

**OPEN LETTER OF THE HONORABLE PETER J. WALSH TO
DELAWARE BANKRUPTCY COUNSEL
RE: FIRST DAY DIP FINANCING ORDERS
DATED APRIL 2, 1998**

UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

JUDGE PETER J. WALSH

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April 2, 1998

RE: First Day DIP Financing Orders

Dear Delaware Bankruptcy Counsel:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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14. The following provision is patently objectionable:

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

15. The following provision is also patently objectionable:

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

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

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

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

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

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

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

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

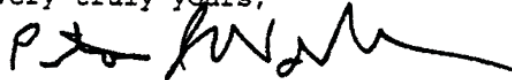
The items discussed above are not intended to be a complete list of the matters that need to be addressed on the issue of first day DIP financing orders. For the most part, they are derived from the latest four or five first day DIP financing orders that I have had before me. If I were to go back over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

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

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

Very truly yours,



Peter J. Walsh

PJW:vw

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