**UNITED STATES BANKRUPTCY COURT**
**DISTRICT OF MAINE**

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| In re:<br><br>MONTREAL MAINE & ATLANTIC RAILWAY, LTD.<br><br>Debtor. | Bk. No. 13-10670<br>Chapter 11 |

**TRUSTEE'S RESPONSE TO LIMITED OBJECTION OF NEW BRUNSWICK SOUTHERN RAILWAY COMPANY LIMITED AND MAINE NORTHERN RAILWAY COMPANY LIMITED TO THE CHAPTER 11 TRUSTEE'S MOTION FOR INTERIM AND FINAL ORDERS (A) AUTHORIZING DEBTOR TO OBTAIN POST-PETITION FINANCING AND (B) GRANTING CAMDEN NATIONAL BANK POST-PETITION PRIORITY LIENS**

Robert J. Keach, the trustee (the "Trustee") of Montreal Maine & Atlantic Railway, Ltd. (the "Debtor"), by and through his undersigned counsel, hereby responds to the *Limited Objection of New Brunswick Southern Railway Company Limited and Maine Northern Railway Company Limited to the Chapter 11 Trustee's Motion for Interim and Final Orders (A) Authorizing Debtor to Obtain Post-Petition Financing and (B) Granting Camden National Bank Post-Petition Priority Liens* [D.E. 705] (the "Objection"), filed by New Brunswick Southern Railway Company Limited and Maine Northern Railway Company Limited (collectively, "Irving"). In support of this response, the Trustee states as follows:

## BACKGROUND

1. On February 5, 2014, the Trustee filed the *Chapter 11 Trustee's Motion for Interim and Final Orders (A) Authorizing Debtor to Obtain Post-Petition Financing and (B) Granting to Camden National Bank Post-Petition Priority Liens* [D.E. 611] (the "Borrowing Motion"), and on February 11, 2014, the Court entered its *Interim Order Granting the Chapter 11 Trustee's Motion for Interim and Final Orders (A) Authorizing Debtor to Obtain Post-*

*Petition Financing and (B) Granting to Camden National Bank Post-Petition Priority Liens* [D.E. 649] (the "Interim Order"). The Interim Order provides, among other things, the following:

> With the consent of MDOT and in the absence of objection from the FRA, the Debtor is authorized to borrow $750,000.00 (the "Interim Funding Amount") of the New Loan . . . In order to adequately protect the FRA in relation to the Interim Funding Amount, the Debtor hereby grants to FRA a first-priority lien, subject only to the interests, if any, of Wheeling & Lake Erie Railway Company ("Wheeling"), in the Debtor's interest in the following: (a) the proceeds of the settlement reached with Travelers Property Casualty Company of America, which settlement was approved by the terms of an Order entered by this Court on December 24, 2013 (the "Travelers' Proceeds"); and (b) the proceeds of the agreement relating to the assignment of 45G tax credits, which agreement was approved by Order of this Court dated December 17, 2013 (the "45G Proceeds").

Interim Order, at ¶ 4. On February 19, 2014, the Court entered an *Amendment to Interim Order Granting Chapter 11 Trustee's Motion for Order (A) Authorizing Debtor to Obtain Post-Petition Financing and (B) Granting to Camden National Bank Post-Petition Priority Liens* [D.E. 672] (the "Amended Order"), which amended the Interim Order to, among other things, increase the Interim Funding Amount from $750,000 to $1.35 million. *See* Amended Order, at ¶ 1.

2. The Court will consider the Borrowing Motion at a hearing on March 12, 2014, and at that hearing the Trustee will ask the Court to enter an order granting the motion on a final basis. The order sought by the Trustee (the "Final Order") would authorize borrowing of up to $1,800,000 (*i.e.*, the maximum amount of the increased availability under the additional financing) and, as a result, increase the FRA's adequate protection lien in the Travelers' Proceeds and the 45G Proceeds (collectively, the "Proceeds") from $1.35 million to $1.8 million.

3. Based on its alleged six-months rule claims, Irving argues that the Final Order must provide that "any lien granted to the FRA in the [Proceeds] or any other unencumbered assets shall not impair and be subject to such rights as the holders of six month claims are able to establish in this case." Objection, at 4.

## ARGUMENT

### A. The FRA Already Has a Vested Lien on the Proceeds for $1.35 Million Under the Amended Order.

4. The FRA already has a lien on $1.35 million of the Proceeds by virtue of the Amended Order. *See* Amended Order, at ¶ 1. At this point, no appeal can be taken from the Amended Order. *See* Fed. R. Bankr. P. 8002(a). If the lien granted by the Amended Order cannot be affected by the reversal of the Amended Order on appeal, *see* 11 U.S.C. § 364(e), then it follows that any subsequent challenge to the Borrowing Motion at a final hearing pursuant to Fed. R. Bankr. P. 4001(c)(2) cannot affect the lien previously granted to the FRA by the Amended Order. This means that Irving is left, at best, with a challenge to the proposed $450,000 increase in the FRA's adequate protection lien.

### B. Irving Seeks to Disturb a Necessary Element of FRA's Agreement to the New Loan.

5. The FRA's consent to the additional financing is critical to obtaining desperately needed liquidity, without which the Debtor's estate would run out of cash before the closing of the sale of the Debtor's assets (the "Sale"). As the Court found in the Interim Order,

> [a]bsent approval of the Motion and entry of this Order, the Debtor and its creditors and other parties in interest will suffer immediate and irreparable harm given that the Debtor does not otherwise have sufficient funds to continue operations and preserve the value of its assets pending the closing of the Sale.

Interim Order, at ¶ L. Irving does not challenge this finding, nor could it.

6. The FRA has advised the Trustee that it will not consent to the additional financing without the receipt of adequate protection in the form of a lien on the Proceeds. The Trustee has made a judgment—one that he and other creditors believe is reasonable if not required—to grant a lien on the Proceeds to the FRA. If the Travelers' Proceeds and the 45G Proceeds were presently available to the estate, those funds would be used by the Trustee to operate the Debtor's business pending the Sale; they would not be available to pay pre-petition

claims of the type asserted by Irving. The Trustee sought and obtained the additional financing precisely because the Travelers' Proceeds and the 45G Proceeds are not presently available, and that financing would not have been available without the grant of a first-priority mortgage on collateral in which the FRA has an interest. The FRA's agreement to allow that priming lien is conditioned on the grant of an adequate protection lien on the Proceeds. The relief Irving seeks in the Objection—a lien for its potential 1171(b) claims—would leave the Trustee in the position of having to seek approval of the Motion over the FRA's objection. In the circumstances of this case, that is a far less attractive option than granting the FRA a lien on funds that would otherwise be used to pay post-petition expenses, in exchange for the FRA's consent to a financing that provides the immediate liquidity needed to pay those very same post-petition expenses in the ordinary course of business. It is difficult to see how Irving is, in the real world, prejudiced by the relief sought by the Trustee.

**C. Irving's Claims Under § 1171(b) Are Unsecured Claims and Unsecured Claims Are Not Entitled to Adequate Protection.**

7. Irving asserts that its "substantial claims" against the Debtor are entitled to priority through operation of section 1171(b) of the Bankruptcy Code and the so-called "six-months rule" sometimes applied in historic railroad receivership cases. *See* Objection, at ¶ 3; *see also* 11 U.S.C. § 1171(b); In re New York, New Haven & Hartford R.R., 278 F. Supp. 592, 598-99 (D. Conn. 1967) (discussing historical application of the six-months rule).

8. As an initial matter, Irving does not have any allowed claim with the priority afforded by section 1171(b). In other words, Irving's claims under section 1171(b) are pre-petition, unsecured claims that have not been allowed.[1] Courts require three elements for a six-months rule claim to be allowed: (a) the claim represents a "current operating expense

[1] Irving has been actively involved with this case since its early days. If Irving believed that it had some type of administrative expense or other priority claims worthy of adequate protection, why Irving waited until days before a final hearing on the Borrowing Motion to assert those claims for the very first time is difficult to comprehend.

necessarily incurred;" (b) the claim was incurred within six months before the reorganization petition was filed; and (c) the goods or services were delivered "in the expectation that they would be paid for out of current operating revenues of the railroad, and not in reliance on the railroad's general credit." In re Boston & Maine Corp., 634 F.2d 1359, 1378-79 (1st Cir. 1980), *cert. denied*, 450 U.S. 982 (1981); *see* Matter of Penn Cent. Transp. Co., 458 F. Supp. 1234, 1321 (E.D. Pa. 1978); 8 Collier on Bankruptcy, ¶ 1171.02 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2013). The third element requires the existence of a "current debt fund" out of which the creditor expected to be paid. *See* Collier, P. 1171.02; New York, New Haven & Hartford R.R. Co., 278 F. Supp. at 598-99. Again, the issue of claim allowance is not before the Court, but it is worthwhile to note that Irving merely has alleged that its claims were necessarily incurred in the applicable six month period, and the Objection does not identify any sort of "current debt fund" or Irving's reliance on that fund (rather than the Debtor's general credit).

9. Perhaps more importantly for current purposes, the claims, if allowed, would be unsecured claims. The six-months rule "is an equitable one designed, at least in part, to promote certain prepetition claims over unsecured creditors[.]" *See* 8 Collier on Bankruptcy ¶ 1171.02 (emphasis added). In fact, "six-months claims should be below all of the section 507 priorities." Id. Thus, even if Irving's 1171(b) claims were allowed, those claims will not be secured, will not have administrative expense priority, and are likely to fall below all other priorities under section 507(a) of the Bankruptcy Code.[2]

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[2] No binding precedent exists that would require the Court, in the event that Irving's claims are allowed, to grant the priority that Irving seeks for its alleged six-months rule claims. Irving cites non-binding precedent which confuses the priority of six-months rule claims with claims under the "necessity of payment" rule, which was also sometimes applied in historic railroad receivership cases. The necessity of payment rule allows, but does not require, a trustee to pay certain creditors' prepetition claims during the pendency of the bankruptcy, where a creditor threatens to withhold critical goods or services in the absence of immediate payment. *See* New York, New Haven & Hartford R.R., 278 F. Supp. at 602, n.15. The rule does not determine claim priority, but simply allows the trustee, in limited circumstances, to pay certain prepetition claims if doing so will ensure the delivery of critical goods and services. Id. This doctrine frequently has been misinterpreted as affecting six-months rule claims and endowing such claims with superpriority over administrative expense or secured claims. As stated in Collier on Bankruptcy:

10. Irving would not be entitled to any form of adequate protection on account of such unsecured claims. In In re Garland Corp., 6 B.R. 456 (B.A.P. 1st Cir. 1980), the court was presented with an analogous situation, where unsecured creditors objected that "the satisfaction of unsecured claims may be delayed, diminished or rendered impossible as a result of the authorization to encumber 'free' assets as security for postpetition operating loans," which were necessary as the "debtor was in urgent need of operating funds." Id. at 461. The court held that, as a matter of bankruptcy law and constitutional law, unsecured creditors had no right to adequate protection against such diminution:

> Congress has chosen to exercise its substantive bankruptcy power so as not to require "adequate protection" of the interests of the holders of unsecured claims under the Bankruptcy Code in circumstances where the debtor obtains postpetition credit on the strength of a lien on previously unencumbered property of the estate theretofore available in whatever measure for the satisfaction of unsecured claims.

Id., at 463; *see also* In re Coastal Cable T.V., Inc., 24 B.R. 609, 612 (B.A.P. 1st Cir. 1982), *vacated on other grounds*, 709 F.2d 762 (1st Cir. 1983) ("As a matter of policy and

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> [T]he [six-months] rule has been the source of vigorously contested litigation, generated largely because of a judicial mingling of two distinct doctrines, the six-month rule and the "necessity of payment" rule.
> …
> [The] necessity of *payment*, which focuses on whether the railroad can continue to operate if these expenses are not paid now, is distinct from the necessity of *incurring* the expenses in the first place, which is an element of the six-month rule . . . the necessity of payment doctrine . . . should arise, if at all, at the outset of the case.

8 Collier on Bankruptcy ¶ 1171.02. For example, Irving cites Southern Ry. v. Flournoy, 310 F. 2d 847 (4th Cir. 1962), for the proposition that its alleged six-months rule claims are entitled to priority over the secured claims of the FRA and Wheeling; however, it is widely recognized that Flournoy misstated and confused the six-months rule and necessity of payment rule. *See* 8 Collier on Bankruptcy ¶ 1171.02, n.9 (stating that Flournoy is "the case most frequently cited as confusing the two doctrines" of six-months rule claims and necessity of payment claims); *Penn Cent. Transp. Co.*, 458 F. Supp. 1234, 1326-28 ("the Flournoy court simply confused the 'necessity of payment' rule with the 'six months' rule. Its decision is contrary to the decision of the Supreme Court in Gregg v. Metropolitan Trust"); *New York, New Haven & Hartford R.R.*, 278 F. Supp. at 602, n.15 ("The Flournoy court confused and merged the six months rule with another priority developed in equity receiverships: the so-called 'necessity of payment' rule. This rule is completely unrelated to the six months rule, with different requirements and a different rationale."). Irving does not and cannot assert claims under the necessity of payment rule, and the claims that it does assert under the six-months rule, if allowed, would not be entitled to superpriority status above administrative or secured claims. See 8 Collier on Bankruptcy ¶ 1171.02.

constitutional law, adequate protection is afforded only to secured claims and unsecured claims are not entitled to such protection."); In re Tellier, 125 B.R. 348, 349 (Bankr. D. R.I. 1991) ("The entitlement to adequate protection of "an interest in property" obviously requires that an interest in that property exists in the first place."); In re Dunckle Assoc., Inc., 19 B.R. 481, 485 n.10 (Bankr. E.D. Pa. 1982) (Under section 364(d), "[t]he law is well settled that valueless junior secured positions or unsecured deficiency claims are not entitled to adequate protection."); *see generally* In re 620 Church Street Bldg. Corp., 299 U.S. 24 (1936) (finding no constitutional requirement for adequate protection of unsecured claims).

**D. Any Prejudice in the Form of Dilution of Irving's Alleged Claims Is Significantly Outweighed by the Benefit of the Additional Financing to the Estate.**

11. If Irving obtains its requested relief in the Objection (such that $450,000 of the Proceeds remained unencumbered), Irving's share of those Proceeds would be *pari passu* with or subordinate to section 507(a) priority claims, including section 1171(a) claims for the victims of the Lac-Mégantic derailment. *See* 8 Collier on Bankruptcy ¶ 1171.02. In this case, there may be hundreds of millions of dollars of administrative expense and other 507(a) priority claims, and Irving's claim would represent a very small fraction of such claims. Any degradation of Irving's unsecured claims—claims that would be paid *pro rata* with administrative claims at best, or more likely after all other 507(a) priority claims—does not outweigh the significant benefit to all creditors and parties in interest provided by the additional financing.

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## CONCLUSION

WHEREFORE, the Trustee requests that this Court enter an order (i) overruling the Objection, and (ii) granting the Motion on a final basis and other relief as this Court may deem just and proper.

Dated: March 10, 2014

ROBERT J. KEACH,
CHAPTER 11 TRUSTEE OF MONTREAL
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By his attorneys:

*_/s/ Michael Fagone, Esq._*

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