SOUTHERN DISTRICT OF NEW YORK BANKRUPTCY COURT APPROVES PAYMENT OF UNDER-SECURED LENDER'S FEES AS PART OF A CASH COLLATERAL STIPULATION

A recent order[1] (the "Order") entered by Judge Arthur J. Gonzalez of the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court") may afford under-secured lenders the opportunity to exact greater monetary concessions from debtors seeking to gain such lenders' consent to use cash claimed as collateral. In the Order, the Bankruptcy Court approved a stipulation authorizing debtors to pay the fees, costs and expenses of Hillside Capital Incorporated ("Hillside"), their under-secured lender that was also the debtors' proposed exit lender. Although Section 506(b) of Title 11 of the United States Code (the "Bankruptcy Code") provides that a lender is not entitled to postpetition interest, fees, and expenses related to its claim unless it is over-secured, the Bankruptcy Court found that the under-secured lender in the cases involving Ampex Corporation ("Ampex") and its affiliates was entitled to seek fees from the estates because of the consensual nature of the debtors' use of cash collateral and the under-secured lender's role as proposed exit lender.

This Order may serve as a tool for under-secured lenders that are willing to assist the debtors in their reorganization efforts (by providing incremental financing or offering some other form of contribution to the debtors' estates) to obtain payment of their attorneys fees', without such fees being strictly limited to the amount necessary to serve as adequate protection of such lender's interest in the cash collateral.

Background

The *In re Ampex Corporation, et al*. bankruptcy cases (the "Bankruptcy Cases") involve seven debtor entities (the "Debtors"). The Debtors operate two main lines of businesses — licensing of proprietary technology and the manufacture of high-performance instrumentation records. The Debtors' major secured creditors are holders of senior notes (the "Senior Notes") issued by Ampex, and Hillside, which holds other notes (the "Hillside Notes") issued by Ampex. The value of the collateral securing the Hillside Notes is substantially less than the obligations outstanding under the Hillside Notes (the "Hillside Obligations").

The Debtors, Hillside and certain of the holders of Senior Notes entered into a Plan Support Agreement on the eve of the Debtors' filing, in which the lenders agreed to support the Debtors' proposed plan of reorganization provided certain terms and conditions were met. Hillside also agreed to provide a credit facility upon the Debtors' emergence that would allow the Debtors to make distributions to creditors and continue to satisfy certain other obligations. On March 30, 2008, contemporaneously with filing their voluntary petitions, the Debtors also entered into a proposed stipulation authorizing their use of cash collateral (the "Stipulation").[2] In the Stipulation,

[1] In re Ampex Corporation, et al., Case No. 08-11094 (Bankr. D. Del.), Docket No. 284.

[2] Docket No. 39.

which was approved on an interim basis by the Bankruptcy Court, both the Debtors and Hillside acknowledged that the value of the collateral securing the Hillside Notes was significantly less than the Hillside Obligations.

The Stipulation stated in part that:

> "The Hillside Note Obligations exceed the estimated value of the Hillside Collateral, as of the Petition Date. As additional adequate protection for Hillside, the Debtors shall pay on a current basis the reasonable fees, costs and expenses (whether incurred prior to or on or after the Petition Date) of Hillside in its capacity as a Secured Lender, which will include payment of the reasonable fees and expenses of counsel to Hillside in its capacity as a Secured Lender."[3]

On June 11, 2008, the Debtors and the secured lenders filed a proposed stipulation authorizing the Debtors' final use of its lenders' cash collateral (the "Final Stipulation"),[4] which contained the same provision requiring the Debtors to pay Hillside's fees and expenses.

The Objections to Payment of Hillside's Fees

There were several objections to the entry of the Final Stipulation, including ones with respect to the payment of Hillside's fees. Ampex's largest shareholder filed an objection to the Final Stipulation stating that the requirement that Hillside's fees, costs and expenses be borne by the Debtors "violates Section 506(b) of the Bankruptcy Code, which provides for only over-secured creditors to receive payment of postpetition fees and expenses."[5] The official committee of unsecured creditors appointed in the Bankruptcy Cases similarly objected to the payment of Hillside's fees and expenses on the grounds that Hillside was not entitled to such accommodation under Section 506(b) of the Bankruptcy Code.[6] In its objection, the committee cited several cases for the proposition that under-secured creditors are not entitled postpetition interest and fees, including *United Savings Assoc. v. Timbers of Inwood Forest Assocs., Ltd.*¸ 484 U.S. 365. In *United Savings Assoc.*, the Supreme Court found that since Section 506(b) of the Bankruptcy Code "permits postpetition interest to be paid only out of the 'security cushion,' [therefore] the undersecured creditor, who has no such cushion falls within the general rule disallowing postpetition interest. *See* 11 U.S.C. § 502(b)(2)." *Id.* at 372-373.

Response to Objections to Payment of Fees and Ruling

On June 24, 2008, Hillside filed a response (the "Response") to objections to the entry of the Final Stipulation, in which it addressed the objections to payment of its fees and expenses. Notably Hillside argued in the Response that:

> "the payment of Hillside's fees is part of a negotiated settlement of the Debtors' use of Cash Collateral that allows the Debtors to avoid the costs attendant to a cash

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[3] Stipulation, ¶ 6(b). Docket No. 284.

[4] Docket No. 227.

[5] Docket No. 67.

[6] Docket No. 263.

> collateral fight and litigation regarding the value of the Hillside Collateral. Accordingly, while Hillside concurs that under-secured creditors may not be entitled to payment of their fees under ordinary circumstances that is not the proper analysis under the circumstances of these cases. In fact, it is entirely appropriate for a secured creditor and proposed exit lender to have its fees paid as part of a negotiated settlement of the use of its cash collateral and a consensual reorganization plan."[7]

Despite a lack of supporting precedent and case law to the contrary, this argument persuaded the Bankruptcy Court, which approved the Final Stipulation on June 25, 2008. In approving the Final Stipulation, the Bankruptcy Court noted that payment of such costs are "a form of adequate protection and a . . . form of overseer for purposes of exit financing."[8] However, in spite of approving the payment of Hillside's fees, costs and expenses, partially as adequate protection for the use of its cash collateral, the Final Stipulation did not require that such fees, costs and expenses be limited to the actual diminution in value of the cash collateral actually used by the Debtors, as is typical when other forms of adequate protection, such as replacement liens, are granted.

Conclusion

In the Order approving the Final Stipulation, the Bankruptcy Court approved payment of reasonable fees, costs and expenses for an under-secured creditor that consented to the Debtors' use of cash collateral on a final basis, due to the negotiated nature of their stipulation and the creditor's role in the Debtors' reorganization efforts. While it is difficult to draw broad conclusions from the Order, it may embolden under-secured creditors to seek payment of attorneys' fees and costs from a debtor's estate.

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If you have any questions concerning the foregoing or would like additional information, please contact Rachel C. Strickland (212-728-8544, rstrickland@willkie.com), Shaunna D. Jones (212-728-8521, sjones@willkie.com), or the attorney with whom you regularly work.

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7 Response, ¶ 17. Docket No. 263.

8 Transcript of June 25, 2008 Hearing, p. 8. Docket No. 318.