearance and forbearance period:

- Initial forbearance period and extensions, if any
- Identify actions lender may and may not take while forbearance is in effect
- Identify actions borrower must take as a condition of continuance of forbearance
- Other conditions for continuation of forbearance
- Termination of forbearance

Pre-closing deliverables and deadlines:

- Full payment of forbearance fee(s)
- Full payment of lender professional fees and costs
- Execution and delivery of documents granting liens in additional collateral or delivering other credit enhancements (such as additional or more liquid collateral, guarantees, letters of credit)
- Execution and delivery of documents correcting any deficiencies in loan documentation or lien perfection
- Engagement of restructuring officer, advisors, collateral disposition agents, appraisers
- Stipulated judgment/confession of judgment (escrowed pending performance or default)
- Deed in lieu of foreclosure (escrowed pending performance or default)

Post-closing deliverables and deadlines:

- Cash payments to lender
- Sale of collateral and payment of net proceeds to lender
- Submission, by a date certain, of a feasible restructuring plan
- Satisfaction of existing and revised/new financial covenants and reporting
- Subordination and intercreditor agreements

Loan document/lending commitment matters:

- Loan documents remain in force and unmodified, absent express modification, and all borrower/guarantor obligations and lender remedies are preserved
- Lender is not required to advance new funds and any previous lending commitments are terminated
- Application of contractual default interest
- Increased default interest during forbearance
- Increased default interest upon default during forbearance

Stipulations/ acknowledgements/admissions:

- Borrower and guarantors requested forbearance from lender

- Lender was not legally obligated to forbear and is not legally obligated to grant additional forbearance unless expressly provided in the agreement
- [if applicable] Primary obligors that refuse to sign the forbearance agreement will not receive the benefit of any of the forbearance terms and lender fully preserves right to proceed against them notwithstanding forbearance as to signers and signers are still bound even though not all obligors have signed (however, do not rely on a provision like this as to guarantors—all guarantors must sign or lender faces exoneration argument as to non-signing guarantors)
- Parties bargained for forbearance terms, at arm's length, and in good faith
- Borrower and guarantors are acting voluntarily (no duress, economic or otherwise; no coercion; borrower had alternatives to forbearance it chose not to pursue, such as filing bankruptcy or defending against foreclosure or collection litigation)
- Borrower and guarantors, with the advice of professionals including counsel, have determined, after considering all relevant circumstances:
    - That the forbearance period granted is all the time required for borrower to accomplish its goals, no additional time is needed
    - That the terms of forbearance are reasonable and in the best interest of borrower and guarantors
- Lender's loan documents and claims under the loan documents (including as to both borrower and guarantors) are valid and fully enforceable
- Lender's liens are valid, perfected, and fully enforceable
- Priority of lender's liens
- Borrower and guarantors are fully obligated under loan documents and have no defenses or other avoidances to lender's claim and liens (including setoff or recoupment) (or, if there are defenses or avoidances, all such are waived and released)
- Neither borrower nor guarantors have any claims against lender or lender's employees, officers, directors, agents, or professionals
- Full and immediate release of all claims against lender and lender's employees, officers, directors, agents, and professionals
- Acknowledgement and preservation of existing defaults, including timing and amount of monetary defaults and identification of non-monetary defaults
- Confirmation of Lender's rights and remedies upon default (including existing defaults) and that these are fully preserved even if temporarily deferred
- Confirmation that certain Lender rights (such as to charge default interest) have been or will be put in effect and not suspended despite other forbearance and generally that all Lender rights not specifically within forbearance (such as reporting, collateral inspection and protection, ability to defend against third party actions, disposition of specified collateral) may continue to be exercised despite other forbearance
- Acknowledgement that lender is not a fiduciary to the borrower/guarantors, that no fiduciary duties are intended or created, and that any such duties are disclaimed
- Acknowledgement that forbearance agreement is a "financial accommodation" to the borrower and guarantors
- Acknowledgement that borrowers and guarantors are receiving substantial and reasonably equivalent value plus itemization of elements of value actually to be received by borrower/guarantors (wherever possible, quantify) (and stipulation that

borrower/guarantors are irrevocably bound by their acknowledgment of these elements of value):

- Grants sufficient time to take required action necessary for borrower/guarantors to:
  - Restructure business operations
  - Sell collateral
  - Obtain financing or capital
  - Engage professionals
  - Return to profitability and thereby to realize greater value through operations and non-foreclosure sales of collateral
- Relieves borrower/guarantors from incurring substantial expenses, such as to prepare and file a bankruptcy petition, retain bankruptcy professionals
- Allows borrower/guarantors to pay other creditors, including employees, vendors, tax creditors, and lease creditors and thereby avoid exposure to breach, termination and penalty claims that would greatly multiply if forbearance were not granted
- [if applicable] Lender's agreement not to charge full default rate or otherwise increase applicable rate of interest saves the borrower/guarantors substantial additional monetary exposure
- [if applicable] Precludes cross defaults under other agreements that would expose borrower/guarantors to substantial damages

Waivers and releases:

- Waiver and release of any borrower/guarantor defenses, claims under loan documents, including any claims against Lender, officers, directors, employees, agents and professionals

- Waiver and release of any borrower/guarantor claims or defenses based on Lender's having granted forbearance (*i.e.*, that notice wasn't otherwise given, that notice wasn't timely, that limitation periods have expired)

- Post-default waiver of notice (*see*, *e.g.*, *Key Equip. Fin. v. Southwest Contr. Inc.,* 87 UCC Rep. Serv.2d 647 (D. Colo.) (waiver of notice allowed under Colorado UCC 4-9-624(a)), *reconsidered in part*, 2016 WL 614398 (slip op. February 16, 2016) (issues unrelated to the waiver of notice)).

- Waiver of redemption rights (potential public policy issue; however, such waivers have been approved in certain settings, *see, e.g., Chapman v. Schiller*, 95 Utah 514, 83 P.2d 249 (Utah 1938) (state court approving receiver's sale of public utility property (rail line) could approve sale without right of redemption))

- Waiver of one action rule rights (potential public policy issue, absent statute authorizing waiver)

Default:

- Carefully define circumstances that are defaults under the loan documents
- Identify or exclude:

  - any notice requirement for default
  - any requirement that lender declare default
  - any cure right for default
- Consider the effect of bankruptcy on the agreement and consider protective provisions

VI. BANKRUPTCY CLAUSES

A. Ipso facto clauses. Ipso facto clauses are contract provisions that terminate or modify rights solely on the basis of some insolvency related event (*i.e.*, the counterparty's financial condition, such as insolvency, the counterparty's being a debtor in a voluntary or involuntary bankruptcy case, the counterparty's property having been seized by a trustee or custodian). Several Bankruptcy Code provisions bar enforcement of ipso facto clauses:

> **11 U.S.C. § 363(l)** (trustee may use, sell or lease property notwithstanding any provision that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title concerning the debtor, or on the appointment of or taking possession by a trustee in a case under this title or a custodian and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in such property).
>
> **11 U.S.C. § 365(e)** (contracts and leases may not be terminated or modified notwithstanding a provision terminating or modifying contract or lease rights solely because of the insolvency or financial condition of the debtor at any time before the closing of the bankruptcy case, the commencement of a bankruptcy case, or appointment of or taking possession by a trustee in a bankruptcy case or by a pre-bankruptcy custodian, with the exception of certain kinds of agreements, namely (i) contracts governed by applicable law that excuses the counterparty from accepting performance from or rendering performance to the trustee or an assignee and (ii) the contract is a contract to make a loan or extend other debt financing or financial accommodations to or for the benefit of the debtor or to issue a security of the debtor).
>
> **11 U.S.C. § 541(c)** (interests in property become part of the bankruptcy estate notwithstanding any provision that restricts or conditions transfer of the interest by the debtor or that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a bankruptcy case or on the appointment of or taking possession by a bankruptcy trustee or pre-petition custodian and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property). *See*, *e.g.*, *Connolly v. Nuthatch Hill Associates* (*In re Manning*), 831 F.2d 205 (10th Cir. 1987) (partnership agreement provision discounting partner's interest by 25% in the event of nonconsensual dissolution resulting from partner's bankruptcy was an illegal modification of the debtor's property interest).

B. **Safe harbored contracts**. The Bankruptcy Code provides safe harbors for the termination of certain contracts (*e.g.,* §§ 555 (securities contracts) and 556 (commodities contracts or forward contracts)) based on ipso facto clauses, provided that the ipso facto provision in question does not include an addition condition for its exercise. For example, in *In re Louisiana Pellets, Inc.,* 2016 WL 4011318 (Bankr. W.D. La. July 22, 2016) the court determined that a wood pellet supply agreement was not safe harbored when the ipso facto provision could only be invoked if the debtor, besides filing bankruptcy, was also in breach of its contract obligations. Since the contract provision required both bankruptcy and breach, the safe harbor of Section 556 did not apply. *See also In re Calpine Corp*., 2009 WL 1578282 (Bankr. S.D.N.Y. 2009) ("[S]ection 556 of the Code is limited to enforcing only those terms that trigger termination upon the occurrence of one of the three specified conditions listed in section 365(e)(1) of the Code. . . . contractual rights that are merely ancillary or incidental to an ipso facto clause are not enforceable under section 556[.]"). (Drafting tip: don't make ipso facto clauses in safe harbored contracts dependent on any other condition.).

C. **Waiver of the right to file bankruptcy** – not enforceable. *See, e.g., Bank of China v. Huang (In re Huang),* 275 F.3d 1173, 1177 (9th Cir. 2002) (against public policy for a debtor to waive, prepetition, the protection of the Bankruptcy Code); *Klingman v. Levinson*, 831 F.2d 1292 (7th Cir. 1987); *Fallick v. Kehr* (*In re Fallick*), 369 F.2d 899, 904 (2d Cir. 1966) (contract provisions waiving the right to file bankruptcy are unenforceable and violative of public policy); *In re Shady Grove Tech Ctr. Assocs. Ltd. P'ship*, 216 B.R. 386, 390 (Bankr. D. Md. 1998), *supplemented*, 227 B.R. 422 (Bankr. D. Md. 1998).

D. **Blocking provisions requiring lender consent for borrower to file bankruptcy** – probably not enforceable. *See, e.g., In re Lake Michigan Beach Pottawattamie Resort LLC*, 547

B.R. 899 (Bankr. N.D. Ill. 2016); *In re Intervention Energy Holdings, LLC*, 553 B.R. 258 (Bankr. D. Del. 2016).

E. **Blocking provisions requiring designated director/manager/member consent to file bankruptcy for a bankruptcy-remote special purpose entity** – probably enforceable, but the designated director/manager/member retains fiduciary duties and must be able to vote in favor of bankruptcy if required to fulfill those duties. *In re Kingston Square Assocs.,* 214 B.R. 713 (Bankr. S.D.N.Y. 1997); *In re Gen. Growth Props., Inc*., 409 B.R. 43 (Bankr. S.D.N.Y. 2009).

F. **Pre-bankruptcy waiver of discharge** – not enforceable except as provided in Bankruptcy Code:

- Section 727(a)(10) (court approved post-order-for-relief written waiver of discharge)
- Section 523(a)(10) (nondischargeability of debt in prior case in which debtor waived or was denied discharge); *see, e.g., Lichtenstein v. Barbanel*, 161 Fed. Appx. 461 (6th Cir. 2005) (bankruptcy court approved stipulated waiver of discharge of debt to ex-spouse in first Chapter 7 case under Section 727(a)(10) was enforceable in second Chapter 7 case for purposes of Section 523(a)(10))
- Section 524(c) (post-petition and pre-discharge reaffirmations, subject to reaffirmation procedures and requirements)
- Section 1141(d)(4) (court-approved post-order-for-relief written waiver of discharge in Chapter 11 cases)

G. **Pre-bankruptcy waiver of the automatic stay** – mixed results in case law but even if not enforceable, stipulations and waiver might be relevant to a court's determination of (1) the good or bad faith of a later voluntary bankruptcy filing, (2) whether to dismiss, abstain from or suspend proceedings in the bankruptcy case, or (3) whether to grant relief from the automatic stay. *See In re DB Capital Holdings, LLC*, 454 B.R. 804, 813-14 n. 10-15 (Bankr. D. Colo. 2011) (Hon. Michael E. Romero). Judge Romero's opinion in *DB Capital* included in footnotes 10-15 a summary of case law treatment of pre-bankruptcy stay relief provisions:

Note 10 (enforceable in appropriate circumstances): *In re Bryan Road, LLC*, 382 B.R. 844, 849 (Bankr. S.D. Fla. 2008) (setting forth factors for a bankruptcy court to consider in deciding whether to enforce a stay relief agreement); *In re Frye*, 320 B.R. 786 (Bankr. D. Vt. 2005) (although such an agreement is not per se enforceable, the creditor in that case could obtain enforcement unless the debtor, after an evidentiary hearing, could show sufficient equity in the property, sufficient likelihood of effective reorganization, or sufficient prejudice to other creditors); *In re Excelsior Henderson Motorcycle Mfg. Co.,* 273 B.R. 920 (Bankr. S.D. Fla. 2002) (enforcing a prepetition agreement); *In re Shady Grove Tech Ctr. Assoc. Ltd. P'ship*, 216 B.R. 386 (Bankr. D. Md. 1998) (setting forth several factors as to whether cause exists to warrant relief from stay); *In re Atrium High Point Ltd. P'ship*, 189 B.R. 599 (Bankr. M.D.N.C. 1995) (prepetition waivers by debtor of automatic stay protection are enforceable in appropriate cases where enforcement does not violate public policy concerns, but are not binding on third-party creditors); *In re Cheeks*, 167 B.R. 817 (Bankr. D.S.C. 1994) (prepetition agreements are enforceable on policy grounds of encouraging out-of-court restructuring and settlements, but waivers are not self-executing and are not binding on third parties); *In re Darrell Creek Associates, L.P.,* 187 B.R. 908, 910 (Bankr. D.S.C. 1995) (prepetition waiver-of-stay agreements are enforceable in appropriate circumstances, and such agreements function as a factor in determining whether relief from stay may be granted); *In re Powers*, 170 B.R. 480 (Bankr. D. Mass. 1994) (same); *In re Club Tower L.P.,* 138 B.R. 307 (Bankr. N.D. Ga. 1991) (prepetition agreement granting creditor relief from the automatic stay was binding on the parties where bankruptcy was filed in bad faith); *In re Citadel Properties, Inc*., 86 B.R. 275 (Bankr. M.D. Fla. 1988) (same); *In re Gulf Beach Dev. Corp*., 48 B.R. 40 (Bankr. M.D. Fla. 1985) (while the debtor cannot be contractually precluded from filing bankruptcy, the stay would be lifted for cause).

Note 11 (enforcement supports public policy to encourage out-of-court restructuring and settlements): *See In re Cheeks*, 167 B.R. at 818 ("Perhaps the most compelling reason for enforcement of the [waiver] is to further the public policy in favor of encouraging out-of-court restructuring and settlement.... Bankruptcy courts may be an appropriate forum for resolving many of society's problems, but some disputes are best decided through other means.") (citation omitted); *In re Powers*, 170 B.R. at 483; *In re Club Tower, L.P*., 138 B.R. at 311.

Note 12 (other courts have declined to enforce): *In re Jenkins Court Assoc. Ltd. P'ship,* 181 B.R. 33 (Bankr. E.D. Pa. 1995) (a pre-petition agreement would not be enforced without further development of the facts); *Farm Credit of Cent. Florida, ACA v. Polk*, 160 B.R. 870 (M.D. Fla. 1993) (same); *In re Sky Group Int'l, Inc*., 108 B.R. 86 (Bankr. W.D. Pa. 1989) (a prepetition waiver was not self-executing or per se enforceable)

Note 13 (enforceable only if part of previous bankruptcy case, such as plan of reorganization): *Wells Fargo Bank Minnesota, N.A. v. Kobernick*, 2009 WL 7808949, *7 (S.D.Tex.2009) (slip opinion).

Note 14 (little distinction between pre-petition stay waiver and pre-petition waiver of right to file bankruptcy): *In re Jenkins Court Assoc. Ltd. P'ship*, 181 B.R. at 37 (cited with approval in *In re Clouse*, 446 B.R. 690 (Bankr. E.D. Pa.2 010)).

Note 15 (unenforceable per se): *Matter of Pease*, 195 B.R. 431 (Bankr. D. Neb. 1996)).

H. Pre-bankruptcy stipulation that debt is not dischargeable – generally not enforceable – *Hebl v. Windeshausen* (*In re Windeshausen*), 546 B.R. 798 (Bankr. W.D. Wis. 2016) (agreement to arbitrate, signed by attorneys but not parties, provided that their intent was that the award be non-dischargeable pursuant to *Archer v. Warner*, 538 U.S. 314 (2003); $310,000 award included no findings of fact; defendant claimed his attorney had no authority to agree to the nondischargeability provision; defendant was bound due to his having given the attorney apparent authority and due to his failure to object after notice, thereby ratifying the agreement; however, the provision was not enforceable); *Klingman v. Levinson*, 831 F.2d 1292, 1296 n. 3 (7th Cir. 1987) (against public policy for debtor to contract away the right to a discharge in bankruptcy); *Rice v. Sasse* (*In re Sasse*), 438 B.R. 631, 645 (Bankr. W.D. Wis. 2010 (pre-petition waivers of discharge or promises not to file bankruptcy not enforceable). *See also Lichtenstein v. Barbanel*, 161 Fed. Appx. 461 (6th Cir. 2005) (bankruptcy court approved stipulated waiver of discharge of debt to ex-spouse in first Chapter 7 case under Section 727(a)(1) was enforceable in second Chapter 7 case for purposes of Section 523(a)(10)). But a stipulated judgment that includes a clear intent that the claim not be dischargeable along with detailed stipulations of fact sufficient to meet each element of non-dischargeability under specific Bankruptcy Code provisions may be sufficient to bind the debtor in a later bankruptcy case. *Klingman v. Levinson*, 831 F.2d 1292, 1296-97 (7th Cir. 1987); *Halpern v. First Georgia Bank* (*In re Halpern*), 810 F.2d 1061, 1062, 1064-65 (11th Cir. 1987); *Martin v. Hauck* (*In re Hauck*), 489 B.R. 208, 214-16 (D. Colo. 2013) *aff'd* 541 Fed. Appx. 898 (10th Cir. 2013).

VII. GENERAL DRAFTING ADVICE

- **Avoid debtor claims that lender is bound to an "agreement in principle"** Consider using a pre-negotiation agreement or term sheet with express disclaimers to prevent misunderstandings and claims that lender "agreed in principle" to settle or forbear even though no agreement was signed.

- **Forms**
  - Don't use forms or boilerplate without careful review
  - Don't include provisions you do not understand
  - Beware mixing forms and ending up with:
    - Terms with no definitions or conflicting definitions
    - Provisions that made sense in another deal but not in yours
    - Provisions specific to the law of a state whose law does not apply in your deal

- **Understand the deal and what it requires**
  - What is the specific intent of each party and what are the deal points?
  - What documents (including schedules and exhibits) will be required?
  - Is any diligence or are any disclosures or representations necessary?
  - Must any new entities be created, dissolved or restructured?
  - What specific steps and mechanics are necessary for closing (prepare closing checklist designating deliverables, deadlines, and responsibility)?
  - Are any third party actions or approvals required?
  - Are any legal opinions required?
  - Will any documents need to be filed or recorded with government agencies?

- **Write clearly**
  - So that parties and counsel aren't left in doubt
  - So that a court can later understand and enforce the agreement

- **Provide context**
  - Consider the importance of telling the story inside the agreement—who, what, where, when, why, and how
  - Build in admissions: Consider including admissions that can be offered and received into evidence
  - Use recitals to show why the agreement is reasonable and necessary.
  - Show that alternatives were considered and rejected or were unavailable

- **Be realistic**
  - Use realistic dates for deliverables and deadlines
  - When notice is required or cure is permitted, use reasonable time periods

- **Guarantors**
  - Include guarantors as parties or be prepared to face the argument that their guaranty obligations will be modified or discharged by modifying the underlying obligation.

See, e.g., Restatement (Third) of Suretyship & Guaranty § 41 (Am. Law. Inst. 1996) (general rule is that a guarantor may be relieved of guaranty obligations if the principal obligor and the obligee agree to a modification (excluding an extension of time or a complete or partial release of the principal obligor's duties pursuant to the underlying obligation)).

- Alternatively, have each guarantor sign at the end with an acknowledgement that this is all being done with their knowledge and approval and that they affirm and reaffirm their guaranty obligations.

- **Bankruptcy**
  Consider potential impact of a counterparty's bankruptcy filing and whether to include bankruptcy clauses (*see* Section VI)

- **Review/analysis of draft agreement**
  - Consistency with term sheet and negotiations
  - Internal consistency of provisions
  - Names and domicile of individuals and entities
  - Sufficient definitions of terms, deletion of unnecessary definitions
  - Consistent usage of names and defined terms
  - Removal of stray boilerplate
  - Assure that provisions copied from forms are properly used and, if so properly adapted to this deal
  - Triple check all numbers, dates, and dollar amounts
  - Assure that all dates and time periods work
  - Assure that no claims or liens are released prematurely or inappropriately (*see*, *e.g.*, *Official Comm. of Unsecured Creditors v. JP Morgan Chase Bank* (*In re Motors Liquidation Co*.), 777 F.3d 100 (2nd Cir 2015) (UCC-3 termination statement as to security interest securing $1.5 billion loan mistakenly filed; borrower subsequently filed bankruptcy, leaving loan unsecured)
  - Spot and eliminate ambiguities
  - Anticipate potential issues with debtor non-performance and determine whether the agreement adequately addresses potential default scenarios
  - Verify representations and warranties
  - Verify covenants and conditions
  - Review any provisos or exceptions for clarity
  - Cross-check all internal references
  - Verify each signature line and any necessary verifications/acknowledgements
  - Verify all exhibits and schedules
  - Are any individuals residents of states where spousal signature is required?

22nd Annual Rocky Mountain Bankruptcy Conference
Drafting Issues
-
Enforceability of Self-Executing Termination Provisions

Caroline C. Fuller
Fairfield and Woods, P.C.
Denver, Colorado

We all know that a bankruptcy filing cannot expand or modify the debtor's rights under a pre-petition executory contract or lease. Thus, a lease or executory contract will terminate or expire automatically, post-petition, in accordance with its terms, and that termination or expiration is not a violation of the automatic stay. *See* 11 U.S.C. §541(b)(2) (non-residential lease ceases to be property of the estate when that lease *has terminated at the expiration of the stated term of such lease during the case*); 11 U.S.C. §362(b)(10) (automatic stay does not preclude action of lessor to regain possession of nonresidential real property when the lease has terminated during a case). The automatic stay does not toll the mere running of time under a contract, and thus it does not prevent automatic termination of the contract, post-petition. *Moody v. Amoco Oil Co.,* 734 F.2d, 1200, 1213 (7th Cir. 1984). *See also In re Innovative Communications*, 390 BR 184 (Bankr. V.I. 2008) (pre-petition settlement agreements terminated automatically, post-petition, when debtor failed to make settlement payment by deadline in contract, and settlement agreements provided they would be void if payment was not made by specified date); *In re Mellen*, 79 BR 385 (Bankr. N.D. Ill. 1987) (failure to exercise purchase option by deadline, as extended by §108(b), resulted in termination of option contract). *Accord In Re Empire Equities Capital Corp.*, 405 BR 687 (Bankr. S.D.N.Y. 2009).

The foregoing decisions involve automatic termination or expiration based on a specified event which was not necessarily a default under the lease or contract itself. Thus, the question

arises whether a provision in a lease or executory contract (or forbearance or workout agreement) that calls for automatic termination on account of the debtor's breach – such as failure to make a payment by a specified date – will be enforced post-petition. Whether such a provision will be enforced depends on the language used in the agreement and in any termination notice, whether any cure of the failure to perform is permitted, whether any further action is required by the counter-party if a cure is not achieved by a specified date, and whether a bankruptcy petition is filed during any cure period.

In a decision under the Bankruptcy Act, the Tenth Circuit in *In re Trigg*, 630 F.2d 1370 (10th Cir. 1980), addressed pre-petition oil and gas leases that provided for automatic termination if the lessee either failed to commence production or failed to pay annual delay rentals on or before the anniversary date. The lessee filed Chapter XI, and failed to pay the delay rentals by the post-petition anniversary date. Instead, after the passing of the anniversary date, the debtor commenced adversary proceedings seeking an injunction to prevent termination of the leases. The Tenth Circuit affirmed the lower court rulings that the automatic stay did not preclude termination of the leases according to their terms. It suggested that the bankruptcy court might have the equitable power to enjoin termination were an injunction action filed prior to the expiration date. Since the debtor failed to take any action until after the leases had already expired, however, the bankruptcy court had no authority to "breathe life back into something which has already died." 630 F.2d at 1372. "A contract that provides for termination on the default of one party may terminate under ordinary principles of contract law even if the defaulting party has filed a petition under the Bankruptcy Act." 630 F.2d at 1374.

In *Nicholls v. Zurich Am. Ins. Group*, 244 F.Supp.2d 1144 (D. Colo. 2003), the District Court reached the same conclusion under the Bankruptcy Code, finding that an insurance policy

automatically terminated, post-petition, for failure to pay premiums. In contrast, in *C.O.P. Coal Dev. Co. v. C.W. Mining C. (In re C.W. Mining Co.)*, 422 BR 746 (10th Cir. BAP 2010), the 10th Circuit BAP affirmed a decision of the bankruptcy court finding that a lease had not terminated automatically because an involuntary petition had been filed against the debtor prior to expiration of the contractual cure period. The BAP distinguished the contract in question from contracts which "explicitly provided for automatic termination upon default . . .[and] [n]o action by the non-debtor party was required to terminate the contract, only the passage of time." 422 BR at 755. "[T]he termination must occur automatically, without further action by the landlord. If the termination does not occur automatically but instead requires further action by the landlord, §541(b)(2) has been held inapplicable. In such a case, the exception found at §362(b)(1) would not apply and the automatic stay would bar any action by the landlord to terminate the lease." *Id. at* 756-7. Here, the lease in question provided that, after notice of default and opportunity to cure, the lease "may be terminated" by the lessor – suggesting that further action by the lessor was required to terminate the lease. The automatic stay precluded the lessor from acting, post-petition, to effect such a termination.

The leading decision outside the Tenth Circuit on the issue is *Moody v. Amoco Oil Co.,* 734 F.2d, 1200, 1213 (7th Cir. 1984), *cert. den.* 469 US 982 (1984). There, the circuit court affirmed lower court rulings that found dealership agreements terminated automatically after expiration of the 90 day notice of termination given by the franchisor pre-petition as a result of various defaults under the franchise agreement, since neither the agreements nor the notice of termination contemplated any right to cure after the termination notices were issued. "After the termination notices were sent, all that remained under the contracts was the passage of time until the terminations were complete. . . . The contract gave debtors no right to cure once the

termination notices were mailed. Amoco did not have to take any further action to terminate the contracts; termination was automatic at the end of ninety days." 734 F.2d 1t 1212. Other circuits have also found pre-petition termination notices to be effective post-petition. *See In re Policy Realty Corp.* 242 BR 121 (S.D.N.Y. 1999), *aff'd* 213 F.3d 626 (2d. Cir. 2000) (pre-petition accelerated termination of master lease by landlord upon tenant's failure to pay rent was effective as to debtor's sublease, when master lease terminated upon expiration of time given in notice, with no right of cure; under New York law, when prime lease is terminated by operation of its stated term, the rights of any subtenants of the prime tenant also terminate); *Counties Contracting & Constr. Co. v. Constitution Life Ins. Co.*, 855 F.2d 1054 (3rd Cir. 1988) (failure to pay insurance premiums within grace period, as extended by 11 U.S.C. §108(b), resulted in automatic termination of life insurance policy).

Should a bankruptcy case be commenced while a notice or grace period to cure a pre-petition default is pending, or where the time for performance by the debtor has not expired as of the petition date (such as in exercising a purchase option), there is no doubt, at a minimum, that 11 U.S.C. §108(b) extends the grace period or deadline for performance by 60 days. *Counties Contracting & Constr. Co., supra.* Upon expiration of the extended period, however, neither the automatic stay, nor the bankruptcy code provisions contemplating cure of default upon assumption or assignment, should preclude the automatic termination of the contract, if it is clear either that (a) a termination notice with no further cure period was delivered pre-petition; or (b) under the terms of the contract, the failure to perform some specific act by a specified deadline results in automatic termination of the contract, without any further action by the counterparty. Lower court decisions enforcing automatic termination provisions include:

- *In re Tornado Pizza, LLC*, 431 BR 503 (Bankr. Kans. 2010) - after notices of default and opportunities to cure had expired, franchise agreements were effectively terminated pre-petition, even though termination date did not occur until post-petition; thus, debtor could not assume franchise agreements).
- *In Greenville American Limited Partnership*, 2000 WL 33710874 (Bankr. S.C. 2000) - lease effectively terminated by tenant pre-petition due to failure of debtor/landlord to satisfy conditions precedent to effectiveness, even though effective date of termination notice did not occur until post-petition.
- *In re Diversified Washes of Vandalia, Inc.*, 147 BR 23 (Bankr. S.D. Ohio 1992), automatic stay did not toll termination of franchise agreement where termination notice, with no further cure rights, was delivered pre-petition.
- *In re New Media Irjax, Inc.,* 19 BR 199 (Bankr. M.D. Fla. 1982*)* – supply agreement was effectively terminated pre-petition, despite subsequent discussions regarding possible cure and reinstatement.
- *In re Anne Cara Oil Co.*, 32 BR 643 (Bankr. Mass. 1983) – franchise agreement was effectively terminated pre-petition; §108(b) did not extend the termination date because that provision only extends the time period within which the debtor may perform some act or cure some default; here, there was nothing the debtor could do to reinstate the contract.
- *In re Lauderdale Motorcar Corp., 35 BR 544 (Banrk. S.D. Fla. 1983)* – pre-petition notice of non-renewal was effective to terminate dealership agreement; debtor failed to avail itself of state law statutory remedies to challenge termination within 90 days of delivery of notice.

Where a cure right remains as of the petition date, however, some courts have held that §365 governs the timing of cure, so that defaults under an executory contract may be cured any time prior to assumption, and §108(b) does not limit the time-frame for cure, even if the contract otherwise purports to call for automatic termination without further action by the counterparty if a cure is not effected by a specified date.

- *In re Masterworks, Inc.* 100 BR 149 (Bankr. Conn. 1989) - petition filed during contractual cure period after termination notice delivered by franchisor; debtor retained cure rights under franchise agreement and §108(b) did not limit time period for cure, even though no further action by franchisor was required to terminate franchise agreement if debtor failed to tender timely cure.
- *In re Independent Management Associates, Inc.,* 108 BR 456 (Bankr. N.J. 1989) – franchise agreements, and related default notices, provided that agreements would terminate automatically if monetary defaults were not cured within defined cure period; debtor retained right to assume agreements post-petition, even though termination notices were purportedly self-executing, when petition was filed during cure period; time frame to cure was not limited by §108(b).
- *In re Round Hill Travel, Inc.*, 52 BR 807 (Bankr. Nev. 1985), where petition was filed during cure period under executory contract, §108(b) does not limit time period within which monetary cure may be effected.
- *In re Dunes Casino Hotel*, 63 BR 939 (D. N.J. 1986) - debtor exercised purchase option but failed to close pre-petition, and petition was filed during contractual cure period; option contract remained executory as of petition date, and §108(b) did not limit the time-frame for assumption.

- *In re Tudor Motor Lodge Associates Ltd. Partnership,* 102 BR 936 (Bankr. N.J. 1989) – licensor issued pre-petition termination notice after numerous defaults by debtor, but subsequently agreed to reinstate license should debtor cure various defaults; subsequent documentation was ambiguous as to whether license agreement had been terminated but was subject to reinstatement, or debtor remained in cure period and license had not yet been effectively terminated. Upon bankruptcy filing by debtor, court found license agreement had not been terminated pre-petition, and thus debtor retained right to assume agreement under §365, which right to cure was not limited by §108(b)

Drafting Tips

1. Courts are more inclined to enforce contractual termination rights if they are not characterized as defaults, but as failure to satisfy a condition that permits the contract to move forward. Thus, if the contract provides that it will automatically terminate if a payment is not made, or performance is not completed, by a specified date, such a provision should be enforced post-petition. The court should not modify the agreed terms of the contract. The same should be true for forbearance and workout agreements.
2. In delivering a notice of termination without further cure rights, be precise - don't say "we intend to terminate" on 10th day – say "we hereby terminate" effective in 10 days.
3. If the contract calls for a notice of default and opportunity to cure before it may be terminated, further provide that the contract will terminate automatically, with no further action by the counter-party, if the cure is not effected by the specified cure date. While §108(b) will at a minimum extend the cure deadline by 60 days, courts will be more inclined to enforce automatic termination provisions if clearly set out in the agreement.

4. If notice of default and opportunity to cure is required prior to automatic termination, the notice of default should clearly say that the contract will terminate automatically upon expiration of the cure period without a proper cure. A default notice that says the contract "will be" or "may be" terminated may be interpreted by the court to require a further notice of termination.
5. Once a termination notice has been delivered with no further cure rights, don't engage in settlement discussions. Or, if there is a desire to engage in settlement discussions, memorialize the effective termination of the agreement first, as a condition of further settlement discussions. And, if an agreement is reached that contemplates continuation of the agreement on terms that require further performance by the debtor, the settlement agreement should provide that the agreement has been effectively terminated; but (a) will be reinstated only if the conditions are met by a specified date; or (b) upon satisfaction of the conditions, the parties will be deemed to have entered into a new agreement.

22nd Annual Rocky Mountain Bankruptcy Conference
Drafting Issues
-
Intercreditor Agreements

Caroline C. Fuller
Fairfield and Woods, P.C.
Denver, Colorado

Intecreditor agreements typically define the relative rights, remedies, and obligations of creditors extending financing to a common borrower. When that borrower files bankruptcy, the terms of intercreditor/subordination agreements may have a significant impact on a subordinate creditor's entitlement to adequate protection; ability to challenge the validity, priority, or lien of, or proposed adequate protection to be granted to, a senior lender, ability to vote its claim; and ability to take positions that may be adverse to the senior creditor's position. While the Bankruptcy Code recognizes the enforceability of subordination agreements, 11 U.S.C. §510(a), some courts have expressed a willingness to restrict the enforcement of onerous intercreditor agreements that are perceived to impermissibly restrict the statutory rights granted creditors under the Bankruptcy Code, or otherwise to be inequitable.

> The intent of §510(a) (subordination) is to allow the consensual and contractual priority of payment to be maintained between creditors among themselves in a bankruptcy proceeding. There is no indication that Congress intended to allow creditors to alter, by a subordination agreement, the bankruptcy laws unrelated to distribution of assets.
>
> The Bankruptcy Code guarantees each secured creditor certain rights, regardless of subordination. These rights include the right to assert and prove its claim, the right to seek court-ordered protection for its security, the right to have a stay lifted under proper circumstances, the right to participate in the voting for confirmation or rejection of any plan of reorganization, the right to object to confirmation, and the right to file a plan where applicable. The above rights and others not related to contract priority of distribution pursuant to Section 510(a) cannot be affected by the actions of the parties prior to the commencement of a bankruptcy case when such rights did not even exist. To hold that, as a result of a subordination agreement, the "subordinor" gives up all its rights to the

> "subordinee" would be totally inequitable. *In re Hart Ski Mfg. Co.,* 5 BR 734, 736 (Bankr. Minn. 1980).

Despite this broad pronouncement made by a bankruptcy court early after the enactment of the Bankruptcy Code, many courts have been willing to enforce provisions of subordination agreements that restrict the rights of junior creditors.

In 2015, an ABA task force promulgated an annotated model form of Intercreditor Agreement, which may be found at

https://apps.americanbar.org/dch/committee.cfm?com=CL190029.

The following is a list of key provisions that parties negotiating an intercreditor agreement may want to address, and court decisions addressing the interpretation and enforceability of such provisions.

1. *What Obligations are Covered by the Agreement?*
   - ✓ Clearly define the specific obligations which are subject to the subordination agreement.
   - ✓ If the agreement is intended to cover subsequent lending by the senior lender, be precise.
   - ✓ Is there a cap on the total senior indebtedness?
   - ✓ Does that cap apply to DIP financing?
   - ✓ Does that cap include interest, fees, and costs?
   - ✓ Does the cap include a carveout granted by senior lender in DIP financing or cash collateral agreement in favor of professionals, unsecured creditors?
   - ✓ Is the junior lender subordinating to post-petition interest, fees, and costs, accruing on the senior loan, even if the senior lender is not entitled to recover those amounts under the Bankruptcy Code?

- ✓ What modifications may the senior lender make to the senior loan documents without the consent of the junior lender?
    - o Increase in senior debt
    - o Increase in interest rate
    - o Extension of maturity date
    - o Modification of mandatory prepayment provisions

Silver Point Fin., LLC, v. Deutsche Bank Trust Co. Ams. (In re K-V Discovery Solutions, Inc.), 496 BR 339 (Bankr. S.D.N.Y. 2013). The court considered language in a subordination agreement which provided that Senior Indebtedness included "interest, including, with respect to the Credit Facility, all interest accrued subsequent to the commencement of any bankruptcy or similar proceeding, whether or not a claim for post-petition interest is allowable as a claim in any such proceeding . . . ." A dispute arose as to whether post-petition interest accruing under other loans made by the senior lender to the debtor also was included in Senior Indebtedness. While the senior lender suggested that the language was intended to mean "including, without limitation" post-petition interest on all obligations to the senior lender, the Court found the language to say just the opposite, and restricted post-petition interest only to that arising under the specifically defined Credit Facility.

Buena Vista Home Entm't, Inc. v. Wachovia Bank, N.A. (In re Musicland Holding Corp.), 374 BR 113 (Bankr. S.D.N.Y. 2007). The intercreditor agreement provided that the senior lenders included "any other lender or group of lenders that at any time refinances, replaces or succeeds to all or any portion of the [senior debt] or is otherwise a party to the [senior loan agreements]" 374 BR at 117; and further provided that the junior lenders waived notice of, and automatically consented to, any amendment to the senior loan agreements. Thus, the senior

lenders were contractually permitted to include additional advances from a second lender as part of the senior debt, further subordinating the junior lenders' position. The Court denied claims of the junior creditors that the senior lender was in breach of the intercreditor agreement by facilitating additional advances by a second lender.

In re Ocean Blue Leasehold Prop. LLC, 414 BR 798 (Bankr. Fla. 2009). Intercreditor agreement precluded the junior lender from receiving any distribution *on account of its mezzanine loans* until the senior loans had been repaid in full. The court held that an administrative expense payment for substantial contribution was not a payment on account of the junior lender's mezzanine loans, and thus was not precluded by the intercreditor agreement.

2. *Payment Subordination v. Lien Subordination*

   - ✓ Clearly define whether the agreement contemplates payment subordination, lien subordination, or both.
   - ✓ To the extent payment subordination is contemplated, is the subordination triggered by an event of default, failing which the junior lender is entitled to ordinary course payments in the interim?
   - ✓ To the extent lien subordination is contemplated, what happens if the senior lien is avoided or itself subordinated in a subsequent bankruptcy filing by the borrower?
   - ✓ To the extent the junior lender is subordinating payment to interest, fees, costs, penalties, etc., arising under the senior indebtedness, does that subordination include post-petition interest, even if the Bankruptcy Code would otherwise preclude recovery by the senior lender of some or all of these amounts?

U.S. Bank, N.A. v. Wilmington Sav. Fund Soc'y (In re MPM Silicones, LLC), 531 BR 321 (S.D.N.Y. 2015). The court considered the language of a subordination agreement which

defined "Senior Indebtedness" to include "all indebtedness . . . unless the instrument . . . expressly provides that such obligations are subordinated *in right of payment* to any other indebtedness . . ", and which further provided that Senior Indebtedness did not include any "indebtedness . . that by its terms is subordinate or junior in any respect to any other Indebtedness . . . " (emphasis added). Finding that these provisions referred only to payment subordination, and not lien subordination, the district court affirmed the bankruptcy court's ruling that second lien notes which were secured by a junior lien, but were not subordinated in payment, were included in Senior Indebtedness and thus remained senior in priority of payment to subordinated unsecured notes.

> "It is important to understand the difference between lien subordination and payment subordination. Under a lien subordination agreement, "the subordinating party agrees to demote the priority of its lien to that of another secured creditor, thereby delaying its recourse to the identified collateral until the other party's secured claim has been satisfied." Ryan E. Manns & Camisha L. Simmons, Safeguarding Enforcement of Lien Subordination Agreements, 32-5 AM. BANKR. INST. J. 52, 52 (2013). In contrast, payment, or debt, subordination, "entitles the senior creditor to full satisfaction of its superior debt before the subordinated creditor receives payment on its debt." In re First Baldwin Bancshares, Inc., 2013 Bankr. LEXIS 4086, 2013 WL 5429844, at *7 (S.D. Ala. Sept. 30, 2013). A recent article explains the difference between the two types of subordination:
>
> > Lien subordination involves two senior creditors with security interests in the same collateral, one of which has lien priority over the other. To the extent of any value derived from the collateral (e.g., its liquidation proceeds upon a sale), the senior lien lender is repaid first from collateral proceeds, and the junior lien lender collects only from any remaining collateral value. If the collateral proceeds are insufficient to repay the senior lender in full, then both the senior lien and junior lien lenders, and all other unsecured senior creditors, rank equally in their right to repayment of their remaining debt from the other assets or resources of the borrower. By contrast, in payment subordination, the senior lender enjoys the right to be paid first from all assets of the borrower or any applicable guarantor, whether or not constituting collateral security for the senior or subordinated lenders. Because payment subordination depends only on the amount owed and not on the value of any particular collateral, it is a more fundamental form of subordination and is generally more advantageous to a senior lender.
> >
> > Robert L. Cunningham & Yair Y. Galil, Lien Subordination and Intercreditor Agreements, THE REV. OF BANKING & FIN. SERVICES, May 2009, at 49, 50.

531 BR at 327-28.

3. *Cash Collateral; DIP Financing; Adequate Protection*

   - ✓ Is the junior lender waiving the right to object to use of cash collateral or DIP financing proposed by the senior lender or a third party?
   - ✓ What if the DIP financing includes a "roll-up" of pre-petition debt into the new DIP facility?
   - ✓ What if the proposed DIP financing is junior to the senior lien but senior to the junior lien?
   - ✓ Is the junior lender also subordinating to, or waiving its right to oppose, carve-outs granted by the senior lender in favor of professionals, other junior classes?
   - ✓ Is it waiving any right to object to adequate protection granted to the senior lender?
   - ✓ Is it waiving any right it might otherwise hold to demand adequate protection for itself?

Aurelius Capital Master, Ltd. v. Tousa Inc., 2009 U.S. Dist. LEXIS 12735 (S.D. Fla. 2009). The intercreditor agreement provided that the junior lender was deemed to have consented to the use of cash collateral and waived any right to seek any form of adequate protection in connection with the use of cash collateral. The district court affirmed the bankruptcy court's holding overruling the junior lender's objection to the proposed cash collateral order in favor of the senior lender, and further held that the junior lender had contractually waived its right to appeal entry of the cash collateral order

Enstar Group v. Bank of New York (In re Amret, Inc., 174 BR 315 (M.D. Ala. 1994). Pre-petition intercreditor agreement which subordinated related party obligations to senior debt, including "all obligations . . whether now existing or hereafter arising . . ." applied to post-

petition financing provided by related party which failed to secure a waiver from senior lender or other protection from the senior lender in connection with the DIP financing.

4. *Claims; Voting; Objections to Confirmation*

- ✓ Is the junior lender ceding the right to the senior lender to file a proof of claim on its behalf?
- ✓ To vote its claim in connection with confirmation of any plan?
- ✓ To object to confirmation?
- ✓ To propose its own plan?

In re TCI 2 Holdings, LLC, 428 BR 117 (Bankr. N.J. 2010). Junior secured lenders proposed a plan of reorganization in conjunction with the debtor. The senior lenders objected to confirmation and sued the junior lenders for breach of the intercreditor agreement, contending numerous plan terms were in violation of the intercreditor agreement. The bankruptcy court struggled to interpret plan confirmation requirements, reconciling 11 U..S.C. §1129(b)(1) which permits a cram-down confirmation of a plan "notwithstanding section 510(a)," with §1129(a), which requires compliance with all provisions of the Bankruptcy Code, presumably including §510(a), as a condition of plan confirmation. The court determined that a plan may be confirmed under §1129(b) even if its terms violate the provisions of an enforceable intercreditor agreement. To the contrary, the court in *In re Consul Restaurant Corp.*, 146 BR 979 (Bankr. Minn. 1992), ruled that the terms of an intercreditor agreement should be enforced under the discrimination and fair and equitable concepts of the cramdown section of the Code.

Wilmington Trust co. v. Tribune Co. (In re Tribune Co.), 2014 U.S. Dist. LEXIS 82782 (D. Del. 2014), *aff'd in part, rev'd in part*, 799 F.3d 272 (3rd Cir. 2015). Litigation trust created

pursuant to confirmed plan was a successor to the debtor, and thus terms of subordination agreement would be enforced in connection with distributions to be made by the litigation trust.

Rosenfeld v. Coastal Broad Sys., Inc. (In re Coastal Broad Sys., Inc.) 2013 US Dist. LEXIS 91469 (D. N.J. 2013), *aff'd* 2014 U.S. App. LEXIS 11738 (3rd Cir. 2014); *Blue Ridge Investors II, LP v. Wachovia Bank (In re Aerosol Packaging, LLC),* 362 BR 43 (Bankr. N.D. Ga. 2006). *In re Inter Urban Broadcasting of Cincinnati, Inc.*, 1994 U.S. Dist. LEXIS 16546, 1994 WL 646176 (E.D. La. 1994); *In re Curtis Center Limited Partnership,* 192 BR 648 (Bankr. E.D. Pa. 1996). Subordination agreement authorizing senior lender to vote junior lender's claims in connection with confirmation of the plan was enforced by the bankruptcy court.

Contra., *In re 203 N. LaSalle St. Partnership* 246 BR 325 (Bankr. N.D. Ill. 2000) *Accord*, *In re SW Boston Hotel Venture, LLC*, 460 BR 38 (Bankr. Mass. 2011), *vacated in part on other grounds,* 479 BR 219 (BAP 1st Cir. 2012); *In re Croatan Surf Club, LLC,* 2011 Bankr. LEXIS 4517 (Bankr. E.D.N.C. 2011). 11 U.S.C. §1126(a) and Bankruptcy Rule 3018(c), which provides that only the "holder of a claim" may vote on a plan, prohibit voting of subordinated creditor's claim by senior lender, despite intercreditor agreement expressly granting such right to senior lender.

5. *Challenging Validity, Priority, or Enforceability of Senior Liens*

   - ✓ Is the junior lender waiving its right to challenge the validity, priority, or enforceability of senior liens?
   - ✓ Is the senior lender also waiving its rights to challenge the junior lien?
   - ✓ Do the lien subordination provisions remain in effect if the senior lender's liens are determined to be unperfected, subject to subordination, or otherwise avoidable?

- ✓ Is the junior lender waiving the right to argue that a particular piece of collateral is not collateral for the senior debt?
- ✓ Is the junior lender waiving any right to demand marshalling or appraisal or other valuation of collateral?

Ion Media Networks, Inc. v. Cyrus Select Opportunities Master Fund (In re Ion Media Networks, Inc.), 419 BR 585 (Bankr. S.D.N.Y. 2009). The debtor's reorganization plan was premised on the enforceability of provisions of an intercreditor agreement. The junior lender, which had acquired the subordinated debt at a steep discount and used "aggressive litigation tactics" to gain leverage, opposed confirmation and questioned whether the senior lender's lien attached to FCC licenses which were critical assets addressed in the reorganization. The court found that the junior lender's challenge to the extent of the senior lender's lien was barred by the terms of the intercreditor agreement which expressly precluded junior lender from challenging the priority of the senior lender's liens and claims in any bankruptcy proceeding by the borrower.

6. *Sales Free and Clear*

- ✓ Is the junior lender waiving the right to object to, or comment on, proposed sale procedures?
- ✓ To oppose any asset sale to which the senior lender consents?
- ✓ Such provisions typically at least reserve the right on the part of the junior lender to raise any objection that could be raised by a general unsecured creditor.
- ✓ Is the junior lender waiving its credit bid right?
- ✓ Must the junior lien be released (or does the senior lender have the right to cause a release of the junior lien) upon a sale or other disposition of the collateral approved by the senior lender?

In re Boston Generating, LLC, 440 BR 302 (Bankr. S.D.N.Y. 2010). Junior lenders opposed the debtor's motion to sell assets free and clear of liens. The senior lender argued that the junior lenders had no standing to oppose the sale, under the terms of their intercreditor agreement. The intercreditor agreement granted the senior lender the "exclusive" right to "enforce rights, exercise remedies . . . and make determinations regarding the release, sale, disposition or restrictions" regarding the collateral without consulting with, or the consent of, the junior lenders, so long as the junior lenders' lien attached to the sale proceeds; and that the "sole right" of the junior lenders was to receive their share of any proceeds of disposition, if any, after payment in full of the senior obligations. It further provided that the junior lenders agreed not to "take any action that would hinder any exercise of remedies" by the senior lender, but the junior lenders retained the right to make any objection that could have been made by an unsecured creditor. The senior and junior lender stipulated that the proposed asset sale was not an "exercise of remedies" by the senior lender. The Bankruptcy Court ruled that the junior lenders had standing to oppose the sale, even though it went "against the spirit of the subordination scheme," because there was no express waiver of standing in the intercreditor agreement, and a waiver of rights "must be clear beyond peradventure." The Court nevertheless approved the sale on its merits. Note that the Court contrasted the language in the intercreditor agreement with the language in the ABA model form in conducting its analysis.

7. *Other Rights and Remedies*

   - ✓ Is junior lender waiving right to commence any enforcement action so long as senior debt is outstanding?
   - ✓ To seek the appointment of an examiner, receiver, or trustee?

- ✓ To conduct discovery into the debtor's operations or validity and enforceability of senior liens?
- ✓ To seek a change of venue?
- ✓ To seek or oppose substantive consolidation of related estates?
- ✓ To challenge the bankruptcy court's jurisdiction to determine intercreditor issues?
- ✓ Does/should assignment of either senior or junior loans affect enforceability of terms of intercreditor agreement?
- ✓ Is junior lender waiving rights under 11 U.S.C. §§506(c), 552?

In re Erickston Ret. Cmtys., LLC, 429 BR 309 (Bankr. N.D. Tex. 2010). Junior lenders sought appointment of an examiner, which request was opposed by the senior lenders. The court denied the request premised on terms of a subordination agreement in which the junior lenders agreed not to "exercise any rights or remedies or take any action or proceeding to collect or enforce any of the" subordinated debts without the prior consent of the senior lender, unless the senior debt was fully satisfied. The court ruled the junior lenders lacked standing and had contractually waived their right to seek appointment of an examiner, and that contractual waiver was enforceable. The court observed, however, that, even without the provisions of the subordination agreement which precluded the relief sought by the junior lenders, it would be hard pressed to find any useful purpose for the appointment of an examiner.

22nd Annual Rocky Mountain Bankruptcy Conference
Drafting Cash Collateral and DIP Financing Agreements[1]

Steven T. Waterman, Partner, Dorsey & Whitney LLP

Preparing and drafting cash collateral and debtor-in-possession financing agreements[2] requires anticipation, forethought, and calculation. The drafter needs to understand the objective and the ultimate relief sought. If the objective is not clear then drafting is confused. The drafter must also understand the applicable law and rules with respect to the objective. At times, the parties or the drafter omits what will occur upon the failure of the expectations of the parties. What constitutes default and what are the remedies upon default need to be articulated. Often both collateral and DIP financings are hurried which results in omissions or a lack of clarity.

Standard legal contract drafting best practices should be followed. Ambiguity arises in agreements because of generality, vagueness, language, omissions, and conflicts.[3] Former President Clinton (and a former lawyer) highlighted the importance of words and definitions with his infamous statements: "I never had a sexual relationship with that woman" and "[i]t depends on what the meaning of the word 'is' is." Much has been written on the subject of legal writing, linguistics, and document drafting. Only a few general comments on contract drafting language are made in this paper.

There should never be a question as to who are the parties to the agreement – and the signature blocks should match the defined parties. By knowing the objective, the drafter should be clear and precise in the use of language. Language, definitions, and terms should be consistent. Be careful of the interplay of the agreement you are drafting with the related underlying agreements between the parties, if any. Duplication or redundancy should be avoided to minimize conflicting provisions.[4] The time periods within an agreement should be clearly defined – whether it be an affirmative action, a deadline, or an expiration. A short sentence is typically less prone to ambiguity than a long one. What constitutes a default and what the remedies will be upon default should be clear. Examples of drafting ambiguity cases include: Liparota v. U.S., 471 U.S. 419 (1985); Mylan Inc v. SmithKline Beecham Corp, 723 F.3d

---

[1] Providing the law with respect to 11 USC §§ 361-365 is beyond the scope of this paper. Other ABI materials are available with respect to the legal requirements for those provisions, including: Cash Collateral and Other Secured Lender Issues, Select Issues in Cash Collateral Orders, Caroline C. Fuller, ABI 21st Annual Rocky Mountain Conference (2016); and The Ins and Outs of DIP Financing: Good Money after Bad (How to Make DIP Financing Better), ABI Southwest Bankruptcy Conference (2013); both available at ABIWorld.org.

[2] In this paper the term "agreement" may reference a stipulation, motion, or objection relating to cash collateral or DIP financing.

[3] See Sprint Nextel Corp. v. The Middle Man, Inc., 10th Cir. No. 15–3108 (May 10, 2016); and Pirkheim v. First Unum Life Ins., 229 F.3d 1008 (10th Cir. 2000).

[4] But see, Lamie v. U.S. Trustee, 540 U.S. 526 (2004) (surplusage does not always create ambiguity and preference to avoid not absolute).

413 (3rd Cir. 2013); I.C.C. v. Allen E. Kroblin, Inc., 113 F. Supp. 599 (N.D. Iowa 1953); and Meyer v. CUNA Mutual Ins. Society, 648 F.3d 154 (3rd Cir. 2011).

Procedural Issues

In drafting cash collateral and financing agreements, the drafter should consider the relevant statutes and rules. There are factual predicates necessary for compliance with the applicable statutes and rules. Particular attention should be paid to the statutory requirements for section 364 motions. Reference should be made by the drafter to the following:

a. 11 USC § 363 – use of cash collateral
b. 11 USC § 364 – financing
c. 11 USC § 361 – adequate protection
d. Bankruptcy Rule 4001
e. CLR 4001-3
f. ULR 4001-2
g. Wyoming – no local rule
h. UST Guidelines

Do not forget about or omit to provide for proper notice. Many a motion has been denied for lack of notice. Also, consider the objection period to your agreement and whether interim relief is possible under the applicable rules.

Scope of Liens

The agreement must identify the scope of the liens – whether currently held or being granted. Real property must be described by a proper description. Personal property at times is more difficult to describe – remember the requirements of UCC Article 9. The agreement should describe current collateral and any additional collateral to be provided. The agreement should explain the status of current encumbrances on the collateral and whether replacement liens are being granted – specifically addressing any issues that may be applicable because of 11 USC § 552(b).

Certain assets or provisions as to collateral may be subject to additional scrutiny or liens prohibited thereon. Special attention should be paid to super-priority status, cross-collateralization and liens on avoidance actions. Know the law and issues with respect to these provisions.

Covenants

The drafter should spend time defining each of the covenants to be performed by the parties and the conditions of the agreement. Insurance is a nearly universal covenant. The secured party always provides for insurance but at times the specific requirements are not clearly defined. Budgets are almost always used in connection with cash collateral agreements and at times used in connection with DIP financing (see Use of Collateral below). At times conditions and covenants with respect to management of the DIP are included. These provisions should be carefully drafted to provide the terms, limitations and replacements for management that may exist under specified conditions. More often than not, covenants with respect to financial performance are included in agreements. There may also be a prohibition as to additional liens on the collateral.

Environmental compliance and remediation are now common provisions with respect to real estate collateral. More recently, secured creditors have requested covenants with respect to deadlines for the filing of disclosure statements and plans of reorganization, and for a deadline confirmation of the plan. Without reporting, many of these covenants have no monitoring methodology. The parties need to consider how reporting is to be done, what is to be included and the appropriate time frames for reporting. Some agreements provide for auditing and some of those require the auditing at the expense of the estate. These provisions and their specific terms need to be carefully drafted.

Use of Collateral

The agreement should describe the permitted uses of the collateral. What controls are in place for monitoring the use of the collateral. Typically, the use of soft collateral is tied to budgets and performance covenants. If so, then define the variances that are permitted with respect to the budget both as to each line item and as to the whole.

Waivers and Releases

More often than not agreements will include waivers and releases. Those waivers and releases often extend to claims under section 506(c), or section 553(b), avoidance actions, claim allowance, necessity of filing claims, perfection of post-petition security interests, control of the debtor both pre-petition and post-petition, and other variations.

Miscellaneous Provisions

For underlying agreements that are subject to third-party guaranties, the parties need to determine the appropriateness of third-party consent or participation. Carve-outs are important to the US Trustee, committees, and debtor's counsel. Specific provision must be made in relation to these parties. The drafter must also consider the term of the agreement, renewal, and termination conditions.

Remedies

The parties need to consider what constitutes default and the remedies available when default arises. Default language at times is very general, when specificity provides much greater clarity. The agreement needs to define each event of default with as much specificity as possible. Then, the agreement needs to define the remedies that are self-executing or are available to the party. Parties need to consider whether a cure period exists and, if so, how the cure period begins, when the cure period commences to run, and the time of the cure period.

Various agreements I have seen provide for the automatic stay to be "lifted" but without any definition of what "lifted" means – Did the automatic stay sink?[5] The word "lifted" in not in section 362. Precision in language, utilizing the language of section 362 ("by terminating, annulling, modifying, or conditioning such stay") will provide greater clarity to parties, other parties in interest, and the court.

[5] What does it mean to "lift" the stay? Historically, the automatic stay was referred to as a protective umbrella. "Lifting the stay" would lift or remove the protective umbrella.

Other common remedies include conversion, dismissal, compelled sales of identified collateral (or the entire business), and change of management.

Conclusion

Justice Scalia has provided this instruction: "The main business of a lawyer is to take the romance, the mystery, the irony, the ambiguity out of everything he touches."[6] Writing agreements with respect to cash collateral and DIP financing is the responsibility of the drafting lawyers.

[6] Juilliard School Remarks, Sep. 22, 2005