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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

August Term 2021

Argued: September 24, 2021
Decided: October 14, 2022

Nos. 20-3343(L), 20-3346(Con), 20-3349(Con)

IN RE: SEARS HOLDINGS CORPORATION

ESL INVESTMENTS, INC., AND CERTAIN OF ITS AFFILIATED ENTITIES, JPP, LLC, JPP II, LLC, WILMINGTON TRUST, NATIONAL ASSOCIATION, AS INDENTURE TRUSTEE AND COLLATERAL AGENT, CYRUS CAPITAL PARTNERS, L.P.,

Appellants,

v.

SEARS HOLDINGS CORPORATION,

Debtor-Appellee,

SEARS HOME IMPROVEMENT PRODUCTS, INC., KMART HOLDING CORPORATION, SEARS, ROEBUCK AND CO., SEARS PROCUREMENT SERVICES, INC., SEARS PROTECTION COMPANY (PR) INC., SEARS PROTECTION COMPANY, SEARS ROEBUCK ACCEPTANCE CORP., SR-ROVER DE PUERTO RICO, LLC, BIG BEAVER OF FLORIDA DEVELOPMENT, LLC., CALIFORNIA BUILDER APPLIANCES, INC., KMART OF WASHINGTON, LLC, SEARS BRANDS

BUSINESS UNIT CORPORATION, SEARS HOLDINGS PUBLISHING COMPANY, LLC, SEARS PROTECTION COMPANY (FLORIDA), L.L.C., SHC DESERT SPRINGS, LLC, A&E HOME DELIVERY, LLC, SEARS OPERATIONS LLC, A&E LAWN & GARDEN, LLC, A&E SIGNATURE SERVICE, LLC, FBA HOLDINGS INC., INNOVEL SOLUTIONS, INC., SEARS HOLDINGS MANAGEMENT CORPORATION, SEARS HOME & BUSINESS FRANCHISES, INC., SEARS INSURANCE SERVICES, L.L.C., FLORIDA BUILDING APPLIANCES, INC., KMART STORES OF TEXAS LLC, KMART OF MICHIGAN, INC., SHC PROMOTIONS LLC, SYW RELAY LLC, A&E FACTORY SERVICE LLC, KMART.COM LLC, KMART OPERATIONS LLC, SHC LICENSED BUSINESS LLC, SERVICELIVE INC., SRE HOLDING CORPORATION, KMART CORPORATION, MAXSERV, INC, PRIVATE BRANDDS, LTD., SEARS DEVELOPMENT CO., KBL HODLING INC., KMART STORES OF ILLINOIS LLC, KLC, INC., WALLY LABS LLC, MYGOFER LLC, SOE, INC., TROY COOLIDGE NO. 13, LLC, SEARS BRANDS MANAGEMENT CORPORATION, STARWEST, LLC, BLUE-LIGHT.COM, INC., SEARS BUYING SERVICES, INC., STI MERCHANDISING, INC., SEARS BRANDS, L.L.C., OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF SEARS HOLDINGS CORPORATION, ET AL, SEARS, ROEBUCK DE PUERTO RICO, INC., FLORIDA BUILDER APPLIANCES, INC.,

*Appellees.**

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* The clerk of Court is respectfully directed to amend the caption as set forth above.

Appeal from the United States District Court for the Southern District of New York

No. 19-cv-7660, Vincent L. Briccetti, *Judge*,

No. 18-B-23538, Robert D. Drain, *Bankruptcy Judge*.

Before: SULLIVAN, BIANCO, *Circuit Judges*, and CHEN, *District Judge*.†

The Sears Holdings Corporation and its affiliates (collectively, the "Debtors" or "Sears") carried approximately $2.68 billion of first- and second-lien secured debt at the time of its bankruptcy petition. The first-lien debt has since been paid in full. The holders of the second-lien debt, however, alleged that they were paid less than the value of the collateral that secured their claims. To recoup the difference, the second-lien holders sought relief under section 507(b) of the Bankruptcy Code, arguing that the value of their collateral decreased during the course of the bankruptcy proceeding, which entitled them to priority payment of the difference. The bankruptcy court (Robert D. Drain, Bankruptcy Judge) disagreed, finding that the value of the second-lien holders' collateral had not decreased since the date the Debtors filed for bankruptcy and that, in fact, the second-lien holders had received more than the value of their collateral.

On appeal, the second-lien holders raise a number of objections to the bankruptcy court's valuation

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† Judge Pamela K. Chen, of the United States District Court for the Eastern District of New York, sitting by designation.

methodology, as well as to its valuation of several specific categories of collateral. Because the bankruptcy court reasonably determined that the second-lien holders had already recovered more than the value of their collateral on the date of the bankruptcy petition, we affirm its denial of the second-lien holders' section 507(b) claims.

Affirmed.

ANDREW M. LEBLANC, Milbank LLP, Washington, D.C. (Robert J. Liubicic, Thomas R. Kreller, Eric R. Reimer, Milbank LLP, Los Angeles, CA, *on the briefs*), *for Appellant* Cyrus Capital Partners, L.P.

Edward M. Fox, Owen R. Wolfe, Seyfarth Shaw LLP, New York, NY, *for Appellant* Wilmington Trust, National Association, as Indenture Trustee and Collateral Agent.

Philip D. Anker, Wilmer Cutler Pickering Hale and Dorr LLP, New York, NY, *for Appellants* ESL Investments, Inc., and certain of its affiliated entities, including JPP, LLC, and JPP II, LLC.

GREGORY SILBERT, Weil, Gotshal & Manges LLP (David J. Lender, Richard Gage, Robert Niles-Weed, Weil, Gotshal & Manges LLP, New York, NY, Paul R. Genender, Erin Choi, Weil Gotshal & Manges LLP, Dallas, TX, *on the brief*), *for Appellees* Sears Holdings Corporation, et al.

Z.W. Julius Chen, Akin Gump Strauss Hauer & Feld, LLP, Washington, D.C., Ira S. Dizengoff, Joseph L. Sorkin, Akin Gump Strauss Hauer & Feld LLP, New York, NY, *for Appellee* Official Committee of Unsecured Creditors of Sears Holding Corporation, et al.

RICHARD J. SULLIVAN, *Circuit Judge*:

This case entails complex calculations and challenging legal theories, but the inquiry at its core comes down to a fundamental concept: how to value the assets and liabilities of a company. On October 15, 2018, when the Sears Holdings Corporation and its affiliates (collectively, the "Debtors" or "Sears") filed their bankruptcy petition (the "Petition Date"), they carried approximately $2.68 billion of debt. One set of priority creditors – the "first-lien holders" – have since been paid in full and do not challenge the value that they have been able to recoup from the Debtors. Another set of creditors – the "second-lien holders," who were entitled to payment only after the debts to the first-lien holders had been discharged – were not so satisfied. In the bankruptcy court, they argued that the value of the collateral that secured their claims, as measured on the Petition Date, vastly exceeded what they have been paid, and that they are accordingly entitled to priority payment of the difference pursuant to section 507(b) of the Bankruptcy Code. The bankruptcy court (Robert D. Drain, *Bankruptcy Judge*) disagreed, valuing the second-lien holders' collateral at a sum less than what they had already been paid, and accordingly denied their claims for any additional payment. The district court (Vincent L. Briccetti, *Judge*) affirmed the bankruptcy court's decision in full. The second-lien holders appealed. For the reasons set forth below, we **AFFIRM** the judgment of the district court, which in turn affirmed the judgment of the bankruptcy court.

I. BACKGROUND

When the Debtors filed for bankruptcy in 2018, they operated 687 stores across the country and employed approximately 68,000 workers. At that time, their debt obligations to the first- and second-lien holders were secured principally by the Debtors' inventory and their rights to payment still owed for goods and services they had previously provided. On the Petition Date, neither the Debtors nor their creditors knew whether Sears would be sold or liquidated.

The filing of a chapter 11 bankruptcy petition triggers an automatic stay that prevents creditors from taking "possession of [the debtor's] property." 11 U.S.C. § 362(a)(3). As a result, the second-lien holders, including Appellants ESL Investments, Inc. ("ESL"), Wilmington Trust, National Association ("Wilmington Trust"), and Cyrus Capital Partners LP ("Cyrus"), were prevented from foreclosing on their collateral. Instead, they were provided with "adequate protection," a statutory right designed to preserve the Petition-Date value of a secured creditor's collateral. *Id.* § 363(e). Specifically, "adequate protection" entitles secured creditors to "a cash payment" or "an additional or replacement lien" in the event of a decrease in the value of their collateral during the bankruptcy proceedings. *Id.* § 361(1)–(2). To the extent that the adequate-protection mechanism fails to preserve the value of the collateral, the creditors are entitled to administrative "super-priority," a right to payment ahead of all other creditors up to the amount of the value lost. *In re Blackwood Assocs.*, 153 F.3d 61, 68 (2d Cir. 1998); *see also* 11 U.S.C. § 507(b).

As is often the case with bankruptcies involving retailers, much of the collateral was the Debtors' inventory. Because such collateral is inherently short-lived and is often sold by debtors at fire-sale prices, the bankruptcy court provided the second-lien holders with adequate protection in the form of replacement liens that granted them section 507(b) super-priority over all other creditors' claims to make up for any diminution in value of their collateral following the Petition Date.

Shortly after the Petition Date, the Debtors entered into negotiations to sell substantially all their assets. After a series of bids that the Debtors rejected, Sears's largest secured creditor, the hedge fund ESL, made a bid through an ESL-controlled entity, Transform Holdco, LLC, to purchase substantially all of the Debtors' assets, which the Debtors accepted. On February 8, 2019, the bankruptcy court approved the transaction, and the Debtors sold substantially all their assets to Transform for approximately $5.2 billion. This sum was comprised of largely non-cash consideration including, as especially relevant here, a $433.5 million "credit bid," which for practical purposes forgave debt that the Debtors owed to ESL, Wilmington Trust, and Cyrus in exchange for a dollar-for-dollar reduction in the purchase price. Although Wilmington Trust and Cyrus were not parties to the transaction, the terms of the credit documents required them to take part in the credit bid, and their rights to payment were thus reduced accordingly.

According to the second-lien holders, the $433.5 million credit bid falls far short of the Petition-Date value of the collateral that secured their claims. As a result, pursuant to section 507(b) of the Bankruptcy Code, the second-lien holders asserted super-priority treatment of the diminution in value of their collateral during the course of the bankruptcy proceeding. Those section 507(b) claims are the subject of this appeal.

As noted above, to assert a successful section 507(b) claim, the second-lien holders' collateral must have decreased in value after the Petition Date. To determine whether the collateral had decreased in value, the bankruptcy court had to calculate the Petition-Date value of the Debtors' collateral and then subtract from this amount the obligations owed to the first-lien holders, as measured on the Petition Date. The second-lien holders have a viable section 507(b) super-priority claim only if this figure exceeds the $433.5 million credit bid ESL already recouped in the transaction.[3]

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[3] Additionally, the agreement governing the Debtors' sale to Transform contained a provision that limited to $50 million the distributions ESL could receive "from the proceeds of any Claims or causes of action of the Debtors or their estates," if ESL were to bring a section 507(b) claim. J. App'x at 1943–44. Thus, in the event that the bankruptcy court determined that the second-lien holders were entitled to more than $50 million in section 507(b)

On July 23 and 31, 2019, the bankruptcy court held a hearing to determine the Petition-Date value of the collateral. At the hearing, the bankruptcy court heard testimony from valuation experts put on by the Debtors and each second-lien holder, whose assessments of the collateral's value varied widely. Marti Murray, Cyrus's expert, valued the collateral on the Petition Date at a minimum of $2.46 billion; David Schulte, ESL's expert, valued it at $2.928 billion; and William Henrich, Wilmington Trust's expert, set the value at $3.28 billion. The differences among these values turned primarily on how the experts calculated the revenue Debtors could expect to earn from selling their inventory – for instance, whether the inventory would be sold at full retail price; a depressed, going-out-of-business or liquidation price; or an orderly company-wide going out of business sale that would sell the Debtors' assets at more than their liquidation value, but less than their full retail price – a point in the price range known as net orderly liquidation value ("NOLV").

After taking evidence, the bankruptcy court decided that it would value the bulk of Debtors' collateral based on the NOLV because, on the Petition Date, a complete liquidation of the Debtors' assets was a genuine possibility. It then determined that the inventory's NOLV was 88.7% of its $2.69 billion book value, and after subtracting 1.3% as an estimate of

super-priority claims, it then had to decide from which sources of funds, if any, the agreement permitted such a recovery.

the overhead costs and legal fees that would be associated with liquidating that inventory, arrived at a total value of 87.4% of the inventory's book value.

With that general approach as its starting point, the bankruptcy court proceeded to make several valuations of other collateralized assets, some of which are no longer at issue. As relevant here, the bankruptcy court undertook to value the Debtors' "non-borrowing-base" ("NBB") inventory, a set of inventory that, for one reason or another, creditors are not willing to lend against – such as live plants in stores, in-transit inventory that would eventually be sold at stores, and inventory that had remained on the shelves even after a store's going-out-of-business sale. Placing significant importance on its determination that the second-lien holders bore the burden of valuing this inventory, the bankruptcy court valued the NBB inventory at zero dollars because, in its view, the second-lien holders had failed to offer a reasonable valuation method for those goods.

The bankruptcy court then considered how to value approximately $395 million in letters of credit held by the Debtors. As a general matter, letters of credit require a bank to assume the obligations incurred by the letter's "purchaser" in the event that the purchaser is unable to meet those obligations itself. *See, e.g., 3Com Corp. v. Banco de Brasil, S.A.*, 171 F.3d 739, 741 (2d Cir. 1999). In this case, the Debtors had purchased letters of credit to pay, among other things, workers' compensation claims brought by their employees. According to the terms of the letters, if the Debtors were unable to meet certain specified obligations, the issuers of the letters of credit would pay out the sums owed and would in turn be entitled to repayment from the Debtors' bankruptcy estate ahead of the second-lien holders.

The bankruptcy court acknowledged that the letters of credit were undrawn on the Petition Date, making their value at that time somewhat speculative. Nonetheless, the court determined that "the realistic context of this case [on the Petition Date was] a short-term sale process, with the very real backdrop of a potential liquidation in which the Sears Debtors would go out of business"; accordingly, the bankruptcy court concluded that, on the Petition Date, the letters of credit were likely to be drawn because "[t]he beneficiaries of the letters of credit would not simply let their collateral in the form of a letter of credit go away." Sp. App'x at 28. The bankruptcy court further explained that the second-lien holders did not propose any means of valuing the letters of credit that accounted for their contingent nature. Rather, the second-lien holders suggested either ignoring the letters of credit entirely because they represented contingent obligations, or else subtracting only the roughly $9 million in letters of credit that were *actually* drawn during the subsequent bankruptcy proceedings. The bankruptcy court found the first suggestion to be untenable and the second to be in conflict with the goal of valuing the collateral *on the Petition Date*. Reasoning that the second-lien holders bore the burden of explaining how to value the letters of credit but proposed no sensible method of doing so, the bankruptcy court subtracted the full face value of the letters from the value of the inventory on the Petition Date.

After making these calculations, the bankruptcy court concluded that the collateral on the Petition Date was worth $2.147 billion. The bankruptcy court also determined that creditors senior to the second-lien holders had claims totaling $1.96 billion and subtracted that amount from the $2.147 billion valuation of all the collateral, yielding only $187 million for the second-lien holders. But since the second-lien holders had already realized more than this from the $433.5 million credit bid, the bankruptcy court held that they were not entitled to any further recovery in the form of section 507(b) super-priority claims. The district court (Vincent L. Briccetti, *Judge*) affirmed in full, and the second-lien holders timely appealed.

II. STANDARD OF REVIEW

"[A]n order of the district court functioning in its capacity as an appellate court in a bankruptcy case is subject to plenary review." *In re Jackson*, 593 F.3d 171, 176 (2d Cir. 2010). In other words, we independently and directly review the bankruptcy court's decision. In so doing, we "accept[] the bankruptcy court's factual findings unless they are clearly erroneous, and review[] its conclusions of law *de novo*." *Id.*

III. DISCUSSION

The key question in this case is the value of the second-lien holders' collateral on the Petition Date, which, as the second-lien holders agree, is the value that controls for purposes of adequate protection and section 507(b) administrative super-priority claims.[4]

[4] It is not settled that the Petition Date is the appropriate time at which to value the collateral. *See, e.g.,* 4 *Collier on Bankruptcy*

As recounted above, the second-lien holders are entitled to section 507(b) super-priority payment to the extent that the value of the Debtors' collateral on the Petition Date, minus the value of the first-lien holders claims on that date, exceeds the $433.5 million credit bid the second-lien holders already received. The second-lien holders raise three challenges to the bankruptcy court's valuation of the collateral on the Petition Date. They argue that the bankruptcy court erred when it (1) valued the bulk of the Debtors' inventory using the inventory's NOLV – and an errantly low NOLV at that – rather than the inventory's book or replacement value, (2) set at zero the value of the Debtors' NBB inventory, and (3) deducted the full face value of the undrawn letters of credit. We address each argument in turn.

A. The Bankruptcy Court's Calculation of NOLV

The second-lien holders raise several challenges to the bankruptcy court's approach to valuing their collateral. Their primary argument is that the bankruptcy court fundamentally erred by not valuing the bulk of the Debtor's inventory at its "book" or "replacement" value instead of the NOLV, which is the value that the Debtors could have expected to realize in an orderly liquidation of the business. They also argue

¶ 506.03[10] (16th ed. 2022). But the bankruptcy court is entitled to deference as to the appropriate time at which to value the collateral, *see In re Heritage Highgate*, 679 F.3d 132, 142 n.7 (3d Cir. 2012) (citing *Collier on Bankruptcy*), and neither party challenges its selection of the Petition Date as the appropriate time, so we proceed on the assumption – at least in this case – that the collateral must be accorded its Petition-Date value.

that, even within the NOLV framework, the bankruptcy court erred in assigning insufficient value to the collateral.

1. The Proper Valuation Framework

According to the second-lien holders, the Supreme Court's decision in *Associates Commercial Corp. v. Rash*, 520 U.S. 953 (1997), required the bankruptcy court to value the Debtor's inventory at its replacement value. The second-lien holders alternatively argue that, to the extent *Rash* permitted the bankruptcy court to deviate from the replacement-cost standard, it should have settled upon a higher, retail value, rather than NOLV.

a. The Replacement-Value Standard

We review the bankruptcy court's application of *Rash* – which is a pure question of law – de novo. *See Jackson*, 593 F.3d at 176.

Rash involved a debtor who "exercised the 'cram down' option" afforded by 11 U.S.C. § 1325(a)(5)(B), which permits a debtor "to retain and use the creditor's collateral" over the creditor's objection, provided that the creditor is paid "the present value of the collateral." 520 U.S. at 955, 957. Alternatively, the debtor may simply surrender the collateral to the creditor. *See id.* at 962. The debtor in *Rash* sought to keep a tractor trailer that he used in his freight-hauling business, requiring him to pay his creditor the present value of the truck. *See id.* at 956–57. The Supreme Court thus had to decide the present value of the tractor trailer under 11 U.S.C. § 506(a), which instructs that "[s]uch value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property." 11 U.S.C. § 506(a)(1). The *Rash* creditor maintained that the value should be assessed based on "the price the [debtor] would have to pay to purchase a like vehicle," known as the "replacement value" of the truck, whereas the debtor argued "that the proper valuation was the net amount [the creditor] would realize . . . . if it exercised its right to repossess and sell the truck," known as the "foreclosure value" of the truck. *Rash*, 520 U.S. at 957–58.

The Supreme Court valued the truck at its replacement value. *Id.* at 962–63. It explained that the statutory distinction between the "'disposition or use' of the collateral . . . turns on the alternative the debtor chooses – in one case the collateral will be surrendered to the creditor, and in the other, the collateral will be retained and used by the debtor." *Id.* at 962. According to the Supreme Court, assessing collateral at its foreclosure value regardless of what the debtor does with it "attributes no significance to the different consequences of the debtor's choice to surrender the property or retain it." *Id.* at 962. By contrast, assessing collateral at its replacement value, at least under the circumstances in *Rash*, respects the debtor's "actual use" of the collateral, "rather than" taking cues from "a foreclosure sale that will not take place." *Id.* at 963.

Citing *Rash*, the second-lien holders argue that because the Debtors "retained and used" the collateral, it should be accorded its replacement value. Appellant Br. at 47–48 (emphasis omitted). The Debtors counter that they proposed to "dispos[e]" of the collateral by selling it – likely in a going-concern sale or a complete liquidation – and so the bankruptcy court permissibly based its valuation on the NOLV. Debtors Br. at 40.

The parties' dispute requires us to decide whether the sale of collateral is properly categorized as a "disposition or use" under section 506(a) – an issue the *Rash* Court had no need to address. 11 U.S.C. § 506(a)(1). In interpreting section 506(a), we begin, as always, "with the statutory text." *BedRoc Ltd. v. United States*, 541 U.S. 176, 183 (2004). Section 506(a) instructs that the value of collateral "shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property." 11 U.S.C. § 506(a)(1); *see also Rash*, 520 U.S. at 961–62 (identifying this sentence of the statute as the one that dictates how collateral should be valued). When a word is not defined by statute, the word is given its "ordinary, contemporary, common meaning." *Perrin v. United States*, 444 U.S. 37, 42 (1979). Surely, selling inventory falls within the common meaning of the word "disposition." *See Disposition*, BLACK'S LAW DICTIONARY (11th ed. 2019) ("The act of transferring something to another's care or possession."). Accordingly, the Debtors' sale of the inventory is properly categorized as a "disposition." *See* Sp. App'x at 32 (explaining that, on the Petition Date, everyone knew "the Debtors were going to dispose of substantially all of their assets in a very short time" (emphasis added)).

Of course, one could employ the verb "use" to describe the sale of inventory, but that is not the "common meaning" of the word in this context. *Perrin*, 444 U.S. at 42. If Sears had proposed to take its ample supply of washers and dryers and convert its stores into a chain of laundromats, then it might be said that it was "using" the washers and dryers, just as the appellant in *Rash* "used" his truck to generate income for the debtor in that case. But, of course, that is not what the Debtors ever proposed to do. Instead, the Debtors sensibly, and predictably, elected to sell the collateral, which falls squarely within the meaning of the word "disposition." Whether those sales were at liquidation prices, retail prices, or somewhere in between, the expectation was that the collateral would be disposed of, not used.

Although the *Rash* Court did not consider the proper valuation method for a proposed "disposition" of retail inventory, the Court's reasoning is instructive. In explaining that replacement value – and not foreclosure value – should be the touchstone of the valuation inquiry in *Rash*, the Court reasoned that the debtor had opted "to use the collateral to generate an income stream," and that this actual use – as opposed to a foreclosure sale that would not occur – was "the proper guide under a prescription hinged to the property's 'disposition or use.'" 520 U.S. at 963. Thus, when valuing collateral pursuant to section 506(a), the value of the property should be calculated "in light of the 'disposition or use' in fact 'proposed,' not the various dispositions or uses that might have been proposed." *Id.* at 964. In other words, *Rash* contemplated that one particular use or disposition must be proposed, and that this proposal must guide the valuation exercise.

Here, on the Petition Date, neither the Debtors nor the second-lien holders knew precisely how the collateral would be sold. Nonetheless, the bankruptcy court reasonably recognized that there were two "realistic scenarios" – a going-concern sale or a forced liquidation. Sp. App'x at 28. Given this backdrop, the bankruptcy court reasonably decided to assess the value of the second-lien holders' collateral in light of what the Debtors would likely be able to recoup from the collateral using the NOLV, which assessed the collateral somewhere between a forced liquidation and its full retail price. *See, e.g., In re Aerogroup Int'l, Inc.*, 601 B.R. 571, 586 (Bankr. D. Del. 2019) (reporting that a particular expert valuation premised on an orderly liquidation was approximately 70% greater than one premised on a forced liquidation). Far from being clearly erroneous, this determination was, by any measure, a sensible one.

b. The Retail Value Standard

The second-lien holders additionally argue that even if the bankruptcy court was permitted to deviate from the replacement-value standard, it should have valued the collateral based on its retail value, rather than NOLV, because the Debtors did not ultimately liquidate, but instead continued operating many of their stores for months before selling the rest of their business as a going concern. But the valuation process in this case turned on the value of the collateral on the Petition Date, without inquiring into how the collateral was *ultimately* used.[5]

The second-lien holders pivot to arguing that even on the Petition Date, the Debtors were clearly contemplating either continued operation of their stores or a going-concern sale. But while the bankruptcy court was aware of these optimistic, best-case-scenario intentions harbored by the Debtors, it also considered that the Debtors were far from financially healthy on

[5] *Rash* held that it is the "actual use" of the inventory that guides the valuation, but that analysis came in the context of explaining that the debtor's "elect[ion] to use the collateral," rather than surrender it, requires using the replacement value of the collateral. 520 U.S. at 963. *Rash* does not hold that the manner in which collateral was actually sold, subsequent to the Petition Date, dictates its value on the Petition Date. The second-lien holders also cite language from *Bank of America National Trust & Savings Ass'n v. 203 North LaSalle Street Partnership*, 526 U.S. 434, 457 (1999), and *Matter of MPM Silicones, LLC*, 874 F.3d 787, 800 (2d Cir. 2017), for the proposition that courts should not "disregard[] available efficient market rates" because "long-standing precedent dictat[es] that 'the best way to determine value is exposure to a market.'" *Matter of MPM Silicones*, 874 F.3d at 800 (quoting *Bank of Am. Nat'l Tr. & Sav. Ass'n*, 526 U.S. at 457). We do not dispute that exposure to the market is a crucial data point in assessing value (although we note that there was expert testimony that ESL itself ended up paying only approximately 85% of the collateral's book value in order to purchase it). But the valuation here did not turn on the bankruptcy court's guess at what consideration the collateral would have fetched at a certain type of sale, such as a foreclosure sale. Instead, the bankruptcy court's valuation was grounded in its assessment that a distressed-asset sale was likely on the Petition Date, and the second-lien holders do not identify any authority suggesting that the bankruptcy court was obliged to reconsider that assessment in light of subsequent developments.

the Petition Date, and a company-wide liquidation was possible. The bankruptcy court's decision to settle on an orderly liquidation value was therefore not an unreasonable conclusion.

2. The Bankruptcy Court's NOLV Analysis

Finally, the second-lien holders argue that, even within an NOLV framework, the bankruptcy court's valuation excessively reduced the value of the Debtors' inventory by assessing it at merely 88.7% of its book value. Because this aspect of the bankruptcy court's valuation turns on a question of fact – whether it arrived at an appropriate NOLV for the collateral – we review it for clear error. *See Jackson*, 593 F.3d at 176. Finding none, we do not disturb the bankruptcy court's NOLV assessment.

To value the collateral, the bankruptcy court used as its principal guide the methodology of one of the second-lien holders' own experts, Ms. Murray, who recommended using NOLV based on the fact that there were no bids for the Debtors' business on the Petition Date, but that Debtors had repeatedly represented that they were ready at any moment to commence a full liquidation sale. *See* J. App'x at 4855–56 (describing Murray's approach). The bankruptcy court also explained the shortcomings of Murray's analysis and the reasons why it would not follow her conclusions completely. As for Schulte's report, which recommended the highest valuation, the bankruptcy court explained that it gave "next to no weight" to that assessment because the valuation indiscriminately discounted *all* the Debtors' inventory at all the stores by less than 1% from its book value. Sp. App'x at 15.

The bankruptcy court cited a number of deficiencies in this approach, including its failure to differentiate among various types of inventory and its refusal to acknowledge that the Debtors would not receive anything near "book value" for any merchandise at the many stores that were going out of business.

The second-lien holders argue that the bankruptcy court should have placed more weight on the valuations of Abacus, the Debtors' liquidation advisor, which estimated that the collateral would be valued at between 90% and 93% of book value. But the bankruptcy court explained that it considered these "data points," Sp. App'x at 20–21, and found Murray's analysis to be more useful because it more accurately reflected the likelihood that existed on the Petition Date of an eventual distressed-asset sale. Indeed, the second-lien holders do not even dispute that, on the Petition Date, a distressed-asset sale was regarded as a reasonably high-probability outcome. Accordingly, we find no clear error in the bankruptcy court's analysis.

* * *

For all the reasons stated above, we conclude that the bankruptcy court made no error of fact or law in devising its general approach to valuing the collateral in this case. Its decision to use NOLV was consistent with section 506(a), *Rash*, and the facts of this case, and the manner in which it analyzed the NOLV of the collateral was not clearly erroneous.

B. The Non-Borrowing Base Inventory

We turn next to the first of two specific valuation decisions that the second-lien holders challenge: the bankruptcy court's decision to assign zero value to the NBB inventory.

The bankruptcy court determined that the second-lien holders, as secured creditors, bore the burden of demonstrating the collateral's value, and that because the only valuation assessment they offered – which assessed the NBB inventory in the same manner as the rest of the inventory – was plainly unsatisfactory, the NBB inventory should be assigned a zero value. On appeal, the second-lien holders argue that the bankruptcy court was wrong not to attribute any value to the NBB inventory. For their part, the Debtors admit that "the ineligible inventory may well have had some value," Debtors Br. at 51, but argue that the bankruptcy court did not err by valuing the collateral at zero, given that the second-lien holders had failed to meet their burden of proof with respect to valuation.

This Circuit has not yet addressed which party has the burden of proof for section 507(b) claims. We do not resolve the question here, however, as the second-lien holders did not preserve this issue on appeal. Indeed, throughout the bankruptcy proceeding, the second-lien holders conceded that they had the burden of proving the value of the collateral. *See* J. App'x at 3980 (second-lien holders acknowledging "their burden of demonstrating an actual diminution in the value of their Petition[-]Date collateral justifying their adequate protection liens and potential [s]ection 507(b) administrative claims"); *id.* at 4459:18–19 (counsel for ESL conceding before the bankruptcy court that as a secured party it bore "the burden of proving what [its] secure claim was"); *id.* at 4843:13

(counsel for Wilmington Trust similarly conceding that it "ha[s] the burden" under section 507(b)). It was not until their reply brief that the second-lien holders argued, for the first time, that they did not have the burden of proving the value of the collateral. Reply Br. at 4, 15. But a party's failure to press an argument in its opening brief generally precludes our review of that issue, and we see no reason to deviate from the rule here, especially since the second-lien holders conceded the point below. *See JP Morgan Chase Bank v. Altos Hornos de Mex., S.A. de C.V.*, 412 F.3d 418, 428 (2d Cir. 2005) (observing that "arguments not made in an appellant's opening brief are waived even if the appellant pursued those arguments in the district court or raised them in a reply brief"); *Norton v. Sam's Club*, 145 F.3d 114, 117 (2d Cir. 1998). Accordingly, the second-lien holders have forfeited the argument that they did not have the burden of proof for their section 507(b) claims.

As for the value of the NBB inventory, we find that the court did not err in declining to value the NBB inventory in the same manner as it valued the rest of the inventory – a determination that the second-lien holders no longer challenge. Among other reasons justifying the bankruptcy court's decision to differentiate between NBB inventory and regular inventory, counsel for ESL admitted before the bankruptcy court that it was aware of no case that had ever ascribed full book value to NBB inventory. And given that the first- and second-lien holders themselves differentiated between the bulk of Debtors' inventory and the NBB inventory, we are certainly not "left with the definite and firm conviction that" the bankruptcy court was mistaken in making such a distinction. *In re CBI Holding Co.*, 529 F.3d 432, 449 (2d Cir. 2008) (internal quotation marks omitted).

Although the second-lien holders now concede that the NBB inventory was worth less than the book value that they argued for below, they nevertheless contend that the bankruptcy court erred in assigning it zero value. We disagree. As the parties acknowledged below, and as we assume for purposes of this appeal, the second-lien holders bore the burden of proof and were required to present the bankruptcy court with a credible method to value their collateral as of the Petition Date. Because the bankruptcy court reasonably rejected the only valuation methodology offered by the second-lien holders – to value the NBB in the same manner as the rest of the inventory, at book value – we cannot say that it was error for the bankruptcy court to assign zero value to the NBB inventory. In other words, having proposed no specific or plausible argument that the collateral had any value, the second-lien holders plainly failed to carry their burden of proof, and the bankruptcy court was not obliged to manufacture an alternative valuation method for them. Accordingly, on the record before us, we find no clear error in the bankruptcy court's determination that the NBB had zero value.

C. The Letters of Credit

The second-lien holders' arguments concerning the letters of credit fail for the same reason. As the bankruptcy court explained, on the Petition Date, the letters of credit were contingent obligations that, if incurred, would have had priority over the claims of the second-lien holders; nevertheless, the bankruptcy court was uncertain as to whether and to what extent the letters of credit would be drawn. The second-lien holders, who again conceded that they bore the burden of proof on this issue, offered two possible approaches to valuing the letters of credit: (1) ignore them altogether, since it was uncertain that they would be drawn at all, or (2) deduct only the approximately $9 million that was ultimately drawn after the Petition Date.

The bankruptcy court was entitled to reject both approaches. In related contexts, courts have explained that the valuation of contingent obligations must consider the likelihood that the obligations may not arise. *See Matter of Xonics Photochemical, Inc.*, 841 F.2d 198, 200–01 (7th Cir. 1988); *id.* at 201 (explaining that when determining whether a business is insolvent, contingent liabilities must not "be treated as definite liabilities even though the contingency has not occurred"). When valuing "contingent liabilit[ies], it is necessary to discount [the liability] by the probability that the contingency will occur and the liability become real." *Id.* at 200. For instance, a contingent liability with a face value of $100, but only a 25% chance that the contingency comes to pass, should be valued at $25. *Cf. id.* (giving a similar example). Indeed, the bankruptcy court here appropriately acknowledged that one could potentially value the letters of credit based on a probabilistic formula, discounting their face value by some probability that they would actually be drawn. Sp. App'x 28–29.

But the second-lien holders never offered any such analysis. Even on appeal, they make little effort to defend a valuation other than "zero." At bottom, the second-lien holders' argument for why the letters of credit should be discounted rests entirely on the fact that the letters were "not drawn on the petition date." Sp. App'x at 29. But the bankruptcy court reasonably rejected this argument, which ignored the "realistic context of this case," including "the very real backdrop of a potential liquidation," and the resulting need to tap available sources of capital. *Id.* at 28.

The second-lien holders' alternative proposal – to value the letters of credit in accordance with how they were subsequently drawn – fares no better. The Petition-Date value of the letters of credit does not hinge on whether, with the benefit of hindsight, the letters were actually drawn. What matters is the likelihood of the contingency *on the Petition Date*. The bankruptcy court thus reasonably rejected this after-the-fact valuation methodology. Because the second-lien holders failed to offer any reasonable method of discounting the letters of credit as of the Petition Date, the bankruptcy court did not err by deducting their full face value from the value of the collateral, especially given the court's view that, on the Petition Date, there would be a need to tap available sources of capital.

*   *   *

In sum, the bankruptcy court committed no legal or factual error in its decision to value the collateral based on NOLV. With respect to the valuation of the

NBB inventory, the bankruptcy court reasonably concluded that the second-lien holders failed to meet their burden of demonstrating the NBB's value, and therefore did not err by valuing the NBB at zero. Similarly, since the bankruptcy court was not presented with any reasonable means of discounting the letters of credit, it did not err by deducting their full face value from the value of the collateral. Accordingly, the bankruptcy court did not commit clear error by denying the second-lien holders' section 507(b) claims.

IV. CONCLUSION

For these reasons, we **AFFIRM** the district court's judgment that in turn affirmed the judgment of the bankruptcy court.

APPENDIX B

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE: SEARS HOLDINGS CORPORATION, et al., Debtors.	
ESL INVESTMENTS, INC., et al., Appellants, v. SEARS HOLDINGS CORPORATION, et al., Appellees.	**OPINION AND ORDER** 19 CV 7660 (VB)

Briccetti, J.:

Appellants ESL Investments, Inc., and certain of its affiliated entities (including JPP, LLC, JPP II, LLC) (together, "ESL"), Wilmington Trust, National Association, as Indenture Trustee and Collateral Agent, and Cyrus Capital Partners, L.P. (collectively, "Appellants" or "Second Lien-Creditors"), appeal from a July 31, 2019, bench ruling and an August 5, 2019, Order (together, the "Orders") of the U.S. Bankruptcy Court for the Southern District of New York (Hon. Robert D. Drain, Judge) finding no diminution in value of the Second Lien-Creditors' collateral following August 15, 2018 (the "Petition Date"), and thus, that the Second Lien-Creditors are not entitled to superpriority claims pursuant to 11 U.S.C. § 507(b). (Case No. 18-23538, Doc. #4740).

Appellants argue the bankruptcy court erred in its valuation of the Second-Lien Creditors' collateral (the "Second-Lien Collateral") after Sears Holdings Corporation ("Sears Holdings") and its affiliates (together, "Debtors") filed a voluntary petition for Chapter 11 bankruptcy protection. Specifically, Appellants argue the bankruptcy court errantly determined there was no net diminution in value of the Second-Lien Collateral from the Petition Date through February 19, 2019 (the "Sale Date"), when Sears Holdings was sold.

For the following reasons, the bankruptcy court's Orders are AFFIRMED.

The Court has subject matter jurisdiction pursuant to 28 U.S.C. § 158(a).

BACKGROUND

Founded in 1893, Sears, Roebuck and Co. ("Sears"), has a storied 125-year history. Long a staple of American shopping malls, Sears led all retailers in the tool, appliance, lawn and garden, and automotive repair and maintenance retail sectors.

Sears was purchased in 2005 and merged into Sears Holdings. Between 2005 and 2018, Sears struggled. Due to declining revenues, poor brick-and-mortar market conditions, and cash flow and liquidity issues, on October 15, 2018, Sears Holdings filed for Chapter 11 bankruptcy protection.

I. Bankruptcy Proceedings and Sale to ESL

As of the Petition Date, all of Sears Holdings's assets were encumbered. (See A-38).[1] Sears Holdings's secured debt totaled approximately $2.68 billion, comprising approximately $1.53 billion in first-lien debt, and approximately $1.15 billion in second-lien debt secured on a junior basis by certain assets including the Second-Lien Collateral.

Sears Holdings's largest secured creditor was ESL, a hedge fund owned by Edward Lampert, Sears Holdings's CEO and Chairman of its Board of Directors. (A-5-6).

The Chapter 11 filing triggered the automatic stay, which prevented the Second-Lien Creditors from foreclosing on the Second-Lien Collateral without the bankruptcy court's permission. The Second-Lien Creditors, as pre-petition lenders, received a protection package following the bankruptcy filing as part of the debtor-in-possession ("DIP") financing process, which allowed Debtors to continue to use, post-petition, the Second-Lien Collateral. (A-460-61).[2] To provide adequate protection, in the Final DIP Order, the

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[1] "A-_" refers to the common appendices submitted by the parties pursuant to Federal Rules of Bankruptcy Procedure 8015 and 8018. (See Docs. ##45-1 to 45-18; 51-1). Appellants' common appendix spans A-1 through A-4875. Appellees' common appendix spans A-4876 through A-5009.

[2] An adequate protection package is the standard package given to creditors in exchange for their consent for debtors to retain the collateral securing their debt obligations so that debtors can use the collateral to continue to operate their business and engage in restructuring activities. See 11 U.S.C. § 363(e).

Second-Lien Creditors were given Section 507(b) superpriority claims to the extent there was any net diminution in value of the Second-Lien Collateral after the Petition Date. (See A-464-65).

As of the Petition Date, neither Debtors nor their creditors knew whether Sears Holdings would be sold or liquidated. Accordingly, Sears Holdings continued to sell its inventory at Go-Forward Stores, going-out-business ("GOB") stores, and to collect accounts receivable.

In December 2018, ESL submitted a going-concern bid to purchase substantially all of Debtors' assets, but the proposal was deemed deficient by Debtors and thus, Debtors pivoted to liquidation. (A-4885-86). ESL requested more time to improve its bid, which Debtors allowed, and in January 2019, ESL submitted a second going-concern bid. (A-4886-89). According to Debtors, this bid too failed to address the deficiencies Debtors had identified in the initial proposal. ESL once again requested additional time to provide a better offer. It was that third offer that Debtors accepted, agreeing that ESL's proposal was the highest and best-provided alternative to liquidation. (A-4889-93).

On February 8, 2019, the bankruptcy court approved the transaction—over the objection of some creditors—and entered an order to that effect (the "Sale Order"). Three days later, on February 11, 2019, the sale closed pursuant to an asset purchase agreement ("APA") between Sears Holdings and Transform Holdco LLC ("Transform"), the ESL entity. Accordingly, Sears Holdings's assets were transferred to Transform.

ESL purchased substantially all of Debtors' assets for approximately $5.2 billion in cash and non-cash consideration. (A-1831). Included in the purchase price was a $433.45 million credit bid (the "Credit Bid") pursuant to Section 363(k) of the Bankruptcy Code, which in effect forgave some of the $1.15 billion debt owed by Debtors to the Second-Lien Creditors. (A-1012-14).[3] Included in the purchase price was $885 million in cash paid by ESL for Sears Holdings's inventory and receivables, some of which comprised the Second-Lien Collateral. (A-1249).

II. <u>Section 507(b) Claims</u>

Following the sale, the Second Lien-Creditors asserted Section 507(b) claims pursuant to the Final DIP Order. The Second-Lien Creditors insisted they were still owed approximately $718 million in outstanding debt, accounting for $1.15 billion less the $433.45 million Credit Bid.

On May 26, 2019, Debtors filed a motion to estimate the Second-Lien Creditors' claims. By stipulation between the parties, the motion was converted into a proceeding under Federal Rule of Bankruptcy Procedure 3012 to: (i) determine the amount of the Second Lien-Creditors' secured claims and Section 507(b) claims; and (ii) adjudicate Debtors' request, pursuant to Section 506(c), to surcharge the Second-Lien Collateral with substantially all the costs of the

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[3] Although neither Cyrus Capital Partners nor Wilmington Trust were purchasers pursuant to the APA, they did participate in the Credit Bid and therefore had the amount of their debts reduced accordingly. (<u>See</u> A-1584).

bankruptcy proceedings. The court so ordered the stipulation.

Accordingly, the bankruptcy court held a two-day evidentiary hearing on July 23 and July 31, 2019. At the hearing, the Second-Lien Creditors presented expert testimony respecting the value of the Second-Lien Collateral as of the Petition Date, in order to assess the value of the Section 507(b) claims.

David M. Schulte, expert for ESL, testified that the value of the collateral on the Petition Date was $2.928 billion, which was $245 million more than the debt owed the first-lien creditors and Second-Lien Creditors, and nearly $600 million more than the maximum amount of any Section 507(b) claim in light of the Credit Bid. (A-2892). Schulte calculated this amount by using the inventory's book value for Go-Forward stores and net retail value for GOB stores, which was slightly lower than book value. (A-2888-92). And for the non-inventory collateral of cash, credit card receivables, pharmacy receivables, pharmacy prescriptions (or "Scripts"), Schulte used the book value provided by the Debtors. (See A-2887-88).[4] Accordingly, Schulte testified that the diminution in value from the Petition Date for the 507(b) claims was $962.7 million, or $250 million more than the $718

[4] Appellants and Debtors disagree about whether certain assets should be included in the assessment pursuant to the Second-Lien security agreement. Specifically, Debtors argue the Second-Lien Creditors' experts improperly considered "pharmacy receivables," "pharmacy scripts," and "cash and cash equivalents," in their valuations. (Doc. #51 ("Debtors' Br.") at 16).

million the Second-Lien Creditors were entitled to recover in light of the Credit Bid. (See A-4285).

William Heinrich, expert for Wilmington Trust, opined that the collateral on the Petition Date was worth \$3.28 billion, which was nearly \$600 million more than the debt owed the first lien creditors and Second-Lien Creditors, and nearly \$950 million more than the maximum amount of any Section 507(b) claim in light of the Credit Bid. (See A-3126). Heinrich calculated this amount by assuming the inventory would be sold at retail price at both the Go-Forward and GOB stores. (See A-3074-81). He too factored in accounts receivable, Scripts, and certain inventory that was deemed "ineligible" by the first-lien creditors. (See A-3074-81). Accordingly, Heinrich testified at the evidentiary hearing that that the diminution in value from the Petition Date for the 507(b) claims was \$1.314 billion, or \$200 million more than the total outstanding debt and nearly \$600 million more than the \$718 million the Second-Lien Creditors were entitled to recover in light of the Credit Bid. (See A -4321).

Marti P. Murray, expert for Cyrus Capital Partners, opined that the value of the collateral on the Petition Date was \$2.46 billion, which was over \$200 million more than the maximum amount of any Section 507(b) claim in light of the Credit Bid. (See A-2003). Murray calculated this amount by assuming the Second-Lien Collateral would be sold through an "orderly liquidation of its business," a company-wide GOB sale. (A-1971). Murray relied on appraisals performed by Tiger Capital Group ("Tiger"), an independent third-party appraiser hired by the first-lien creditors. (A-1971). Tiger ascribed an overall net orderly liquidation value ("NOLV") of 88.7 percent to the Second-Lien Collateral—the value expected to be realized from the inventory, net of all costs necessary to sell the inventory in an orderly liquidation. (A -1971). Accordingly, Murray testified that the Second-Lien Creditors' interest in the collateral on the Petition Date totaled between $925 million and $1.469 billion. (A-2002-04).

The Debtors' fact witness, Brian Griffith, offered his opinion that all of the inventory was worth, on the Petition Date, only eighty-five percent of its book value. (A-4221). Griffith opined that the valuation was based on the APA and the sale value to Transform. (A-4221).

Following the two-day hearing, Judge Drain ruled that the Second-Lien Creditors had not met their burden of proof to establish there was a diminution in the value of the Second-Lien Collateral after the Petition Date, and therefore that the Second-Lien Creditors were not entitled to Section 507(b) superpriority claims. (A-4798, A-4805). Specifically, the bankruptcy court gave "next to no weight to Mr. Schulte's purported expert report" and similarly discounted Heinrich's report, which proposed an even higher valuation. (A-4790-92).

Finding neither the Second-Lien Creditors' experts' valuations nor Debtors' fact witness's valuation credible, Judge Drain undertook his own valuation of the Second-Lien Collateral as of the Petition Date and determined that the collateral was worth $2.147 billion, and that following payments to the first-lien creditors, and other necessary reductions, the Second-

Lien Creditors' remaining value on their collateral was $186 million.

Specifically, Judge Drain figured that the appropriate measure should be going-concern value, but noted that "[t]he concept of going concern versus liquidation is not a binary, either or situation. Instead, a company's status appears on a spectrum between the sale of a true, financially healthy going concern business, and a forced liquidation. With an orderly liquidation somewhere in between." (A-4787-88) (citing In re Aerogroup Int'l, Inc., 601 B.R. 571, 593 (Bankr. D. Del. 2019), motion to certify appeal denied, 2020 WL 757892 (D. Del. Feb. 14, 2020)). The bankruptcy court determined that a NOLV analysis was appropriate because, like in Aerogroup, there ultimately was a going-concern sale but "that sale was in the context of a failed standalone plan process, and the distinct possibility of veering or pivoting to a liquidation." (A-4788).

In order to undertake a NOLV-based approach, Judge Drain used Murray's expert opinion as a starting point, finding it was "tethered to reality or the reality that faced these second lien Creditors at the start of this case with respect to their interest and the Debtor's interest in their collateral, as well as the reality of asset-based lending." (A-4794). Accordingly, the court applied Tiger's methodology of applying an 88.7 percent face value for eligible inventory and receivables.[5] But he deducted 1.3 percent for corporate

[5] Appellants contend the Bankruptcy Court actually discounted the collateral 77 percent because "[t]he combination of the bankruptcy court's valuations–0% for ineligible inventory and 88.7%

overhead and thus found a resulting 87.4 percent inventory recovery rate for eligible inventory. (A-3208).

Next, Judge Drain added collateral to the discounted inventory total, $46.6 million in credit card receivables—Debtors' proffered amount—and $10.5 million in pharmacy receivables, Murray's proffered amount. (A-4799). The bankruptcy court rejected the Second-Lien Creditors' arguments that Scripts and cash should be included in the valuation. (A-4800).

Then the bankruptcy court accounted for senior first-lien debt, including post-petition interest, and deducted those amounts from the total figure. (A-4802). The court also deducted undisputed debt: (i) a revolving credit facility of $836 million, (ii) a first-lien loan of $570.8 million, and (iii) a FILO (first-in, last-out) term loan of $125 million. (A-4801-02).

Finding the Second-Lien Creditors did not meet their evidentiary burden respecting whether the face amounts of the letters of credit exceeded the underlying obligations, the bankruptcy court deducted two senior letters of credit, determining that these letters of credit should be counted as debt senior to the Second-Lien Creditors' debt. (See A-4803-05).

The bankruptcy court also deducted the Credit Bid and determined that there was no net diminution in value of the Second-Lien Collateral from the Petition Date and thus, the Second-Lien Creditors were not

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for eligible inventory–resulted in the court's blended average for all of the inventory of only 77% of book value, markedly less than even the Debtors' claim that the inventory was worth 85% of book value." (Doc. #45 ("Apps. Br.") at 34).

entitled to superpriority for their Section 507(b) claims.

Indeed, as reflected in the below chart from the bankruptcy court's August 5 Order, the Second Lien-Collateral was valued at approximately $2.147 billion, and approximately $1.96 billion comprised senior first-lien debt. Thus, the remaining value of the Second-Lien Collateral was approximately $186.57 million. (A-3208-09). However, because the Credit Bid provided for recovery of $433.5 million, Judge Drain determined that the Second-Lien Creditors' interest in the collateral was actually negative, and thus that there was no diminution in value for the Second-Lien Collateral after the Petition Date; therefore, the Second-Lien Creditors were not entitled to Section 507(b) superpriority claims. (A-3208-09).

($ in millions)	
Collateral	
Net Eligible Inventory as of Petition Date	2,391.5
Inventory Value Recovery Rate	87.40%
Inventory Value	2,090.17
Credit Card Receivables	46.6
Cash	–
Scripts	–
Pharmacy Receivables	10.5
Total Collateral	2,147.27[4]
First Lien/Senior Debt	
Revolving Credit Facility	836.0
First Lien Letters of Credit	123.8
First Lien Term Loan B	570.8
FILO Term Loan	125.0

Stand-Alone L/C Facility	271.1[5]
Post-petition First Lien Interest	34.0
Total First Lien Debt	1960.7
2L Debt Remaining Value	186.57
Credit Bid	(433.5)
Credit Bid: Adjusted 2L Debt Collateral Value	(246.93)
Less: Value of 2L Adequate Protection	(0.3)
Total	(246.63)

(A-3208, A-3209).

On August 15, 2019, the Second-Lien Creditors filed notices of appeal of the Orders (the "507(b) Appeals").[6]

DISCUSSION

I. Legal Standard

The Court has jurisdiction to hear these appeals pursuant to 28 U.S.C. § 158(a). A district court reviews a bankruptcy court's conclusions of law de novo and its findings of fact under a clearly erroneous standard. See In re Ames Dep't Stores, Inc., 582 F.3d 422, 426 (2d Cir. 2009) (citing Momentum Mfg. Corp.

[6] On August 27, 2019, Debtors appealed the 506(c) Orders, which comprised the July 31, 2019, bench ruling and the August 8, 2019, Order on the 506(c) motion (the "506(c) Appeals"). On October 30, 2019, this Court granted Debtors' motion to stay the 506(c) Appeals pending the outcome of the 507(b) Appeals. (See 19 Civ. 8002 Doc. #25).

v. Emp. Creditors Comm., 25 F.3d 1132, 1136 (2d Cir. 1994)).[7]

With respect to a bankruptcy court's factual findings, clear error exists only when a reviewing court is "left with the definite and firm conviction that a mistake has been committed." In re Manville Forest Prods. Corp., 896 F.2d 1384, 1388 (2d Cir. 1990). "[T]he standard of review for a mixed question depends on whether answering it entails primarily legal or factual work." U.S. Bank Nat'l Ass'n v. Vill. at Lakeridge, LLC, 138 S. Ct. 960, 962, (2018).

II. Second-Lien Creditors' Burden of Proof

"The burden of proving valuation falls on different parties at different times." In re Residential Capital, LLC, 501 B.R. 549, 590 (Bankr. S.D.N.Y. 2013). "In establishing its claim, a secured creditor generally bears the burden under section 506(a) of proving the amount and extent of its lien." Id. "Once the amount and extent of the secured claim has been set, the burden shifts to a debtor seeking to use, sell, lease, or otherwise encumber the lender's collateral under sections 363 or 364 of the Code to prove that the secured creditor's interest will be adequately protected." Id. "But in all cases, the creditor bears the burden in the first instance of establishing the amount and extent of its lien under section 506(a)." Id.

[7] Unless otherwise indicated, case quotations omit all internal citations, quotations, footnotes, and alterations.

Section 507(b) of the Bankruptcy Code governs whether the Second-Lien Creditors are entitled to superpriority. It provides:

> If the trustee, under section 362, 363, or 364 of this title, provides adequate protection of the interest of a holder of a claim secured by a lien on property of the debtor and if, notwithstanding such protection, such creditor has a claim allowable under subsection (a)(2) of this section arising from the stay of action against such property under section 362 of this title, from the use, sale, or lease of such property under section 363 of this title, or from the granting of a lien under section 364(d) of this title, then such creditor's claim under such subsection shall have priority over every other claim allowable under such subsection.

11 U.S.C. § 507(b).

Here, the Second-Lien Creditors had the burden of proving: (i) they were previously provided adequate protection under Bankruptcy Code Sections 362, 363, or 364; (ii) notwithstanding such adequate protection, they held an allowable claim under 11 U.S.C. 507(a)(2); and (iii) their claim arose from Debtors' use, sale, or lease of the Second-Lien Collateral under Section 363. (A-4781-82). Superpriority status, what the Second-Lien Creditors seek, arose only if there was a diminution of value of the Second-Lien Collateral after the Petition Date.

The bankruptcy court concluded that the first two requirements of the Section 507(b) analysis—that the Second-Lien Creditors received adequate protection and that they had an allowable claim under Section 507(a)(2)—were satisfied. (A-4781). Thus, the bankruptcy court analyzed the third requirement: whether the Second-Lien Creditors were entitled to superpriority for such claims.

Ultimately, the bankruptcy court determined the Second-Lien Creditors did not meet their burden respecting whether there was a diminution in value of the Second-Lien Collateral from the Petition Date, and thus, they were not entitled to superpriority. (See A-4798). In reaching that conclusion, for the reasons discussed above, the bankruptcy court rejected the valuations of the Second-Lien Creditors' three experts.

On appeal, the Court agrees with the bankruptcy court that the Second-Lien Creditors did not meet their burden of proof to establish superpriority for their Section 507(b) claims. See In re Residential Capital, LLC, 501 B.R. at 590. Moreover, the Court is aligned with Judge Drain that the Second-Lien Creditors' failure to meet that burden alone ends the inquiry. (A-4798) ("Courts have denied 507(b) requests in toto for a failure of proof of the amount of diminution.") (collecting cases). Nevertheless, the bankruptcy court went further and performed its own valuation for the Second-Lien Collateral, and determined that there was no net diminution from the Petition Date. Thus, said the bankruptcy court, the Second-Lien Creditors were not entitled to Section 507(b) superpriority claims.

The Court sees no reason to upset the bankruptcy court's holding given that it was well-reasoned, and the bankruptcy court applied the law to the facts. Although it may appear the inquiry ends here—given that the Second Lien Creditors did not meet their burden-because the bankruptcy court reached its conclusion by performing its own valuation, and because Appellants now challenge that valuation, the Court will address such arguments in tum.

II. Valuation of Second-Lien Inventory

Appellants argue the bankruptcy court erred by failing to follow Supreme Court precedent when it applied its own formula for valuing the inventory which comprised the Second-Lien Collateral. Appellants argue the court should have relied on replacement value, what Appellants contend was the inventory's book or retail value.

The Court disagrees.

As discussed above, the Bankruptcy Code requires a debtor to provide a secured lender with adequate protection against a diminution in value of the secured lender's collateral resulting from the post-petition use, sale, or lease of the property under Section 363 of the Bankruptcy Code. See In re Residential Capital, LLC, 501 B.R. at 589 (citing 11 U.S.C. § 361(1)).

To determine whether there was a diminution in value, courts apply the valuation set forth in Section 506(a)(l) of the Bankruptcy Code, which provides in relevant part:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest, ... is a secured claim to the extent of the

> value of such creditor's interest in the estate's interest in such property, ... and is an unsecured claim to the extent that the value of such creditor's interest ... is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property.

11 U.S.C. § 506(a)(l).

In Associates Commercial Corporation v. Rash, 520 U.S. 953 (1997), the Supreme Court held that the value of collateral retained by the debtor is the cost the debtor would incur to obtain a like asset for the same proposed use. In reaching this holding, the Supreme Court rejected the foreclosure-value standard for retained collateral in a Chapter 13 bankruptcy proceeding. Specifically, in Rash, the debtor retained his truck-collateral for which Associates Commercial Corporation held a lien-in order to use the truck in the debtor's business to generate income after the Chapter 13 plan was confirmed. Id. Here, by contrast, Debtors retained the Second-Lien Collateral, namely, Debtors' inventory, in order to sell the inventory in a going-concern sale or liquidation. Such distinctions matter.

Appellants argue the bankruptcy court was required, pursuant to Rash, to apply the valuations proffered by their experts, Schulte and Heinrich, and that in rejecting those experts' opinions, the bankruptcy court failed to follow controlling precedent. But as the Supreme Court observed in Rash, "[o]f prime significance, the replacement-value standard accurately gauges the debtor's 'use' of the property." Assocs. Comm. Corp. v. Rash, 520 U.S. 953 at 963. The Supreme Court did not mandate the replacement-value standard in every context, but rather determined that the replacement-value standard in the context of Rash "renders meaningful the key words 'disposition or use.'" Id. at 962. Indeed, the bankruptcy court addressed this distinction, reasoning, "the Supreme Court has made it clear in Associates Commercial Corp. v. Rash, that the court should look to the purpose of the proposed use of the value, and if it is to be a reorganization, that use would be in the hands of the Debtor and would normally call for replacement value." (A-4785).

The bankruptcy court was not required to use the retail or book value of the inventory, like Schulte and Heinrich did, in making its valuation under Rash because Debtors' purpose for retaining the collateral was to sell it, either through a going-concern sale or liquidation, or worst-case scenario, a forced liquidation.[8] The bankruptcy court considered each of these scenarios and determined the valuations put forward by Schulte and Heinrich did not account for the range of outcomes as of the Petition Date. (See A-4627, A-4688-89, A-4790).

Moreover, the formula the bankruptcy court did apply—NOLV—was not the foreclosure-value stand-

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[8] As Debtors point out, the "collateral here was inventory and so, not surprisingly, all parties agreed the proposed use was to sell it. The question was how it would be sold." (Debtors' Br. at 40).

ard, but rather a valuation that discounted the inventory and sought to calculate what Debtors would have obtained had they sold the Second-Lien Collateral in an orderly liquidation. Such valuation, which relied on the testimony of one of Appellants' experts, Murray, was not clear error. See Anderson v. Bessemer City, N.C., 470 U.S. 564, 575 (1985) ("[W]hen a trial judge's finding is based on his decision to credit the testimony of one of two or more witnesses, each of whom has told a coherent and facially plausible story that is not contradicted by extrinsic evidence, that finding, if not internally inconsistent, can virtually never be clear error."). Nor were Judge Drain's departures from Murray's analysis clear error. See In re Motors Liquidation Co., 576 B.R. 325, 425 (Bankr. S.D.N.Y. 2017) ("[T]he Court need not choose any party's proffered appraisal wholesale, but may instead pick and choose to determine 'the best way' to value the collateral.").

Accordingly, the Court concludes the bankruptcy court did not overlook or misapply controlling Supreme Court precedent in rejecting certain Second-Lien Creditors' experts' opinions, or by applying the NOLV calculation advanced by one of the Second-Lien Creditors' experts.

III. Excluded Collateral and Other Reductions

Next Appellants advance a number of claims that the bankruptcy court erred by excluding or reducing the value of certain assets from the overall valuation of the Second-Lien Collateral.

The Court finds each of these claims unpersuasive.

A. <u>Letters of Credit</u>

Appellants argue the bankruptcy court erred by deducting the total face value of the stand-by letters of credit from the overall valuation of the Second-Lien Collateral as of the Petition Date, even though the letters had not been drawn as of that date.

The Court disagrees.

As of the Petition Date, Debtors had $395 million in stand-by letters of credit. These letters included: (i) two first-lien letter of credit facilities, which comprised outstanding stand-by letters of credit that secured principally Debtors' potential worker's compensation obligations (A-19-23); and (ii) a stand-alone letter of credit facility. (A-23-25, A-4491, A-4635-42).

The bankruptcy court determined that even though these obligations remained undrawn as of the Petition Date, they were still "real obligations" that stood ahead of the Second-Lien Creditors, and that in the event of an orderly liquidation, these stand-by letters may have been drawn. (A-4803). Appellants argue Judge Drain erred because the letters of credit had not been drawn as of the Petition Date, and only $9 million was drawn during the bankruptcy proceedings. Moreover, Appellants insist it is common for such obligations either to never be drawn, or, in the event of a going-concern sale, to be "cancelled, reissued or assumed by the buyer." (Apps. Br. at 62). But that was the best-case scenario and, importantly, the bankruptcy court held that the Second-Lien Creditors did not meet their burden in providing a valuation of the letters of credit based on their contingency. (A-4805) ("Given the 2L Creditors' burden of proof here, I believe they were required to do more, and that I should count the letters of credit in their face amount, rather than do my own attempt to value such obligations, which again, according to the DIP agreement, are senior obligations.").

The Court agrees with the bankruptcy court's determination because, as discussed above, the Second-Lien Creditors had the burden of establishing their Section 507(b) claims and the proper valuations to assert diminution in value. The Second-Lien Creditors having failed to offer an alternative valuation for the stand-by letters of credit besides zero, the bankruptcy court applied the face value of these "real obligations," seeing no reason not to. The Court finds that decision was not clear error.

B. Post-Petition Interest

Appellants argue the bankruptcy court erred in deducting the post-petition interest to be paid to the first-lien creditors.

The Court disagrees.

The bankruptcy court reasoned that because the first-lien creditors were over-secured, in the event of an orderly liquidation-the bankruptcy court's chosen framework- first-lien creditors were entitled to $34 million in interest on the collateral at issue. Judge Drain reached this conclusion because his Petition Date valuation assumed an orderly liquidation, which would have occurred over the course of three months; he relied on Murray's assessment that three months was how long an orderly liquidation would take. (A-1997-98, A-4802-03). Thus, in the event of an orderly liquidation, and given that the first-lien creditors were over-secured, their post-petition interest would be senior to the Second-Lien Creditors' claims. (A-4614).

Appellants' invocation of Matter of Rupprect, 161 B.R. 48 (Bankr. D. Neb. 1993), is unpersuasive. Although there, the court held "on the facts of this case, the [junior creditor] is entitled to be adequately protected from interest accrual," id. at 49, here, the Second-Lien Creditors neither sought nor received adequate protection to protect against post-petition interest.

Accordingly, the Court concludes the bankruptcy court did not err in assessing post-petition interest on the collateral.

C. Costs

Appellants argue the bankruptcy court's 1.3 percent deduction for overhead and professional costs was a backdoor to asserting Debtors' 506(c) claims and therefore, in error. In other words, the court erred in deducting costs because such deductions were actually surcharge claims against the collateral, which the bankruptcy court previously denied.

The Court disagrees.

Although the Second Circuit has said that a bankruptcy court cannot "direct that interim fees and disbursements of attorneys and accountants be paid from the encumbered collateral" it has allowed "fees payable from [the creditor's] collateral ... for services which were for the benefit of [the creditor] rather than the debtor or other creditors." In re Flagstaff Foodservice Corp., 739 F.2d 73, 75 (2d Cir. 1984).

Here, the bankruptcy court reasoned that a 1.3 percent cost deduction on the inventory was appropriate because, in order to effectuate an orderly liquidation, there would be certain costs borne through the sale of the inventory. These costs are appropriately deducted from the encumbered collateral because such costs would inure to the benefit of the Second-Lien Creditors. See In re Flagstaff Foodservice Corp., 739 F.2d at 75. Thus, it was appropriate for the bankruptcy court to deduct costs from the total valuation if such costs were anticipated in furtherance of an orderly liquidation.

Appellants argue that such claims for costs are really a "backdoor 506(c) surcharge." (Apps. Br. at 66). But this argument strains credulity. In the Section 506(c) Appeals, which are stayed pending the outcome of the 507(b) Appeals, Debtors are seeking review of the bankruptcy court's determination that Debtors did not meet their burden of proof with respect to their request to surcharge the Second-Lien Collateral with substantially all the costs of the bankruptcy proceedings. Debtors seek $1.4 billion in Section 506(c) claims. However, the bankruptcy court deducted a modest $31 million in costs. (A-3208). Given the delta between what Debtors seek for their 506(c) claims—$1.4 billion-and what Appellants argue the bankruptcy court erroneously provided in the 507(b) claims—$31 million—the Court declines to upset the bankruptcy court's eminently reasonable assessment of costs for overheard and professional services.

D. Credit Card Receivables

Appellants argue the bankruptcy court erred in using the Debtors' valuation for credit card receivables.

The Court disagrees.

The bankruptcy court was not persuaded by any of the Second-Lien Creditors' experts respecting their valuation for the credit card receivables. The bankruptcy court rejected Schulte and Heinrich's valuations of $64.2 million and $64.3 million, respectively, finding that those experts had merely taken the face value of the credit card receivables rather than some discounted formula. (A-4798). The court also rejected Murray's valuation of $54.8 million for credit card receivables, finding "[t]here seems to be no real analysis behind Ms. Murray other than her desire ... to comport with what was on the Debtor's books of the discounted value." (A-4798-99). Instead, the court applied Debtors' $46.6 valuation for credit card receivables. (A-4799). Seeing no basis for finding the bankruptcy court's determination was clear error, the Court declines to disturb the valuation for credit card receivables.

E. Ineligible Inventory

Appellants argue the bankruptcy court erred by declining to attribute any value to so-called ineligible inventory.[9]

[9] Under the bankruptcy court's assessment, ineligible inventory comprised inventory marked as ineligible on the borrowing base as well as in-transit inventory. (A-3208, A-4796-97). The court's assessment was based on Murray's report which noted, "Tiger

The Court disagrees.

The bankruptcy court applied an 88.7 percent NOLV on the inventory (and a 1.3 percent deduction for overhead and professional fees), but only on the eligible inventory. Indeed, the court determined "the Second-Lien Holders [had] not met their burden to include ineligible inventory or inventory-in-transit as Collateral on the Petition Date." (A-3208).

The gravamen of Appellants' argument on this point is that because neither Debtors nor the APA distinguished between eligible and ineligible inventory, it was clear error to exclude this category of inventory from the overall valuation of the Second-Lien Collateral. In short, Appellants argue that the distinction between eligible and ineligible inventory was "strictly for purposes of assessing the willingness of the First-Lien Lenders to lend against certain collateral. It had nothing to do with whether the Debtors could sell that inventory—they did." (Apps. Br. at 72).

The bankruptcy court concluded the Second-Lien Creditors did not meet their burden of establishing the value of such collateral. Moreover, even if the bankruptcy court assigned the ineligible inventory some value greater than zero, it would not have changed the outcome, because as Debtors point out, "[a]t most, the 2Ls would only be entitled the $74.6

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also ascribed a value of 51.6%-55.8% to in-transit inventory in its appraisal dated February 4, 2019, which was considered ineligible for purposes of calculating the borrowing base, but which still had value." (A-1971).

million for in-transit inventory that Ms. Murray calculated," which is "not sufficient to overcome the negative $246 million diminution." (Debtors' Br. at 58 n.17; see also A-2030).

Accordingly, the Court concludes the bankruptcy court did not err in excluding ineligible inventory from the valuation.

F. Pharmacy Prescriptions

Appellants argue the bankruptcy court erred by failing to include Scripts in the valuation.

The Court disagrees.

The bankruptcy court held that "the right to fill a prescription ... clearly is not inventory." (A-4800). The bankruptcy court went on to note that "[t]he lien on books and records as set forth in a 2L security agreement, has a qualifying clause, which states that their

books and records pertaining to the collateral." (A-4800). The bankruptcy court concluded that the "right to sell un-presented prescriptions" is not "an item of collateral." (A-4800).

The Court finds such assessment was not clear error. The first-lien creditors' security agreement explicitly includes "all Prescription Lists," but the Second-Lien Creditors' security agreement contains no such language. (Compare A-4908-09 with A-3431). This supports the bankruptcy court's finding that Scripts were not part of the Second-Lien Collateral. Accordingly, the Court concludes the bankruptcy court did not commit clear error when it excluded pharmacy prescriptions from its valuation.

G. Cash

Appellants argue the bankruptcy court erred by failing to include any of the cash Debtors held on the Petition Date in its valuation of the Second-Lien Collateral.

The Court disagrees.

The bankruptcy court excluded cash from the valuation of the Second-Lien Collateral, finding the Second-Lien Creditors did not meet their burden of establishing the cash was proceeds of such collateral. (A-4799-800). Indeed, the bankruptcy court determined "cash should not be included here given the lack of tracing and the other problems with the proof as established – to establish this is an element of collateral or this should be part of the collateral determination." (A-4800). Moreover, like the pharmacy prescriptions, the first-lien creditors' security agreement included "all cash and cash equivalents," but such language was not included in the Second-Lien Creditors' security agreement. (Compare A-4908-09 with A-3431). Even still, the Appellants argue the "proceeds," under New York law, includes "[w]hatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral." (Apps. Br. at 77 n.19 (citing A-3431; N.Y. U.C.C. Law § 9-102(a)(64)(A)). Appellants assert Debtors' witness, Brian Griffith, indicated at his deposition that the cash was the proceeds of the collateral. (A-4213-14). However, the Second-Lien Creditors' expert, Murray, acknowledged that cash may be generated from sources other than inventory. (A-4347-48).

Given the various rationales asserted by the parties and their witnesses respecting whether cash should be included in the valuation of the Second-Lien Collateral, it was not clear error for the bankruptcy court to exclude cash from such calculation having found the Second-Lien Creditors did not met their burden of establishing its necessary inclusion.[10]

IV. Cap on ESL's Section 507(b) Recovery

Finally, ESL argues the bankruptcy court erred in capping at $50 million the recovery available to ESL for its Section 507(b) claims.[11]

The Court disagrees.

Delaware law governs interpretation of the contract. (A-1641-43) (APA § 13.8(a)). Under Delaware law, the plain text of the APA controls. See Salamone v. Gorman, 106 A.3d 354, 367-68 (Del. 2014).

"Delaware law adheres to the objective theory of contracts, i.e., a contract's construction should be

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[10] The parties also offer competing views on whether the cash should have been used by Debtors to help pay off the first-lien debt, thereby reducing the senior debt ahead of the Second-Lien Creditors. (See Apps. Br. at 78-79; Debtors' Br. at 63). The parties further dispute whether such issue is properly on appeal. (See Debtors' Br. at 63; Doc. #54 ("Apps. Reply") at 37-38). Because the bankruptcy court ultimately determined the Second Lien-Creditors had not met their burden to show that the cash was traceable to the proceeds of the Second-Lien Collateral, the Court declines to address whether such arguments are properly before it on appeal.

[11] The other appellants take no position respecting this argument.

that which would be understood by an objective, reasonable third party." Salamone v. Gorman, 106 A.3d at 367-68. "When interpreting a contract, this Court will give priority to the parties' intentions as reflected in the four comers of the agreement, construing the agreement as a whole and giving effect to all its provisions." Id. at 368. "Contract terms themselves will be controlling when they establish the parties' common meaning so that a reasonable person in the position of either party would have no expectations inconsistent with the contract language." Id. "Under standard rules of contract interpretation, a court must determine the intent of the parties from the language of the contract." Id.

Here, the provision which addresses the amount of any Section 507(b) claim by ESL is Section 9.13(c), which provides:

> After giving effect to the credit bid set forth in Section 3.1 (b), ESL shall be entitled to assert any ... Claims arising under Section 507(b) of the Bankruptcy Code, ... provided that (i) no Claims or causes of action of ESL shall have recourse to, or any other right of recovery from, ... any Claim or cause of action involving any intentional misconduct by ESL, or the proceeds of any of the foregoing, (ii) any ESL Claims arising under Section 507(b) of the Bankruptcy Code shall be entitled to distributions of not more than $50 million from the proceeds of any Claims or

> causes of action of the Debtors or their estates other than the Claims and causes of action described in the preceding clause (c)(i); provided that, in the event that, in the absence of this clause (c)(ii), any such proceeds to the Debtors or their estates would have resulted in distributions in respect of such ESL Claims in excess of $50 million, the right to receive such distributions in excess of $50 million shall be treated as an unsecured claim and receive pro rata recoveries with general unsecured claims other than the Claims and causes of action described in the preceding clause (c)(i), and (iii) notwithstanding any order of the Bankruptcy Court to the contrary or section 1129 of the Bankruptcy Code, it shall not be a condition to confirmation of any chapter 11 plan filed in the Bankruptcy Cases that any ESL Claims arising under Section 507(b) of the Bankruptcy Code be paid in full or in part.

(A-1628-29) (emphasis added).

The bankruptcy court read this provision and determined that Section 9.13(c)(ii) capped at $50 million ESL's recovery for its Section 507(b) claims. (A-4806) ("I also have determined that the proper interpretation of Paragraph 9.13 of the asset purchase agreement is that to the extent there is a 507(b) claim for ESL, that claim is capped at -- recovered on that claim is capped at $50 million, again, based on the definition of claim, uppercase Claim in the APA.")

The APA defines "Claims" broadly to include:

> [A]ll rights to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or rights to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured, in each case, of whatever kind or description against any Person.

(A-1540).

ESL now argues Judge Drain erred because a plain reading of Section 9.13(c) limits ESL's recovery in only two respects: first, ESL cannot recover the proceeds of any distributions to the estates from specific causes of action, including for claims of ESL's intentional misconduct; and second, ESL can only recover $50 million for any of the other causes of action—namely, other "litigation claims" or legal proceedings. (A-4617). Thus, ESL argues recovery for its Section 507(b) claims is not capped at $50 million.

Moreover, ESL insists that any other reading of clause (ii) of Section 9.13(c) of the APA would render superfluous the second half of the provision—"from the proceeds of any Claims or causes of action of the Debtors or their estates other than the Claims and causes of action described in the preceding clause."

(Apps. Br. at 82). ESL argues that the bankruptcy court's reading of the provision violates Delaware rules of contract construction. See Kuhn Const., Inc. v. Diamond State Port Corp., 990 A.2d 393, 396-97 (Del. 2010) (noting "give each provision and term effect, so as not to render any part of the contract mere surplusage").

Debtors counter that a plain reading of Section 9.13(c) expressly limits to $50 million recovery for Section 507(b) claims. In support of this view, Debtors note that the definition of "Claims" in the APA is derived from the Bankruptcy Code, and courts have concluded the Bankruptcy Code definition of "the term 'claim' is sufficiently broad to encompass any possible right to payment." Conway Hosp., Inc. v. Lehman Bros. Holdings Inc., 531 B.R. 339, 342 (S.D.N.Y. 2015) (citing In re Mazzeo, 131 F.3d 295, 302 (2d Cir. 1997)). Moreover, Debtors argue any other reading would make "Claims" coextensive with "causes of action," thereby violating the other rule of contract construction ESL cites, the rule against surplusage. Further, Debtors contend the phrase "from the proceeds" is not rendered superfluous by the $50 million cap on recovery for Section 507(b) claims because the APA limits any claims ESL has, in excess of $50 million, including the Section 507(b) claims, and that any such claims in excess "shall be treated as an unsecured claim and receive pro rata recoveries with general unsecured claims other than the Claims" excluded in Section 9.13(c)(i). (A-1629).

The Court agrees with Debtors and thus concludes the bankruptcy court did not clearly err when it concluded that ESL's Section 507(b) claims were capped at $50 million pursuant to the APA. The plain text of the APA supports the bankruptcy court's finding that the limitation on recovery was not limited to legal proceedings, as ESL insists, but rather encompasses a broader set of claims, including Section 507(b) claims.

CONCLUSION

The bankruptcy court's Orders of July 31, 2019, and August 5, 2019, are AFFIRMED.

The Clerk is instructed to terminate the pending appeals and close these cases. (19 Civ. 7660; 19 Civ. 7697; and 19 Civ. 7782).

By September 15, 2020, Debtors shall advise the Court on how they wish to proceed with respect to the 506(c) Appeals. (See 19 Civ. 8002, 19 Civ. 8237).

Dated: September 1, 2020
White Plains, NY

SO ORDERED:

/s/ Vincent L. Briccetti
Vincent L. Briccetti
United States District Judge

APPENDIX C

UNITED STATES BANKRUPTCY COURT

SOUTHERN DISTRICT OF NEW YORK

Case No. 18-23538-rdd

In re	Chapter 11
SEARS HOLDINGS CORPORATION, et al.,	Case No. 1823538 (RDD)
Debtors.	(Jointly Administered)

United States Bankruptcy Court
300 Quarropas Street, Room 248
White Plains, NY 10601

July 31, 2019
10:12 AM

B E F O R E:

HON ROBERT D. DRAIN

U.S. BANKRUPTCY JUDGE

ECRO: A. VARGAS

HEARING re Notice of Hearing / Notice of Continuation of Hearing on Debtors Rule 3012 Motion (related document(s) 4034)

* * *

[218] (Recess)

THE COURT: Okay. We're back on the record in In re Sears Holdings, et al. Does anyone else have anything further to say before I give you my ruling? No. Okay.

No one should draw anything from the fact that since I got off the bench a few minutes ago, it turned pitch dark and we had a thunderstorm.

In any event, I'm going to give you an oral ruling on what is a set of fairly complicated issues. I'm doing that because I understand that the parties in this case would benefit considerably from getting the result promptly. And obviously giving it to you this afternoon is more prompt than sitting down and writing a written opinion.

As is the case when I give an oral ruling, often I may review the transcript and in addition to correcting any typos or mis-citations, supplement it, correct my grammar, et cetera. If I do that, I'll file it as an amended bench ruling. It won't be a transcript. And obviously it won't have the weight of a fully written opinion, but it will read better. But my rulings won't change.

I have before me two motions, both involving the so-called second lien, or 2L creditors, which comprise ESL, Cyrus and those parties to the so-called 2010 Notes, whose trustee, or indenture trustee, is Wilmington Trust. Wilmington Trust also serves as the collateral agent for all **[219]** the 2L parties.

The two motions, two contested matters, before me pertain to the following overall issues. First, whether the 2L creditors have a claim under Paragraphs 17 and 18, (d) in each case, of the final Debtor in Possession Financing Order in this case, and section 507(b) of the Bankruptcy Code, which provides, "If the trustee" in this case the debtor in possession – "under section 362, 363 or 364 of this title provides adequate protection of the interest of a holder of a claim secured by a lien on property of the debtor, and if, notwithstanding such protection, such creditor has a claim allowable under subsection (a) (2) of this section arising from the stay of action against such property under section 362 of this title from the use, sale or lease of such property under section 363 of this title, or the granting of a lien under section 364(d) of this title, then such creditor's claim under such subsection shall have priority over every other claim allowable under such subsection," that is, subsection 507(a) (2) of the Bankruptcy Code. The parties refer to this as the "section 507(b) dispute."

In addition, I have a contested matter before me pertaining to an assertion by the debtors in possession in this case under section 506(c) of the Bankruptcy Code. That provision states that the "trustee" -- in this case, the **[220]** debtor in possession – "may recover from property securing an allowed secured claim the reasonable necessary costs and expenses of preserving or disposing of such property to the extent of any benefit to the holder of such claim, including the payment of all ad valorem property taxes with respect to the property."

It is often the case that in debtor in possession financing/cash collateral orders on a final basis 506(c) rights or claims against the secured creditor and/or its collateral are waived. But that is not a case in this case with respect to the second lien lenders' collateral. Therefore, it's a live issue.

I will address the section 507(b) contested matter first. That is a matter in which the second lien creditors bear the burden of proof in showing their entitlement to the superpriority claim set forth in section 507(b). See Official Committee of Unsecured Creditors v. UMB Bank NA, 501 B.R. 549 -- oh, I'm sorry, it's the wrong no, I'm sorry -- 501 B.R. 549 at 590 (Bankr. S.D.N.Y. 2013), and the cases cited therein.

I should note that while section 507(b) gives, to the extent the statute's requirements are satisfied, the 2L creditors a superpriority administrative expense claim, that claim has been limited in this case by two orders of the Court, which set up certain reserves and then deal with the **[221]** reserves, the so-called "winddown reserves." But the claim itself, except in one respect, has not otherwise been limited by contract.

As is clear from the plain language of section 507(b), Congress set forth several criteria that have to be satisfied for there to be such a claim. First, the creditor has to have a claim allowable under subsection 507(a) (2) of the Bankruptcy Code, which defines allowed administrative expenses as the "actual necessary costs and expenses of preserving the estate."

The vast majority of cases, as well as the leading commentator, Collier on Bankruptcy, view this requirement as relatively easy to meet, as long as the creditors' collateral was used in a necessary way to preserve the estate. And I conclude here that that element of the test is satisfied, at least through the date of the sale to Transform in this case.

Then the creditor must establish, first, that adequate protection was provided and, later, proved to be inadequate. And there's no question here that adequate protection was in fact provided in the form of a replacement lien.

Second, as I said, the creditor must have an administrative expense claim under section 507(a) (2). And finally, the claim must have arisen from either the **[222]** automatic stay of section 362, or the use, sale or lease of property under section 363, or the granting of a lien under section 364.

Here, the claim for diminution, if such a claim exists, arose from the use, sale or lease of property under section 363 of the Bankruptcy Code, given the alleged diminution in the value of the collateral from the grant of adequate protection through the sale to Transform.

It is clear, however, that the mere use of a secured creditors' collateral is insufficient to establish a 507(b) claim. Instead, the use of the collateral here has to be shown to have resulted in a diminution in the value of the collateral, and it is the amount of that diminution, i.e. comparing the value at time 1, and value at time 2, that leads to an allowed 507(b) claim.

For all of the foregoing points, see In re Construction Supervision Services, 2015 Bankr. LEXIS 2700 at pages 17-19 (Bankr. E.D.N.C., August 13, 2015).

Consequently, 507(b) claims-- and the claims at issue before me are no exception -- fundamentally raise issues concerning value, the valuation of collateral, a topic, for probably obvious reasons, that has led to much case law and development of the law over the years, with still an ultimate realization that valuation exercises are exercises of judgment and not an exact science and are **[223]** driven heavily by the facts of a particular case.

Congress itself recognized this point in the legislative history of the Bankruptcy Code, to section 506(a) of the Code. As stated in the Congressional Reporter, "Value does not necessarily contemplate forced sale or liquidation value of collateral, nor does it always imply a going concern value. Courts will have to determine the value on a case-by-case basis, taking into account the facts of each case and the competing interests in the case." H.R. Rep. No. 95-595, 95th Congress, 1st Sess., 365 (1977).

The legislative history of section 361 of the Bankruptcy Code provides the same concept: "The section does not specify how value is to be determined for purposes of adequate protection," that is. "Nor does it specify when it is to be determined. These matters are left to case-by- case interpretation and development. This flexibility is important to permit the courts to adapt to varying circumstances and changing modes of financing. Neither is it expected that the courts will construe the term 'value' to mean in every case forced sale liquidation value or a full going concern value. There is wide latitude between those two extremes, although forced sale liquidation value will be a minimum." And then Congress went on to say, "In any particular case, especially of a reorganization case, the determination of which entity should be entitled to the **[224]** difference between the going concern value and the liquidation value must be based on equitable considerations arising from the facts of the case." S.Rep. No. 95-989 95th Congress 2d Sess., 54 (1978). See also H.R. Rep. No. 95-595 95th Congress, 1st Sess., 338 -- excuse me -- 340.

As noted by In re Craddock-Terry Shoe Corp., 98 B.R. 250 at 253-54 (Bankr. W.D.Va. 1988), the courts have applied this flexibility in attempting to determine the most commercially reasonable disposition practical under the circumstances. The court there also noted that in order to determine the most commercially reasonable disposition practical, the court must follow the directive of section 506 and consider the purpose of the valuation. That is in reference to section 506(a) of the Bankruptcy Code, which states in (a) (1) that with respect to valuing the collateral for determining the amount of an allowed secured claim, "such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property and in conjunction with any hearing on such disposition or use, or in a plan affecting such creditors' interests."

Craddock-Terry Shoe Corp. went on to state, "The purpose of adequate protection, as stated in the legislative history of section 361 of the Bankruptcy Code, is to ensure that the secured creditor receives in value essentially what **[225]** he bargained for." Of course, that concept leaves a lot up to the discretion of the court. Many courts have held that what a creditor bargains for is what it would get outside of the bankruptcy case, since the statute measures the creditor's interest in the debtor's interest in the collateral, and normally the creditor would bargain for its right outside of the bankruptcy case.

However, at least in terms of exit value, the Supreme Court has made it clear in Associates Commercial Corp. v. Rash, 520 U.S. 953 (1997), that the court should look to the purpose of the proposed use of the asset, and if it is to be for a reorganization, that use would be in the hands of the debtor and would normally call for replacement value.

I have not been asked for the Court to determine valuation in the context of a sale allocation or a Chapter 11 plan of collateral, but, rather, under section 507(b). The courts in this District have properly applied the Rash case's approach to 507(b) questions. Again See The Official Committee of Unsecured Creditors v UMB Bank 501 B.R. 549, 593-97, and In re Sabine Oil and Gas Corp. 537 B.R. 503, 506 – I'm sorry, 576-577 (Bankr. S.D.N.Y. 2016).

As is perhaps to be expected, as I said, that general case law has not led to agreement among the parties here as to the starting and ending -- well, at least the **[226]** starting values, and perhaps the ending values for the 507(b) analysis, or even how to, as a matter of law, go about that analysis.

The 2L creditors have largely taken the view that because their collateral, which is primarily inventory and accounts receivable, is -- well, was used in the Debtors' retail business, that I should apply a retail value to it in the first instance, subject to discounts or a 506(c) claim, the retail value being derived almost entirely, if not entirely from how those assets were listed at cost on the Debtor's books and records. That's the contention by the experts for two of the three 2L movants here, Messrs. Schulte and Henrich.

The third expert, Ms. Murray, contends that these types of assets are reasonably and traditionally valued based on customary borrowing base formula -- formulas, with respect to eligible assets, at least, and at least to set a floor value for those assets.

The Debtors, on the other hand, contend that the ultimate -- they contend allocation of the sale value to Transform under the ultimate section 363(b) sale in this case should set the value of the collateral, both at the beginning of the case, and, of course, at the end case -- end of the case.

They contend that that value is 85 percent of book **[227]** value for all of the collateral, both eligible for the borrowing base and not eligible. All four parties use the concept of going concern value but in different ways, even though they all recognize that because of the nature of the disposition of the collateral here, i.e. in a going concern sale, some form of going concern value should be used under the Rash case and the two SDNY cases that I've cited.

That, too, begs the question, however, as amply stated, or as aptly stated, that is, by Bankruptcy Judge Carey in In re Aero Group International, A-e-r-o G-r-o-u-p, 2019 Bankr. LEXIS 904 (Bankr. D Del., March 26, 2019), at Page 38, the concept of going -- this is a quote, "The concept of going concern versus liquidation is not a binary, either/or situation. Instead, a company's status appears on a spectrum between the sale of a true, financially healthy going concern business, and a forced liquidation, with an orderly liquidation somewhere in between."

Judge Carey noted that in that case there was a going concern sale ultimately, but that that sale was in the context of a failed standalone plan process and the distinct possibility of veering or pivoting to a liquidation. Those facts are also the case here. Thus, although the collateral was used in the Debtors' retail business, the reality of this case was quite clear: the Debtors would need a financial reorganization that was premised upon, under all **[228]** realistic scenarios, either a going concern sale in the context of competing liquidation bids, or no going concern bid acceptable and pivoting to a liquidation. It is in that context that I consider the valuation evidence put before me.

I believe that that approach is also entirely consistent with Judge Glenn's approach in Official Committee of Unsecured Creditors v UMB Bank, 501 B.R. 549, starting at page 594, and continuing through 597. As Judge Glenn there states, "The Court remains faithful to the dictates of 506(a) by valuing the creditors' interest in the collateral in light of the proposed post-bankruptcy reality." That's at page 595. He goes on to criticize the valuation assumption of the secured creditors in that case that was ostensibly at fair market value, since there was a fair market disposition ultimately in the case, as quote, "assuming that the JSN Collateral could have been sold on the petition date by the Debtors. This assumption ignores reality."

As Judge Glenn stated, that did not take into account the costs associated with obtaining requisite consents or other costs and timing concerns that pertain to the real facts facing the secured creditors at the commencement of the case.

Moreover, Judge Glenn faulted the secured creditors' expert's assumption in not looking to sales **[229]** conducted by other distressed entities on the brink of insolvency and, instead, considering only a solvent company able to capture fair value for its assets.

To the contrary, Judge Glenn held that the debtor was very substantially, and the collateral was -- and the collateral was very substantially impaired by reason of existing defaults that prevented the debtors from disposing of most of their collateral at that time.

Any assessment, I believe, of the 2L creditors' collateral at the commencement of the case in order to determine its -- whether it has diminished in value, therefore needs to take those concerns into account.

It may well be that some lesser form of value than retail value, in a retail customer's hands, or full book value, therefore, is appropriate, and that some form of orderly liquidation value, instead, would be more appropriate under these facts. See, for example, In re T.H.B. Corp. 85 B.R. 192 (Bank. D. Mass. 1988).

In conducting such an analysis, one would expect an expert to look at different types of collateral and to make adjustments for their reasonably realizable value, which is what the experts did in the Aero Group case, with respect to accounts receivable and inventory, for example, deducting off the face value or book value of accounts receivable for old or potentially uncollectable receivables, **[230]** and making similar deductions based on the ability to realize on inventory in the context of the case itself.

Accordingly, I have given next to no weight to Mr. Schulte's purported expert report, where he simply took the companies' book value inventory for "go-forward stores," and discounted it by less than one percent. That includes not only eligible receivables, which I believe are properly discounted as the borrowing base does, but also ineligible receivables and inventory and other assets that the record reflects should be in fact steeply discounted.

Such discounting is normal and customary and expected of a valuation of collateral, as was done in the Aero Group case that I just cited, as well as the In re MD Moody and Sons Inc. case, 2010 Bankr. LEXIS 5220 (Bankr. M.D. Fla., March 5, 2010), where Judge Funk quite rightly distinguished between the fair market value of eligible and ineligible receivables, albeit in the context of an adequate protection decision as opposed to a 507(b) decision.

It appears to me this really wasn't particularly Mr. Schulte's fault, but was based on the direction he was given, which I believe is based on a misguided interpretation of the effect of the Rash case as applied to determining initial adequate protection value and as was properly construed in Official Committee of Unsecured v UMB Bank, to the contrary to the legal approach applied by Mr. **[231]** Schulte apparently at the direction of counsel. That valuation is simply not tied to reality, i.e. the normal realizable value of this collateral in the context at the start of this case.

That reasonable expectation of the 2L creditors was not based on a pure book value analysis without taking into account reasonable projections that would inform actual valuation upon which a person would actually exercise some judgment to determine the value of the collateral.

Rather, it assumed in essence an immediate sale of the collateral to realize value on day one of the case at retail value, as if anyone that would buy all the collateral in that context where the Debtor was in severe financial distress would in fact buy it for the same price that it was marked on the Debtor's books, or, in the case of Mr. Henrich's valuation, at retail value, i.e., as Mr. and Mrs. Smith would buy an item of inventory, a washing machine, at retail value.

It's clear to me that this is-- this should have come as no surprise to any of the 2L creditors. Certainly it should not have come as a surprise to ESL, the largest 2L creditor, which had an intimate familiarity with the Debtors' operations and analyses of the collateral for its 2L debt that were conducted over the years. But frankly, it would -- should have come as no surprise to any **[232]** sophisticated lender.

I believe that Cyrus' expert, Ms. Murray, does attempt to take realistic realizable value into account in applying a borrowing base type of analysis to the collateral. She does so, however, frankly based on another entity's analysis who has not served as an expert in this case, a company called Tiger Asset Intelligence, which Intelligent, excuse me, which provided a net orderly liquidation value analysis of the collateral as of September -- on September 28th, 2018, covering that value as of the start of October, which is the closest valuation that one has to the commencement of this case in mid-October of 2018.

Ms. Murray makes no effort to vet Tiger's analysis, but assumes, based on her knowledge generally of inventory and accounts receivable asset based facilities that Tiger's conclusions as to a net orderly liquidation value are reasonable.

She then applies that percentage to the "go-forward store" inventory and then slightly different percentages or somewhat different percentages to other types of collateral, including inventory in transit and other assets.

There are problems with this analysis that aren't limited just to the fact that the Tiger analysis is almost exclusively relied on without any real vetting. Ms. **[233]** Murray's analysis includes, for example, valuations for inventory in transit, credit card receivables, pharmacy scripts, and pharmacy receivables that differ considerably from Tiger's own analyses as of the start of October of 2018.

For example, Tiger put a value on inventory in transit of between 10 and 30 percent, which would lead to a range between $19.8 million and $58 million. Ms. Murray put a value on it of $74.6 million. Ms. Murray also appears to have valued pharmacy scripts at face or near face, $72.8 million, when Tiger put a 38.1 percent value on such scripts, and caveated its analysis by noting that the sale of scripts on a liquidation basis is a delicate and difficult task, given that other pharmacies know that the debtor is going out of business.

Nevertheless, it appears to me that Ms. Murray's general approach is at least somewhat, probably more than somewhat, tethered to reality or the reality that faced these second lien creditors at the start of this case with respect to their interest in the Debtors' interest in their collateral, as well as the reality of asset-based lending, which is well established and reflected not only in the DIP Order for the treatment of the ABL lenders and their rights under the borrowing base calculations, but in numerous DIP orders over the years. See, for example, In re RadioShack **[234]** Corp., 2015 Bankr. LEXIS, 4541 (Bankr. D Del., March 12, 2015), and in re Visteon Corp. 2010 Bankr. LEXIS 5516 (Bankr. D. Del. March 16, 2010).

Tiger, in adopting an 87.7 percent value against face for eligible inventory and receivables stated that it took certain costs into account, both direct and indirect. It of course has not testified or been deposed, and we don't know how it did that or what costs it considered. And Ms. Murray does not evaluate that analysis in any way.

It's clear to me that certain costs were not included, such as legal costs directly related to selling the inventory, however. And as I noted, while there is some value in the other inventory and assets, Tiger has heavily discounted it.

The Debtors have a totally different approach. As I stated, they contend that there is sufficient evidence to show that the ultimate transaction here reflected both the starting and ending value of the collateral, which should be measured at 85 percent of book. There is a problem with this evidence, however, as well, in that there's no binding agreement to show that the parties intended that 85 percent discounted number to be the allocable value for the collateral.

To the contrary, the parties waived any allocation of value among the forms of consideration in the Asset **[235]** Purchase Agreement with Transform, and the specific references to 85 percent of book value, which are in evidence, are in evidence in connection with prior and lower bids made by Transform for the Debtors' assets or substantially all the Debtors' assets as a going concern.

So, at best, that 85 percent discounted figure serves as a "data point," for what it's worth. On the other end of the scale, Ms. Murray refers to data points, as well, that have similar evidentiary problems, namely, proposals, that were not accepted, to use the Debtors' resources to sell in going concern – I'm sorry, in orderly liquidation sales, going-out-of-business sales, the collateral by a company called Abacus and bids by consortiums of liquidators, which on their face show, in discount to book, a net realizable value of between 89 and slightly under 94 percent of face value.

In addition, the 2L lenders point to analyses of the collateral by the Debtors or the Creditor's Committee that place a 90 percent discount to face value on it.

The problem with all of those data points is similar to the problem with the 85 percent data point related to the APA. There's no detail in the record as to what collateral was covered and what costs were netted out from the proposals. Moreover, they were just that, proposals. They were not accepted, and, therefore, not **[236]** binding on anyone.

Finally, the Court has another data point, which is the adjusted going-out-of-business-sale net recovery which is in evidence in two different forms, one measuring the actual going-out-of-business-sale net recoveries in this case -- and that is with respect to many stores that were sold and did not form the consideration sold to Transform -- where essentially some combination of inventory and other assets were sold.

The two statements purporting to be accurate statements of the results of those inventory sales state that the discount on a net basis to face was either 95.6 percent or 96.4 percent. There is a similar problem with these data points beyond the difference between the two numbers. The first is that at least Mr. Henrich's calculation came from ESL, and we don't know how ESL derived its numbers, except that it is stated that ESL derived it from succeeding to the Debtors' books and records. Secondly, and more importantly, we don't know the makeup of the inventory that was actually sold. Was it primarily eligible inventory? Did it include ineligible inventory? Did it include other assets referenced in the Tiger report from September 28, 2018? It clearly did not include inventory in transit. So although, again, it is a data point, what makes up the figure that I'm being told to use **[237]** as an absolute marker is unknown. Finally, it is acknowledged that the only adjustment off of the purchase price for the net costs of the sales are the "four-wall costs" related to the individual GOB sales, as opposed to any on-top corporate costs, such as maintaining HR services related to the employees who were selling the inventory and the like.

I began this discussion of section 507(b) by noting that the 2L creditors have the burden of proof here. That's an important burden. Courts have denied 507(b) requests in toto for a failure of proof of the amount of diminution. See, for example, In re Bailey Tool Mfg. Co., 2018 Bank. LEXIS 154 at 20 (Bankr. N.D. Tex. Jan. 23, 2018), and In re Modern Warehouse Inc., 74 B.R. 773 (Bankr. W.D. MO. 1987).

Simply based upon the information before me with respect to the starting value of inventory, I conclude that a proper measure of value for 507(b) purposes is with regard to eligible inventory, exclusive of inventory in transit, of 86.5 percent of face.

There were certain other elements of the collateral that have some value, which the 2L experts place a value on, namely credit card receivables, pharmacy scripts, and pharmacy receivables. The valuation of credit card receivables by Messers. Schulte and Henrich are $64.2 **[238]** and $64.3 million, apparently, also at face. Ms. Murray values them at 64.3 percent -- I'm sorry, $64.3 million, excuse me, while the Debtor -- I'm sorry -- Ms. Murray values them at $54.8 million, while the Debtor puts a value at $46.6 million. There seems to be no real analysis behind Ms. Murray's value other than her desire, at least from what I took away from statements made in oral argument, to comport with what was on the Debtors' books of the discounted value. I will go with the Debtors' book value, $46.6, given that fact, $46.6 million.

As far as pharmacy scripts are concerned, all three of the 2L experts value those scripts at $72.8 million, again apparently at face. However, as noted, Tiger, the one whom Ms. Murray relied on for everything else, puts a value of 38.1 percent as against face.

If I concluded that the scripts were in fact collateral, I would discount them by that same 38.1 percent number.

As far as pharmacy receivables are concerned, I will take Ms. Murray's number of $10.5 million.

All three experts count cash as part of the 2L lenders' collateral at the starting point of the case. They do that notwithstanding the fact that they do not have a lien specifically on all cash, but instead only have a lien on the proceeds of their collateral.

[239] They acknowledge that they have not done any sort of tracing exercise to determine what cash was actually proceeds of their collateral as existed on the books of the company at the start of the case, although they urge me simply to infer that most of the cash should be viewed as their proceeds.

They also argue that the first lien debt that comes ahead of them would apply the cash to reduce the first lien debt, notwithstanding that there's no evidence if that happened, specifically, or -- and, excuse me, the waiver of marshaling in the Debtor in Possession Financing Order.

I agree with the Debtors that cash should not be included here given the lack of tracing and the other problems with the proof as established -- to establish this is an element of collateral or this should be part of the collateral determination.

There's also an underlying problem as to whether the pharmacy scripts constitute the Debtors' – I'm sorry -- constitute the 2L creditors' collateral. The 2L creditors contend that the scripts, which are the right to fill a prescription that has not yet been presented, are either inventory or "books and records," and that if one sold the books and records, i.e. the scripts, there would be value attributable to it.

The right to fill a prescription, to my mind, **[240]** clearly is not inventory. The lien on "books and records" as set forth in the 2L security agreement, has a qualifying clause which states that they are books and records pertaining to the collateral. I do not believe that a right to sell un-presented prescriptions is in fact such an item of collateral. In that sense, it's not like a creditor list – I'm sorry -- a customer list, which would be a separate item of collateral and clearly has value just as scripts have some value. So I believe it is also properly excluded from the collateral calculation, even as to its heavily discounted value as I previously found.

As I've noted, the diminution-in-collateral analysis requires a starting point valuation, which I've just conducted. One has to then determine what the diminution was as of an end date. The parties agree that the only end date value was the designated 2L credit bid under the APA of $433.5 million.

So it would appear that the calculation of diminution is relatively easy, i.e. subtract the collateral value – I'm sorry -- subtract from the starting collateral value, which I've previously determined, the amount of $433.5 million. It is complicated, however, by the fact that this was second lien collateral. There is first lien debt ahead of it.

Clearly, the 2L creditors' interest in the **[241]** collateral -- interest in the collateral as of the starting date, has to take into account that senior debt, i.e., that senior debt needs to be deducted from the collateral value that I had previously found, in addition to subtracting the $433.5 million credit bid.

The parties agree that the revolving credit facility of $836 million and the first lien term loan of $570.8 million and the FILO term loan of $125 million should all be subtracted from the starting collateral value. They disagree, however, about three other deductions that the Debtors contend need to be made on account of the first lien debt.

First, they disagree that postpetition interest for the assumed 11 to 12 weeks of orderly liquidation sales would have to be deducted. The Debtors calculate that number at $34 million and no one has challenged that. The 2L creditors say that I must look at the petition date, when, of course, that postpetition interest had not accrued, and, therefore, I should not count it.

I conclude, to the contrary, that I must count it, consistent with Judge Glenn's opinion in Official Committee of Unsecured Creditors v UMB Bank, which I believe entirely correctly says that one must apply projected "post-bankruptcy reality," that's a quote, to the calculation.

It is completely unreal to assume a realizable **[242]** value on the collateral without a period to realize that value in. The Debtors have assumed, I believe, the minimal period for that realization in coming up with the $34 million of postpetition interest.

Clearly, the first lien creditors are -- would be, entitled to that interest, given that they were oversecured, and therefore have a right to it under section 506(b) of the Bankruptcy Code. One might argue that postpetition interest should continue to accrue through the sale, since that was the real reality here. But the Debtors have not done so, and I won’t do so here.

In part I’m not doing so because of the pay downs to the first lien creditors from the GOB sales, which would have reduced the number against which postpetition interest would be calculated. So the $34 million is a fair number.

That leaves what I believe to be the most difficult issue with respect to the 507(b) determination. Namely, the Debtors contend that two first lien letter of credit facilities need to be counted in the first lien debt and accordingly subtracted from the collateral value before the 2L creditors would be entitled to any collateral value on the petition date.

One facility is for $123.8 million of issued letters of credit. Another one is for $271.1 million. Neither of those facilities was drawn on the petition date. **[243]** Namely, they were therefore contingent obligations, although they were collateralized.

Nevertheless, they were real obligations. They were denominated in the Debtor in Possession Financing Order as “senior debt.” They clearly stood ahead of the 2L creditors and had a claim, albeit contingent, to the 2L collateral senior to the 2L creditors’.

Again, the realistic context of this case is not a long-term going concern, but a short-term sale process, with the very real backdrop of a potential liquidation in which the Sears Debtors would go out of business.

Under that scenario, it appears clear to me that the letters of credit would be drawn, either immediately or upon their expiration date. The beneficiaries of the letters of credit would not simply let their collateral in the form of a letter of credit go away.

Ms. Murray calculates that almost 90 percent of the letters of credit are in respect of worker’s compensation contingent obligations, obligations that, as a going concern, the Debtors would be funding, but in a liquidation scenario, would not fund.

One could conceivably do a valuation of those letter of credit facilities and not simply take the value at face. Congress does recognize in one context, namely determining whether an entity is insolvent or not, that debt **[244]** as well as assets can be subject to a fair valuation and section 101(32) (A) of the Bankruptcy Code. See for example Traveler’s International AG v TWA, 134 F.3d 183 (3d Cir. 1998). But it doesn’t -- but Congress doesn’t require a valuation of debt in other contexts in the Code, and this issue does not appear to have arisen in a 507(b) context.

One also could conceivably value the letters of credit, not just on -- in terms of valuing the contingency as to whether they would be drawn, but also as to whether their face amounts exceed the underlying obligations that they in essence secure, namely the worker's compensation claims and other claims that they cover.

Neither of those valuation exercises was undertaken here by the 2L creditors. They simply contend that I should ignore the letters of credit because they were not drawn on the petition date. As a backup, they say that I should simply value them at roughly $9 million, the amount that was drawn between the petition date and the sale.

Given the 2L creditors' burden of proof here, I believe they were required to do more, and that I should count the letters of credit in their face amount, rather than do my own attempt to value such obligations, which, again, according to the DIP Agreement, are senior obligations.

I do so, again, in the context of this case, where **[245]** an orderly liquidation going out of business was clearly a very available option against which ESL was bidding.

I believe that this resolves all of the open disputes as far as determining the value of the collateral, which subsumes in it what constitutes the collateral and the diminution of the collateral between the petition date and today.

I also have determined that the proper interpretation of Paragraph 9.13 of the Asset Purchase Agreement is that to the extent there is a 507(b) claim for ESL, that claim is capped -- at recovery on that claim is capped at $50 million, again based on the definition of "Claim," uppercase Claim in the APA.

That definition, which is very broad and includes a right to payment, I believe would mean that it would include claims based on accounts receivable derived from inventory. I'll note a similar argument, which I accepted, was made by the 2L creditors for my including pharmacy receivables in their collateral, even though it wasn't specifically a defined term but can be viewed as based on a right to inventory and the proceeds thereof.

So I don't know what that adds up to, but I think the parties can do the math. And if there's a dispute, you could explain the dispute to me as to what the diminution claim will be.

[246] Let me turn then to the second issue. And before doing that, though, there is one issue that somewhat bleeds over into the second issue.

The second issue, of course, is the 506(c) rights of the debtor in possession. The Creditors Committee and the Debtors have argued that I should take equitable considerations into account in determining those 506(c) rights. And I'll address that when I address the 506(c) issues.

I will note, however, that at least a couple of cases have taken equitable considerations into account when doing a 507(b) calculation. They're relatively old cases. I think the leading one is probably In re McFarland's Inc. 33 B.R. 788 (Bankr. W.D.N.Y. 1983). See also In re Cheatham, C-h-e-a-t-h-a-m, 91 B.R. 982 (Bankr. E.D.N.C. 1988).

I recognize that in the 1980s bankruptcy courts, (perhaps because it was an accepted fact of bankruptcy jurisprudence then) that bankruptcy courts as "courts of equity" -- and that seemed to mean what it said -- were more willing to apply equitable principles to determinations. And clearly Congress in drafting section 506(a) and section 361, as reflected in the legislative history that I've just read, also contemplated applying equitable principles in a valuation.

The Supreme Court has severely narrowed the equity **[247]** jurisdiction of the bankruptcy courts over the years, culminating in Law v Siegel, 134 S.Ct. 1188 (2014). And I actually now view these cases through that lens.

I also view them as entirely consistent with my holding on the valuation of the collateral for the 2L creditors at the start of the case, in that I believe when applying the equities in McFarland's and Cheatham and in citing In re Callaster in doing so, those courts were actually talking about what would be an appropriate valuation in light of the facts of the case, namely, what were the reasonable expectations as to the value of the collateral given the nature of the case.

And again, as I've heavily relied on Judge's Glenn and Carey's opinions, it seems to me the nature of this case at the start was one where everyone knew -- none more than ESL -- but everyone knew, that the Debtors were going to dispose of substantially all of their assets in a very short time, and that that was the only way that the secured creditors would realize any value.

Applying mere book or retail value in those circumstances, one could say would be inequitable, but it's really just unrealistic. So I equate "equity" here as really meaning what's realistic.

All right, turning to section 506(c), unlike the 507(b) issue, the Debtors here have the burden of proof. **[248]** See In re Flagstaff Food Service Corp., 739 F.2d 73, 77 (2d 2 Cir. 1984), and First Services Group Inc. v O'Connell (In re Ceron), C-e-r-o-n, 412 B.R. 41, 48 (Bankr. E.D.N.Y. 2009).

Under the law of the Second Circuit, the statute's plain language, which is requiring -- which requires, that the expenses incurred by the debtor in possession were necessary and the amounts expended were reasonable and benefited the secured creditor -- require three different things, including a gloss, namely that the benefit be "direct" or "primary." See General Electric Credit Corp v Peltz (In re Flagstaff Food Service Corp.), 762 F.2d 10, 12 (2d Cir. 1985). This does not mean that the creditor be the only beneficiary of the expenses, but that the benefit be not only direct, but primary.

The valuation of the collateral that I have given already takes into account costs of realizing on the collateral, not only the so-called "four-wall" costs and the assumed, apparently, although, again, this has not been vetted, 3.1 percent discount applied by Tiger, but also my belief as to proper costs applied for corporate overhead attributable to the collateral and legal fees and professional fees directly attributable to the collateral.

Where do I come up with that extra discount? In part from, largely from, Mr. Henrich's analysis of 506(c) claims, as well as Judge Stong's analysis in the Ceron case, **[249]** in which she makes the clearly correct point that whether expenses incurred were "reasonable," requires an assessment that shows that there's some sensible proportion to the value of the benefit to be received.

The relatively modest adjustment I've made to the Tiger/Murray analysis takes that into account I believe already. This is important because I think to do the analysis again would be double counting in the 506(c) context. Moreover, the 506(c) evidence provided to me by the Debtors, which consists primarily of a one-page breakout of alleged costs that would fit 506(c) itemized simply by category adding up to over $1,400,000,000 does not break out in sufficient detail any costs beyond what I've included in the value of the collateral that I believe would properly be charged under section 506(c).

I think without that level of detail, in other words, I cannot make the "reasonable" and "necessary," let alone "primary and direct benefit" analysis that the Second Circuit case law requires. Consequently, I will deny the Debtors' motion under section 506(c).

So I will ask counsel for Cyrus to prepare the order denying the 506(c) motion, and counsel for the Debtors to prepare the order on the 507(b) matter. You don't need to formally settle those orders on the docket, but you should clearly run them by the parties involved in this **[250]** litigation, including the Creditors Committee, before you submit them to chambers.

And, again, if there's some dispute as to how my rulings total up to a 507(b) claim, I would ask the parties to give me their dueling orders with an explanation, emailed obviously to each other as well as to chambers, of the basis for their contention. Anything else?

MR. SCHROCK: Ray Schrock, for the Debtors. That said, Your Honor, thank you very much for taking all this time today.

THE COURT: Okay.

MR. SCHROCK: And we'll move to settle the orders ASAP.

THE COURT: Okay.

MR. SCHROCK: Or not settle the orders, but prepare them.

THE COURT: All right. I have to say also, I greatly appreciate the efficient way that the parties set this litigation up.

MR. SCHROCK: Thank you.

THE COURT: Thank you.

(Whereupon these proceedings were concluded at 5:49 PM)

APPENDIX D

UNITED STATES BANKRUPTCY COURT SOUTHERN DISTRICT OF NEW YORK

IN RE: **SEARS HOLDINGS CORPORATION, *et al.*,** **Debtors.**[1]	**Chapter 11** **Case No. 18-23538 (RDD)** **(Jointly Administered)**

[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are as follows: Sears Holdings Corporation (0798); Kmart Holding Corporation (3116); Kmart Operations LLC (6546); Sears Operations LLC (4331); Sears, Roebuck and Co. (0680); ServiceLive Inc. (6774); SHC Licensed Business LLC (3718); A&E Factory Service, LLC (6695); A&E Home Delivery, LLC (0205); A&E Lawn & Garden, LLC (5028); A&E Signature Service, LLC (0204); FBA Holdings Inc. (6537); Innovel Solutions, Inc. (7180); Kmart Corporation (9500); MaxServ, Inc. (7626); Private Brands, Ltd. (4022); Sears Development Co. (6028); Sears Holdings Management Corporation (2148); Sears Home & Business Franchises, Inc. (6742); Sears Home Improvement Products, Inc. (8591); Sears Insurance Services, L.L.C. (7182); Sears Procurement Services, Inc. (2859); Sears Protection Company (1250); Sears Protection Company (PR) Inc. (4861); Sears Roebuck Acceptance Corp. (0535); SR - Rover de Puerto Rico, LLC (f/k/a Sears, Roebuck de Puerto Rico, Inc.) (3626); SYW Relay LLC (1870); Wally Labs LLC (None); SHC Promotions LLC (9626); Big Beaver of Florida Development, LLC (None); California Builder Appliances, Inc. (6327); Florida Builder Appliances, Inc. (9133); KBL Holding Inc. (1295); KLC, Inc. (0839); Kmart of Michigan, Inc. (1696); Kmart of Washington LLC (8898); Kmart Stores of Illinois LLC (8897); Kmart Stores of Texas LLC (8915); MyGofer LLC (5531); Sears Brands Business Unit Corporation (4658); Sears Holdings Publishing Company, LLC. (5554); Sears

<u>ORDER DETERMINING THE AMOUNT OF SECOND-LIEN HOLDERS' SECTION 507(B) ADMINISTRATIVE CLAIMS PURSUANT TO RULE 3012 OF THE FEDERAL RULES OF BANKRUPTCY PROCEDURE</u>

Upon the *Motion to Estimate Certain 507(b) Claims for Reserve Purposes* dated May 26, 2019 (ECF No. 4034), and as supported by *Debtors' (I) Opposition to Second-Lien Holders' Requests to Determine Amount of Second-Lien Secured Claims Under Section 506(a) and Section 507(t) Administrative Claims and (II) Reply in Support of Debtors' Rule 3012 Motion to Determine the Amount, if Any, of 507(t) Claims and to Surcharge Second-Lien Collateral Pursuant to Section 506(c)* (ECF No. 4381), the *Debtors' Supplemental Brief on Expert Discovery and in Further Support of (I) Opposition to Second-Lien Holders' Requests to Determine Amount of Second-Lien Secured Claims Under Section 506(a) and Section 507(t) Administrative Claims and (II) Reply in Support of Debtors' Rule 3012 Motion to Determine the Amount, if Any, of 507(b) Claims and to Surcharge Second-Lien Collateral Pursuant to Section 506(c)* (ECF No. 4565), and supporting declarations of Brian Griffith and Brandon Aebersold (ECF Nos. 4035, 4382, 4383, and 4567)

Protection Company (Florida), L.L.C. (4239); SHC Desert Springs, LLC (None); SOE, Inc. (9616); StarWest, LLC (5379); STI Merchandising, Inc. (0188); Troy Coolidge No. 13, LLC (None); BlueLight.com, Inc. (7034); Sears Brands, L.L.C. (4664); Sears Buying Services, Inc. (6533); Kmart.com LLC (9022); Sears Brands Management Corporation (5365); and SRe Holding Corporation (4816). The location of the Debtors' corporate headquarters is 3333 Beverly Road, Hoffman Estates, Illinois 60179.

(collectively, the "**Rule 3012 Motion**")[2] of Sears Holdings Corporation and its debtor affiliates, as debtors and debtors in possession in the above-captioned chapter 11 cases (collectively, the "**Debtors**"); and upon the *Debtors' Motion to Strike Second-Lien Holders' Experts in Connection with July 23, 2019 Hearing on Rule 507(t) Determination* (ECF No. 4568); and upon the *Common Memorandum of Law on Behalf of the Second Lien Parties: (A) In Support of Their Requests to Determine the Amount of Their Second Lien Secured Claims Under Section 506(a) and Their Section 507(b) Administrative Claims Pursuant to Bankruptcy Rule 3012; and (B) In Opposition to Debtors' Motion to Surcharge Their Collateral Pursuant to Section 506(c)* (ECF No. 4272), the *Common Reply Memorandum of Law on Behalf of the Second Lien Parties: (A) In Further Support of Their Requests to Determine the Amount of Their Second Lien Secured Claims Under Section 506(a) and Their Section 507(t) Administrative Claims Pursuant to Bankruptcy Rule 3012; and (B) In Opposition to Debtors' Motion to Surcharge Their Collateral Pursuant to Section 506(c)* (ECF No. 4439), *Common Supplemental Brief of the Second Lien Parties Addressing Discovery: (A) In Connection With Their Requests to Determine the Amount of Their Second Lien Secured Claims Under Section 506(a)*

[2] *See Stipulation and Order Concerning the Resolution of Certain Section 507(b) Claims* (ECF No. 4316) whereby the Debtors' motion is deemed to be a motion pursuant to Bankruptcy Rule 3012.

Capitalized terms used but not otherwise defined herein shall have the respective meanings ascribed to such terms in the Rule 3012 Motion.

and Their Section 507(b) Administrative Claims Pursuant to Bankruptcy Rule 3012; and (B) In Opposition to Debtors' Motion to Surcharge Their Collateral Pursuant to Section 506(c) (ECF No. 4570), supporting expert reports and declarations from Marti Murray, David Schulte, and William Henrich (ECF Nos. 4314, 4372, 4569, 4571, 4573), and the individual memoranda and reply memoranda of the Second-Lien Holders (ECF Nos. 4273, 4276, 4278, 4313, 4440, 4441, 4445, 4586, 4587) (collectively, the **"Second-Lien Holders' Request for 507(b) Administrative Claims"**); and upon the Second-Lien Parties' Motion *in Limine* and supporting declaration (ECF Nos. 4564 and 4566); and upon the *Creditors' Committee's (I) Qualified Joinder to the Debtors' Objection to the Second Lien Parties' Requests to Determine Claims Under Section 506(a) and Section 507(t) and Reply in Support of the Debtors' Rule 3012 Motion and (II) Supplemental Objection to the Second Lien Parties' Request to Determine Claims Under Section 506(a) and Section 507(b)* (ECF No. 4538); and the Court having jurisdiction to consider the Rule 3012 Motion and the relief requested therein in accordance with 28 U.S.C. §§ 157(a)-(b) and 1334(b) and the Amended Standing Order of Reference M-431, dated January 31, 2012 (Preska, C.J.); and consideration of the Rule 3012 Motion and the requested relief being a core proceeding pursuant to 28 U.S.C. § 157(b) that the Court can decide by a final order under the United States Constitution; and venue being proper before the Court pursuant to 28 U.S. C. §§ 1408 and 1409; and due and proper notice of the relief sought in the Rule 3012 Motion and in the Second-Lien Holders' Request for

507(b) Administrative Claims and the opportunity for a hearing thereon having been provided in accordance with the Amended Case Management Order; and such notice having been adequate and appropriate under the circumstances, and it appearing that no other or further notice need be provided; and the Court having held an evidentiary hearing to consider the relief requested in the Rule 3012 Motion and the Second-Lien Holders' Request for 507(b) Administrative Claims on July 3, 2019 and July 31, 2019 (together, the **"Hearing"**); and upon the record of the Hearing and all of the proceedings had before the Court; and, after due deliberation, the Court having determined for the reasons stated by the Court in its bench ruling at the Hearing,[3] which is incorporated herein, that the legal and factual bases established at the Hearing warrant the relief granted herein; now, therefore, it is hereby **ORDERED THAT**:

1. Pursuant to Rule 3012 of the Federal Rules of Bankruptcy Procedure, the amount of the Second-Lien Holders' claims pursuant to section 507(b) of the Bankruptcy Code is determined to be $0.00, a calculated below:

[3] Upon reviewing the proposed orders submitted by the parties, the Court realized that it had erred in assuming a starting 87.8% value as against eligible inventory instead of an 88.7% value, in each case before a 1.3% reduction for corporate overhead attributable to such collateral; this Order reflects the correct assumption.

($ in millions)

Collateral	
Net Eligible Inventory as of Petition Date	2,391.5
Inventory Value Recovery Rate	87.40%
Inventory Value	2,090.17
Credit Card Receivables	46.6
Cash	–
Scripts	–
Pharmacy Receivables	10.5
Total Collateral	2,147.27[4]
First Lien/Senior Debt	
Revolving Credit Facility	836.0
First Lien Letters of Credit	123.8
First Lien Term Loan B	570.8
FILO Term Loan	125.0
Stand-Alone L/C Facility	271.1[5]
Post-petition First Lien Interest	34.0
Total First Lien Debt	1960.7
2L Debt Remaining Value	186.57
Credit Bid	(433.5)
Credit Bid: Adjusted 2L Debt Collateral Value	(246.93)
Less: Value of 2L Adequate Protection	(0.3)
Total	(246.63)

[4] For the reasons set forth on the record of the Hearing, the Second-Lien Holders have not met their burden to include ineligible or inventory-in-transit as Collateral on the Petition Date.

[5] For the reasons set forth on the record of the Hearing, the Second-Lien Holders have not met their burden to show a lower value for either Letter of Credit Facility senior debt.

2. Because there was no diminution in the value of the Second-Lien Holders' Collateral from the Petition Date through the Effective Date, neither the Prepetition Second Lien Collateral Agent (on behalf of any Second-Lien Holder or itself) nor any Second-Lien Holder shall have any liens on or recourse to the Winddown Account.

3. The Court's rulings on the record at the Hearing are incorporated herein by reference, except as specified in footnote 3 hereof.

4. The Debtors are authorized to take all actions necessary to effectuate the relief granted pursuant to this Order in accordance with the Motion.

5. The terms and conditions of this Order shall be effective and enforceable immediately upon its entry.

6. This Court shall retain jurisdiction to hear and determine all matters arising from or related to the implementation, interpretation, and/or enforcement of this Order.

Dated: August 5, 2019
White Plains, New York

/s/ Robert D. Drain
THE HONORABLE
ROBERT D. DRAIN
UNITED STATES
BANKRUPTCY JUDGE

APPENDIX E

RELEVANT STATUTORY PROVISIONS

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11 U.S.C. § 361. Adequate protection

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--

(1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property;

(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; or

(3) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

11 U.S.C. § 506(a)(1). Determination of secured status

(a)(1) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.