

UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

In re	}	Chapter 11
HAWAIIAN TELCOM COMMUNICATIONS, INC., <i>et al.</i> , ¹	}	Case No. 08-13086 (PJW)
Debtors.	}	Joint Administration Requested
	}	Hearing Date: December 2, 2008, at 4:00 p.m.

OPPOSITION TO MOTION OF HAWAIIAN TELCOM COMMUNICATIONS, INC., ET AL. FOR ENTRY OF INTERIM AND FINAL ORDERS (A) AUTHORIZING THE USE OF CASH COLLATERAL, (B) GRANTING ADEQUATE PROTECTION TO PREPETITION LENDERS AND (C) SCHEDULING A FINAL HEARING

Pacific Investment Management Company and Capital Research and Management Company (the “*Senior Noteholders*”), on behalf of various funds that are beneficial holders of the Senior Floating Rate Notes due 2013 and the 9.75% Senior Fixed Rate Notes due 2013 (collectively, the “*Senior Notes*”) issued by debtor Hawaiian Telcom Communications, Inc. (“*Hawaiian Telcom*”) and guaranteed by debtors Hawaiian Telcom, Inc. (“*Telcom*”) and Hawaiian Telcom Services Company, Inc. (“*Services*”), hereby submit this Opposition to the Debtors’ Motion for Entry of Interim and Final Orders (A) Authorizing the Use of Cash

¹ The “Debtors,” together with the last four digits of each Debtor’s federal tax identification number, are: Hawaiian Telcom Communications, Inc. (0376); Hawaiian Telcom Holdco, Inc. (9868); Hawaiian Telcom, Inc. (9500); Hawaiian Telcom Services Company, Inc. (5722); Hawaiian Telcom IP Service Delivery Investment, LLC (9423); Hawaiian Telcom IP Service Delivery Research, LLC (9685); Hawaiian Telcom IP Video Investment, LLC (9295); and Hawaiian Telcom IP Video Research, LLC (9571). The location of the Debtors’ corporate headquarters and the service address for all Debtors is: 1177 Bishop Street, Honolulu, HI 96813.

Collateral, (B) Granting Adequate Protection to Prepetition Lenders, and (C) Scheduling a Final Hearing (the “*Motion*”).

I. INTRODUCTION²

1. By the Motion, under the guise of adequate protection, the Debtors propose to give the Prepetition Lenders a wealth of unjustified and unjustifiable protections. Among other things, the Debtors would have this Court bless the cross-collateralization of the Prepetition Lenders’ partially-secured prepetition claims, effectively immunize the Prepetition Lenders and their claims from future causes of action and objections by any party (including an official committee), grant the Prepetition Lenders a veto right over any and all of the Debtors’ postpetition expenditures, and compel the payment not only of postpetition interest but also of an unlimited amount of undisclosed fees and bonuses to the Prepetition Lenders’ professionals.

2. The Debtors claim that these case-defining capitulations were necessary to obtain consent to the Debtors’ ongoing use of the Prepetition Lenders’ alleged cash collateral, and the Debtors assert that the various concessions made in favor of the Prepetition Lenders are appropriate because the Prepetition Lenders are secured by a lien on “substantially all” of the Debtors’ assets. Motion ¶ 11.

3. This assertion of a blanket lien in favor of the Prepetition Lenders is demonstrably false. As shown below, the Prepetition Lenders do not have valid, perfected liens in a substantial portion of the Debtors’ assets, *including 163 of the 202 parcels of real property (more than*

² The Senior Noteholders are considering the appropriate venue for these cases. As all of the Debtors’ assets, operations, and employees are in the State of Hawaii, the District of Hawaii may be a more appropriate venue. By submitting this Opposition, the Senior Noteholders do not consent to the venue chosen by the Debtors and reserve all rights in this regard.

80%) from which the Debtors operate and service their customers and the deposit accounts in which the Debtors hold the Prepetition Lenders' alleged cash collateral.

4. The Debtors, in other words, have significant unencumbered assets – including a substantial portion of their enterprise value – that will be available for distribution to the Senior Noteholders and other unsecured creditors. Although the determination of distributional entitlements is a matter for a later day, the presence of material unencumbered assets – without which the Debtors could not operate – establishes the inappropriateness of the relief requested in the Motion. Given that there are major holes in their collateral package, the Prepetition Lenders are not entitled to a blanket lien on all of the Debtors' postpetition assets in the guise of adequate protection. In fact, the Prepetition Lenders have not even proven that they have a lien on cash that is entitled to any protection whatsoever, much less an interest that would justify the current payment of postpetition interest and fees and the various other “bells and whistles” that the Debtors propose to dole out. To the contrary, it appears likely that the Debtors could operate indefinitely with their unencumbered cash on hand and with the proceeds of the unencumbered property from which they service a substantial portion of their customer base.

5. Accordingly, the Senior Noteholders, who beneficially own more than half of the \$350 million outstanding unsecured Senior Notes, object to the Motion and respectfully request that the Court deny the relief sought by the Debtors.³

³ The Senior Noteholders' analysis of the Prepetition Lenders' alleged liens and security interests is preliminary and ongoing. It is likely that additional defects in the liens and claims asserted by the Prepetition Lenders exist, and the Senior Noteholders reserve all rights with respect to available rights and remedies in this regard.

II. BACKGROUND

A. The Debtors' Business And Significant Assets.

6. Hawaiian Telcom is the incumbent local telephone exchange carrier for the State of Hawaii. As detailed in the Declaration of Robert F. Reich, Senior Vice President, Chief Financial Officer and Treasurer of Hawaiian Telcom Communications, Inc., In Support of First Day Pleadings (the "**Reich Declaration**"), Hawaiian Telcom has an integrated telecommunications network servicing approximately 524,000 switched access lines, approximately 253,000 long distance lines, and approximately 95,000 high-speed internet connections as of September 30, 2008. Reich Decl. ¶ 20. The Debtors utilize a cash management system comprised of accounts with Bank of Hawaii, First Hawaiian Bank, JP Morgan, and Wells Fargo (the "**Depository Banks**"). Reich Decl. ¶ 48. The Debtors assert that these accounts held approximately \$75 million as of the commencement of these cases. Reich Decl. ¶ 9.

7. The Senior Noteholders are informed and believe that the Debtors' operate their network and business from at least 202 parcels of real property, 128 of which are owned by the Debtors and 74 of which are leased by the Debtors. As described more fully below, these properties contain central offices, remote switch modules, antennae, cell phone towers, microwave equipment, huts, retail locations, storage, and office space.

B. The Credit Agreement.

8. The Debtors have over \$1 billion principal amount in debt for borrowed money, consisting of \$574.5 million principal amount in partially secured debt under the Credit Agreement, \$350 million principal amount in Senior Notes, and \$150 million principal in Subordinated Notes. Reich Decl. ¶ 22.

9. The partially secured debt arises under the Credit Agreement dated June 1, 2007, between Debtors Hawaiian Telcom and Hawaiian Telcom Holdco, Inc. ("**Holdco**") and Lehman

Commercial Paper, Inc. ("**Lehman**") as administrative agent and the Prepetition Lenders. Obligations under the Credit Agreement are secured pursuant to an Amended and Restated Guarantee and Collateral Agreement dated June 1, 2007 (the "**Collateral Agreement**"), a copy of which is attached hereto as Exhibit A, by which Debtors Hawaiian Telcom, Holdco, Telcom, and Services (collectively, the "**Debtor Obligors**") granted Lehman as collateral agent a security interest in substantially all of their *personal property*, including deposit accounts. To perfect that security interest, on June 1, 2007, Lehman filed financing statements (vis-à-vis Holdco, Hawaiian Telcom, and Services) with the Delaware Secretary of State listing "all assets" in the description of the collateral, and Lehman also filed a financing statement (vis-à-vis Telcom) with the Hawaii Bureau of Conveyances listing "all assets" in the description of the collateral. However, *Lehman does not appear to have executed any control agreements with the Depository Banks with respect to the Debtors' deposit accounts, none of which are maintained at Lehman or otherwise in the control of Lehman.*

10. The Debtor Obligors and Lehman also entered into an Amended and Restated Mortgage, Assignment of Leases and Rents, Security Agreement, Financing Statement and Fixture Filing; Collateral Agent Agreement dated June 29, 2007 (the "**Amended Mortgage**"), a copy (omitting the lengthy legal property description) of which is attached hereto as Exhibit B. *That Amended Mortgage identified and encumbered only 39 of the Debtors' 128 parcels of owned real property and none of the Debtors' 74 parcels of leased property. See Amended Mortgage at 3, Ex. B. In other words, the Debtors granted a security interest in less than 20% of the real property locations from which the Debtors conduct their business.* Attached hereto as Exhibit C is a schedule that identifies the Debtors' known owned and leased properties that are not included in the Amended Mortgage.

III. ARGUMENT

11. Through the Motion, the Debtors seek to give substantial protections to the Prepetition Lenders in exchange for the Prepetition Lenders' consent to the Debtors' use of the alleged cash collateral. The Motion, however, is based upon the faulty premise that the Prepetition Lenders have valid and perfected liens on "substantially all" of the Debtors' assets. In fact, the Debtors never granted the Prepetition Lenders any liens on the majority of the Debtors' owned and leased real property and the fixtures attached thereto, which together comprise a significant portion of the Debtors' telecommunications network.

12. In addition, the Prepetition Lenders' liens on the Debtors' deposit accounts are not perfected, and therefore are avoidable under section 544 of the Bankruptcy Code, because Lehman, as collateral agent, failed to obtain control over those accounts. As a result, funds in the deposit accounts do not constitute cash collateral, and there is no basis for affording the Prepetition Lenders adequate protection in respect of cash in which they do not have an interest.

13. Further, given the existence of significant unencumbered assets, many of the other provisions requested by the Debtors in the Motion – including the ongoing payment of postpetition interest and fees and other provisions summarized below – are patently inappropriate.

A. The Prepetition Lenders Do Not Have A Lien On A Majority Of The Debtors' Real Property Assets.

14. Section 363 of the Bankruptcy Code provides for a grant of adequate protection only to the extent that the secured party has an interest in the property being used by the debtor. 11 U.S.C. § 363(e). Contrary to the Debtors' assertions, the Prepetition Lenders do not have valid and perfected liens against "substantially all" of the Debtors' real property. In fact, as shown below, the Debtors did not grant the Prepetition Lenders a security interests in a

substantial majority of their owned real property, or in any of their leased real property, or in any of the fixtures attached to such unencumbered property.

1. The Debtors Did Not Grant A Lien On A Majority Of Their Owned And Leased Real Property.

15. Hawaii law⁴ requires that a grant of a security interest in real property, including a leasehold with a term longer than one year, must be evidenced by a writing. HAW. REV. STAT. § 656-1 (“No action shall be brought and maintained . . . upon any contract for the sale of lands, tenements, or hereditaments, or of any interest in or concerning them . . . unless the promise, contract, or agreement, upon which the action is brought . . . is in writing”). Here, the only document evidencing a grant of a security interest in any real property, owned or leased, is the Amended Mortgage. That document only identifies 39 of the Debtors’ 128 parcels of owned real property, and none of the Debtors’ 74 leased properties.

16. This was no oversight. Section 5.12(c) of the Credit Agreement limits the Debtors’ obligation to deliver mortgages to just the 39 parcels identified on Schedule 3.05 to the Credit Agreement and any properties acquired after the execution of the Credit Agreement that had a value in excess of \$2,000,000. A recent search of the Hawaii real property records revealed that the only mortgage ever recorded in favor of Lehman in fact is the Amended Mortgage.

⁴ Matters relating to interests in real property are governed by the local law of the jurisdiction where the land is situated, which, in this case, is Hawaii. See *In re Grayco Land Escrow*, 57 Haw. 436, 450 (Haw. 1977) (“It is a universal principle of law that real property is exclusively subject to the law of the country or state within which it is situated.”); *California Fed. Sav. & Loan Ass’n v. Bell*, 6 Haw. App. 597, 604 (Haw. Ct. App. 1987) (“as a general rule, matters relating to interests in land depend for their determination on the local law of the *situs* of the land”); see also RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 223 (stating that conveyances of an interest in land are governed by local law).

17. Accordingly, the Prepetition Lenders simply do not have a valid security interest in at least 163 parcels of the Debtors' owned and leased real property.⁵ These unencumbered assets are not trivial properties. Indeed, in June 2007, the Debtors' ascribed more than \$39 million in book value to just 71 of those parcels of owned and unencumbered real property. More importantly, this unencumbered real estate is critical to the Debtors' operations. Among other things, many of the unencumbered properties contain central offices or remote switch units for the Debtors' network. Central offices and remote switch units are the locations in the network that connect the copper and fiber lines from a customer's premises to the Debtors' service network. The Senior Noteholders are informed and believe that the owned properties alone are connected to at least 189,334 phone lines, representing more than 30% of the Debtors' existing customer base. As a practical matter, the Debtors cannot move their switching facilities and operations from these locations to other locations. These facilities (particularly those housing copper lines) are very large and difficult to reconnect into alternative addresses without incurring substantial economic costs. In other words, the Debtors' business depends on the ability to operate from the unencumbered locations.

18. In addition to the central offices and switching facilities, the unencumbered real property also includes tower locations, huts, and repeaters. These types of locations are critically important in providing for interoffice transmission between the Debtors' central offices. Further, the repeater locations are necessary to regenerate the signal and to allow for the transmission of traffic between central offices. Finally, huts are used to house remote units where copper

⁵ Even if documentation existed granting the Prepetition Lenders a security interest in the Debtors' unencumbered real property, that security interest would be subject to avoidance under 11 U.S.C. § 544 because Lehman failed to record that instrument in accordance with HAW. REV. STAT. §502-83.

facilities (which extend out to customer premises) are converted into signals that can travel across fiber-based facilities to connect back to the central office or remote switching unit. All of these facilities work together to give functionality across the entirety of the Debtors' network and are vital to the Debtors' ongoing operations.

2. The Lenders Do Not Have A Valid Security Interest In The Fixtures Installed On The Unencumbered Real Estate.

19. In addition to the unencumbered real property, the Lenders also do not have a valid security interest in any fixtures other than fixtures installed on the 39 parcels of owned real property listed in the Amended Mortgage.⁶ The New York U.C.C. provides that a security interest must be granted by an authenticated security agreement that provides a description of the collateral. N.Y. U.C.C. LAW § 9-203(b)(3)(A). A description of the collateral is sufficient "if it reasonably identifies what is described." N.Y. U.C.C. LAW § 9-108(a). One method of describing collateral is to list the collateral by type or category under the UCC. N.Y. U.C.C. LAW § 9-108(b). Unlike in a financing statement, however, super generic terms, such as "all assets," are insufficient descriptions of collateral in a security agreement. N.Y. U.C.C. LAW § 9-108(c).

20. While the Collateral Agreement identifies numerous categories of personal property in which the Lenders are given a security interest, such as deposit accounts, general intangibles, inventory, investment property, and equipment, it does *not* specifically identify "fixtures." See Collateral Agreement § 4.01. Rather, the Amended Mortgage appears to be the

⁶ Almost all of the Debtors' real property interests include some form of fixtures. Among other things, the Debtors appear to have installed radio towers, antennae, masts, remote switch modules, cables, storage sheds, power generators, and other telecommunications equipment on much of the real estate. These assets qualify as fixtures. See N.Y. U.C.C. LAW § 9-102(a)(41) (personal property becomes a fixture when it has "become so related to particular real property that an interest in them arises under real property law.").

only document that specifically includes a grant of a security interest in fixtures. However, as explained above, the Amended Mortgage is limited solely to the 39 identified parcels of owned real property and no other property.⁷

21. The failure of the Collateral Agreement, or any other document, to specifically identify “fixtures” as a category of collateral is fatal to the Prepetition Lenders’ claim of a valid security interest in fixtures installed on the unencumbered real estate.

B. The Debtors Do Not Require Authority To Use Their Deposit Accounts Because The Prepetition Lenders’ Security Interest In The Deposit Accounts Is Avoidable Under Section 544 Of The Bankruptcy Code.

22. Citing section 363(c)(2) of the Bankruptcy Code, the Debtors assert that they must obtain authority to use the cash held in the deposit accounts with Depository Banks because that cash constitutes “cash collateral” under the Bankruptcy Code. Section 363(a), however, only defines cash collateral to include deposit accounts that are “subject to a security interest.” 11 U.S.C. § 363(a). As shown below, while the Debtors apparently granted the Prepetition Lenders a lien in their “deposit accounts,” Lehman never perfected that security interest in accordance with applicable law. Thus, the liens against “deposit accounts” maintained with the Banks are avoidable under section 544 of the Bankruptcy Code and are not cash collateral entitled to any protection under section 363.

⁷ The Prepetition Lenders may argue that the identification of “equipment” as a category of collateral in the Collateral Agreement is sufficient to capture equipment that has been affixed to real property such that it may also qualify as a fixture. Several courts have rejected just such an argument. See *In re Sand & Sage Farm & Ranch, Inc.*, 266 B.R. 507, 513 (Bankr. D. Kan. 2001) (“[Creditor’s] security agreement grants it a security interest in all of the debtors’ equipment and farm-related assets. Unfortunately, to claim an interest in this fixture, [creditor] needed to do more. Its security agreement omits any mention of the debtors’ fixtures.”); *In re Flores de New Mexico*, 151 B.R. 571, 583 (Bankr. D.N.M. 1993) (“even if this Court were to hold the phrase ‘miscellaneous equipment’ to be a sufficient indication of the type of collateral [fixtures] in the financing statement, the same phrase would not be sufficient in the security agreement as it fails to reasonably identify what is described”).

23. Unlike perfection for most personal property, the only way a secured party may perfect a security interest in a deposit account is to obtain control of the account. HAW. REV. STAT. § 490:9-312(b)(1) and § 90:9-314(a); N.Y. U.C.C. LAW § 9-312(b)(1) and § 9-314(a).⁸ There are three ways to obtain control over a deposit account. First, a secured party can obtain control over a deposit account if the secured party is the depository bank. HAW. REV. STAT. § 490:9-104(a)(1); N.Y. U.C.C. LAW § 9-104(a)(1). Second, a secured party can obtain control if the depository bank enters into an agreement with the debtor and the secured party, commonly called a “control agreement,” in which the depository bank agrees to comply with instructions from the secured party upon the occurrence of a default and without further consent from the debtor. HAW. REV. STAT. § 490:9-104(a)(2); N.Y. U.C.C. LAW § 9-104(a)(2). Finally, a secured party can obtain control of a deposit account if it becomes a customer on the account. HAW. REV. STAT. § 490:9-104(a)(3); N.Y. U.C.C. LAW § 9-104(a)(3).

24. Lehman did not obtain “control” of the Debtors’ deposit accounts in any of these ways. None of the accounts are maintained with Lehman. Neither the Debtors nor the Prepetition Lenders have alleged that there exists a control agreement with the Depository Banks, and the Senior Noteholders have been unable to locate one. Nor does it appear that Lehman is listed as a customer on any those accounts. Given Lehman’s failure to obtain control, the liens granted in those deposit accounts under the Collateral Agreement are avoidable under section 544 of the Bankruptcy Code. *See McLean v. City of Philadelphia Water Revenue Board,*

⁸ The governing law for perfection of a security interest in a deposit account is the law of the jurisdiction of the bank in which the account is maintained. N.Y. U.C.C. LAW § 9-304(a). In this case, the New York UCC dictates that Hawaii law would apply to the accounts maintained with First Hawaiian Bank and Bank of Hawaii, which are located in Hawaii. It appears that New York law applies to the accounts maintained with JPMorgan Chase Bank and that California law applies to the accounts maintained with Wells Fargo.

891 F.2d 474, 479 (3d Cir. 1989) (“Because the City’s liens had not then been perfected against bona fide purchasers, section 544(a)(3) permits the trustee . . . to avoid these liens”).

C. The Proposed Order Contains Provisions That Violate Local Rule 4001-2 And Otherwise Are Inappropriate.

25. *Payment of Postpetition Interest.* The Debtors propose to pay postpetition interest to the Prepetition Lenders. However, particularly given the substantial gaps in the Prepetition Lenders’ collateral package, there has been no showing whatsoever that the Prepetition Lenders’ collateral is at risk of declining in value or otherwise diminishing. To the contrary, that collateral is enhanced in value by the Debtors’ ongoing operations, which are made possible in part by the various critical unencumbered real property locations from which the Debtors service customers. The Senior Noteholders submit that ongoing payment of postpetition interest to the Prepetition Lenders is unnecessary and inappropriate under the circumstances.

26. *Cross-Collateralization.* With no disclosure whatsoever in the Motion, the proposed Order that accompanies the Motion surreptitiously provides for cross-collateralization of the Prepetition Lenders’ prepetition claims. It accomplishes this by granting the Prepetition Lenders a blanket lien on all assets of the Debtors, including the substantial unencumbered real estate assets, to secure the so-called “Adequate Protection Obligations.” Order ¶ 9(a). The Adequate Protection Obligations, in turn, include “the aggregate amount of the Cash Collateral used by the Debtors from and after the Petition Date.” Order ¶ 9. “Cash Collateral” is defined to include “all funds of the Debtors” – notwithstanding that the Lenders do not have a perfected security interest in the Debtors’ deposit accounts (see above) – *and* “all cash proceeds of Prepetition Collateral received after the Petition Date.” Order ¶ F. “Prepetition Collateral” in turn improperly is defined to include all of the “Collateral” (meaning all of the assets of the Debtors), Order ¶ E(e), notwithstanding that the Lenders demonstrably do not have a lien – much less a perfected lien – on over 80% of the properties from which the Debtors conduct their

business. These definitions work together to give the Prepetition Lenders a lien on previously unencumbered property (“all assets” of the Debtors) for every dollar of cash spent postpetition, effectively converting unsecured prepetition obligations into secured postpetition obligations.

27. Similarly, keying off the same improperly-defined and overreaching “Adequate Protection Obligations,” the Order provides for a superpriority claim “payable from and [with] recourse to all prepetition and postpetition property of the Debtors and all proceeds thereof.” Order ¶ 9(b). This too has the effect of converting unencumbered prepetition assets (“all prepetition . . . property”) into collateral for the Lenders’ defectively-secured prepetition claims. This creeping, undisclosed cross-collateralization violates Local Rule 4001-2(a)(i)(A) and is unjustified.

28. **Improper Lender Fortification.** Perhaps recognizing the extreme vulnerability of their liens, the Prepetition Lenders have attempted in the Order to limit, and effectively prohibit, challenges to their liens and claims. For example, in the Order the Debtors purport to “stipulate” (a) that the Prepetition Lenders have “a continuing lien on and security interest in substantially all of the property of the Company, HTC, and all of the other Debtors,” (b) that such liens are “valid, binding, perfected, enforceable first-priority liens on” all of the Debtors’ assets and are “not subject to avoidance,” and (c) that the Prepetition Lenders “perfected [their] security interests and Liens in and on the domestic Prepetition Collateral.” Order ¶¶ E(b), E(e), E(g). As shown above, these assertions are demonstrably false as to more than 80% of the Debtors’ real property and as to the Debtors’ deposit accounts. The Debtors cannot and should not be permitted to “stipulate” to facts that do not exist.⁹

⁹ Similarly, the Order provides for the Court to make certain “findings” of fact that are utterly unsupported by the record, including a “finding” that “[t]he ability of the Debtors to have sufficient available sources of working capital to continue their businesses, effectuate a

29. Further, in exchange for the Prepetition Lenders' largely-illusory and potentially-unnecessary consent to use of the alleged cash collateral, the Debtors purport to grant a full and far-reaching release of the Prepetition Lenders for all conceivable claims against them, including "lender liability" and avoidance actions. Order ¶ 24(a). The Order does include a short (60 days after appointment of an official committee, and 75 days maximum) challenge period for others, including a committee, "to file a complaint pursuant to Bankruptcy Rule 7001 seeking to invalidate, subordinate, or otherwise challenge the Prepetition Obligations or the Prepetition Liens." Order ¶ 24(b). But this is cold comfort. For one thing, there is nothing that reserves to a committee or anyone else the right to bring other claims (such as the "lender liability" claims released by the Debtors) against the Prepetition Lenders. For another, there is no grant of standing to a committee to pursue claims against the Prepetition Lenders, meaning that much of the 60-day challenge period may be consumed in a fight with the Prepetition Lenders over the right to commence an action. Order ¶ 24(c) ("[n]othing in this Order shall confer standing upon any Committee or any other person or entity to bring, assert, commence, continue, prosecute, or litigate the Claims and Defenses against" the Prepetition Lenders).

30. Most importantly, by employing the same improper definitional scheme described above, the Order essentially precludes a committee from using any of the estates' cash to "object, contest, or raise any defense to the validity, perfection, priority, extent, or enforceability of the [Prepetition Lenders'] Prepetition Obligations or the Prepetition Liens" or to "assert or prosecute any Claims and Defense" against the Prepetition Lenders or to "prevent, hinder, or otherwise delay the [Prepetition Lenders'] assertion, enforcement, or realization" on the alleged cash

reorganization of their businesses, and maximize the value of their assets depends upon the Debtors' use of Cash Collateral." Order ¶ 1(b).

collateral. Order ¶ 5. Specifically, the Order prohibits the use of “Lender Funds” for such purposes, with Lender Funds defined as “all of the Debtors’ existing or future cash and Cash Collateral.” Order ¶ 5(a). A period in which to challenge the liens and claims of the Prepetition Lenders is meaningless without an accompanying right of the committee to use estate assets to investigate and pursue meritorious claims like those available in this case.

31. **Improper Lender Control and Domination.** The Order gives the Prepetition Lenders absolute veto power over any sale, transfer, or lease of *any* of their assets – including their unencumbered assets – regardless of whether or not this Court otherwise authorizes a sale, transfer or lease under section 363. Order ¶ 7. The Debtors cannot even attempt to sell or dispose of *any* property – including unencumbered property – absent the prior written consent of the Prepetition Lenders. Order ¶¶ 7, 8. In fact, the Order prohibits the Debtors from using *any* of their assets even to seek authorization of the Court to obtain postpetition financing, to use cash collateral, or to make any other expenditures not approved by the Prepetition Lenders. Order ¶¶ 2(ii), 2(iii), 2(vii), 5, 10, and 8. Moreover, the Order requires that the Debtors strictly adhere to a “Budget” that, as of the time of this Opposition, the Debtors had not even filed with the Court or disclosed to the Senior Noteholders.

32. Further, the Order requires that the Debtors pay to the Prepetition Lenders 100% of the *gross* proceeds resulting from any sale, transfer or lease of any property – including unencumbered property. Order ¶ 19(a). The Order similarly requires that the Debtors pay the Prepetition Lenders 100% of all insurance proceeds and condemnation awards with respect to *any* of their assets, including unencumbered assets. Order ¶ 19(b). The Order even requires the Debtors to pay all of the proceeds received in connection with any avoidance action to the Prepetition Lenders within two days of receipt of such funds. Order ¶ 19(c).

33. These provisions effectively place the lenders in possession of the estates, and are inappropriate under any circumstances, particularly here where the Prepetition Lenders do not even have valid, perfected security interests in numerous critical assets of the estate.

34. **Payment of Unlimited and Undisclosed Fees and Indemnification Obligations.** The Order directs the Debtors to pay a myriad of fees without the right of review by any parties in interest. Order ¶¶ 9(c) (fees “shall be paid without further motion, fee application, or order of the Court”) and 22 (“[n]one of such reasonably documented attorneys’, financial advisers’, and accountants’ fees and disbursements shall be subject to the approval of this Court or the U.S. Trustee guidelines, and no recipient of any such payment shall be required to file with respect thereto any interim or final fee application with this Court”).

35. Those fees include “transaction fees, deferred fees and success fees of Houlihan Lokey,” Order ¶ 9(c), and various “agent fees, commitment fees, letter of credit fees, and underwriting fees.” Order ¶ 22. (By way of contrast, for professionals not employed by the Prepetition Lenders, the Order *prohibits* use of the professional fee Carve Out for “any success fee, transaction fee, deferred compensation fee or similar payment to any professionals or other persons payable in connection with a restructuring or asset disposition.” Order ¶ 15.) The Order even directs the Debtors to indemnify the Prepetition Lenders for any liability arising in connection with the Order. Order ¶ 22.

36. Yet, the Debtors do not disclose or describe any of these fees or their amounts. With the exception of the reference to Houlihan Lokey (which was buried on page 20 of the Order and not mentioned anywhere in the Motion), the Debtors do not even identify the “attorneys, financial advisers, and accountants” whom they wish to pay on an ongoing, unlimited, and indefinite basis without Court approval.

37. As with the payment of postpetition interest, this secret blank check for payments to the Prepetition Lenders' professionals is wildly inappropriate under the circumstances.

38. *Improper Termination Events and Remedies*. The Order automatically, and apparently permanently, cuts off the Debtors' "right" to use the alleged cash collateral upon the occurrence of no less than 22 "Termination Events." Order ¶ 2. Many of the "Termination Events" are within the sole control and discretion of the Prepetition Lenders, including the right to approve a "Revised Budget" by year end, just four weeks from now. Order ¶ 2(xix); see Order ¶¶ 2(ii), (iii), (v), (vi), and (xx). Others have no logical relationship whatsoever to the Debtors' use of the alleged cash collateral, such as the "Termination Event" upon a "Change in Control" of the Debtors (a provision based upon entrenchment of the Debtors' existing, out-of-the-money shareholder). Order ¶ 2(xii).

39. To make matters worse, the Order provides that, upon a Termination Event, the Debtors' authority to use the alleged cash collateral terminates immediately, without notice or further order of the Court, yet "all of the rights, remedies, benefits, and protections provided to the [Lenders] under [the] Order shall survive such Termination Event." Order ¶ 3. Does this mean that the Prepetition Lenders continue to be entitled to receive current payment of interest and advisor fees? That the Debtors remain obligated to provide the other benefits required under the Order, such as weekly reporting, adherence to a budget, and the like?

40. All of these provisions are entirely unnecessary and should be stricken from the Order.

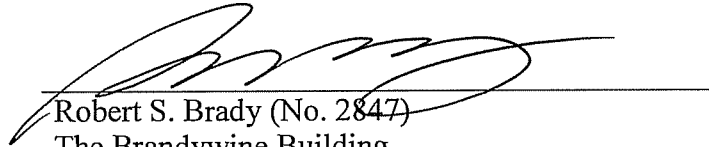
IV. CONCLUSION

For all of the foregoing reasons, the proposed "adequate protection" to be afforded to the Prepetition Lenders is grossly excessive and extremely inappropriate. Based upon the foregoing,

the Court should deny the Motion and grant such other relief as is just and proper under the circumstances.

DATED: December 2, 2008

YOUNG, CONAWAY, STARGATT & TAYLOR, LLP



Robert S. Brady (No. 2847)
The Brandywine Building
1000 West Street, 17th Floor
Wilmington, Delaware 19801
Telephone: (302) 571-6600
Facsimile: (302) 571-1253

-and-

HENNIGAN, BENNETT & DORMAN LLP

Bruce Bennett

James O. Johnston

Joshua M. Mester

865 S. Figueroa St., Suite 2900

Los Angeles, California 90017

Telephone: (213) 694-1200

Facsimile: (213) 694-1234

*Attorneys for Pacific Management Investment Company
LLC and Capital Research and Management Company*