UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	)	Chapter 11
AppliedTheory Corporation, et al.,	)	Case No. 02-11868 (REG) through 02-11874 (REG)
Debtors.	)	
	)	Jointly Administered

BENCH DECISION[1] AND ORDER ON CHAPTER 11 TRUSTEE'S MOTION, PURSUANT TO FED.R.BANKR.P. 9019, FOR APPROVAL OF SETTLEMENT WITH LENDERS

APPEARANCES:

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Counsel for the Chapter 11 Trustee
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[1] I use bench decisions to lay out in writing decisions that are too long, or too important, to dictate in open court, but where the circumstances do not permit more leisurely drafting or more extensive or polished discussion. Because they often start as scripts for decisions to be dictated in open court, they typically have fewer citations and other footnotes, and have a more conversational tone.

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BEFORE: ROBERT E. GERBER
UNITED STATES BANKRUPTCY JUDGE

In this contested matter in the jointly administered chapter 11 cases of AppliedTheory Corporation and its subsidiaries, chapter 11 trustee Yann Geron (the "Trustee") moves for authorization to enter into a settlement with secured lenders Halifax Fund and Elliott Associates (the "Lenders"). The Trustee's motion is opposed by the Creditors' Committee, which, while it has withdrawn its general objections to the settlement, still voices four bases for disapproval—generally arguing that aspects of the settlement are contrary to law and prejudicial to the Debtors' unsecured creditor community and/or administrative expense creditors.

Specifically, the Creditors' Committee argues that:

> (a) unencumbered assets of the Estate are not subject to the Lenders' liens (whether pre-petition, post-petition or replacement), and hence that turning over to the Lenders proceeds of the unencumbered assets is impermissible;
>
> (b) the Debtors' cash position *increased*, providing no bases for tapping unencumbered assets to make adequate protection awards to the Lenders under the cash collateral orders entered in these cases;
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> (c) only select administrative expense claims would be paid, while "ignoring other administrative claims"; and

(d) Creditors' Committee professionals would receive "discriminatory and disparate treatment."

After an evidentiary hearing, I find that the first and third bases for objection lack merit, under the law or as to the factual premises upon which the legal contentions rest. But two others—the objection to tapping unencumbered assets to make adequate protection awards to the Lenders, and discriminatory treatment for the Creditors' Committee professionals—prevent me from approving the settlement as is. I'll be able to find a variant of the settlement to be in the best interests of the Estate if, but only if, the Trustee addresses the latter objection (which he should be able to easily fix), and takes into account the much stronger position that the Trustee is in with respect to the computation of the diminution in cash collateral value.

The First Objection

I was surprised to see the Creditors' Committee arguing that under no circumstances could the Lenders have a claim on the proceeds of avoidance actions and other initially unencumbered assets, even if necessary to give them adequate protection. Of course those assets started out unencumbered. But those assets can thereafter be encumbered (or made available to satisfy superpriority claims), if necessary to provide adequate protection. That's expressly authorized under section 361(2).[2]

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[2] Section 361 of the Code provides, in relevant part:

> When adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by—
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> …
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> (2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property….

And that's exactly what we did early in this case, in the first and successive cash collateral orders, to protect the Lenders against any diminution in their cash collateral. Frankly, it's likely, if not certain, that I would have rejected this argument if it had been put to me at the outset of the case, when the Estate first wanted to use cash collateral and the Lenders said, in substance, "okay, but only if you give us adequate protection." But in any event, the time to raise that objection, and to make that argument, was at the outset of the case, when the cash collateral orders were put in place. It's much too late to make that argument now, especially after the Lenders allowed their cash collateral to be used in light of orders that were entered for their protection.

The Third Objection

As all parties will recall, I was concerned, when the settlement was first presented to me, that non-professional administrative expense creditors (*e.g.*, post-petition vendors) weren't getting fair treatment. Thereafter, the Trustee and the Lenders created reserves sufficient to ensure the payment of any such creditors if and to the extent their claims for administrative expense treatment were allowed.[3]

That's adequate to satisfy my concerns, and I consider this issue now resolved.

The Fourth Objection

Though discriminatory treatment of the Creditors' Committee professionals was the fourth and final issue, I discuss it now, because it can so quickly and easily be addressed. When the settlement was first presented to me, I was concerned that inadequate reserves would be established to satisfy the Creditors' Committee

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[3] *See* Geron Aff. at ¶ 5. In accordance with my Case Management Order, direct testimony was presented by affidavit and cross-examination and subsequent questioning proceeded live. Mr. Geron was entirely truthful, open and candid, and the accuracy and completeness of his mathematical computations and factual investigation was not questioned.

professionals' allowed claims. That matter has now been addressed. But a second issue remains. It appears that of all the professionals in this case, only those of the Creditors' Committee would be subject to disgorgement.

While I am not troubled by arrangements under which professionals, in exchange for "haircuts" they'd take in their fees, would be spared from fee review processes (or under which, if the Creditors' Committee professionals don't negotiate their own haircuts and alternate arrangements, they be required to submit fee applications, to be paid out of a reserve created for that purpose), selective disgorgement is a different story. That's discriminatory treatment. Though I fully understand and respect the Lenders' unwillingness to bankroll the very litigious activities of the Creditors' Committee, the Lenders' adversary, and also understand that an important element of the settlement is the Lenders' willingness to subordinate their liens to the payment of administrative expenses, I as a judge cannot countenance or find to be in the best interests of the Estate any scenario under which professionals for different constituencies are treated differently. Either all professionals must be subject to a risk of disgorgement, or none must be.

The Second Objection

I saved this for last, because the Lenders' adequate protection entitlement, which in turn rests on the issue of diminution of cash collateral—an important premise on which the settlement rests—requires the most discussion, and it's ultimately the critical consideration in connection with the approval of this settlement.

As I noted a few moments ago, previously unencumbered assets can be used to provide substitute liens in favor of secured creditors, or as a source of payment of superpriority claims, if necessary to provide adequate protection. But tapping those unencumbered funds is proper only to the extent that prior orders of the Court so provide,

and only to the extent that the value of the collateral protected under any such order (here, cash collateral orders) has diminished.

Here, as the Trustee properly recognized,[4] whether or not cash collateral diminished depends on how it is defined and measured. It "is actually a legal point, not a factual point."[5] If "cash collateral" included (in addition to cash at the outset as that increased or decreased from operations and administrative expenses) *the proceeds of non-cash assets* that were converted into cash, cash collateral did not diminish. By that way of measurement, cash collateral *increased*, from approximately $2.448 million to approximately $14.2 million. (Though other dates, and figures, might be used to measure the increase when proceeds of non-cash assets are taken into account, any differences would be immaterial; the diminution in cash collateral would still be zero.)

But if cash collateral *does not* include the proceeds of non-cash assets subject to the Lenders' lien, it *diminished*, from $2.448 million to $341,000, or by approximately $2.1 million.[6] In the latter circumstance, the Lenders would be entitled to a substitute lien and/or a superpriority claim sufficient to make them whole for that diminution. The Trustee assumed as part of his analysis that this latter construction would ultimately be upheld by the Court.[7]

At this point I believe I should digress to note the standards under which I approve a settlement, and to note what I do and don't do in addressing the issues that would be litigated if the matters before me weren't settled. I discussed the legal

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4 *See* Evident. Hrg. Tr. at 8.

5 *Id.*

6 *See* Geron Aff. at ¶ 5; Evident. Hrg. Tr. at 9.

7 *See* Evident. Hrg. Tr. at 6 ("the settlement is based on one fundamental fact and that there [are] no unencumbered assets…."); *id.* at 9 ("and that is the fundamental assumption in my agreement with the lenders").

standards for determining the propriety of a bankruptcy settlement under a Rule 9019 motion in a lengthy decision in the *Adelphia* chapter 11 cases,[8] and need not repeat that discussion in comparable length here. As discussed more extensively in *Adelphia* (in which I there considered, and granted, a motion for approval of a settlement between Adelphia, the SEC and the United States Department of Justice), consideration of a Rule 9019 motion is within the discretion of the court.

The bankruptcy court's duty when exercising its discretion pursuant to Rule 9019 is to determine whether the settlement is in the "best interests of the estate."[9] To determine that a settlement is in the best interests of the estate, the Supreme Court held in *TMT* that the settlement must be "fair and equitable."[10] Such a finding is to be based on "the probabilities of ultimate success should the claim be litigated," and:

> [A]n educated estimate of the complexity, expense, and likely duration of ... litigation, the possible difficulties of collecting on any judgment which might be obtained, and all other factors relevant to a full and fair assessment of the wisdom of the proposed compromise. Basic to this process in every instance, of course, is the need to compare the terms of the compromise with the likely rewards of litigation.[11]

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8 *In re Adelphia Commc'n Corp.*, 327 B.R. 143, 158-65 (Bankr. S.D.N.Y. 2005) (Gerber, J.) ("*Adelphia SEC Settlement*").

9 *In re Purofied Down Prods. Corp.*, 150 B.R. 519, 523 (S.D.N.Y.1993) (Leisure, J.) ("*Purofied Down Products*").

10 *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424 (1968) ("*TMT*").

11 *Id.* at 424-25; *see also Adelphia SEC Settlement*, 327 B.R. at 165; *Purofied Down Products*, 150 B.R. at 523; *Official Comm. of Unsecured Creditors of Int'l Distrib. Ctrs., Inc. v. James Talcott, Inc. (In re Int'l Distrib. Ctrs., Inc.)*, 103 B.R. 420, 422 (S.D.N.Y. 1989) (Conboy, J.) ("*International Distribution Centers*") (determination as to whether proposed compromise is fair and equitable requires exercise of informed, independent judgment by court).

The settlement need not be the best that Debtors could have obtained.[12] Rather, the settlement must fall "within the reasonable range of litigation possibilities."[13]

In evaluating the desirability of a proposed settlement, it is not necessary for the court to conduct a "mini-trial" of the facts or the merits underlying the dispute.[14] A bankruptcy court ordinarily need not conduct an independent investigation into the reasonableness of the settlement but must only "canvass the issues and see whether the settlement falls below the lowest point in the range of reasonableness."[15]

With that as backdrop, I "canvass the issues," as the relevant caselaw directs me to do, without now deciding, with certainty or finality, who would win if the respective positions of the Trustee, on the one hand, and the Lenders, on the other, ever devolved into litigation. I'm materially assisted in this regard because I can construe my own orders.[16] Here, in my view, while the Lenders could make some plausible arguments in support of a construction that would exclude cash proceeds of asset sales from the cash

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12 *See In re Penn Cent. Transp. Co.*, 596 F.2d 1102, 1114 (3d Cir. 1979) ("*Penn Central*"); *accord International Distribution Centers*, 103 B.R. at 423 ("Indeed, a court may approve a settlement even if it believes that the Trustee ultimately would be successful.") (citation omitted).

13 *Penn Central*, 596 F.2d at 1114; *In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. 723, 758-59 (Bankr. S.D.N.Y. 1992) ("*Drexel Burnham*"). "[T]here is a range of reasonableness with respect to a settlement-a range which recognizes the uncertainties of law and fact in any particular case and the concomitant risks and costs necessarily inherent in taking any litigation to completion-and the judge will not be reversed if the appellate court concludes that the settlement lies within that range." *Newman v. Stein*, 464 F.2d 689, 693 (2d Cir. 1972) (Friendly, J.), *cert. denied*, 409 U.S. 1039 (1972) (construing *TMT* in context of settlement of derivative suit).

14 *Purofied Down Products*, 150 B.R. at 522; *International Distribution Centers*, 103 B.R. at 423.

15 *Casoff v. Rodman (In re W.T. Grant Co.)*, 699 F.2d 599, 608 (2d Cir. 1983) (internal quotation marks omitted); *In re Lion Capital Group*, 49 B.R. 163, 175 (Bankr. S.D.N.Y. 1985) (Buschman, III, J.) (citations omitted).

16 *See, e.g., Truskoski v. ESPN, Inc.*, 60 F.3d 74, 77 (2d Cir. 1995) ("It is peculiarly within the province of the district court ... to determine the meaning of its own order ... and the court's interpretation of its order will not be disturbed absent a clear abuse of discretion ....") (citations and internal quotation marks omitted); *Global Crossing Estate Representative v. Alta Partners Holdings, LDC (In re Global Crossing Ltd.)*, 2008 Bankr. LEXIS 988, at *86 & n.113, 2008 WL 934012, at *22 & n.113 (Bankr. S.D.N.Y. Apr. 8, 2008) (Gerber, J.) (noting and applying that principle).

that is considered in measuring diminution of cash collateral, the Trustee would have substantially the better of the argument.

To determine which of the two means of measuring diminution in cash collateral value would be appropriate (which could result in a swing of up to $1.8 million in how much the Trustee would try to fight for, on the one hand, or might leave on the table, on the other), we have to look at the language of the cash collateral orders, and the strength of the parties' positions if they then were to litigate over the Lenders' adequate protection entitlement and, as the key determinant of that, the diminution in the value of the Lenders' cash collateral.

The Debtors obtained the use of cash collateral through a series of nine cash stipulations, each of which incorporated arrangements that had been included in an initial emergency order.[17] The original cash collateral order, *i.e.*, the emergency order (later echoed in successor versions), stated that it would provide adequate protection to the Lenders,[18] granting them a replacement lien and super-priority administrative claim for:

> any decrease in the value of their interests in the Cash Collateral existing as of the Petition Date caused by the use of Cash Collateral authorized hereunder.[19]

I refer to this clause, when discussing alternative arguments as to its construction, as the "Granting Clause."

The capitalized term "Cash Collateral" was defined in the cash collateral orders; it was defined as "cash collateral of the Debtors, as such term is defined in section 363(a)

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17 *See* ECF # 15, Exh. T4, Emergency Cash Collateral Order ("Emergency Order"); ECF #'s 61, 65, 108, 109, 159, 170, 213, 224, 348, Exhs. T5-T13, Cash Collateral Stipulations and Orders through the Ninth Cash Collateral Stipulation and Order (collectively the "Cash Collateral Orders").

18 Emergency Order at 2 (a)(i)-(iii).

19 *Id.* at 4.

of the Bankruptcy Code." I refer to this clause as the "Orders' Cash Collateral Definition."

The Orders' Cash Collateral Definition requires the Court to then turn to section 363(a), to see what was, or wasn't, included. Because of section 363(a)'s importance, I first quote section 363(a) in full, and then prune it for relevance and readability

Section 363(a) provides, in full:

> (a) In this section, "cash collateral" means cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest and includes the proceeds, products, offspring, rents, or profits of property and the fees, charges, accounts or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties subject to a security interest as provided in section 552(b) of this title, whether existing before or after the commencement of a case under this title.

As pruned for relevance and readability, section 363 provides, in relevant part:

> (a) In this section, "cash collateral" means cash … whenever acquired in which the estate and an entity other than the estate have an interest and includes the proceeds … of property ….

And taking that same language and emphasizing its key portions, section 363 provides, in relevant part:

> (a) In this section, "cash collateral" means cash … *whenever acquired* in which the estate and an entity other than the estate have an interest *and includes the proceeds … of property ….*

The Trustee could argue, strongly and persuasively (as the Creditors' Committee argues here), that under the plain meaning of "Cash Collateral" as defined in these cash collateral orders, "cash collateral" included "the proceeds … of property," including

proceeds of non-cash collateral such as the Fastnet and Clearblue lines of business. The Trustee's position would be bolstered further by noting that the words "whenever acquired" were added in 1984 amendments to the Code, and are not without significance. The words "whenever acquired" plainly cover, to the extent there might be any doubt, cash that came into the Estate on a post-petition basis.

If, as is likely, construction of the Orders' Cash Collateral Definition were a prominent feature of any future litigation, the Lenders would be at a material disadvantage. The Lenders could have chosen to exclude proceeds from sales of assets already subject to their lien from any computation of the diminution in their cash collateral. But they did not do so. To this end, they could have caused the adequate protection entitlement language to provide, in words or substance:

> any decrease in the value of the Lenders' interests in the Cash Collateral existing as of the Petition Date caused by the use of Cash Collateral authorized hereunder, *provided that any change in the level of Cash Collateral resulting from proceeds of collateral already subject to any liens in favor of the Lenders shall not be counted in computing any such decrease.*

That is not, of course, the only way that the cash collateral orders could have been drafted to convey that idea, but it underscores how additional language would be necessary to trump the plain meaning of the cash collateral orders as they were drafted here.

I also note some related points that anyone focusing on the issues in any such future controversy would note. It was foreseeable, to say the least, that elements of the Debtors' business, upon which the Lenders had a lien, would be sold. Such sales took place almost immediately in these cases, and liquidating chapter 11 cases, for better or worse, have been the rule and not the exception in this Court and others over the last

decade, if not longer. The possibility that non-cash collateral could be converted into cash could hardly have been a surprise to the Lenders. But they did not provide for an exclusion from the definition of cash collateral to address that possibility in orders that they sought and obtained. Rather, they provided for an expansive definition of cash collateral. The effect of that drafting may or may not have been their intent, if they had any intent as to this, when the cash collateral orders were presented to the Court. But the language as drafted would be the starting point, and the likely ending point, in determining what cash collateral would and would not be considered.

And the Trustee might also note that there also is no principled basis upon which some matters which could cause the level of cash collateral to rise or fall (such as results of operations, or administrative expenses) could be taken into account for the purpose of computing diminution in cash collateral, and others (like augmentation of cash from the proceeds of asset sales) would *not* be counted, except by the drafting of a cash collateral order that embodied standards for what would or would not be taken into account.

That is not to say, however, that the issues would be entirely one-sided. Potential arguments to the contrary might have been a factor in causing the Trustee to assume that he would not win on this issue. The Lenders might argue that the battle shouldn't be fought solely with respect to the Orders' Cash Collateral Definition, but also with respect to the Granting Clause. And the Lenders might place emphasis on the italicized word below in the Granting Clause, repeated here:

> any decrease in the value of their interests in *the* Cash Collateral existing as of the Petition Date caused by the use of Cash Collateral authorized hereunder.

They might argue that the extra word "the" limits the "Cash Collateral" that may be considered to exclude other Cash Collateral, and that the extra clause "caused by the use of Cash Collateral authorized hereunder"—while not defining or limiting the subject of the clause—puts a context around the words that precede it.

This would hardly be a frivolous argument, but it would not be as likely to be persuasive. "The Cash Collateral existing as of the Petition Date" was, after all, the benchmark for computing decreases, and was also the only Cash Collateral then in existence. If, as is likely, no court could disregard the Orders' Cash Collateral Definition, the Lenders would very likely lose under any plain meaning analysis. And the likelihood of generating more cash collateral, from asset sales, was so high and foreseeable that the Lenders would be hard pressed to explain why, if "proceeds … of property" were to be excluded from any definition of Cash Collateral when considered for computing its diminution, they did not say so.

Thus, while I do not now decide the ultimate issue and merely "canvass the issues," I have to conclude that if disputes as to the Lenders' adequate protection entitlement ever were to be litigated, the Trustee would have much the better of the argument. I believe, with respect, that assuming that he would lose on that issue, the Trustee underestimated his strength as to that.

The resolution of that issue could result in a major swing in entitlements. The $1.6 to $1.8 million value of the unencumbered assets is less than the $2.1 million in the decrease in Cash Collateral that would be the result if the Lenders' preferred way of computing diminution were to prevail. But putting aside, as they must be, the very important but uncontroversial aspects of the settlement that anyone in the Lenders'

position would understandably expect (*e.g.*, the allowance of the Lenders' secured claims, and an end to litigation against them), and that the Trustee understandably sought (subordination of the Lenders' liens to pay administrative expenses), the Trustee's give-up of control over the unencumbered assets was one of the most prominent, and material, features of the settlement. And it was premised upon the assumption that the Trustee would lose as to diminution issues.

As I believe the Trustee would likely win as to these issues, and they are so material, I must conclude—despite the very considerable effort and analysis on the part of the Trustee that led to the proposed settlement before me—that the settlement must be disapproved, without prejudice to the presentation of an alternative settlement that would be premised upon the Trustee's materially stronger position in this regard.

In connection with any further negotiations, the Trustee may, however, still take into account that I have not determined that victory is a certainty; that there might be other arguments, not presented to me yet, that the Lenders might put forward; and that this issue, while very important, is only one of many issues that the Trustee addressed before, and would still have to address going forward.

Conclusion

As discussed, the Trustee's position vis-à-vis adequate protection for the Lenders was stronger than he gave himself credit for. I find that the proposed settlement fails sufficiently to take into account the Trustee's stronger position in that respect. While the Trustee more than adequately evidenced appropriate care and business judgment in negotiating the settlement, on a motion for approval of a settlement under Fed.R.Bankr.P. 9019 (as contrasted, *e.g.*, to a motion under section 363), that is not the test. A bankruptcy court must find, instead, that the settlement is in the best interests of the

estate. Here, since I find that important concessions to the Lenders were premised, in material part, on perceived adequate protection entitlements that the Lenders likely would not prevail on, I can't make such a finding.

The motion for approval of the settlement is thus denied, without prejudice to any new settlement that appropriately takes into account the Trustee's stronger position on the issue of adequate protection, and that has even-handed provisions with respect to disgorgement of any fees previously paid. Except to the extent just noted, any other Creditors' Committee grounds for objection (as articulated in its letter of August 14, 2007 or otherwise), are rejected. My Findings of Fact, which underlie my exercise of discretion on this motion, are attached as Appendix A.

Dated: New York, New York
April ***24***, 2008

s/Robert E. Gerber
United States Bankruptcy Judge

Appendix A

Findings of Fact

As predicates for the previous conclusions, I find the following key facts:

1. Before the failure of their business, the Debtors were in the business of providing internet services. In June 2000, the Debtors borrowed $30 million from the Lenders, initially on an unsecured basis. A little more than a year later, the Debtors entered into new agreements with the Lenders, under which the Lenders were to make new loans of up to $6 million pursuant to a revolver. To secure their obligations under both the previously unsecured debentures and the revolving credit agreement, the Debtors gave security interests in nearly all of their assets to the Lenders.

2. As a practical matter, then, except to the extent that there might be value in the Debtors' assets in excess of the aggregate debt owed to the Lenders; exclusions from definitions of "collateral" in the financing documents with respect to particular assets; or proceeds (or the equivalent) from avoidance actions, there here were minimal assets available to satisfy claims of unsecured creditors.

3. On April 17, 2002 (the "Filing Date"), the Debtors filed voluntary petitions for relief under chapter 11 of the Code. It was apparent very early in the cases that to maximize recoveries for whomever had the claim to Debtor assets, the Debtors would have to sell their assets very quickly, in section 363 sales. But the great bulk of the Debtors' assets, and all of their cash assets, had been pledged to the Lenders, requiring the Debtors to obtain the Lenders' consent, and/or one or more cash collateral orders, in order to use available cash to keep the Debtors alive through the necessary section 363 sales and their ongoing chapter 11 cases.

4. As is common in chapter 11 cases where cash collateral is to be used, the Debtors secured a cash collateral stipulation from the Lenders, which thereafter became a cash collateral order, upon its approval by the Court after a hearing on the cash collateral order terms. As is also common in chapter 11 cases where cash collateral is to be used, the cash collateral order provided the Lenders with "adequate protection" of their interests in the cash collateral—in this case by a substitute lien, and a superpriority claim, two of the most common means of providing adequate protection.

5. Within eight weeks of the chapter 11 filing, the Debtors sold their two lines of business and substantially all of their non-cash assets. The need to do so was foreseeable. The internet service line of business ("Fastnet") and web hosting line of business ("Clearblue") (in each case referring to them in shorthand by the names of their ultimate purchasers), were auctioned off as going concerns.

6. After the final sale and significant intercreditor litigation, the Debtors moved to convert the cases to chapter 7. The Committee objected to conversion and moved for appointment of a chapter 11 trustee. On July 30, 2003, I directed the appointment of a chapter 11 trustee, in large part to address the litigious nature of the case. The Trustee was appointed shortly thereafter.

7. On August 3, 2004, the Trustee issued a comprehensive report reviewing potential claims against the Lenders. The Trustee's report concluded there was an insufficient basis to assert all but one of the claims suggested by the Creditors' Committee. The Trustee brought the single claim that he determined might have merit—a fraudulent conveyance claim arising from the transactions under which the Lenders' unsecured debt became secured debt. But while the claim was vigorously and

competently litigated, I dismissed it on summary judgment, ruling that while the transaction was in economic effect a preference, it was not a *voidable* preference (because it took place more than 90 days prior to the Debtors' chapter 11 filing), and was not a fraudulent conveyance. The Trustee appealed that determination, but it was affirmed by the District Court.[20] A further appeal of that determination is currently pending before the Second Circuit.

8. The Creditors' Committee also sought to equitably subordinate the Lenders' claims, principally by reason of their actions in acquiring their secured creditor status. But in an orally-delivered decision, I agreed with the Lenders that the Creditors' Committee required court approval before it could assert such a claim, and that the Trustee had the sole and exclusive right to assert the claim. And while the Creditors' Committee appealed that determination, my decision was thereafter affirmed by the district court and then by the Second Circuit.[21]

9. After the Trustee's repeated failed attempts at a settlement that included the Committee, the Trustee agreed to an initial settlement with the Lenders and most administrative claimants. When I determined that there were material disputed issues of fact in connection with the motion, I held an evidentiary hearing. At the evidentiary hearing, the Trustee and Lenders presented an amended Settlement Stipulation, responding to several of the concerns I had previously voiced.

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[20] *See In re AppliedTheory Corp.*, 330 B.R. 362 (S.D.N.Y. 2005) (Buchwald, J.) *aff'g* 323 B.R. 838 (Bankr. S.D.N.Y. 2005) (Gerber, J.) (the "Fraudulent Conveyance Decision").

[21] *See* Order Granting Lenders' Motion to Clarify Or Limit The Scope Of The Committee's Authority to Engage in Litigation dated Oct. 11, 2005 (Bankr. S.D.N.Y. 2005) (Gerber, J.), *aff'd* 345 B.R. 56 (S.D.N.Y. 2006) (Cote, J.), *aff'd* 493 F.3d 82 (2d Cir. 2007) (*per curiam*) (the "Authority Decision").

10. The principal remaining dispute with respect to the wisdom of the Settlement Stipulation concerns the disposition of between $1.6 million and $1.8 million of assets, not subject to the Lenders' pre-petition liens, received from various sources (the "Unencumbered Assets"). The Unencumbered Assets would be unencumbered in reality if, but only if, they did not thereafter become encumbered by reason of the Lenders' post-petition adequate protection substitute liens, or become subject to a superpriority claim that while not, strictly speaking, a lien, would be the economic equivalent of such.

11. All parties appear to agree that $496,000 of the cash the Trustee now holds (representing avoidance action recoveries) is unencumbered by any pre-petition lien, and that the proceeds of three more avoidance actions still pending would be unencumbered as well. Additionally, the Fastnet and Clearblue sale documents allocated a total of $700,000 in cash and notes as payment for unencumbered assets. (This consisted of $200,000 of the Fastnet sale consideration as payment for the Debtors' waiver of avoidance actions against vendors and customers, and $200,000 in cash and a $300,000 note from the Clearblue sale consideration for "unencumbered acquired assets and assumed contracts," including additional waivers of avoidance actions.) The Lenders objected to this allocation.

12. An additional $237,000 is held as proceeds of Red Hat stock that had been held in escrow. The Lenders, on the one hand, and the Trustee and the Creditors' Committee, on the other, dispute whether the Red Hat stock proceeds are encumbered. If

the matter were litigated, I would likely conclude that the Red Hat stock proceeds are unencumbered.[22]

13. The Trustee (understandably) did not seek to calculate or determine cash balances with 100% precision or to determine exact amounts where the exact amount would not make a difference, and instead analyzed the numbers that could affect the proposed settlement by gauging their approximate amounts, orders of magnitude, and materiality. He was sensible in doing so. I have done likewise.

14. The Debtors had approximately $2.448 million in cash, which was cash collateral, on the Filing Date, April 17, 2002, and (though I fail to see the relevance of this) approximately $2.229 million in cash, which was cash collateral, at the end of April 2002.[23]

15. Cash and cash equivalent proceeds of the sales of the Debtors' internet service and web hosting lines of business, to Fastnet and Clearblue, respectively (the "Fastnet/Clearblue Proceeds"), were approximately $14.2 million on July 31, 2003.[24] These proceeds became additional cash collateral, though whether they constituted "Cash Collateral" within the meaning of the Granting Clause and the Orders' Cash Collateral Definition (defined above), to be considered in any computation of a diminution in Cash Collateral under the cash collateral orders, is a matter of debate. If the Fastnet/Clearblue Proceeds are properly included in any computation of the diminution of Cash Collateral

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[22] The security agreement included a specific exclusion for the Red Hat stock in its definition of "Pledged Securities", exempting securities received by Debtors with respect to the Red Hat stock from the Lenders' security interest.

[23] Geron Aff. at ¶ 12.

[24] Evident. Hrg. Tr. at 8.

(as a matter of law or mixed question of fact and law), there was no diminution of cash collateral.

16. The Debtors' cash, exclusive of the Fastnet/Clearblue Proceeds, decreased (principally by reason of negative cash flow from operations, but also as a consequence of professional fees and other administrative expenses) to a level of approximately $341,000 on July 31, 2003.[25] If the Fastnet/Clearblue Proceeds should properly be excluded from any computation of the diminution of cash collateral (as a matter of law or mixed question of fact and law), the Lenders' cash collateral decreased by approximately $2.107 million.[26]

17. It is likely that the Trustee would prevail in any litigation with the Lenders with respect to whether the portion of Fastnet/Clearblue Proceeds that was allocated to waivers of avoidance action claims was unencumbered by the Lenders' liens. The more likely litigation result would be a holding that the allocations were valid, and that the portion allocated to waivers of avoidance actions would be unencumbered.

18. It is very likely that the Trustee would prevail in any litigation with the Lenders with respect to whether the "Debtors' Owned Stock"—the Red Hat stock and Center for American Jobs stock—and any proceeds thereof, was unencumbered by the Lenders' liens. The much more likely litigation result would be that the Red Hat stock and the Center for American Jobs stock, and any proceeds thereof, would be unencumbered.

19. It is very likely that the Trustee would prevail in any litigation with the Lenders with respect to diminishment in the Lenders' cash collateral. The much more

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[25] Geron Aff. at ¶ 16; Evident. Hrg. Tr. at 58.

[26] Evident. Hrg. Tr. at 58.

likely litigation result, in light of the definitions of Cash Collateral in the relevant cash collateral orders, would be that the Fastnet/Clearblue Proceeds had to be included, along with other cash and cash proceeds, in any computation of cash collateral; that the level of cash collateral increased; and that there thus would be no factual predicate for tapping unencumbered assets to compensate the Lenders for diminutions in cash collateral.