AMERICAN BANKRUPTCY INSTITUTE

2023 Rocky Mountain Bankruptcy Conference

Employing and Effectively Using Nonattorney Professionals

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CONCURRENT SESSION

2023

Employing and Effectively Using Non-Attorney Professionals

Discussion Outline

1. Intro (5 minutes)
   a. General intro
   b. What are non-attorney professionals?
2. Prepetition Considerations (20 minutes)
   a. Getting non-attorney professionals engaged early
   b. Importance of an early valuation
   c. Consider bankruptcy alternatives
3. Communication flow (15 minutes)
   a. Communication flow with non-attorney professionals
      i. Need to be on the same page
      ii. Balance with privilege considerations
   b. Transparency of a bankruptcy process
   c. Be open about administrative insolvency risk
4. Engagement (20 minutes)
   a. CROs in chapter 11 cases
   b. Preparation of SOFAs and Schedules
   c. Conflict issues
   d. Fee Apps/Billing (327 vs. 328)
5. Open Discussion (Balance of time)

Prepetition Considerations

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Determining a Course of Action

The decision on whether a business should immediately file a chapter 11 petition or attempt an out-of-court strategy depends on several factors. Financial professionals are experts in helping a company determine a course of action based on the following:

- **Size of Company**
  a) Public
  b) Private
- **Number of Creditors**
  a) Secured
  b) Unsecured
- **Complexity of Matter**
- **Nature of Debt**
  a) Prior Relationships with creditors
  b) Pending Lawsuits
- **Executory Contracts, especially leases**
- **Tax Impact of Alternate Selected**
- **Nature of Management**
  a) Mismanagement
  b) Irregularities

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Out-of-Court Alternatives vs. Chapter 11

There are advantages and weaknesses for a Company to pursue an out-of-court restructuring. Financial professionals can provide analysis that helps lay out the different courses of action.

Advantages of Out-of-Court	Advantages of Chapter 11
Less disruptive to business operations.	Orderly, court-supervised process that allows entity or individual to reorganize
More business-like solutions can be adopted.	Does not require 100% agreement from or prepetition payment to all creditors.
Frustrations and delays are minimized.	Automatic stay prevents assets being subject to attack during restructuring.
Agreement often reached much faster.	Ability to assume, reject, or assume and assign executory contracts and unexpired leases
Costs of restructuring are generally less.	Formal mechanism to recover preferences or fraudulent transfers and avoid unperfected liens.
Lower reputational damage risk.	Certain tax benefits during bankruptcy.
	Ability to sell assets “free and clear” of liens and other interests.


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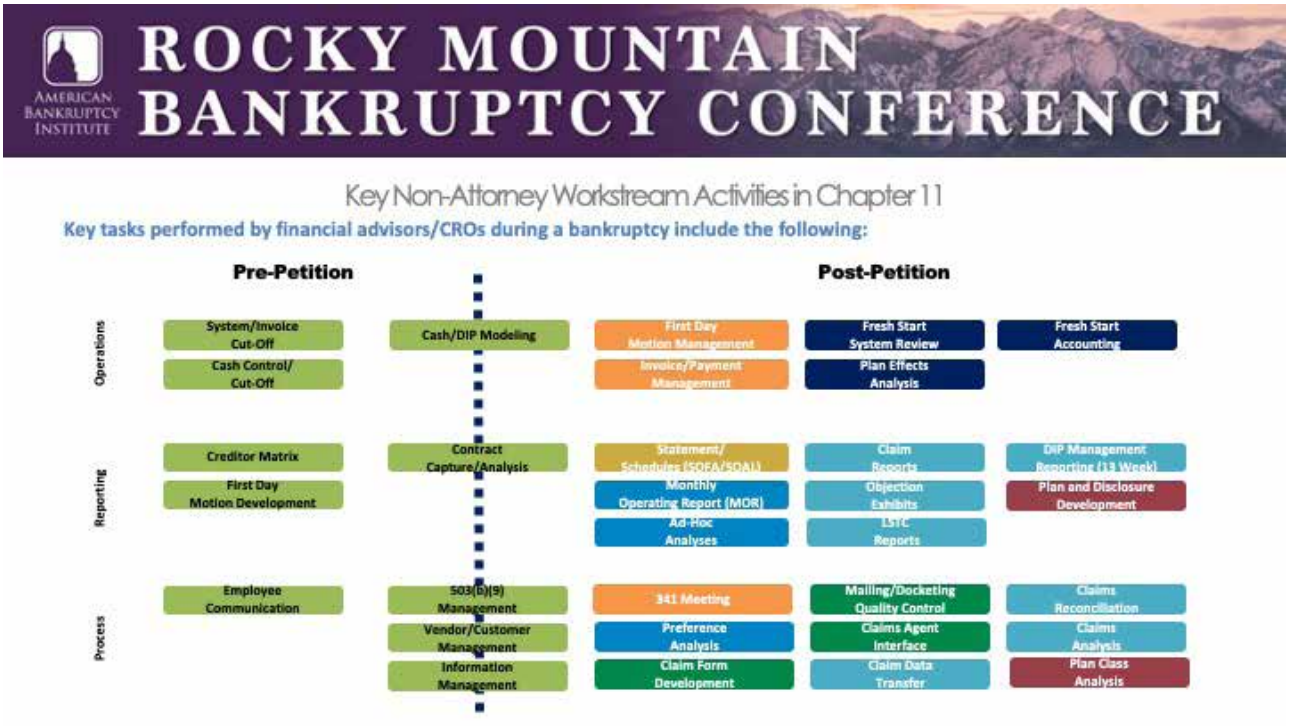
Out-of-Court Alternative
State Court Jurisdiction
Federal Court Jurisdiction
Non-Exhaustive Alternatives to Chapter 11
CONTINUITY
RELIEF
TIME
COST
Lender Workout
Consensual arrangement whereby a distressed company and its lenders adjust credit facilities
High – Mgmt. typically stays
Low – limited to debt addressed
Fast – can be executed quickly
Low Cost
Exchange Offer
Recapitalization or reorganization by swapping one or more types of debt or equity for another security, typically exchange debt for equity
High – Mgmt. typically stays
Low – limited to debt addressed
Depends – longer with registered securities
Low Cost
Composition of Creditors
Consensual arrangement whereby a debtor and its creditors (usually unsecured) agree to a less favorable claim against debtor to reorganize creditor
Moderate - as long as payments are made
Moderate – limited to creditors who agree to be bound
Depends – on complexity of negotiations
Moderate – depends on complexity of agreement
UCC Foreclosure (Article 9)
Similar to a §363 sale by which a secured party forecloses on its collateral by way of public or private sale under the UCC
Depends - on assets subject to foreclosure
Moderate – depends on scope of liens released
Depends – controlled by UCC
Low Cost
Assignment for the Benefit of Creditors (ABC)
Akin to a Chapter 7 bankruptcy whereby a non-court appointed assignee takes control of the debtor's assets, liquidates them, and distributes the proceeds
Low – assignee appointed
Moderate – no automatic stay, no clean title
Depends – deadline for assignee to bond
Moderate – usually limited to % of assets
Receivership*
Process by which a court-appointed fiduciary assumes control of disputed assets and either operates the assets or liquidates them for the benefit of creditors
Low – receiver appointed
High – usually ends in asset sale and distribution to creditors
Long – depending on subject assets
High – cheaper than BK but could be high
Chapter 7
Process by which the assets of a business are liquidated under the auspices of a court-appointed trustee
Low – trustee appointed
High – liabilities generally defeased
Depends - on complexity
Depends - on complexity
*Generally. There are federal receiverships under certain circumstances and for certain types of organizations. Receiverships under most private enterprises are presided over by state courts. These receiverships can be general (over all assets) or limited (over certain assets).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Key Non-Attorney Workstream Activities in Chapter 11
Key tasks performed by financial advisors/CROs during a bankruptcy include the following:
Pre-Petition
Post-Petition
Operations
Reporting
Process
System/Invoice Cut-Off
Cash Control/ Cut-Off
Cash/DIP Modeling
First Day Motion Management
Invoice/Payment Management
Fresh Start System Review
Plan Effects Analysis
Fresh Start Accounting
Creditor Matrix
First Day Motion Development
Contract Capture/Analysis
Statement/ Schedules (SOFA/SOAL)
Monthly Operating Report (MOR)
Ad-Hoc Analyses
Claim Reports
Objection Exhibits
LSTC Reports
DIP Management Reporting (13 Week)
Plan and Disclosure Development
Employee Communication
503(b)(9) Management
Vendor/Customer Management
Information Management
341 Meeting
Preference Analysis
Claim Form Development
Mailing/Docketing Quality Control
Claims Agent Interface
Claim Data Transfer
Claims Reconciliation
Claims Analysis
Plan Class Analysis

Preparing for Bankruptcy – Hiring a CRO Early

- **Financial Preparations**
  - 13-week Cash Flow Creation / Modification
  - Debtor-in-Possession Financing Sizing
  - Business Plan / 3-Statement Projections (pre-packaged, pre-arranged)
  - Enterprise Valuation / Determination of Fulcrum Security (depends on case)
- **Legal / Reporting Preparations**
  - First Day Motion Preparation
  - Creditor Matrix Development
  - Claims Agent Selection
  - Plan and Disclosure Statement (pre-packaged, pre-arranged)
- **Operational Preparations**
  - Bank Management / Payment Cut Off
  - Accounts Payable Cut-Off
  - Petition Date Soft Ledger Close
  - Post-Petition Payment Tracking / Cash Management
- **Communications Preparations**
  - Internal Employee Communications
  - Vendor Management / Escalation Protocols
  - Frequently Asked Questions / External Messaging

Preparing for Bankruptcy – A Case Study

- **Engagement Phase 1 (≈6 Months Before Filing):**
  - CRO was engaged to assist in developing restructuring alternatives to address debt levels and pension obligations
  - CRO helped the company develop an integrated 3-statement model to assist in multiyear business projections
  - CRO also helped the company develop a liquidity forecast to assist in near-term cash management
- **Engagement Phase 2 (≈3 Months Before Filing):**
  - Scope of the CRO engagement was amended to include preparations specifically for a chapter 11 process
  - CRO attended all-day meetings with management team and bankruptcy counsel to address first day motions
  - Over the next several months, CRO worked with company to create analyses supporting the first day motions
  - CRO also worked with the company to gather noticing information for the creditors matrix
- **Engagement Phase 3 (≈2 Months Before Filing):**
  - CRO and its strategic communications team ("Strat Comm") pitched in a competitive process to provide crisis communications services
  - Strat Comm developed a communications roll out plan with considerations for internal and external stakeholders
  - Strat Comm developed a suite of communications documents, including a restructuring microsite
- **Final Preparations (≈1 Month Before Filing):**
  - CRO assisted Company and Counsel with analyses for the development of the plan and disclosure statement
  - CRO worked with the Finance team to develop accounts payable cut off training and other post-petition controls
  - CRO teams began rank-and-file employee trainings to prepare for new normal in a post-petition world

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Communication Flow is Critical

- Communication flow with non-attorney professionals.
  - Need to be on the same page.
  - Delaying does not always save fees.
  - Changes in the case – new information can change conclusions.
  - Balance with privilege considerations.
- Transparency of a bankruptcy process.
  - Level of experience with bankruptcy proceedings.
- Be open about administrative insolvency.
  - Bad news does not get better with time.
  - Strategic with estate needs.

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Engagement of "Crisis Managers" in Chapter 11 Cases

- Jay Alix Protocol
- USTP Manual Regarding Jay Alix Protocol
- Future of USTP's CRO "Protocol" by Clifford J. White III, William K. Harrington, and Nan Roberts Eitel, ABI Journal, September 24, 2018
- *In re Tamarack Resort, LLC*, Bankr. D. Idaho, October 19, 2010.

Protocol for Engagement of Jay Alix & Associates and Affiliates

I. Retention Guidelines

A. Jay Alix & Associates ("JA&A") is a firm that provides turnaround and crisis management services, financial advisory services, management consulting services, information systems services and claims management services. In some cases the firm provides these services as advisors to management, in other cases one or more of its staff serve as corporate officers and other of its staff fill positions as full time or part time temporary employees ("crisis manager"), and in still other cases the firm may serve as a claims administrator as an agent of the Bankruptcy Court. JA&A and its affiliates[1] will not act in more than one of the following capacities in any single bankruptcy case: (i) crisis manager retained under Sec. 363, (ii) financial advisor retained under Sec. 327, (iii) claims agent/claims administrator appointed pursuant to 28 U.S.C. § 156(c) and any applicable local rules or (iv) investor/acquirer; and upon confirmation of a Plan may only continue to serve in a similar capacity. Further, once JA&A or one of its affiliates is retained under one of the foregoing categories it may not switch to a different retention capacity in the same case. However, with respect to subsequent investments by Questor this prohibition is subject to the time limitations set forth in IV.B below.

B. Engagements involving the furnishing of interim executive officers[s2] whether prepetition or postpetition (hereinafter "crisis management" engagements) shall be provided through JA&A Services LLC ("JAS").

C. JAS shall seek retention under section 363 of the Bankruptcy Code. The application of JAS shall disclose the individuals identified for executive officer positions as well as the names and proposed functions of any additional staff to be furnished by JAS. In the event the Debtor or JAS seeks to assume additional or different executive officer positions, or to modify materially the functions of the persons engaged, a motion to modify the retention shall be filed. It is often not possible for JAS to know the extent to which full time or part time temporary employees will be required when beginning an engagement. In part this is because the extent of the tasks that need to be accomplished is not fully known and in

[1] Affiliates of JA&A presently are System Advisory Group (an organization that provides information services), JA&A Services LLC (an entity that provides temporary employees), Questor Management Company LLC, an organization that manages Questor Partners Fund, Questor Partners Fund II, and various Side-by-Side entities, which are limited partnerships that invest in underperforming and troubled companies, and ACT Two (an entity that owns and operates a private airplane). Future affiliates of JA&A, if any, will be subject to the limitations set forth herein.

[2] "Executive officers" shall include but is not necessarily limited to Chief Executive Officer, President, Chief Operating Officer, Treasurer, Chief Financial Officer, Chief Restructuring Officer, Chief Information Officer, and any other officers having similar roles, power or authority, as well as any other officers provided for in the company's bylaws.

part it is because JAS is not yet knowledgeable about the capability and depth of the client's existing staff. Accordingly, JAS shall file with the Court with copies to the UST and all official committees a report of staffing on the engagement for the previous month. Such report shall include the names and functions filled of individuals assigned. All staffing shall be subject to review by the Court in the event an objection is filed.

D. Persons furnished by JAS for executive officer positions shall be retained in such positions upon the express approval thereof by an independent Board of Directors whose members are performing their duties and obligations as required under applicable law ("Board"), and will act under the direction, control and guidance of the Board and shall serve at the Board's pleasure (*i.e.* may be removed by majority vote of the Board).

E. The application to retain JAS shall make all appropriate disclosures of any and all facts that may have a bearing on whether JAS, its affiliates, and/or the individuals working on the engagement have any conflict of interest or material adverse interest, including but not necessarily limited to the following:

1. Connection, relationship or affiliation with secured creditors, postpetition lenders, significant unsecured lenders, equity holders, current or former officers and directors, prospective buyers, or investors.

2. Involvement as a creditor, service provider or professional of any entity with which JA&A or any affiliate has an alliance agreement, marketing agreement, joint venture, referral arrangement or similar agreement.

3. Any prepetition role as officer, director, employee or consultant,[3] but service as a pre-petition officer will not *per se* cause disqualification.

4. Any prepetition involvement in voting on the decision to engage JA&A or JAS in the bankruptcy case, and/or any prepetition role carrying the authority to decide unilaterally to engage JA&A or JAS.

[3] In no case shall any principal, employee or independent contractor of JA&A, JAS and affiliates serve as a director of any entity while JA&A, JAS or any affiliate is rendering services in a bankruptcy proceeding, and JA&A, JAS and their affiliates shall not seek to be retained in any capacity in a bankruptcy proceeding for an entity where any principal, employee or independent contractor of JA&A, JAS and affiliates serves or has previously served as a director of the entity or an affiliate thereof within two years prior to the petition date. During such two year period, neither JA&A, JAS or affiliates shall have provided any professional services to the entity nor shall any individuals associated with JA&A, JAS and affiliates have served as an Executive Officer.

5. Information regarding the size, membership and structure of the Board so as to enable the UST and other interested parties to determine that the Board is independent.

6. Whether the executive officers and other staff for the engagement are expected to be engaged on a full time or part time basis, and if part-time whether any simultaneous or prospective engagement exists that may be pertinent to the question of conflict or adverse interest.

7. The existence of any unpaid balances for prepetition services.

8. The existence of any asserted or threatened claims against JA&A, JAS or any person furnished by JA&A/JAS arising from any act or omission in the course of a prepetition engagement.

F. Disclosures shall be supplemented on a timely basis as needed throughout the engagement.

G. Where JA&A does not act as a crisis manager its retention will be sought as a financial advisor under section 327 of the Code or as a Court appointed claims representative.

II. Compensation

A. Compensation in crisis management engagements shall be paid to JAS.

B. The application to retain JAS shall disclose the compensation terms including hourly rates and the terms under which any success fee or back-end fee may be requested.

C. JAS shall file with the Court, and provide notice to the UST and all official committees, reports of compensation earned and expenses incurred on at least a quarterly basis. Such reports shall summarize the services provided, identify the compensation earned by each executive officer and staff employee provided, and itemize the expenses incurred. The notice shall provide a time period for objections. All compensation shall be subject to review by the Court in the event an objection is filed (*i.e.*, a "negative notice" procedure).

D. Success fees or other back-end fees shall be approved by the Court at the conclusion of the case on a reasonableness standard and shall not be pre-approved under section 328(a). No success fee or back-end fee shall be sought upon conversion of the case, dismissal of the case for cause or appointment of a trustee.

III. Indemnification

A. Debtor is permitted to indemnify those persons serving as executive officers on the same terms as provided to the debtor's other officers and directors under the corporate bylaws and applicable state law, along with insurance coverage under the debtor's D&O policy.

B. There shall be no other indemnification of JA&A, JAS or affiliates.

IV. Subsequent Engagements

A. Pursuant to the "one hat" policy as stated above, after accepting an engagement in one capacity, JA&A and affiliates shall not accept another engagement for the same or affiliated debtors in another capacity.

B. For a period of three years after the conclusion of the engagement, Questor shall not make any investments in the debtor or reorganized debtor where JA&A, JAS or another affiliate has been engaged.

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application was filed should be considered as a request for *nunc pro tunc* approval. Some circuits enforce a rule denying compensation to professionals for work done prior to the filing of an application for employment unless, as a matter of fundamental fairness, the court approves a *nunc pro tunc* application. Some courts limit entry of *nunc pro tunc* employment orders to extraordinary circumstances and not merely because the approval requirement was overlooked. Mere oversight and inadvertence of counsel are not extraordinary circumstances.

Courts permitting a liberal *nunc pro tunc* approach generally consider if:

1. the application would have been approved originally by the court;
2. evidence appears in the record that demonstrates that the court and other interested parties had actual knowledge of the services being rendered;
3. an application seeking an order *nunc pro tunc* has been filed as soon the matter is brought to the applicant's attention; and
4. a sustainable objection has not been filed to the application for fees.

The Supreme Court has criticized the use of a *nunc pro tunc* order as an "Orwellian vehicle for revisionist history" when reviewing a *nunc pro tunc* order in a non-employment setting. *Roman Catholic Archdiocese of San Juan, Puerto Rico v. Acevedo Feliciano*, 140 S. Ct. 696, 701 (2020). Although the better interpretation of *Acevedo Feliciano* is that *nunc pro tunc* retention may be appropriate depending on the facts of the case, bankruptcy courts may apply the decision differently. For instance, one bankruptcy court has interpreted the reasoning of *Acevedo Feliciano* to preclude any *nunc pro tunc* relief for professional retention. *See In re Benitez*, No. 8-19-70230-REG, 2020 WL 1272258, at *2 (Bankr. E.D.N.Y. Mar. 13, 2020) ("[T]his Court will no longer require or grant nunc pro tunc retentions.")

The United States Trustee should enforce the requirement of prior court approval and object to the entry of *nunc pro tunc* orders, if appropriate.

3-7.1.1 Retention of Crisis Managers under 11 U.S.C. § 363

In some cases, the debtor may seek to retain a crisis manager, restructuring adviser, or chief restructuring officer (collectively, "crisis manager"). Although the specific terms of the retention and duties of these persons will vary from case to case, the hallmark of such engagements is that the crisis manager predominantly will assume duties that, outside of bankruptcy, typically would be performed by an officer or full-time employee of the debtor.

Because the nature of the crisis manager's duties arguably renders him or her non-disinterested, and therefore ineligible to be retained as a professional under section 327, debtors frequently seek to authorize the employment of such persons as a non-ordinary course transaction under section 363(b).

Although the USTP has never conceded that crisis managers fall outside the scope of section 327, which governs the retention of professionals, it has been the policy of the USTP not to object to applications to retain crisis managers under section 363(b) as long as certain conditions are observed. These conditions are memorialized in the *Jay Alix Protocol*, a 2003 stipulation between the United States Trustee for Region 3 and a crisis manager.

Among other key terms, the *Jay Alix Protocol* requires the crisis manager to limit itself to a single function in the bankruptcy case. The crisis manager may not fully supplant the debtor's existing management, but must remain answerable to the debtor's independent board of directors. In addition, the *Jay Alix Protocol* requires the crisis manager to file fee applications under procedures similar to those applicable to professionals under section 330 and limits the indemnification rights that the crisis manager's firm may receive. An individual crisis manager may be indemnified to the same extent as state law, the bylaws or other documents of corporate governance permit the indemnification of individual officers or directors, along with insurance coverage under the debtor's D&O policy. The firm or corporate entity for which the crisis manager works may not be indemnified. The *Jay Alix Protocol* does not have the force of law. Rather, it is a compromise that the USTP historically has offered to debtors and crisis managers. As a result, if the debtor or crisis manager rejects any term of the *Jay Alix Protocol*, the United States Trustee retains the right to object to all issues regarding the crisis manager's employment, including the request to be retained under section 363 rather than section 327.

3-7.1.2 11 U.S.C. § 329 and Fed. R. Bankr. P. 2016(b) and 2017

Every attorney for a debtor must file the statement required by section 329 within 14 days of the order for relief setting forth the compensation paid or agreed to be paid for services rendered or to be rendered in contemplation of or in connection with the bankruptcy case and the source of such compensation. Fed. R. Bankr. P. 2016(b) also requires disclosure of any agreement to share compensation with any other entity, other than a member or regular associate of the attorney's law firm. Fed. R. Bankr. P. 2017 permits the court on the motion of a party in interest or on its own initiative to determine whether any payment or transfer to an attorney is excessive. Pursuant to section 329(b), the court may order the return of any excessive payments to the estate or the entity that made the payment.

3-7.1.3 Definition of Professional Person

Professional persons employed pursuant to section 327 or 1103 may be awarded compensation pursuant to sections 330 and 331. Clearly, the statute recognizes that attorneys, accountants, appraisers, and auctioneers are professional persons for whom prior court approval of employment would be required. Occasionally, it is necessary for the trustee, debtor in possession, or committee to contract with outside firms or individuals who do not fall within these categories for assistance in the performance of their statutory duties. In these circumstances, the question sometimes arises whether an order of employment is required. The classic

On Our Watch

By Clifford J. White III, William K. Harrington and Nan Roberts Eitel[1]

Future of USTP'S CRO "Protocol"

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Seventeen years ago, the U.S. Trustee Program (USTP) entered into settlement agreements regarding the terms for the retention of firms providing chief restructuring officers (CROs) and other staff to assist debtors in possession (DIPs) with their chapter 11 duties. These settlements, which have come to be known as the "J. Alix Protocol" after the firm involved, apply the conflict-of-interest provisions of the Bankruptcy Code to the hiring of CROs, who are charged with mixed professional and business-management duties. Courts have approved hundreds of these settlements, which allow employment under § 363(b) (the use of estate property outside the ordinary course of business) while applying the relevant conflict protections of § 327(a) (the employment of professionals).

These settlements have brought predictability and consistency to CRO engagements. Nonetheless, after almost two decades during which the complexity of bankruptcy reorganizations and CRO industry practices have changed significantly, the USTP began outreach to stakeholders more than a year ago to discuss how to update the J. Alix Protocol without disturbing its essential features. While that process unfolds, the USTP will continue to follow the J. Alix Protocol and object to applications that do not comply with it.

Background

In 2001, in *In re Safety-Kleen Corp.*[2] and *In re Harnischfeger Industries Inc.*,[3] bankruptcy courts approved the USTP's settlements of its objections to the DIPs' applications to retain a CRO and the CRO's firm as a restructuring advisor. These cases provided a template for USTP agreements on the employment of CROs that allowed the CROs' employment under § 363 and applied § 327(a)'s relevant conflict protections, such as the bar on a professional's service as a director. CROs, which are hybrids of professional responsibilities covered by § 327(a) and executive functions covered by § 363, did not exist 40 years ago when the Bankruptcy Code was adopted.

Although DIPs retain the authority to appoint *traditional* corporate officers and *salaried* professionals without court approval,[4] the hybrid nature of the CRO's engagement makes them neither fish nor fowl, or (perhaps more accurately) both fish *and* fowl. CROs are not wholly traditional corporate officers, no matter how traditional many of their duties might be, and a DIP's decision to hire a CRO is, by definition, outside the ordinary course of business.[5]

In settling, the USTP recognized the dual nature of the engagements, the litigation risk arising from a CRO's legally uncertain status under a Bankruptcy Code that never contemplated their existence, and the debtors' legitimate need for CRO services at the time of a crisis. The USTP's goal was twofold: (1) Take a principled approach in harmonizing the applicable Code provisions,[6] and (2) provide notice of the USTP's litigating position on this complex issue.

As the U.S. Supreme Court has stated many times, statutory interpretation is a "holistic" endeavor[7] that should avoid (1) rendering other statutory provisions unnecessary and (2) interpreting them inconsistently with the policy of another provision.[8] Statutory construction requires reading "the statutes to give effect to each if we can do so while preserving their sense and purpose."[9] Consistent with these canons, the J. Alix Protocol gives the fullest effect to all of the pertinent Code provisions, including §§ 363(b) and 327(a).

The J. Alix Protocol has no force of law. It merely telegraphs to the bankruptcy community how the USTP interprets and will apply the law in carrying out its statutory duty to review applications to employ. Even though a few courts have criticized the J. Alix Protocol as being too accommodating to the CRO industry,[10] most courts and the CRO firms

1 Mr. White served as an *ex officio* member of ABI's Commission to Study the Reform of Chapter 11 and currently serves in the same capacity on ABI's Commission on Consumer Bankruptcy.
2 Case No. 00-2303 (Bankr. D. Del. 2000).
3 Case No. 99-2171 (Bankr. D. Del. 1999).
4 *See Jacobson v. AEG Capital Corp.*, 50 F.3d 1493, 1500 (9th Cir. 1995) ("[D]irectors still have the power to elect officers.") (quotation omitted); 11 U.S.C. § 327(b) (professionals regularly employed on salary are subject to § 327(b), not § 327(a)).
5 Restructuring in bankruptcy can never be considered "ordinary course" for any business, and courts have approved the retention of restructuring professionals under § 363(b). *See, e.g., In re Liberty Asset Mgmt. Corp.*, No. 16-13575 (Bankr. C.D. Cal. June 9, 2016), Docket No. 94; *In re Interfaith Med. Ctr.*, No. 12-48226 (Bankr. E.D.N.Y. Jan. 25, 2013), Docket No. 177; *In re Qualteq Inc.*, No. 11-12572 (KJC) (Bankr. D. Del. Sept. 2, 2011), Docket No. 135; *In re Hartford Computer Hardware Inc.*, No. 11-49744 (PSH) (Bankr. N.D. Ill. April 12, 2012), Docket No. 270; *In re Colad Grp. Inc.*, 324 B.R. 208, 215 (Bankr. W.D.N.Y. 2005).
6 Section 327(a)'s rigorous disinterestedness requirement makes any officer ineligible for professional employment notwithstanding § 363's more deferential business-judgment standard. It is this statutory conflict and the hybrid nature of CRO engagements that was the genesis for the protocol in 2001.
7 *United Sav. Ass'n v. Timbers of Inwood Forest Assocs. Ltd.*, 484 U.S. 365, 371 (1988).
8 *Ratzlaf v. United States*, 510 U.S. 135, 140 (1994); *Timbers of Inwood*, 484 U.S. at 371.
9 *Matter of Spanish Peaks Holdings II LLC*, 872 F.3d 892, 899 (9th Cir. 2017) (quoting *Watt v. Alaska*, 451 U.S. 259 (1981)).
10 *See, e.g., In re Mirant Corp.*, 354 B.R. 113, 127 n.29 (Bankr. N.D. Tex. 2006) ("The [U.S. Trustee] and other parties acquiesced in this method of retention [under § 363] (which was intended to avoid application to AP of the disinterestedness test of 11 U.S.C. § 101(14) due to AP's personnel serving as officers of Debtors). The court is not satisfied that use of Code § 363 is appropriate for such a purpose, but need not here reach that issue." *Id.*; *contra In re Ajubeo LLC*, 2017 WL 5466655, *4 (Bankr. D. Colo. Sept. 27, 2017) (approving CRO's retention under § 363 and stating that the "[c]ourt believes it is enforcing the Code").

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On Our Watch: Future of USTP's CRO "Protocol"

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have widely accepted and followed the J. Alix Protocol. Therefore, the USTP intends to continue to follow the J. Alix Protocol and to enforce it consistently. Likewise, if proposed CROs deviate from the J. Alix Protocol, the USTP will continue to object to their employment applications under § 327.

Key Provisions of the CRO Protocol

The key ethical and disclosure components of the protocol can be summarized in the following manner.

- *The J. Alix Protocol incorporates §§ 327(a) and 101(14)'s prohibition on serving, or having served within two years, on a debtor's board*. This is important, because the two-year ban is a bright-line rule set forth in statute. Directors — not officers — are vested with ultimate management authority and owe a duty of loyalty to the corporation. A board must be independent of the CRO in order to prevent actual or apparent conflicts of interest, which are key aspects of § 327(a). For example, if the CRO serves on the board while that same board decides to retain the CRO's firm, this insider transaction presents a conflict of interest.
- *The J. Alix Protocol incorporates § 327(a)'s conflict-of-interest rules to bar those with an actual conflict of interest from being retained*. The protocol also avoids conflicts of interest by preventing the CRO from managing the engagement to the financial benefit of the CRO's firm. It does so by establishing the so-called "one hat rule: allowing the professional to serve in only one capacity, such as CRO, crisis manager, financial advisor, claims agent or investor. Similarly, it also bans the CRO's firm from investing in the DIP for two years after the engagement concludes.
- *The J. Alix Protocol incorporates the disclosure requirements governing a § 327(a) application by requiring an affidavit setting forth connections with parties and professionals*. These disclosures are analogous to those required under Fed. R. Bankr. P. 2014. Disclosure and transparency are key to evaluating potential conflicts of interest and enhancing public confidence in the integrity of the system.
- *The J. Alix Protocol requires disclosure of staffing and compensation, as well as a court review of compensation under a "reasonableness" standard, which is analogous to the review of compensation of professionals employed under § 327(a)*. Approval of retention under § 363 alone would deprive the court and the parties of their critical role in protecting the estate by evaluating the justifications for the fees and other payments made to key players who are employed to guide the debtor company through the bankruptcy process.

USTP Consistently Follows J. Alix Protocol

The USTP widely disseminated and posted the J. Alix Protocol, as well as gave notice that the USTP would object under § 327 to any CRO employment application that failed to comply with every component of the protocol.[11] As stated in the USTP manual posted online, "[I]f the debtor or crisis manager rejects any term of the [*J. Alix Protocol*], the [U.S.] Trustee retains the right to object to all issues regarding the crisis manager's employment, including the request to be retained under section 363 rather than section 327."[12] It is fair to say that the USTP's reserved § 327 objection for violations of the J. Alix Protocol is as much a part of the protocol itself as are the conflict and disclosure provisions.

The USTP has occasionally, but rarely, been forced to object to CRO retentions under § 327.[13] More commonly, the USTP resolves these objections once the CRO comes into compliance with the protocol or the debtor withdraws its application if compliance is not possible. The relative absence of CRO retention litigation over the last 17 years is a testament both to the J. Alix Protocol's widespread acceptance and to the CRO firms' adherence to it.

Just as the USTP seeks to bring integrity and efficiency to the bankruptcy system, it also seeks to bring predictability and stability through consistent litigating positions. Any major changes in the jurisprudence governing CRO retentions would create uncertainty and inefficiency for all parties, the court and the USTP.

One recent court decision calls into question the future viability of the J. Alix Protocol and could reopen previously settled questions about CRO retentions going forward. In *Nine West*, the debtors sought to retain a restructuring firm to provide an interim CEO and retain the firm itself to provide additional restructuring services.[14] The CEO had served on one debtor's board of directors for several years and resigned only once a bankruptcy filing was imminent. Thus, given the failure to comply with the J. Alix Protocol's *sine qua non* of an independent board, the USTP objected to the retention under § 327.[15]

The *Nine West* court seemingly approved of the J. Alix Protocol and its ethical protections, noting that "[r]equiring parties to comply with the Protocol has served as a way to avoid conflicts of interest."[16] However, in overruling the USTP's § 327 objection, the court applied neither § 327 nor the J. Alix Protocol and instead ruled that "nothing precludes the Debtors from relying on section 363(b) to seek authorization for the retention of [the restructuring firm and CEO]."[17]

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11 *See* "Volume 3: Chapter 11 Case Administration," *available at* justice.gov/ust/file/volume_3_chapter_11_case_administration.pdf/download (hereinafter the "USTP Manual"; unless otherwise specified, all links in this article were last visited on July 26, 2018).

12 *Id.* at 106-07.

13 *See, e.g., In re Patriot Nat'l Inc.* (Bankr. D. Del. 2018); *Ajubeo*, 2017 WL 5466655; *In re Adams Res. Exploration Corp.* (Bankr. D. Del. 2017); *In re The Adoni Grp. Inc.* (Bankr. S.D.N.Y. 2014); *In re Revstone* (Bankr. D. Del. 2013).

14 *In re Nine West Holdings Inc.*, 2018 WL 3238695 (Bankr. S.D.N.Y. July 2, 2018).

15 The USTP has never knowingly failed to object to a CRO's and his/her firm's retention when a firm member has served on a debtor's board. For example, in *In re Allen Systems Grp.* (Bankr. D. Del. 2015), one of the principals of the CRO's firm had served on the board pre-petition in violation of the J. Alix Protocol. The USTP filed an objection under § 327, and the firm withdrew its application because the conflict could not be remedied.

16 *Nine West* at *6. The court further recognized that the J. Alix Protocol is "designed to avoid the 'inherent conflict' between an advisor's duty to a debtor and its own business interests where the advisory firm serves both as a financial advisor retained pursuant to § 327 of the Bankruptcy Code and as a crisis manager with firm staff serving as officers of the debtor corporation." *Id.*

17 *Id.* at *8.

If case law develops that § 363 is the sole hurdle for CRO applicants, then the J. Alix Protocol might become obsolete and other unintended consequences could follow. For example, because § 363 independently imposes no disclosure requirements or conflict-of-interest standards,[18] the result could be little transparency and accountability for those arguably serving in the most critical role in the chapter 11 case. Furthermore, a "§ 363 only" rule renders future CRO applications susceptible to ad hoc standards, thereby depriving debtors and the CRO industry of the predictability and stability that the J. Alix Protocol affords. If officers provided by restructuring firms are like any other corporate officers and are not subject to § 327's constraints incorporated in the protocol, then those officers are likely insiders for all purposes, including § 503(c)'s limits on insider compensation and bonuses for the firm.

Future of the J. Alix Protocol

Like all policies and practices, the J. Alix Protocol is worthy of reevaluation from time to time. Indeed, the USTP has publicly stated, "We have reached out to participants in the restructuring business and other stakeholders for information on how the Protocol should be updated to account for the facts of modern practice, while remaining faithful to the conflict of interest provisions of the Code."[19] In this outreach to stakeholders, we have explained that in considering any changes to the J. Alix Protocol, we will follow a process similar to that followed for the large-case fee guidelines issued in 2013: Acquire information, publish for comment (even though the Administrative Procedure Act does not apply), convene a public meeting, and issue an updated CRO protocol for final publication.

The USTP should be prudent and careful when considering whether to modify longstanding policy on which creditors, debtors and professionals alike have relied. Thus, we are considering potential consequences as we deliberately reevaluate and study the J. Alix Protocol. For now and the foreseeable future, however, the USTP intends to continue to abide by the protocol and consistently enforce it as we have for almost two decades, because we believe the J. Alix Protocol to be a legally principled approach for employing CROs.

Conclusion

The USTP understands the valuable role that CROs play in business reorganizations. We developed the J. Alix Protocol as a workable framework for analyzing employment applications in a manner that faithfully follows the law and ensures that statutory safeguards against conflicts of interest are observed. With the growing complexity of the CRO industry, some modifications to the protocol might be appropriate. However, it would be a mistake and contrary to statute to jettison the conflict and disclosure provisions of the J. Alix Protocol that govern all other professional retentions in chapter 11.

The USTP stands ready to listen to stakeholders about updating the J. Alix Protocol in a way that does not violate statutory mandates. Unless and until changes are made to the protocol or law, however, the bankruptcy community can continue to rely on the USTP to follow the protocol and to object to employment applications that deviate from its terms. abi

18 At least, not beyond what would be necessary to show a proper exercise of a DIP's business judgment as opposed to the more rigorous standards of § 327 imported into the J. Alix Protocol.

19 "Director's Remarks Delivered at the 33rd Annual Bankruptcy and Restructuring Conference of the Association of Insolvency and Restructuring Advisors," June 7, 2017, *available at* justice.gov/ust/speeches-testimony/remarks-director-33rd-annual-bankruptcy-and-restructuring-conference-association.

UNITED STATES BANKRUPTCY COURT

DISTRICT OF IDAHO

IN RE	)	
	)	**Case No. 09-03911-TLM**
TAMARACK RESORT, LLC,	)	
	)	**Chapter 11**
Debtor.	)	
_____	)	

MEMORANDUM OF DECISION

INTRODUCTION

Pending before the Court are two motions in this chapter 11[1] case. Both are filed by the chapter 11 debtor in possession[2] Tamarack Resort, LLC ("Tamarack"). Tamarack is a Delaware limited liability company organized for the purpose of developing and managing a master-planned, four-season ski and golf resort and real estate development in Valley County, Idaho (the "Resort").

The motions, both filed on September 25, 2010, are inter-related and co-dependent. The first is a "Motion for Entry of Order (I) Authorizing Post-Petition Financing; (II) Authorizing the Debtor's Use of Cash Collateral; and (III) Granting

[1] Unless otherwise indicated, all "chapter," "section," and other statutory references in this Decision are to the Bankruptcy Code, 11 U.S. Code §§ 101-1532 (the "Code").

[2] A debtor in a chapter 11 case, unless supplanted by a trustee appointed under § 1104, is a "debtor in possession" and given many, though not all, of the powers of such a trustee. *See* §§ 1101(1), 1107.

Adequate Protection." Doc. No. 322 (the "§ 364 Motion"). The second is a "Motion for Entry of an Order Approving the Appointment of Links Realty Advisors, Inc., by and through Michael Fleischer, as Responsible Officer for the Debtor Effective as of September 24, 2010." Doc. No. 323 (the "Responsible Officer Motion").

The Motions drew numerous objections by creditors and parties in interest. The Motions and objections were addressed in an evidentiary hearing held on October 12 and 13, 2010, and taken under advisement. This Decision resolves them. The Court concludes that the Motions are not well taken and were inadequately supported by their proponents, and they will be denied.[3]

BACKGROUND AND FACTS

It has been stated, though in a different context, that "To understand how we got where we are, it is necessary to understand where we were."[4] So it is here.[5]

Tamarack has for many years been engaged in the planning, development,

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[3] This Memorandum of Decision constitutes the Court's findings of fact and conclusions of law. Fed. R. Bankr. P. 7052, 9014.

[4] Vern Countryman, *Scrambling to Define Bankruptcy Jurisdiction*, 22 HARV. J. ON LEGIS. 1, 2 (1985) (quoted in *Marshall v. Stern (In re Marshall)*, 600 F.3d 1037, 1050 (9th Cir. 2010)).

[5] This Court has presided over the present case since it was commenced as an involuntary chapter 7 on December 11, 2009. It also presided over two prior chapter 11 cases related to Tamarack, as discussed below. It takes notice of its files and records in all these cases for purposes of providing this admittedly selective summary of the history of this matter. It is also noted that, though the background facts were not subject to evidence submitted at the October, 2010, hearings, the parties all assumed they, and the Court, were familiar with them.

construction, and operation of the Resort, located near Donnelly, Idaho, approximately 90 miles north of Boise. The Resort is composed of a ski facility, a golf course, numerous residential (home, cottage, condo) developments, a conference facility, and commercial and retail facilities. *See generally* Ex. 117 (masterplan map). Tamarack does not own all of the 3,600+ acres of real property comprising the Resort; a majority of the real estate is leased from the State of Idaho.[6] Though much has been accomplished, the Resort is only partially complete. For example, the "Village" complex is roughly 60% complete.[7]

In 2006, Tamarack obtained a loan in the principal amount of $250,000,000 from a syndicate of lenders for which Credit Suisse AG, Cayman Islands Branch ("Credit Suisse") is an "administrative agent" and a "collateral agent."[8] Credit Suisse took security in the Tamarack-owned and the leased land and other assets. The obligation to Credit Suisse went into default, and negotiations ensued. Tamarack, at one point, planned on refinancing this Credit Suisse debt, and other

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[6] In addition to land ownership by Tamarack and Tamarack-related entities (for convenience collectively referred to in this Decision as Tamarack) and the State of Idaho, many individuals have purchased and are now the owners of parcels within the overall Resort development. Tamarack Municipal Association, Inc. ("TMA") has participated on behalf of its member homeowners.

[7] Jean-Pierre Boespflug, manager and CEO of Tamarack, testified on October 12 that some $75,000,000 was spent in constructing this much of the Village, and that another $60,000,000 to $73,000,000 would be needed to complete it.

[8] For simplicity's sake, the Court will at times refer to Credit Suisse alone, intending such reference to include recognition that it acts in such various roles for the lenders.

obligations, through a credit facility with Sociètè Gènèrale, though that refinancing fell apart in early 2008 just as it was scheduled to close due to this prospective lender's own serious financial problems.

On February 15, 2008, Cross Atlantic Real Estate, LLC, and VPG Investments, Inc., filed voluntary chapter 11 cases in this Court.[9] Cross Atlantic and VPG were the limited liability company members of Tamarack, and were guarantors of Tamarack's debt to Credit Suisse. These filings forestalled Credit Suisse's ability to take Cross Atlantic and VPG's membership rights in Tamarack, which had been pledged as collateral.[10]

Credit Suisse, in March, 2008, commenced an action in the District Court of the Fourth Judicial District, State of Idaho, for foreclosure, appointment of a receiver, and other relief, including adjudication of priorities of lien rights.[11]

On October 14, 2008, this Court entered a ruling dismissing the Cross Atlantic and VPG chapter 11 cases. As the state court legal processes continued, a

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[9] *In re Cross Atlantic Real Estate, LLC.*, Case No. 08-00249-TLM; *In re VPG Investments, Inc.*, Case No. 08-00253-TLM.

[10] Cross Atlantic is owned by Boespflug. VPG is owned by Miguel Alfredo Afif. According to a pleading filed in the present case, Doc. No. 215, Tamarack is owned by Boespflug (18.5%), Cross Atlantic (32%), VPG (25.8%), Jerry Barnett (8.3%) and Richard Getty (8.3%).

[11] *See* Case No. CV-08-114C (the "Foreclosure Action"), presided over by the Hon. Patrick H. Owen, Fourth Judicial District Judge. Thereafter, dozens of other cases between and among Tamarack, Credit Suisse, and lien and other creditors have been consolidated into the Foreclosure Action.

receiver, Douglas Wilson, was appointed in late 2008, funded by Credit Suisse.[12] The receivership terminated in mid-2009.

On December 11, 2009, an involuntary petition for chapter 7 bankruptcy relief was filed against Tamarack. Doc. No. 1. Tamarack answered and contested the Petition, and an evidentiary hearing was held on February 24, 2010. On March 17, 2010, the Court entered a decision resolving numerous factual and legal issues presented in connection with the involuntary petition, and entered an order for relief against Tamarack under chapter 7. Doc. Nos. 150, 151.

Prior to the entry of that order adjudicating Tamarack as a debtor under the Bankruptcy Code, the Court entered an oral ruling on January 15, 2010, and a related order on February 3, modifying and lifting the automatic stay of § 362(a) so that Judge Owen in the Foreclosure Action could "proceed to determine the validity, priority and amount (includ[ing] attorneys fees and costs) of any and all mortgages, liens, claims or interests regarding the Real Property, as to any party ... under applicable state law." Doc. No. 101. The State Court has diligently proceeded to hear and resolve a large number of complex and complicated disputes under Idaho state law, some of which are mentioned again below. Litigation in the Foreclosure Action continues.

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[12] Counsel for Credit Suisse represented, in argument on October 13, that Credit Suisse had advanced over $12,000,000 through the receivership, an assertion Tamarack had echoed in a motion earlier in this case. *See* Doc. No. 247 at 16–17.

After the March 17 order adjudicating Tamarack a chapter 7 debtor, Tamarack moved to convert this case to a chapter 11, which motion was granted on April 9, 2010. Doc. No. 190.[13]

Following the conversion to chapter 11, Tamarack is responsible for performing all the duties and obligations imposed by the Bankruptcy Code, Bankruptcy Rules and case law on a debtor in possession (sometimes called "DIP"). In performing those duties, the responsible officer of Tamarack has been its CEO, Boespflug. He and Tamarack have been assisted by counsel.[14]

Tamarack, in this chapter 11, has always had inadequate funds with which to operate, even on a skeletal basis. An early motion for post-petition financing sought approval for Tamarack to borrow $530,000 from Boespflug, Afif, Barnett and Getty personally, noting that each was also a member of an Idaho limited liability company (Friends of Tamarack, LLC) that had previously provided some $10,000,000 of loans to Tamarack when other funding was unavailable.[15]

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[13] Some apparently interpret the conversion to chapter 11 as reflecting an evaluative decision by the Court as to the prospects for Tamarack's reorganization or the desirability of a chapter 11 rather than a chapter 7 liquidation. That would be an erroneous view of the order. Under § 706(a) and the case law, a debtor has an essentially absolute, one-time right to convert a chapter 7 to a chapter 11, and thus the order was here promptly entered on Tamarack's motion.

[14] Randal J. French of Bauer & French, Boise, Idaho, is general counsel under § 327(a) (employment approval effective May 7, Doc. No. 275); Jorian Rose of Venable LLP, New York City, New York, is special counsel under § 327(e) (employment approval effective May 12, Doc. No. 276).

[15] *See* Doc. No. 247. That motion asserted that Tamarack had "been unable to obtain

(continued...)

This motion was never scheduled for hearing. Credit Suisse subsequently filed a motion to prohibit use of cash collateral,[16] which resulted in motions by Tamarack seeking authority to use of cash collateral.[17] *See* § 363(c). Following hearings, an order was entered allowing Tamarack to use approximately $100,000 pursuant to an agreed budget, with such authorization expiring September 13, 2010.[18]

The post-petition authorizations sought and granted have concerned funding of only the most basic administrative functions.[19] Nothing in these authorizations addressed a process by which Tamarack would either reorganize or liquidate, much less operate the Resort in the interim.

However, Tamarack did seek by an application filed in July, 2010, the

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[15] (...continued)
financing of any nature since early 2008" and had exhausted other options to address illiquidity. *Id.* at 15. The motion indicated that this proposed financing would be on a senior secured (priming) basis, carry a 1% loan fee and bear interest at 15% per annum and be paid upon asset sales but not later than March 31, 2011. *Id.* at 5. The motion indicated that Credit Suisse had proposed providing post-petition financing on "substantially more onerous terms." *Id.* at 12–13.

[16] Doc. No. 282.

[17] Doc. Nos. 289, 290, 300.

[18] Doc. No. 303. That agreed use of funding was subject to certain conditions that could cause a termination of the granted authority before September 13.

[19] The approved budget did not provide for, *inter alia*, payment of insurance, payment of land lease payments to the State of Idaho, or any winterization or maintenance on Resort facilities. While the budget provided for payments to TMA and to the North Lake Recreational Sewer & Water District (the "District"), the full amounts of the post-petition accruing debts to TMA and the District were not funded.

judicial approval required under § 327(a) for its employment of CB Richard Ellis ("CBRE"), a real estate consulting and marketing firm, "to attempt to market [the Resort] as a going concern." Doc. No. 278. Credit Suisse objected to that request[20] as did the United States Trustee ("UST").[21] By agreement of those parties and Tamarack, two hearing dates set in September were vacated and the matter is presently set for a hearing on October 25. CBRE's employment by Tamarack remains unapproved.[22]

Tamarack also sought, and was granted, an extension of time through November 5, 2010, within which to assume under § 365 the State of Idaho land lease. Doc. Nos. 286, 287.

As noted, this history and context is important. However, the specific matters before the Court are only two: the § 364 Motion and the Responsible Officer Motion. These Motions must be evaluated on their specific terms, on the evidentiary record presented, and upon the requirements of the Bankruptcy Code, Bankruptcy Rules, Local Bankruptcy Rules and case law that dictate whether they may be granted.

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[20] Doc. Nos. 295, 296

[21] Doc. No. 310.

[22] Boespflug testified that, if the Responsible Officer Motion were granted, Links would have to determine whether to continue to pursue the approval of CBRE's employment or propose a different broker.

The § 364 Motion

On September 25, the § 364 Motion, Doc. No. 322, was filed. Tamarack noticed it for an October 12 evidentiary hearing.[23]

The § 364 Motion seeks authorization for Tamarack to borrow from an unidentified group of "DIP Lenders" the sum of $2,000,000, but indicates that "Candlewood Investment Group or its affiliates" will fund at least 51% and possibly as much as 100% of the amount. Credit Suisse is, again, the administrative agent and collateral agent for the DIP Lenders.[24] No specific DIP Lender appeared, nor testified, and Credit Suisse's long-standing counsel in this bankruptcy appeared simultaneously for Credit Suisse in its pre-petition capacity and for the DIP Lenders.

The Motion contained a summary of the proposed financing, *id.* at 5–11, noting that the terms were further explained in an attached "term sheet." The term sheet, *id.* at 46–65, suggested that the identity of the DIP Lenders was disclosed on a "schedule" thereto, but that schedule was blank. *Id.* at 66. No copy of a lending agreement was provided, and the term sheet, by its own language, indicated that it was incomplete, and did not contain all terms, provisions and conditions of the

[23] Doc. Nos. 324, 325.

[24] A verified statement of Boespflug included in the § 364 Motion asserted that Tamarack negotiated the terms of the proposed financing with the "DIP Agent" (*i.e.*, Credit Suisse) and the DIP Lenders. His testimony, however, suggested his involvement in negotiations was limited to interaction with Credit Suisse alone.

credit facility. It was, effectively, a September 24 draft.

Still, the same outlined a proposed financing arrangement that included the following features:

a) $2,000,000 in DIP financing secured by a first priority lien on all assets, senior to all pre-petition liens (a "priming lien"), and by a superpriority administrative expense claim;

b) the funds would be used to pay (I) the State of Idaho land lease that came due January 1, 2010, in the amount of $250,000 but was not paid; (II) costs and expenses for maintenance and preservation of Resort assets, but not for any "operations" other than such preservation; (III) marketing expenses; (IV) liability and casualty insurance premiums; (V) legal and accounting fees incurred by Tamarack; (VI) expenses of the DIP Lenders; and (VII) interest on the DIP Loan accruing at 15% per annum to the DIP Lenders;

c) the DIP financing would mature and be payable in 6 months from the closing date, or even earlier in the event of default;

d) a 1% "loan fee" would be paid the DIP Lenders from the DIP financing proceeds;

e) a $50,000 "administrative agency fee" would also be paid to the DIP Agent (Credit Suisse) from the DIP Loan proceeds;

f) no portion of the DIP Loan proceeds nor any collateral[25] could be used to challenge the validity, perfection, priority, extent or enforceability of, or the security for, the DIP Loan, or the Credit Suisse receivership claims, or Credit Suisse's pre-petition claims;[26]

g) a carve out for some administrative expenses, specifically including a "disposition fee," if necessary, to the Responsible Officer and payments to the DIP Lenders;

h) a closing date of October 29, 2010 for the DIP Loan subject to satisfaction of all conditions to closing;

i) conditions precedent to closing including (I) provision of an acceptable 6-month budget; (II) retention of the Responsible Officer by order acceptable to the DIP lenders, together with resignation of Boespflug and Afif; and (III) entry of an order approving the DIP Loan;[27]

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[25] "Collateral" was later defined as a first priority security interest in virtually all pre-petition and all post-petition assets of Tamarack including all rights, claims and causes of action except those under certain specified sections of chapter 5 of the Code.

[26] The term sheet did indicate that, if an unsecured creditors committee was appointed, it could expend up to $10,000 in fees and expenses to "investigate" such claims against Credit Suisse and its underlying lenders ("as opposed to asserting a claim or challenge" to those claims) provided that such investigation conclude before the earlier of 60 days of the entry of a DIP financing order or 60 days after the date of appointment of such a committee. *Id.* at 49. The outside date for exercise of this $10,000 concession was later established as November 9, 2010. Doc. No. 353-2 at 37.

[27] The term sheet also provided that such order had to be entered within 10 days of the (continued...)

j) the requirement of the filing of a "sales procedure motion" with the Court within 30 days after the closing[28] which motion had to be acceptable in form and substance to the Credit Suisse Lenders, and the filing of a plan and disclosure statement within 60 days of closing similarly acceptable to Credit Suisse;[29]

k) identification of numerous "events of default" including failure to meet any of the "milestones" or conditions to closing, failure to timely make any payments, and prohibition on Tamarack or any of its insiders or affiliates engaging in or supporting any challenge to or even investigation of claims against Credit Suisse as pre- or post-petition agent or against any of the DIP Lenders or the pre-petition lenders;

l) a stay of litigation in United States District Court Case No. CV 08-

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[27] (...continued)
conclusion of the hearing.

[28] This *post*-closing event could not be a condition *precedent* to closing, though seemingly so styled, and it was subsequently characterized as a post-closing "milestone" that, if unmet, would constitute a default.

[29] The plan filing date was also later characterized as a milestone rather than a condition of closing. Additionally, the term sheet required that such a plan had to waive and release any and all claims of Tamarack arising from or related to the Credit Suisse pre-petition claims, liens, priorities or actions, including waiver of any challenge to validity, enforceability or priority of its liens, including but not limited to any attempt to equitably subordinate or avoid such liens. The term sheet also contained a "negative covenant" that prohibited Tamarack from asserting or consenting to claims against the DIP Agent, DIP Lenders, Credit Suisse as pre-petition agent or the pre-petition Credit Suisse lenders under certain Code provisions or otherwise adverse to their interests.

139-S-EJL between Credit Suisse and Tamarack's guarantors, and a stand-still agreement under which Credit Suisse would agree not to bring other actions against the guarantors and the guarantors would agree not to bring actions against Credit Suisse of the sort immediately above described;

m) Tamarack paying the expenses of the DIP Agent and the DIP Lenders including their counsel, advisors, appraisers, agents, internally allocated expenses, etc.;

n) entry of a DIP Order consistent with all the foregoing and all other terms of the DIP Loan;

o) a replacement lien and security interest, and an administrative expense, to the benefit of the Credit Suisse pre-petition lenders, subject to the DIP Loan and carve out only, to provide adequate protection to such pre-petition Credit Suisse lenders for any diminution in value of their interests due to the priming lien in favor of the DIP Lenders or the continuation of the automatic stay, or the use of Tamarack's property or the lenders' collateral.[30]

There was no budget provided with the Motions explaining how the DIP Loan proceeds could or would be used.

[30] The § 364 Motion proposed no similar adequate protection to any other creditors.

On September 27, Tamarack filed an addendum to the § 364 Motion, consisting of a one-page Sept. 2010 – March 2011 budget.[31]

On September 28, Tamarack filed another addendum to the § 364 Motion. Doc. No. 331. This filing contained a more legible copy of the budget, and a copy of a letter agreement between Tamarack and Links Realty Advisors, Inc. ("Links"), discussed below.

Following numerous objections to the § 364 Motion and the Responsible Officer Motion, Tamarack filed, on Saturday, October 9, another addendum to the § 364 Motion, Doc. No. 353 (the "Saturday Addendum"). The Saturday Addendum provided:

a) a "schedule" of the DIP Lenders, replacing the blank one from the prior term sheet. This schedule disclosed five entities by name only[32] together with their respective "commitment amounts" totaling $2,000,000. No information about any of the entities was ever provided.

b) a 111-page draft of the DIP Credit Agreement. This heretofore undisclosed document bore a notation that it was a "Sidley draft –

[31] Doc. No. 327.

[32] Candlewood Special Situations Master Fund Ltd.; Credit Suisse Loan Funding LLC; GSC Recovery III, LP; GSC Recovery III Parallel Fund, LP; and Airlie CLO 2006-II Ltd.

10/8/10."[33]

The Responsible Officer Motion

The Responsible Officer Motion is brought, according to Tamarack, under § 105(a) and § 1107 of the Code, and also pursuant to or under § 18-407 of the Delaware Limited Liability Company Act.

This Motion asks that Links (by and through its principal, Michael Fleischer) be the "responsible person (the 'Responsible Officer') to act as or on behalf of the Debtor, effective as of the date of the filing of this Motion[.]" It suggests that the Responsible Officer will "act as the manager and governing body for the Debtor in all respects, including to exercise any and all rights and powers of the Members, the Directors, the Board of Directors, the Chief Executive Officer, and all other Officers of the Debtor[.]"[34]

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[33] Credit Suisse's *pro hac vice* counsel in this case is the firm of Sidley Austin LLP in Los Angeles, California.

[34] The Motion also indicates that the governing documents of Tamarack require a Board of Directors of not less than four nor more than eight directors. (An excerpted page from what is alleged to be the governing document is attached to the Motion and so indicates, though it is but one of just a few selected pages provided from what is evidently a much longer document.) The Motion asserts that two of Tamarack's directors "recently resigned" leaving only Boespflug and Afif. Whether that was before or after the alleged "consent of a majority of the Debtor's Board and a majority of its members" to the appointment of Links as a Responsible Officer is not clear in the text of the Motion. However, exhibits to the Motion reflect that Barnett and Getty resigned as directors before Boespflug and Afif entered into their "unanimous" consent as Board members to the appointment of Links. Even if Boespflug, Cross Atlantic and VPG constituted a majority of the members of the Tamarack limited liability company, the attempted act of a two-member Board of Directors appears questionable under the entity's governing documents.

Additionally, in considering this point, the Court notes that an exhibit, Ex. 119, was

(continued...)

This Motion is clear that Boespflug and Afif agree to surrender and delegate to Links their powers to manage and control Tamarack, the DIP. *Id.* at 10. A list of duties to be assumed by Links is specified. *Id.* at 10–11 (para. 30). However, the employment is also subject to a proposed agreement or engagement letter with Links. That document was not provided with the Motion on September 25, but later provided with the September 28 addendum, Doc. No. 331.

The engagement letter reflects that Links' willingness to serve is conditioned upon the following occurring by October 30, 2010, unless Links agrees to an extension of that deadline:

a) provision of D&O insurance in amount acceptable to Links;

b) Court approval of Links' employment; and

c) funding of a DIP Loan adequate to fund the agreed compensation to be paid Links (more fully discussed below) on a current and ongoing basis.

The engagement letter also indicates that compensation is expected to be approved under § 328(a).[35] Links reserves the right to terminate services at any time if it is

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[34] (...continued)
marked by Tamarack for use at the October 12 hearing. It, like all of Tamarack's marked exhibits, was never offered by counsel and consequently never admitted into evidence. The only exhibits admitted at hearing on October 12 and 13 were Ex. 117 (Masterplan map, for illustrative purposes) and Ex. 800 (9/10–3/11 budget). *See* Doc. Nos. 361, 362 (minute entries).

[35] Section 328(a) deals with compensation payable to a "professional person" whose employment under § 327 is approved by the Court. Clarification of § 328 compensation, as opposed to § 330 compensation, of § 327 professionals is important in this Circuit. *See In re* (continued...)

not timely paid.[36] The agreement also terminates automatically six months from the first day of the first full month following execution, though Tamarack and Links could agree on successive 30-day extensions of the engagement, while reserving to either the ability to terminate without cause on 30-days' notice.[37]

The Motion also indicated that certain indemnity and exculpation provisions would be provided Links. The later-provided engagement letter in Doc. No. 331 contained an "annex A" that set out the same. *Id.* at 15–17. Its provisions are broad.[38]

Links' compensation is to consist of:

a) A $33,500 nonrefundable retainer, fully earned upon execution of the agreement and payable at closing of the DIP loan, though the amount would be credited against the "disposition fee" if skiing operations are not reopened;

b) an initial (first) monthly fee of $67,000 and a set fee of $33,500 per

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[35] (...continued)
Circle K Corp., 279 F.3d 669 (9th Cir. 2002). Tamarack, however, has not sought approval of Links' employment under § 327.

[36] Fleischer expressly and candidly testified at hearing that he would exercise that right, and not work without the agreed payment.

[37] The concept that "Tamarack" and Links would negotiate with one another in six months is illusory when Tamarack, under the engagement, would be controlled and managed by Links.

[38] Fleischer also testified on October 13 that, without such provisions, he and his firm would be unwilling to serve.

month thereafter, payable in advance;

c) a "disposition fee" in the event of a transfer or sale of the Resort pursuant to an agreement entered into during Links' engagement (or in the 12 months following termination of the engagement if the agreement is with any person with whom Tamarack or Links had contact within the engagement period regarding such a transaction), calculated as follows:

i) in a non-credit bid structure, 1% of the aggregate Transaction Amount[39] minus an amount ("Creditable Amount") calculated in reference to the number of monthly payments made to Links; or

ii) in a Credit Suisse credit bid scenario, $250,000 minus the Creditable Amount; or

iii) if a chapter 7 sale or a nonbankruptcy foreclosure sale, $175,000;

d) monthly reimbursement for all expenses;

e) additional compensation, and expense reimbursement, for any post-termination attendance at or participation in judicial proceedings relating to the engagement.

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[39] This term is defined in a complicated, though expansive, way. It includes all forms of consideration, including deferred consideration.

On Monday, October 11, a legal holiday[40] and the day before the hearing was to commence, Tamarack filed yet another addendum. Doc. No. 358. It contained a "revised" retainer agreement between Tamarack and Links, to replace that attached to the September 28 addendum. It also contained a proposed order approving the employment of Links.

The Hearing

Objections to both Motions were raised and asserted by the United States Trustee ("UST"); the District; Wells Fargo Bank (as trustee in connection with certain revenue bonds for a District LID); BAG Property Holdings, LLC; Banner/Sabey II, LLC; Tri-State Electric, Inc.; Scott Hedrick Construction; MHTN Architects, Inc.; EZA, P.C. dba Oz Architecture; and Quality Tile Roofing, Inc.

Tamarack's Motions were supported by Credit Suisse (in both pre- and post-petition capacities). The Motions were also supported by TMA, and to a limited degree by the Unsecured Creditors Committee.[41]

Boespflug, CBRE broker Russell Johnson, and Fleischer testified.

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[40] *See* Fed. R. Bankr. P. 9006(a)(6)(A).

[41] The Unsecured Creditors Committee filed an objection to the Motions noting a number of defects and problems, and expressly requesting that the Court deny the Motions. Doc. No. 335. It subsequently filed an "amended statement of support of, with qualification and limited objection to" the Motions. Doc. No. 354. At the October 12 hearing, its counsel effectively conceded the tepid nature of the support for the Motions, but explained that it was clear to the Committee that there was no recovery possible for unsecured creditors should the Motions be denied and, though any recovery were the Motions to be granted was similarly unlikely, they would support the Motions as a "Hail Mary" pass. Counsel departed at the conclusion of the October 12 hearing without having examined witnesses, and did not attend the October 13 hearing.

Boespflug

Boespflug testified that the negotiations on possible DIP financing started with Credit Suisse in June, 2010. He indicated that another entity, from southern California, had earlier indicated during "serious discussions" an interest in providing a $3,000,000 DIP credit facility, but that it did not want to get into due diligence unless it knew that Credit Suisse was "on board" with such financing given Credit Suisse's position as the main lender. Boespflug testified that Credit Suisse did not go along with this proposal, and wanted to handle DIP financing itself.

Boespflug also testified in regard to the 6-month budget submitted in support of the Motion. Ex. 800.[42] In cross examination, Boespflug acknowledged several points:

a) The "cash balance" shown in the budget as presently available (provided the ability to use cash collateral was extended beyond its present September 13 ending date) was inaccurate when compared to either his initial testimonial estimate or the amounts shown on Tamarack's monthly operating reports;

b) The projected receipt of $69,000 in March, 2011, was not certain, as it reflected a claim against the State of Idaho in connection with a

[42] Boespflug testified that the budget was prepared by Fleischer, with Boespflug's input.

reclamation bond that was in dispute;

c) Though the budget did anticipate payment upon DIP Loan approval of $250,000 to the State of Idaho, this would satisfy only the principal amount of the unpaid 1/1/10 lease payment, with no provision made for costs, fees or other charges, and that there was no agreement with the State that it would accept such amount as satisfying the obligation;[43]

d) Some $200,000 to $260,000 of the budget (slightly more than 10%) would be dedicated to maintenance, utilities, and winterizing the property at the Resort,[44] while some 2/3 of the budget was earmarked for legal fees and payments to Credit Suisse or the Responsible Officer; and

e) Only partial payments are projected to be made to the District and to TMA on their ongoing, post-petition claims.

Boespflug additionally acknowledged that Tamarack had no ability to generate cash. And, while the negotiations with Credit Suisse for DIP financing

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[43] Additionally, as noted above, the lease with the State of Idaho is subject to a pending November 3, 2010, deadline for assumption or rejection under § 365. Doc. No. 287. No testimony was provided in connection with how Tamarack proposed to deal with that issue, or how assumption, which requires both cure of defaults and adequate assurance of future performance, would be effected. Boespflug did acknowledge that the budget contained no provision for payment of the 1/1/11 lease payment that would come due during the 6-month period covered by the budget.

[44] Boespflug testified that $30,000 to $40,000 would be required for winterization, and the budget dedicated $50,000 to such efforts.

had started in the summer, the proposal put before the Court was prepared only in late September, after the authority to use cash under the prior cash collateral order had expired on September 13. Lack of cash also meant no skiing operations, and Boespflug acknowledged that there was no provision in the budget for renewal of skiing at the Resort.

Boespflug indicated that there were three existing letters of intent ("LOI") from interested buyers of the Resort, and another "mature interest" without LOI, and perhaps five or six potentially interested parties. However, some, and perhaps all, of these parties would require Credit Suisse to discount its debt in order to go forward with a purchase proposal. Tamarack, according to Boespflug, has an idea of what sort of "discount" by Credit Suisse would be a target, but no specific number was disclosed in his testimony, and no indication given that there was any agreement.[45]

Boespflug indicated that the number of lenders involved in the Credit Suisse syndicate and the complexity of its loan structure complicated the situation, including potential sale. He admitted that the details of potential sale are unformed, and that no draft sale motion has been prepared, even though it would

[45] Boespflug also testified that the potential buyers had inquired about Credit Suisse's ability to "credit bid" in the event of a sale process, an issue not addressed in the Motions. He stated that he conveyed to buyers what he understood to be Credit Suisse's position, which was that it reserved the right to credit bid but might not exercise that right if there were a "reasonable offer." Specifics as to what might be a "reasonable offer" would help Tamarack's marketing efforts, he testified, but had not been provided by Credit Suisse.

be required within 30 days of closing of the DIP financing.

Finally, Boespflug testified that he had wanted more than the $2,000,000 in DIP financing, and a financing period longer than 6 months, but was unsuccessful in getting those terms. He also stated that Fleischer was identified by Credit Suisse as the intended Responsible Officer, and that Tamarack did not consult with creditors other than Credit Suisse in connection with the Responsible Officer proposals.

Johnson

Russell Johnson of CBRE testified regarding the efforts it has made on behalf of Tamarack over the past year. Charged with "making a market" for sale of the Resort, CBRE has attempted to develop and sustain interest from potential buyers. Such parties were advised that the Resort was a "$68,000,000 asset" – a figure CBRE developed with Tamarack. Johnson indicated, however, that the absence of any organized pathway to consummate a purchase has been a significant deterrent in ripening and sustaining the interest of possible buyers. Still, he stated, four very interested parties were developed, some having provided LOIs. The problem now facing CBRE and Tamarack, he said, is getting someone with the authority on behalf of Tamarack to negotiate a final deal, and having a process structured where such a deal could be consummated. He also testified

renewal of skiing was important,[46] and that, if skiing were to occur and if coupled with the potential of a certain sale process, the value of the Resort could be five to six times its liquidation value (often called "salvage" value). What that salvage value was thought to be was never explained.[47]

Johnson felt that the 6-month milestone for a sale motion was "tight" but, given knowledge developed by buyers over the prior year, might be achievable. The primary difficulty, in his view, was the absence of a clear and certain process by which a sale would occur and be closed.

Fleischer

Much of Fleischer's testimony concerned his experience and qualifications to be a Responsible Officer,[48] and the proposed terms of his engagement which have been addressed above. He acknowledged that the Resort was a tough asset to sell, primarily because of the complexity of the project. But he felt that the time lines could be met, as there was general "market awareness" of the availability of

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[46] Johnson felt that renewal of skiing operations was critical to the process, given the target group of potential purchasers and the segment of the population that they would need to appeal to were they to acquire the Resort. Fleischer, on the other hand, testified that renewed skiing might have some potential benefit, but would not be a necessity in marketing and selling the Resort.

[47] Boespflug had opined that, with skiing and a certain sale procedure, a sales price four to five times the "liquidation" value might be obtained, but he did not identify what the liquidation value was.

[48] In cross examination, he acknowledged that he had never been a Responsible Officer before, and also that he was not conversant with the role or duties of a chapter 11 trustee. His familiarity with the duties of a debtor in possession, and how those duties would be addressed if he were the sole officer as well as the Responsible Officer, were issues not fully addressed.

the Resort, even though the process of negotiation and closing of a sale was unsettled. He emphasized that buyers needed to have confidence in the authority and ability of the person with whom they were negotiating, and that the removal of Boespflug was critical to a successful marketing process.

Fleischer had dealt primarily with Credit Suisse and its underlying lenders, but stated that he advised them he would insist on independence. As noted above, Fleischer confirmed several provisions of the engagement, including his position that the compensation structure and indemnification provisions were essential.

These were the only witnesses. As noted earlier, only two exhibits were admitted. That evidentiary record was closed.[49] The disputed matters are presented on that record, plus what is disclosed in or reflected by the several pleadings the Court has outlined above, and on the legal arguments of counsel.

DISCUSSION AND DISPOSITION

A. § 364 Motion

Tamarack's § 364 Motion specifically seeks authority under § 364(c) and § 364(d), characterizing its request as one for "secured superpriority financing."[50]

Section 364(c) provides that, if the trustee (here DIP) is unable to obtain

[49] On October 14, Tamarack filed a "fourth addendum" and a "fifth addendum" to the § 364 Motion. Doc. Nos. 363, 364. These post-hearing submissions are untimely, the record before the Court having been closed. Consideration of them, especially without the ability of adverse parties to evaluate and address them, would be improper.

[50] The Motion also seeks authority to use cash collateral, *see* § 363(c), and proposes to provide adequate protection for that use to Credit Suisse.

unsecured credit allowable as an administrative expense under § 503(b)(1), the court may authorize obtaining of credit or incurring of debt (1) with priority over any or all administrative expenses, (2) secured by a lien on otherwise unencumbered property of the estate, or (3) secured by a junior lien on property.[51] Section 364(d)(1) provides that the Court may authorize the obtaining of credit or incurring of debt secured by a senior or equal lien on property that is already subject to a lien (a so-called "priming lien") but only if (A) the DIP cannot obtain credit otherwise, and (B) there is adequate protection of the interest of any holder of a lien on the property on which the proposed senior lien is to be granted.

The DIP has the burden of showing that it was unable to obtain financing other than on a superpriority or priming basis. *See* §§ 364(c), (d)(1)(A). It also has the burden of proof on adequate protection under § 364(d)(2).[52]

1. Procedural deficiencies

Before considering whether Tamarack has met its burden under §§ 364(c) and (d), the Court first addresses the objecting parties' procedural objections to the Motions.

Bankruptcy Code provisions are implemented by the Bankruptcy Rules, and

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[51] *See generally* 3 Collier on Bankruptcy ¶ 364.04 (Alan N. Resnick & Henry J. Sommer eds., 16th ed.) (hereafter "Collier").

[52] *See generally* Collier at ¶ 364.05; *see also In re Utah 7000, LLC*, 2008 WL 2654919, at *1 (Bankr. D. Utah July 3, 2008) (noting burden on debtor to show a) inability to obtain credit otherwise; b) the transaction is within debtor's business judgment; and c) the interests of all primed lienholders are adequately protected).

Fed. R. Bankr. P. 4001(c) provides that a motion for authority to obtain credit "shall be accompanied by a copy of the credit agreement and a proposed form of order." Rule 4001(c)(1)(A). The motion, if over 5 pages in length, as it is here, must also contain a summary of the relief requested, and a summary of "all material provisions of the proposed credit agreement" together with setting out the location in the relevant document(s) of such provisions. Rule 4001(c)(1)(B). That Rule also lists eleven special provisions, any of which, if included in the borrowing, must be specifically identified and summarized, with their respective locations in the relevant document identified. *Id.* Hearing can commence no earlier than 14 days from the filing and service of the motion (except for emergency relief pending a final hearing, a situation not here presented).

In addition to these provisions of Rule 4001, this Court has enacted LBR 4001.1, which addresses use of cash collateral and obtaining post-petition credit. LBR 4001.1(b) specifies that a request under § 364 must, in addition to the disclosures required by Rule 4001: (1) identify the proposed "lender" and its relationship to the debtor; (2) explain the timing of funding; (3) be accompanied by a line-item budget; (4) provide information on the lender's pre-petition creditor status; (5) describe the collateral intended to secure the borrowing, with an assertion of that collateral's fair market value; (6) if any other entity has an interest in such collateral, identify the creditor and the balance owed such creditor and, if such creditor is to be subordinated or made junior to the lending, disclose whether

that creditor has consented and, if not, how it is to be adequately protected; and (7) disclose whether the proposed financing will include any provision contained in the "Guidelines Regarding Motions to Use Cash Collateral or to Obtain Credit" which are other than provisions normally approved by the Court, clearly identifying any such provisions.[53]

The § 364 Motion was filed and served on September 25 and hearing noticed for October 12. Doc. Nos. 322, 324, 325.[54] As noted by several of the objectors, and in the Court's findings above, the § 364 Motion lacked a copy of the credit agreement as required by Rule 4001(c)(1)(A). It contained instead a "summary of preliminary terms and conditions" bearing a date of September 24, which expressly indicated it was "intended as an outline of certain of the material terms of a DIP loan" and did not include description of all terms and conditions. Doc. No. 322 at 46. That summary did not identify the DIP Lenders, as the "schedule" was blank. *Id.* at 66. The "copy of the credit agreement" required under Rule 4001(c)(1)(A) was not provided in any form until the Saturday

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[53] The Guidelines are contained in Appendix I to the Local Bankruptcy Rules, and note eight provisions normally approved and, under part (b) of that Appendix, twenty provisions that are normally not approved. Appendix I notes that approval of any of the latter twenty provisions at a final hearing under § 364 and Rule 4001 "is dependent on adequate notice and cause having been shown. Inclusion of any of these provisions will be scrutinized by the Court even in the absence of an objection by a party in interest."

[54] The Motion was filed on a Saturday. The fourteenth day thereafter fell on a weekend, and the following Monday, October 11, was a legal holiday. Under Rule 9006(a)(1), October 12 was the first day (*i.e.*, "no earlier than 14 days") on which a hearing could properly be held under Rule 4001(c)(2).

Addendum filed on October 9. Even then, it was not the final agreement, but a draft.

The Rule and Local Rule provisions just summarized recognize the seriousness of post-petition financing motions, and the special circumstances in which they arise. Debtors often need access to credit in order to advance a reorganization, and often on emergent bases. But creditors are entitled to know precisely what is being proposed and provided an opportunity to evaluate the facts, and legal sufficiency, of the request. This is true for all creditors, and even more critical for those creditors whose liens are proposed to be primed under § 364(d).

Fourteen days is relatively little time for interested parties to digest and evaluate a proposed financing arrangement, especially where the financing is complicated, and the agreements governing the financing are long, dense and complicated. Thus, the Rule requires significant disclosure, and the Local Rule requires additional focus on specific issues that commonly arise.

Tamarack's piece-meal disclosure, including its Saturday Addendum which provided for the first time a copy of the 111-page lending agreement, fails to accord with the intent and purpose of these Rules. That last minute disclosure is *per se* unreasonable and objectionable. These violations of the Rules are not, in this case, harmless or nonprejudicial.

Even overlooking the timing issue, the substance of the Motion and serial addenda, fails to provide what the law requires. The identity of the DIP Lenders

was disclosed inadequately as well as late. The relationships between Credit Suisse's pre-petition lenders and the DIP Lenders is unclear. The pleadings fail to assert the fair market value of the collateral, and there is no disclosure of the fact that, as several objections have pointed out, Judge Owen has determined that some lienors have priority positions as to Credit Suisse. LBR 4001.1(b)(1), (3), (4), (5) and (6) are implicated.

In addition, the lending agreement, once it was disclosed, clearly contains provisions that fall within LBR 4001.1(b)(7), and require special disclosure.[55] The provisions found in part (b) of LBR Appendix I are clearly specified, and are available to parties as they draft proposed credit agreements.[56] They were promulgated by the Court based upon experience, and with the awareness that a DIP often lacks significant negotiating leverage and that creditors may be tempted to overreach. As one court has stated:

> Courts recognize that in connection with postpetition financing, lenders often exact favorable terms that may or may not have the effect of

[55] Many of those relate to special terms favoring Credit Suisse in plan treatment or litigation. These include provisions that bind the estate and all parties in interest with respect to the validity, perfection and amount of the Credit Suisse pre-petition debts; provisions that operate as a practical matter to limit or divest Tamarack of any discretion in the formulation of a plan or administration of the estate, or limit access to the court to seek any relief under applicable law; releases of potential pre-petition liabilities of Credit Suisse lenders, as well as releases of pre-petition and post-petition defenses and/or counterclaims; and provisions that waive causes of action. *See* LBR Appendix I at (b)(2), (9), (10), and (11).

[56] Tamarack was certainly aware of these provisions as its motion for financing in June, 2010, not only referred to Appendix I, *see* Doc. No. 247 at 6, but also stated that in unsuccessfully negotiating post-petition financing with Credit Suisse, Credit Suisse "sought to impose a variety of terms which [Tamarack] believed were overly burdensome, and which would likely have run afoul of BR 4001(c) and Local 4001.1," *id.* at 15.

> causing harm to the estate and creditors. *See In re Defender Drug Stores, Inc.*, 145 B.R. 312, 317 (9th Cir. BAP 1992), citing *Ames Department Stores*, 115 B.R. [34 (Bankr. S.D. N.Y. 1990)] at 38; *In re Tenney Village Co., Inc.*, 104 B.R. 562, 567–570 (Bankr. D. N.H. 1989). As the court in *Defender Drug Stores* pointed out,
>
> [w]hile certain favorable terms may be permitted as a reasonable exercise of the debtor's business judgment, bankruptcy courts do not allow terms in financing arrangements that convert the bankruptcy process from one designed to benefit all creditors to one designed for the unwarranted benefit of the postpetition lender. Thus, courts look to whether the proposed terms would prejudice the powers and rights that the Code confers for the benefit of all creditors and leverage the Chapter 11 process by granting the lender excessive control over the debtor or its assets as to unduly prejudice the rights of other parties in interest.

In re Mid-State Raceway, Inc., 323 B.R. 40 (Bankr. N.D. N.Y. 2005). While Tamarack mentioned a few such provisions in the Motion, Doc. No. 322 at 16–17, not all were, and no required cross references to the credit agreement were made. *See* LBR 4001.1(b)(7); *see also* Rule 4001(c)(1)(B).

One of the substantive areas addressed by the objectors is the failure of the § 364 Motion to identify the fair market value of the collateral, which is a factor related in part to the adequacy of disclosure of how Tamarack proposes to provide adequate protection to affected creditors. *See* Rule 4001(c)(1)(B); LBR 4001.1(b)(5), (6)(B)(ii).[57]

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[57] Adequate protection, when required under § 364, may be provided by cash payments or an additional or replacement lien, or other relief as will provide the affected creditor the indubitable equivalent of its interest. *See* § 361. Tamarack proposes no cash payments nor any replacement or additional liens to primed non-Credit Suisse creditors. Adequate protection is effectively premised on the value of the property, now and after DIP financing.

(continued...)

There is also no description of adequate protection proposed to be provided any creditor other than Credit Suisse. This is true even though the State Court in the Foreclosure Action has entered decisions addressing the lien priority of several non-Credit Suisse creditors who are proposed to be primed and are statutorily entitled to adequate protection.[58]

The Court could, as one creditor's counsel suggested in argument, summarily deny the § 364 Motion for the failures to comply in so many separate regards with applicable disclosure requirements and the balance of the Rules. However, in its discretion, the Court has also considered the substance of the disclosures, though untimely, and the evidence presented by Tamarack in its

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[57] (...continued)
Collier at ¶ 364.05[1], states in pertinent part:

> The ability to prime an existing lien is extraordinary, and in addition to the requirement that the trustee be unable to otherwise obtain the credit, the trustee must provide adequate protection for the interest of the holder of the existing lien or obtain such lien holder's consent. ...
>
> In most cases, adequate protection is provided by conditioning or limiting the borrowing in order to maintain a sufficient equity in the subject property to protect the existing lienholder. ...
>
> When the effect of the new borrowing with a senior lien is merely to pass the risk of loss to the holder of the existing lien, the request for authorization should be denied absent the lien holder's consent. The authorization to prime an existing lien should not be read as authorization to increase substantially the risk of the existing lender in order to provide additional protection for a new, postpetition lender.

[58] Credit Suisse acknowledged in argument what Banner/Sabey, BAG and the District alleged – that Judge Owen had entered decisions indicating priority of liens held by those creditors over the liens of Credit Suisse. That Credit Suisse intended on continuing litigation, or contested the amount of those creditors' priority liens, did not negate the requirement that Tamarack identify those creditors, propose adequate protection, and prove that the protection offered was indeed adequate.

attempt to meet the burdens placed on it by § 364(c), § 364(d) and the case law.

2. Evidentiary deficiencies

Tamarack's allegation that it extensively investigated and explored financing options to the DIP Loan ultimately proposed and could not otherwise obtain credit was belied by the evidence. Not only was there inadequate proof of those efforts actually being made, Boespflug testified that there was a $3,000,000 DIP financing possibility that was lost because Credit Suisse wished to control the lending.

Similarly, Tamarack's assertion that the interests of the objecting creditors will be adequately protected is not supported by the evidence. The suggestion made by Tamarack as to "adequate protection" was not premised on the existence of an equity cushion (value over secured debt) as to any one or all creditors.[59] Rather, Tamarack essentially concedes that the value of the Resort will be grossly insufficient to secure the Credit Suisse pre-petition debts under the $250,000,000 facility, the receivership debts of $12,000,000 and the several other lien claims (whether prior to or junior to Credit Suisse).[60] Instead, Tamarack appears to

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[59] *Cf. Utah 7000, LLC*, 2008 WL 2654919, at *3–4 (rejecting an argument by Credit Suisse as agent for pre-petition lenders that the value to be used in evaluating adequate protection was a liquidation value and concluding, instead, that the court should determine value on a case-by-case basis, and also concluding that affirmative evidence of value presented in that case established an equity cushion sufficiently in excess of secured claims so as to provide adequate protection).

[60] The schedules set forth secured creditors' claims totaling over $347,000,000 and another $5,000,000 in "unsecured" creditors, many of whom are noted as "lien claims." Doc. No.

(continued...)

contend that the value of the Resort, should the DIP Loan be approved, would be sufficient to secure the DIP Lenders' $2,000,000 interest, as well as protect the interests of those secured creditors with liens prior to the lien held by the Credit Suisse pre-petition lenders. The Motion, however, did not identify those lienholders or specify the amount of those claims or the collateral therefore. Thus, the argument appears to be that the Credit Suisse pre-petition lenders, who have consented to the DIP Loan (and who are also offered adequate protection), would be the only secured creditors whose primed interests might be adversely affected. The argument presumes there will be no value left in the Resort for any interests junior to the Credit Suisse pre-petition lenders.

Tamarack's evidence regarding the value of the Resort is unclear and widely variable. Tamarack asserted, in its bankruptcy schedules, that its real and personal property together was worth just under $58,000,000.[61] Such filed schedules signed under penalty of perjury have some evidentiary effect[62] though they are not conclusive. CBRE was instructed to "make a market" for the Resort at a value of $68,000,000 according to the testimony of its vice president, Russell

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[60] (...continued)
213.

[61] Doc. No. 213.

[62] *See In re Martell*, 349 B.R. 233, 234 n.1 (Bankr. D. Idaho 2005) (assertions in a debtor's schedules made under penalty of perjury may be considered by the court as evidentiary admissions).

Johnson.[63] Johnson, Boespflug and Fleischer were all quite circumspect in discussing the ranges of potential values of the Resort reflected by letters of intent or other expressions of buyer interest, given that there were confidentiality agreements entered into with prospective buyers or bidders. Though their hesitancy was understandable, this left Tamarack with thin evidentiary bases for suggesting the present value, or prospective sale value, of the Resort.

Complicating this case is the complex nature of the Resort. Several of the objectors hold liens on properties that represent only portions of the entire Resort; properties on which they performed labor or for which they furnished materials or services.[64] Yet, Tamarack provided no evidence as to the fair market values of those separate properties. Instead, the evidence, as unclear and variable as it was, related to the value of the Resort as whole. Thus, no evidence was presented to show that, should a sale of the Resort as a whole not be accomplished, the non-Credit Suisse primed creditors would nonetheless be protected to the same extent they would be without approval of the DIP Loan. It was Tamarack's burden to present such evidence. It did not.

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[63] During his testimony, Boespflug indicated another estimate of value would be "15 times" the $2,000,000 provided under the proposed DIP Loan. However, the context of this $30,000,000 "valuation" was rather vague and never clarified.

[64] For example, Banner/Sabey asserts a mechanic's lien on the Village Plaza property, a property upon which it performed labor or furnished materials as general contractor. *See* Doc. No. 340 and 341. Similarly, EZA claims a mechanic's lien on the Village Plaza and the Trillium Townhomes properties, Resort properties for which it provided architectural services. *See* Doc. No. 352.

On the evidence presented, the DIP Loan would appear headed for default. There is no sale process motion yet drafted, even though it is due 30 days after DIP Loan closing in order to avoid a default. There is no Credit Suisse commitment to a discount or to how it would credit bid. Boespflug testified only that the subjects had been raised, and that Credit Suisse suggested it would reserve the right to credit bid but perhaps waive that right if a "reasonable" offer were made, though what that amount might be is unknown to Tamarack. Johnson and Fleischer both noted that the financial and legal situation at the Resort was complex, and that this complicated the creation of a sales structure. That makes the short time frames even more problematic and, indeed, unrealistic at least on the evidence the parties presented.

The "milestones" are all weighty and on short fuses. And, the requirements of a sales procedure motion and a plan and disclosure statement are not only time sensitive; the agreement Tamarack proposes gives Credit Suisse (in some capacity) approval authority over their terms.[65] Not only is such control over the

[65] Milestone requirements are shown on schedule 1.1(c) on pages 109–110 of Doc. No. 353-2, part of the Saturday Addendum. The sales procedures motion must be in accordance with § 5.20B of the agreement. *Id.* That section requires that the terms and conditions of the sales procedures motion be in form and substance acceptable to the "Requisite Lenders" in their sole discretion. *Id.* at 70. Requisite Lenders is defined as holders of more than 50% of the aggregate loan exposure of all "Lenders." *Id.* at 28. Lenders is defined by reference to the agreements "preamble," *see id.* at 21, and that preamble, *id.* at 8, refers to the (presently draft) signature pages. The approach leaves ambiguous whether "Requisite Lenders" includes lenders in Credit Suisse's pre-petition syndicate as well as the so-called DIP Lenders, in large part because of inadequate disclosure of the identity and connections of the putative post-petition lenders. In this regard, it is also noted that the milestones also include a "conforming plan" that meets § 5.20C of

(continued...)

DIP suspect, *see* LBR 4001.1(b)(7) and Appendix I at (b)(2), (9), (10), (11), it suggests the likelihood of default is high.

Default under the proposed agreement gives Credit Suisse the benefit of the priming loan.[66] Default also defeats the theory advanced regarding adequate protection for the non-Credit Suisse lien holders. Their protection, it is argued, comes from the likelihood of increased fair market value, and a protection against loss of existing value, of the Resort should the DIP Loan be approved. Default could erase that alleged protection, and the higher the risk of default, the more speculative the protection. Credit Suisse's control over the sale and plan process, and the short milestone deadlines, especially given the balance of the evidence as to the complexity of sale and the lack of commitment of Credit Suisse to discount or credit bid, make the risk of default high, and concomitantly reduce the "adequacy" of the alleged protection.

It was Tamarack's burden to establish the adequate protection to non-Credit Suisse lienholders proposed to be primed, and it did not meet that burden.

Even though DIP financing would have the potential benefit of providing

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[65] (...continued)
the agreement, which section, *id.* at 70, includes a requirement of waiver and release of claims (including but not limited to equitable subordination) against the Credit Suisse pre-petition lenders.

[66] The UST and Wells Fargo Bank cogently observed in argument that in return for a short-term $2,000,000 in DIP financing, a very small percentage of what Credit Suisse already has at stake, Credit Suisse potentially gains significant benefits whether Tamarack moved forward with sale and a plan (on Credit Suisse-approved terms) or defaulted.

funds for winterization and for casualty and liability insurance (expenditures no one argued were unreasonable), and provided sums for a partial payment of amounts owed the State of Idaho under its lease, Tamarack had to show that the financing was properly structured, disclosed and supported by evidence. It did not.

All of the foregoing provides ample grounds for the denial of the § 364 Motion.

B. Responsible Officer Motion

The fact that the § 364 Motion is inextricably linked to the Responsible Officer Motion is additional justification for denial.[67]

Tamarack suggests the appointment of a Responsible Officer is proper under § 105(a) and § 1107.[68] Recognizing these provisions do not directly provide authority for the relief sought in the Motion, Tamarack cites *Matter of Gaslight Club, Inc.*, 782 F.2d 767 (7th Cir. 1986), and *In re Boileau*, 736 F.2d 503 (9th Cir. 1984), as "implicitly" approving its approach. Neither case offers persuasive support. They are distinguishable and, at best, limited to their facts, and they do

[67] That linkage is Tamarack's and Credit Suisse's. *See*, *e.g.*, Responsible Officer Motion, Doc. No. 323 at 2 n.1; § 364 Motion, Doc. No. 322 at 2.

[68] Section 1107(a) defines generally the powers of a DIP. Section 105(a) grants the Court the power to enter any order "that is necessary or appropriate to carry out the provisions of [the Code]." Despite the breadth of § 105(a), it may not be used to create new rights or remedies but, rather, is designed to allow for implementation or enforcement of other Code provisions. *Walls v. Wells Fargo Bank, N.A.*, 276 F.3d 502, 507 (9th Cir. 2002); *S & C Home Loans, Inc. v. Farr (In re Farr)*, 278 B.R. 171, 179 (9th Cir. BAP) (citing *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988)).

not provide the sort of broad pronouncement of power under § 1107 and § 105 that Tamarack suggests.

The term "corporate restructuring officer" (or "CRO") has been used in reorganization practice. It often refers to those hired by financially distressed businesses before, and as a way to avoid, bankruptcy. However, it is not so easily transported into the post-bankruptcy context. As noted in *In re Kobra Props.*, 406 B.R. 396 (Bankr. E.D. Cal. 2009):

> At the outset of the case, the debtors in possession proposed hiring a "chief restructuring officer" (CRO) in an effort to defuse fear and loathing by various banks regarding self-dealing and lack of transparency. This elicited skepticism because of the vagueness of the CRO concept in the context of chapter 11 (as opposed to the turnaround and workout environment) and the inability to articulate whether and to whom a CRO would owe fiduciary and loyalty duties and how those duties would contrast with the duties of a chapter 11 trustee. The initial CRO request was withdrawn.
>
> When, months later, the debtors in possession revived their CRO proposal in the face of persistent cash collateral issues, the denouement was agreement that the proposed CRO could be appointed as chapter 11 trustee.

406 B.R. at 400–01. And in *In re Blue Stone Real Estate, Constr. & Dev. Corp.*, 392 B.R. 897 (Bankr. M.D. Fla 2008), the court rejected an attempt to use § 363 as support for employment of a CRO because it avoided the analysis required under § 327(a), which governs the estate's employment of a professional. 392 B.R. at 906–07.

Employment of Links under 327(a) is not, however, what the Responsible Officer Motion advocates. It doesn't attempt to comply with the requirements for

approval of employment under § 327 and related authority.[69] It suggests, instead, that the Responsible Officer be the sole and only management authority for the DIP. Boespflug and Afif would, under the Motion, be gone; no one else with any authority would be left to supervise and direct the performance of the duties of DIP, other than Links.

The point is not whether Links has the skill and expertise to be a Responsible Officer or even a CRO outside bankruptcy. Here, it is that the proposed Responsible Officer would assume and perform some, but not all, of Tamarack's DIP duties.[70] That would leave a vacuum in this chapter 11. All creditors are entitled to a DIP bound to the full performance and accountability required by the Code. Exclusion of DIP duties, coupled with the proposed indemnification, exposes the estate and its creditors.

Chapter 11 is a flexible process. It tolerates DIPs, chapter 11 trustees, examiners, and a host of potential professionals. Tamarack has not persuaded the Court that it tolerates, under the alleged aegis of § 1107 and § 105, a Responsible Officer on the specific terms here proposed, and the facts established by the

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[69] Fleischer did file what purports to be a Rule 2014(a) statement, *see* Doc. No. 323 at Ex. C, which is odd because that Rule applies to § 327 employment proposals, which is not what the Responsible Officer Motion advocates.

[70] This is true notwithstanding the statement in the Motion that the Responsible Officer be appointed "to act as and on behalf of the Debtor as a debtor in possession in all respects." *See* Doc. No. 323 at 5. The balance of the Motion and submissions does not support the allegation that Links is assuming all the responsibilities and obligations that would entail, nor did Fleischer's testimony (which *inter alia* indicated he would terminate the engagement absent payment or indemnification).

evidence.

CONCLUSION

This is not about the desirability of a ski season at Tamarack in 2010. Nor is it about what ultimate result (reorganization, sale, or other) would best serve the area or its residents. Nor is it an invitation to dictate by judicial fiat a perceived better approach to sale of the Resort and satisfaction of the competing interests of all creditors and other parties.

At bottom, it is a question of whether *this* specific financial and management proposal, made by Tamarack and supported by Credit Suisse, meets the standards that federal law imposes as a condition of its granting. It does not.

The objections of the UST, the District, Wells Fargo Bank, Banner/Sabey, BAG, EZA and the others joining therewith are well taken and will be sustained. The Motions will be denied. The Court will enter such an order.

DATED: October 19, 2010

TERRY L. MYERS
CHIEF U. S. BANKRUPTCY JUDGE

Faculty

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Gabriel Fried is the founder and CEO of Hilco Streambank, LLC in Needham, Mass. He began liquidating intangibles in 2000, when he was retained to dispose of his former employer's digital and trademark assets. He pioneered the distressed brokerage of intangibles during his roles as liquidator, auctioneer, investor, buyer's agent, expert witness and appraiser. As a freelance IP sales agent, Mr. Fried worked through a number of retail and manufacturing cases from 2000-07, when he launched Streambank in order to build a team. After four years of working most major insolvency cases in the U.S. with intellectual property assets, the Streambank team joined Hilco in 2011. Mr. Fried has worked on several hundred appraisals of intellectual property assets for lenders and regularly testifies as an expert in cases involving disputes over intellectual property value, as well as sale process integrity. He received his B.A. with honors from the University of Massachusetts at Amherst and his M.S. in economics from the University of Illinois, Champaign-Urbana, where he was a Ph.D. candidate.

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