IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	)	Chapter 11
Quicksilver Resources Inc., et al.,[1]	)	Case No. 15-10585 (LSS)
Debtors.	)	Jointly Administered

DEBTORS' REPLY IN FURTHER SUPPORT OF DEBTORS' CASH COLLATERAL MOTION AND RESPONSE TO THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS' OBJECTION THERETO

The debtors and debtors in possession in the above-captioned chapter 11 cases (collectively, the "Debtors") hereby submit this reply (the "Reply") in support of the *Debtors' Motion for Entry of Interim and Final Orders (A) Authorizing the Use of Cash Collateral, (B) Granting Prepetition Secured Parties Adequate Protection, (C) Scheduling a Final Hearing, and (D) Granting Related Relief* [D.I. 16] (the "Cash Collateral Motion")[2] and in response to the *Objection of the Official Committee of Unsecured Creditors to Debtors' Motion for Entry of Interim and Final Orders (A) Authorizing the Use of Cash Collateral, (B) Granting Prepetition Secured Parties Adequate Protection, (C) Scheduling a Final Hearing, and (D) Granting Related Relief* [D.I. 234] (the "Objection") filed by the Official Committee of Unsecured Creditors (the "Committee"). In support of this Reply, the Debtors rely upon (i) the *Declaration of Vanessa*

[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are: Quicksilver Resources Inc. [6163]; Barnett Shale Operating LLC [0257]; Cowtown Drilling, Inc. [8899]; Cowtown Gas Processing L.P. [1404]; Cowtown Pipeline Funding, Inc. [9774]; Cowtown Pipeline L.P. [9769]; Cowtown Pipeline Management, Inc. [9771]; Makarios Resources International Holdings LLC [1765]; Makarios Resources International Inc. [7612]; QPP Holdings LLC [0057]; QPP Parent LLC [8748]; Quicksilver Production Partners GP LLC [2701]; Quicksilver Production Partners LP [9129]; and Silver Stream Pipeline Company LLC [9384]. The Debtors' address is 801 Cherry Street, Suite 3700, Unit 19, Fort Worth, Texas 76102.

[2] Capitalized terms not otherwise defined herein shall have the meanings ascribed in the Cash Collateral Motion or the Final Order, as applicable. To the extent necessary, this Reply shall also be in further support of the *Debtors' Motion for (A) Authority to (I) Continue Using Existing Cash Management System, (II) Honor Certain Pre-petition Obligations Related to the Use of the Cash Management System, and (III) Maintain Existing Bank Accounts and Business Forms; and (B) an Extension of Time to Comply with Bankruptcy Code Section 345(b)* [D.I. 8] (the "Cash Management Motion").

Gomez LaGatta in Further Support of (1) the Debtors' Motion for Entry of Interim and Final Orders (A) Authorizing the Use of Cash Collateral, (B) Granting Prepetition Secured Parties Adequate Protection, (C) Scheduling a Final Hearing, and (D) Granting Related Relief and (2) Debtors' Motion for (A) Authority to (I) Continue Using Existing Cash Management System, (II) Honor Certain Pre-Petition Obligations Related to the Use of Cash Management System, and (III) Maintain Existing Bank Accounts and Business Forms; and (B) An Extension of Time to Comply with Bankruptcy Code Section 345(b) and Local Rule 4001-3 [D.I. 250] (the "LaGatta Declaration"), (ii) the *Declaration of Stan G. Page in Support of Debtors' Motion for Entry of Interim and Final Orders (A) Authorizing the Use of Cash Collateral, (B) Granting Prepetition Secured Parties Adequate Protection, (C) Scheduling a Final Hearing, and (G) Granting Related Relief* [D.I. 251] (the "Page Declaration"), and (iii) the *Declaration of John-Paul Hanson in Support of Debtors' Motion for Entry of Interim and Final Orders (A) Authorizing the Use of Cash Collateral, (B) Granting Prepetition Secured Parties Adequate Protection, (C) Scheduling a Final Hearing, and (G) Granting Related Relief* [D.I. 252] (the "Hanson Declaration" and, together with the LaGatta Declaration and the Page Declaration, the "Declarations"). In further support of this Reply, the Debtors respectfully state as follows:

PRELIMINARY STATEMENT

1. By its Objection, the Committee relies on material misstatements of fact and law to support its request that this Court supplant the Debtors' reasoned business judgment for that of the Committee in respect of the negotiation of the consensual use of Cash Collateral and the grant of adequate protection to the Prepetition Secured Parties. Specifically, the Committee objects to entry of the Final Order on the grounds that it believes that (i) the adequate protection package agreed to by the Debtors is excessive, (ii) the Debtors' decision to agree to Bankruptcy

Code section 506(c) and 552(b) waivers is not justified, (iii) liens on proceeds of avoidance actions are inappropriate, (iv) the Committee's investigation period is "woefully inadequate," (v) the definition of "Adequate Protection Obligations" in the Final Order is overly broad, and (vi) final approval of the application of hedge termination proceeds to the Debtors' obligations under the Combined Credit Agreements should be delayed for six months. The Objection is rife with factual and legal inaccuracies and should be overruled.

2. Rather than advantage one constituency to the detriment of another as the Committee would have the Court believe, the adequate protection package (the "Adequate Protection Package") proposed in exchange for the Prepetition Secured Parties' consent to use of Cash Collateral is narrowly tailored and designed to protect the Prepetition Secured Parties against the very real risk of diminution in value of the Prepetition Collateral. The Committee's arguments to the contrary reflect a misunderstanding of the Debtors' assets and business and, as such, are inconsistent with the realities of these chapter 11 cases. Indeed, the Prepetition Collateral consists primarily of the Debtors' hydrocarbon assets which, in the absence of future discoveries and development, are a finite resource that if extracted during the ordinary operation of the Debtors' business will eventually be exhausted. Further, the proposed cash adequate protection payments to the Prepetition Secured Parties are appropriate in view of the uncertain value of the Unencumbered Property on which the Prepetition Secured Parties will be granted replacement liens, and as set forth in the Final Order, are subject to recharacterization. Lastly, the Committee takes particular umbrage with the Debtors' decision to grant waivers under Bankruptcy Code sections 506(c) and 552(b) in the alleged situation where Unencumbered Cash would be used to enhance pre-petition collateral. Here, the opposite is true. Indeed, the Committee misapprehends the Debtors' capital plan and fails to acknowledge that the substantial

majority of capital is intended to be deployed to Unencumbered Property rather than to enhance the value of the Prepetition Collateral and that such waivers are routinely granted where, as here, secured lenders agree to subordinate their claims to a carve-out.

3. Moreover, securing a consensual agreement to use the Prepetition Collateral, including Cash Collateral, will substantially benefit the Debtors' estates by (i) avoiding costly and time consuming litigation over the value of replacement liens, (ii) serving as consideration for the Canadian Forbearance, (iii) avoiding costly and potentially detrimental litigation with the Prepetition Secured Parties, and (iv) avoiding the negative consequences attendant to segregation of the Unencumbered Cash and Cash Collateral.

4. The Committee's request to double its investigation period is unsupportable. The investigation period included in the proposed Final Order is consistent with the Local Rules and local practice, and the Debtors have provided the Committee's advisors with all of the materials necessary to conduct a review of the liens and claims of the Prepetition Secured Parties. As such, the Committee provides no compelling reason to deviate from the time frame that is consistently approved in this jurisdiction.

5. Finally, the Committee's request to delay final approval of the application of hedge termination proceeds to the Debtors' obligations under the Combined Credit Agreements is misplaced and unreasonable. The Debtors' determination to facilitate the repayment of the obligations under the Combined Credit Agreements was a critical aspect of the Prepetition Secured Lenders' agreement to permit consensual use of the Prepetition Collateral, including Cash Collateral, and provides the Debtors with significant additional benefits, including, among others, reducing the amount of interest accruing under the Combined Credit Agreements and

avoiding litigation with counterparties to the Debtors' hedge agreements. Accordingly, the Committee's request with respect to the foregoing should be denied.

6. For all of the reasons set forth herein, the Committee's Objection is without merit and should be overruled in its entirety.

REPLY

I. THE ADEQUATE PROTECTION PACKAGE REFLECTS THE DEBTORS' REASONABLE EXERCISE OF BUSINESS JUDGMENT AND IS APPROPRIATE UNDER THE CIRCUMSTANCES.

7. The Committee objects to the Adequate Protection Package as too rich. Obj. at 11. In so doing, the Committee would have this Court apply law inapposite to the approval of the relief requested under the Cash Collateral Motion and ignore the well-established standard in this jurisdiction applicable to a grant of adequate protection.

8. Despite the Committee's failure to acknowledge the well-established standard in this jurisdiction—a debtor's negotiated use of cash collateral is measured by its reasonable business judgment. *See, e.g., In re CB Holding Corp.*, 447 B.R. 222, 227 (Bankr. D. Del. 2010) (approving the use of cash collateral as a prudent exercise of the debtors' business judgment); *In re Atrium Corp.*, 2010 WL 2822131, at *7 (Bankr. D. Del. Mar. 17, 2010) (approving the use of cash collateral as a prudent exercise of the debtors' business judgment); *In re The Penn Traffic Co.*, 2010 WL 2822043, at *6 (Bankr. D. Del. Jan. 25, 2010) (same); *In re Champion Enterprises, Inc.*, 2009 WL 7226978, at * 3 (Bankr D. Del. Dec. 16, 2009) (same). When a consensual cash collateral order has been negotiated in good faith and at arm's length, courts defer to the negotiated result between a debtor and its secured creditors. *See, e.g.*, *In re PNG Ventures, Inc.*, 2009 WL 7226389, at *5 (Bankr. D. Del. Oct. 21, 2009) (approving a cash collateral order supported by reasonably equivalent value and fair consideration, as part of negotiations conducted in good faith and at arm's length within the meaning of Section 364(e));

see also In re Trans World Airlines, Inc., 261 B.R. 103, 121-22 (Bankr. D. Del. 2001) (deferring to debtor's business judgment in rejecting executory contracts, as "whether the debtor is making the best or even a good business decision is not a material issue of fact under the business judgment test." (quoting *In re Wheeling-Pittsburgh Steel Corp.*, 72 B.R. 845, 849 (Bankr. W.D. Pa. 1987))); *In re PNG Ventures, Inc.*, 2009 WL 7226389, at *5 (Bankr. D. Del. Oct. 21, 2009) (approving a cash collateral order supported by reasonably equivalent value and fair consideration, as part of negotiations conducted in good faith and at arm's length within the meaning of Section 364(e)).

9. Courts routinely hold that "it is not appropriate to substitute the judgment of . . . objecting creditors, for the business judgment of a debtor." *In re Spansion, Inc.*, 426 B.R. 114, 140 (Bankr. D. Del. 2010). Courts give great latitude to the business judgment of a debtor as a tacit acknowledgement that a debtor is in a much more informed and educated position to make sound business decisions. *See In re Marvel Entm't Grp, Inc.*, 273 B.R. 58, 78 (D. Del. 2002) ("'[U]nder the business judgment rule, a board's 'decisions will not be disturbed if they can be attributed to any rational purpose' and a court 'will not substitute its own notions of what is or is not sound business judgment.'" (internal citations omitted)).

10. Before the Petition Date, the Debtors engaged in arm's-length negotiations with the Prepetition Secured Parties regarding the use of Prepetition Collateral, including Cash Collateral. Those negotiations resulted in a carefully crafted balance between affording the Debtors the critical use of the Prepetition Collateral necessary to operate, on the one hand, and lender protections, on the other. The balance achieved with the Prepetition Secured Parties through these arm's-length negotiations reflects a valid exercise of the Debtors' business judgment in view of the facts of these chapter 11 cases.

A. The Prepetition Collateral Comprises Primarily the Debtors' Hydrocarbon Assets, the Value of which is at Risk of Diminution in Value.

11. In its Objection, the Committee argues that certain aspects of the adequate protection package are "excessive" because there is little risk of diminution in value and that use of the Prepetition Secured Parties' Cash Collateral and other Prepetition Collateral is likely to enhance the value of the Prepetition Collateral. *See* Obj. at 11. This argument must fail under the weight of its own absurdity.

12. Indeed, the Committee erroneously asserts that the Prepetition Secured Parties must demonstrate the actual or anticipated diminution in the value of the Prepetition Collateral before they are entitled to receive adequate protection. *See* Obj. at 9. The Committee not only misstates the law but also misstates the relief requested in the Cash Collateral Motion. The proposed Adequate Protection Package provides for various, reasonable forms of protection to the Prepetition Secured Parties *only* to the extent that there is any diminution in the value of their Prepetition Collateral during these chapter 11 cases. This is not only common, accepted practice, but also consistent with Bankruptcy Code section 361, which provides that adequate protection may consist of "additional or replacement lien[s] 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." 11 U.S.C. § 361(2).

13. There is no requirement under Bankruptcy Code section 361 or otherwise that a lender must first demonstrate diminution in value before a debtor may agree to grant an adequate protection lien to the extent that such collateral diminishes in value. The Debtors, consistent with common practice and in their reasoned business judgment—the applicable standard with respect to the relief requested in the Cash Collateral Motion—agreed to provide adequate protection now, but only to the extent of diminution in value. The notion that the Debtors should

be required to litigate—or worse, stipulate to—diminution in value at the outset of the case before providing such adequate protection is inconsistent with the Bankruptcy Code and common practice.[3]

14. These facts and applicable law notwithstanding, as set forth in the Declarations and discussed further herein, the Debtors believe that there is a significant risk of diminution in the value of the Prepetition Collateral in these cases from both the use of the Prepetition Collateral and the nature and volatility of commodity prices. As a result, to protect against any such potential diminution and in exchange for the consensual use of Cash Collateral, the Debtors propose to provide the Prepetition Secured Parties with the Adequate Protection Package.

(i) The Debtors' Hydrocarbon Assets are a Finite Resource, the Value of which is Necessarily Decreased through Extraction and Use of Proceeds

15. The Prepetition Collateral consists primarily of the Debtors' hydrocarbon assets, which are a ***finite resource*** that if developed and extracted from the ground will eventually be depleted. Under the proposed Final Order, the Debtors would be authorized to continue extracting hydrocarbons, convert the extracted hydrocarbons to cash and use that cash to fund their operations.[4] It simply cannot follow that the process of exploiting a finite resource and

[3] The cases cited by the Committee in connection with its argument are inapposite as such cases do not relate to the consensual use of cash collateral and instead relate to a circumstance where a secured lender is requesting adequate protection and hold, in that circumstance, that the burden is on the moving party to demonstrate the need for adequate protection. *See* Obj. at 9. Here, the Debtors have proposed to provide adequate protection to the Prepetition Secured Parties consistent with Bankruptcy Code section 361(2) to the extent of diminution in value of the Prepetition Collateral. It is antithetical that to provide adequate protection on this basis (i.e., adequate protection that arises only if and to the extent of diminution in value) that one must first prove that diminution in value has occurred or will occur.

[4] The Committee notes that the Debtors have "…stressed that they intend to rely on the Unencumbered Cash to fund operations…." Obj., at 12. This is a gross misstatement of how operations will be funded during these chapter 11 cases. More accurately, under the proposed Final Order, the Debtors will utilize cash generated by the sale of Prepetition Collateral to fund day-to-day operations, but the Debtors project that those funds will be insufficient to meet all of the Debtors' needs. As a result, the Unencumbered Cash will also be used to meet the shortfall. Without access to Cash Collateral and the Prepetition Collateral, the Debtors' need to use the Unencumbered Cash would only increase.

using the proceeds thereof to operate a business equates to an increase in the value of such finite resource.

16. Nowhere is this point more clearly illustrated than by the very cases cited by the Committee. Each of the cases cited by the Committee for the proposition that the value of collateral is enhanced by using operating cash to fund working capital needs occurred in the context of maintaining and/or improving commercial real estate. For example, in *In re Central Park Ave. Corp.*, the debtor sought to obtain credit on a priming basis to finance structural changes to commercial real estate property to attract new tenants and increase base rents. 136 B.R. 626, 628 (Bankr. S.D.N.Y. 1992). The court approved the Debtors' request over the objection of a pre-petition secured creditor and concluded that the objecting party was adequately protected because "…there [was] no question that the property would be improved by the proposed renovations and that an increase in value will result." *Id.* at 631.[5]

17. No one disputes that improving a commercial real estate asset to facilitate higher rents and better quality tenants benefits the value of the applicable underlying property. The same, however, cannot be said of expending the Debtors' hydrocarbon assets and using the proceeds therefrom to operate the Debtors' business. As explained above, the hydrocarbon assets are fixed and will eventually be exhausted if extracted and sold. In other words, every molecule of natural gas that is flowed from one of the Debtors' wells means that there is one less molecule than existed in such well previously and one less molecule that constitutes Prepetition Collateral. This scenario is fundamentally different from the commercial real estate context where using operating cash ensures that the underlying collateral (i.e., the commercial real

[5] The other two cases cited by the Committee, *In re 499 W. Warren St. Assocs.* and *In re Salem Plaza Assoc.*, both involve the use of cash collateral to pay necessary operating expenses of a commercial real property asset — an office building and a shopping center, respectively. *See* 142 B.R. 53 (Bankr. N.D.N.Y 1992); 135 B.R. 753, 759 (Bankr. S.D.N.Y 1992). In both cases, use of cash collateral was necessary to preserve the value of the underlying commercial real estate property and did not involve depleting a finite asset.

estate) remains in at least the same condition and maintains the same value or enhances the value of such collateral. Producing a finite asset, like oil or natural gas, and then using the proceeds of that asset to produce it further, through continued extraction, does precisely the opposite.

18. Further, the Committee contends that reducing output or shutting in wells could impact the Debtors' ability to fully realize on those wells at a later point in time and thus operating and extracting the hydrocarbons instead enhances the value of the Prepetition Collateral. While creative, this argument, too, misses the point. Although the Debtors acknowledge that a complete shut-in of all of their wells could yield potentially damaging results when attempting to bring those wells back online, there is a material level of shut-ins and decreased production (far in excess of where the Debtors are operating today) that could occur without damaging the integrity of the assets. *See* Page Decl. at 11. Perhaps more importantly, as a result of the potential risks attendant to shutting in all wells, the Debtors believe that they must maintain some level of operations and as a result, will necessarily decrease the finite resources comprising the Prepetition Collateral during the pendency of these cases. *See* Page Decl. at 16.

(ii) The Value of the Debtors' Hydrocarbon Assets is Contingent on Commodities Prices.

19. Even if the Debtors were able and determined to fully shut-in all of their wells, the Prepetition Collateral remains at risk of diminution in value due to the fluctuation of natural gas prices. As set forth more fully in the Hanson Declaration, future natural gas prices are unknown, subject to significant volatility and can be unpredictable, even from one trading session to the next depending on factors such as general supply, weather patterns, gas available in storage and transportation constraints, among others. *See* Hanson Decl. at 11. As demonstrated by Exhibit A to the Hanson Declaration, although current prices are very low, they have not yet reached the historical low point. *See* Hanson Decl., Exh. A. Further, unfavorable

economic and political developments, natural disasters, and an unseasonably warm and late winter for much of North America have caused, and continue to cause, commodity prices to fall precipitously. *See* Hanson Decl. at 12. Accordingly, the value of the Debtors' Barnett Shale assets—one of the Debtors' core natural gas production and development areas and the substantial majority of the Prepetition Collateral—is at risk of diminution due to the daily production of the finite natural gas reserves and unknowable, unpredictable volatility in the fluctuation of natural gas prices. *See* Hanson Decl. at 13.

B. The Agreed Adequate Protection Obligations will Materially Benefit the Debtors' Estates.

20. In addition to obtaining necessary access to the Prepetition Collateral, including Cash Collateral, through the negotiated use of such collateral and the proposed Adequate Protection Package for the Prepetition Secured Parties, the Debtors secured substantial additional benefits for their estates. Specifically, as set forth more fully below, the Adequate Protection Package:

- avoids costly litigation attendant to (i) the valuation of replacement liens, (ii) the issue of whether the Prepetition Secured Parties have a lien on the Unencumbered Cash, and (iii) the Prepetition Secured Parties' potential foreclosure on the Prepetition Collateral, which litigation at this stage of the chapter 11 cases could not only result in significant expense and delay, but would likely distract key members of the Debtors' team and, with respect to foreclosure, if successful, could jeopardize the Debtors' restructuring in *toto*. *See* LaGatta Decl. at 12-13.

- was part of the consideration for the Canadian Forbearance, the entry into which allowed the Debtors to avoid the costs and uncertainty attendant to a restructuring proceeding for QRCI and its subsidiaries under the Companies' Creditors Arrangement Act. *See* LaGatta Decl. at 9-10.

- avoids the (x) cost and time associated with any litigation regarding whether the Company is required to segregate under applicable law and (y) material operational and financial implications attendant to segregation. *See* LaGatta Decl. at 14.

Accordingly, for all of the foregoing reasons and those set forth further herein, the Debtors' determination to provide the Prepetition Secured Parties with the Adequate Protection Package to

protect against the diminution in value of the Prepetition Collateral and in exchange for consent to use Cash Collateral is a sound exercise of the Debtors' business judgment and thus the Committee's Objection should be overruled.

C. The Adequate Protection Payments are Appropriate.

21. The Committee objects to the cash payments (the "Adequate Protection Payments") to the Second Lien Parties as adequate protection, arguing that replacement liens on the Unencumbered Property and Prepetition Collateral and superpriority 507(b) claims "are more than sufficient to protect the Prepetition Secured Parties." Obj. at 18. The Committee's argument, however, ignores the risk of diminution in value of the Prepetition Collateral described above and the uncertain value of the Unencumbered Property on which the replacement liens are proposed to be granted.

22. Although the Committee would have the Court (and all parties in interest) subscribe to the view that the Unencumbered Property is worth "hundreds of millions of dollars," Obj. at 18, with the exception of the Unencumbered Cash, the actual value of such assets is simply uncertain at this time. *See*, *generally*, the Declarations. As such, the Debtors determined that the Adequate Protection Payments were necessary to ensure that the Prepetition Secured Parties are adequately protected and to avoid litigation with respect to the value of the replacement liens on the Unencumbered Property. Specifically,

- the value of the Intercompany Note is subject to potential recharacterization as an equity contribution from QRI to QRCI (65% of which equity is already pledged to the U.S. Lenders and the Second Lien Parties) and, if it is not recharacterized, the Intercompany Note is subject to potentially material unsecured claims against QRCI, including any claims owed to KKR in connection with the Fortune Creek Partnership and any claims owed to a third party in connection with the gathering and processing contract; *see* LaGatta Declaration at 6-8;
- the value of the West Texas assets is speculative given that the play is in its exploratory phases and significant continuous development or lease

renewal costs will be incurred to maintain the acreage in West Texas; *see* Page Declaration at 5-7; and

- the value of the Barnett Shale is materially impacted by the volatility and fluctuation of natural gas prices; Hanson Declaration at 9-12.

23. Any litigation with respect to the value of the replacement liens (as with litigation attendant to any lien asserted by the Prepetition Secured Parties on the Unencumbered Cash or any attempt by the Prepetition Secured Parties to foreclose on the Prepetition Collateral) would be lengthy and expensive and would distract the Debtors and their employees from managing their operations as well as a prompt and effective restructuring. *See* LaGatta Decl. at 12-13.

24. The Debtors are presently attempting to manage vendor, supplier, and operational issues following the commencement of these chapter 11 cases and meet all requirements associated with these chapter 11 cases while also seeking to develop a longer-term business plan and advance negotiations with significant contract counterparties that are critical to the Debtors' overall restructuring. *See* LaGatta Decl. at 12. Many of the Debtors' employees who are integral to the foregoing efforts also likely would be critical to any litigation with respect to a dispute regarding the valuation of the replacement liens on the Unencumbered Property or whether the Prepetition Secured Parties have a lien on the Unencumbered Cash. *See id.* As a result, any such litigation could materially delay the Debtors' advancement in key restructuring projects as well as potentially impact operations. *See id.* Further, avoiding litigation at this time affords the Debtors the opportunity to attempt to negotiate a consensual path to exit from these chapter 11 cases with all of their constituencies that may obviate the need for the litigation in its entirety. *See id*.

25. The Committee further contends that the payments to be made to the Second Lien Parties (collectively, the "Second Lien Adequate Protection Payments") violate Bankruptcy Code section 506(b) and as such, should not be approved. *See* Obj. at 27-29. The Committee's

logic, however, is flawed. The Debtors are not seeking to pay the Second Lien Parties as oversecured creditors pursuant to section 506(b) of the Bankruptcy Code. Instead, payment of the Second Lien Parties' professional fees and expenses and cash adequate protection payments (the calculation of which is consistent with an interest calculation) was one of a number of components of the Adequate Protection Package that the Debtors negotiated and believed was reasonable under the circumstances. As a result, the Committee's reliance on the Supreme Court's opinion in *Timbers* in objecting to the Adequate Protection Payments to the Second Lien Parties is misplaced. *See* Obj. at 27-29 (citing *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365 (1988) for the proposition that Bankruptcy Code section 506(b) prohibits interest payments to undersecured creditors).

26. The Supreme Court in *Timbers* discussed secured creditors' entitlement to post-petition interest payments under Bankruptcy Code section 506(b), which is unrelated to adequate protection. 484 U.S. at 372. Instead, the Second Lien Adequate Protection Payments are meant to be a proxy for diminution in value, not interest on the Second Lien Parties' secured claims, and are subject to recharacterization as principal payments if it is determined that such payments exceed the amount of any diminution in value of the Prepetition Collateral and, if the Second Lien Parties are in fact undersecured. *See* Final Order at 17. The Debtors do not believe it is necessary or appropriate to litigate the value of the Second Lien Parties' claims through the Cash Collateral Motion and the recharacterization provision in the Final Order obviates the need to do so. Indeed, for all of the reasons stated above, the Debtors negotiated for consensual use of Cash Collateral and all other Prepetition Collateral to, among other things, avoid just such a fight in this early stage of their chapter 11 cases.

27. Courts in this District have regularly ordered the payment of non-default rate interest as a proxy for diminution in value to pre-petition undersecured creditors in other recent chapter 11 cases. *See*, *e.g.*, *In re Dex One Corp.*, No. 13-10533 (KG) (Bankr. D. Del. April 10, 2013) (providing adequate protection payments in the form of monthly interest at the non-default rate set forth in the pre-petition documents); *In re NewPage Corp.*, No. 11-12804 (KG) (Bankr. D. Del. Oct. 4, 2011) [D.I. 310] (same); *In re Nebraska Book Co., Inc.*, No. 11-12005 (PJW) (Bankr. D. Del. July 7, 2011) [D.I. 195] (same); *In re Stallion Oilfield Servs. Ltd.*, No. 09-13562 (BLS) (Bankr. D. Del. Nov. 18, 2009) [D.I. 173] (same); *In re Masonite Corp.*, No. 09-10844 (PJW) (Bankr. D. Del. Apr. 14, 2009) [D.I. 170] (same).

28. Courts in this District also routinely grant payment of professional fees and expenses as adequate protection. *In re Entgra Power Group LLC, et al.*, No. 14-11859 (PJW) (Bankr. D. Del. Sept. 3, 2014) [D.I. 106]; *In re Source Home Entertainment, LLC*, No. 14-11553 (KG) (Bankr D. Del. July 22, 2014) [D.I. 162]; *In re Gate House Media, Inc.*, No. 13-12503 (MFW) (Bankr D. Del. Oct. 23, 2013) [D.I. 101]; *In re Otelco Inc., et al.*, No. 13-10593 (MFW) (Bankr. D. Del. Apr. 18, 2013) [D.I. 109]; *In re NewPage Corp. et al.*, No. 11-12804 (KG) (Bankr. D. Del. Oct. 4, 2011) [D.I. 310]; *In re NextMedia Group, Inc., et al.*, No. 09-14463 (PJW) (Bankr. D. Del. Jan. 22, 2010) [D.I. 118 & 119].

29. Accordingly, for all of the foregoing reasons, the Committee's objection to the proposed Adequate Protection Payments should be overruled.

D. The Debtors' Proposed Waivers of Bankruptcy Code Sections 506(c) and 552 are Appropriate Under the Circumstances.

30. The Committee objects to the inclusion of waivers under Bankruptcy Code sections 506(c) and 552(b) in the Adequate Protection Package asserting that replacement liens and Bankruptcy Code section 507(b) claims granted in favor of the Prepetition Secured Parties

should be sufficient and that, in view of the fact that the Debtors' need to use Unencumbered Cash to fund post-petition operations (including operation of the assets comprising Prepetition Collateral), such waivers would grant a windfall to the Prepetition Secured Parties. For all of the reasons discussed above, and as further set forth in the Declarations, the Debtors determined that replacement liens and Bankruptcy Code section 507(b) claims on the Unencumbered Property were potentially insufficient to protect against the risk of diminution in value of the Prepetition Collateral.

31. Further, the Committee's assertions that the Debtors intend to use "substantial Unencumbered Cash that will be used to satisfy their capital requirements for the Prepetition Secured Parties' benefit" reflects a material misunderstanding of the Debtors' capital plan. Indeed, the Debtors' capital plan as approved by their board of directors in March 2015 (the "Capital Plan") reveals that a substantial majority of the Debtors' capital expenditures in 2015 inure to the benefit of the Unencumbered Property, namely the West Texas assets and the unencumbered portion of the Barnett Shale. *See* LaGatta Decl. at 15. Specifically, the Debtors' capital plan contemplates significant expenditures for development of new assets in West Texas and for drilling and completion of the Debtors' Robbins wells and completion of Texas Motor Speedway wells within the Barnett shale assets. *See id.* The West Texas assets constitute Unencumbered Property and both the Robbins and Texas Motor Speedway wells are associated in part or in full with leases comprising part of the unencumbered Barnett Shale. *See id.*

32. Accordingly, although some Unencumbered Cash may be used to operate the assets comprising Prepetition Collateral, as discussed above and in the Declarations, such operation will in fact deplete the Prepetition Collateral and the substantial majority of the Debtors' capital expenditures are intended to benefit the Unencumbered Property. Further, the

Debtors expect that the Unencumbered Cash will also be required, in addition to Cash Collateral to fund the administrative cost of these chapter 11 cases. As such, and for the reasons set forth below, the Debtors submit that the Committee's Objection to the grant of waivers under Bankruptcy Code sections 506(c) and 552(b) should be overruled.

(i) The Bankruptcy Code Section 506(c) Waiver Should Be Approved.

33. The Committee argues that the Debtors' waiver of surcharge rights under Bankruptcy Code section 506(c) is inappropriate and should be preserved for the benefit of the Debtors' unsecured creditors. The Committee's argument fails, however, because the right to assert a surcharge claim under section 506(c) belongs exclusively to the Debtors, and the Debtors have reasonably exercised their business judgment in agreeing to include a section 506(c) waiver in the Adequate Protection Package.

34. Section 506(c) provides, "***the trustee*** 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." 11 U.S.C. § 506(c) (emphasis added). Thus, as a threshold matter, the right to use Bankruptcy Code section 506(c) to recover the costs of preserving or disposing of a secured creditor's collateral is limited to a trustee or debtor in possession. *See Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1 (2000) (only a trustee or debtor in possession may invoke the surcharge provisions of section 506(c)). The Supreme Court in *Hartford Underwriters* expressly held, "[t]he question thus becomes whether it is a proper inference that the trustee is the only party empowered to invoke the provision [section 506(c)]. We have little difficulty answering yes." *Id.* at 6; *see also In re Debbie Reynolds Hotel & Casino, Inc.*, 255 F.3d 1061, 1066 (9th Cir. 2001) ("Because [creditor] was not the trustee (or the debtor-in-possession) it could not seek a §

506(c) surcharge."); *In re Concord Mktg., Inc.*, 268 B.R. 415, 428-29 (Bankr. D.N.J. 2001) (applying *Hartford Underwriters* and holding that neither the debtors' professionals, nor the committee's professionals, had independent or derivative standing to assert a claim under 506(c)); *In re Suntastic USA, Inc.*, 269 B.R. 846, 849 (Bankr. D. Ariz. 2001) (applying *Debbie Reynolds* and holding that "even where the trustee has no economic incentive to pursue recovery under 506(c), nobody else may pursue surcharge—period.").

35. Pursuant to *Hartford Underwriters*, only the Debtors may invoke the surcharge provisions of section 506(c). Thus, it follows that the Debtors' waiver of that right in exchange for the myriad material benefits they will receive under the Final Order and as part of the consensual negotiation with respect to Cash Collateral usage and the provision of adequate protection is well within their business judgment. *See supra*. Additionally, in view of the potential diminution in value of the Prepetition Collateral, the decision to agree to a section 506(c) waiver is well within Debtors' sound business judgment and should be approved. *See supra*.

36. Not only is the waiver a valid exercise of Debtors' business judgment, section 506(c) waivers are common, particularly where, as here, a secured lender has agreed to permit the use of its cash collateral to fund post-petition expenses on a current basis and to subordinate its liens and claims to a post-default "carve-out." Indeed, courts in this District routinely approve section 506(c) waivers, particularly when coupled with a professional fee carve-out. *See*, *e.g.*, *In re Source Home Entm't, LLC*, No. 14-11553 (KG) (Bankr. D. Del. July 22, 2014) [D.I. 162]; *In re Tuscany Int'l Holdings (U.S.A.) Ltd*., No. 14-10193 (KG) (Bankr. D. Del. Mar. 21, 2014) [D.I. 219]; *In re EWGS Intermediary, LLC*, No. 13-12876 (MFW) (Bankr. D. Del. Apr. 29, 2014) [D.I. 89, 371]; *In re Pallet Co. LLC*, No. 13-11459 (KG) (Bankr. D. Del. July 1,

2013) [D.I. 225]; *In re Conexant Sys., Inc*., No. 13-10367 (MFW) (Bankr. D. Del. Apr. 19, 2013) [D.I. 203]; *In re Vertis Holdings, Inc*., No. 12-12821 (CSS) (Bankr. D. Del. Nov. 27, 2012) [D.I. 203]; *In re Dallas Stars L.P.*, No. 11-12935 (PJW) (Bankr. D. Del. Oct. 17, 2011) [D.I. 121]; *In re NewPage Corp*., No. 11-12804 (KG) (Bankr. D. Del. Oct. 5, 2011) [D.I. 310]; *In re The Penn Traffic Co*., No. 09-14078 (PJW) (Bankr. D. Del. Jan. 25, 2010) [D.I. 460].

37. Moreover, the Committee misstates the law in this jurisdiction in asserting that courts in this District have "uniformly refused" to enforce section 506(c) waivers when an official committee of unsecured creditors objects. *See* Obj. at 25. Indeed, in numerous cases, waivers of Bankruptcy Code section 506(c) have been granted over an objection by an official committee of unsecured creditors. *See* Hr'g Tr. at 172-173, *In re Orchard Supply Hardware Stores Corp., et al.*, No. 13-11565 (CSS) (Bankr. D. Del. July 15, 2013) [D.I. 244] (overruling committee's objections and including a section 506(c) waiver in final cash collateral order); Hr'g Tr. at 72-73, 90-92, *In re NewPage Corp.*, No. 11-12804 (KG) (Bankr. D. Del. Oct. 4, 2011) (overruling committee's objections and including a section 506(c) waiver in final cash collateral order, reasoning, in part, that "the first and second lien holders have negotiated and received consideration for their permitting the DIP loan to proceed and I think that's entitled to great weight and I don't think that absent very unusual circumstances or extraordinary circumstances that a court should, sort of, break up that bargain and I think that's significant"); *In re Badanco Acquisition LLC, et al.*, No. 09-11638 (CSS) (Bankr. D. Del. June 3, 2009) (overruling committee's objections and including a section 506(c) waiver in final cash collateral order; certificate of counsel indicated that all objections were overruled). Accordingly, and for all of the foregoing reasons, the Committee's objection with respect to the Debtors' grant of the waiver of Bankruptcy Code section 506(c) should be overruled.

(ii) The Section 552(b) Waiver Should Be Approved

38. In the Committee's judgment, the Debtors' waiver of the "equities of the case" exception under Bankruptcy Code section 552 is "particularly egregious" and should not be approved. The Committee's argument ignores the realities of this case, including the finite and depleting nature of the Prepetition Collateral and Debtors' need to utilize Cash Collateral in addition to Unencumbered Cash to continue operations.

39. Bankruptcy Code section 552 provides that, "prepetition security interests extend to postpetition 'proceeds, product, offspring, or profits' of prepetition collateral, 'to the extent provided by such security agreement and by applicable nonbankruptcy law, *except to the extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise*.'" *In re Tower Air, Inc.*, 397 F.3d 191, 205 (3d Cir. 2005) (citing 11 U.S.C. § 552(b)(1)) (emphasis added). The "equities of the case" exception in Bankruptcy Code section 552(b) is primarily intended to prevent a debtor's secured creditors from reaping any disproportionate windfall of the debtor's use of other unencumbered assets of its estate to increase the value of the secured lender's collateral. *See generally In re Tower Air, Inc.,* 397 F.3d at 205 ("[T]he normal application of the equity exception is in chapter 11 cases, to prevent an oversecured lender from receiving a windfall by taking assets that would otherwise go to rehabilitating the debtor."); *see also In re J. Catton Farms, Inc.,* 779 F.2d 1242, 1246 (7th Cir. 1985) ("The equit[ies] exception is meant for the case where the trustee or debtor in possession uses other assets of the bankrupt estate (assets that would otherwise go to the general creditors) to increase the value of the collateral.") (citations omitted).

40. Here, there has been no showing that the Prepetition Secured Parties are (a) oversecured or (b) will obtain a windfall by an increased value of their collateral as a result of the

Debtors using assets that otherwise would be available to unsecured creditors. In fact, the opposite is true. As discussed above, the primary Prepetition Collateral (i.e., the Debtors' hydrocarbon assets) is, by its nature, a finite and depleting resource. The Debtors' continued operation of their business will necessarily result in a decrease in the Prepetition Collateral and a limited capacity to replace such assets. *See supra*; *see also* Page Decl. at 16. The Committee's argument that Unencumbered Cash will be used to preserve the Prepetition Collateral or generate post-petition revenue therefrom ignores the fact that at current pricing the proceeds generated from the Debtors' extraction of hydrocarbons are minimal, and continued operations require use of Cash Collateral and Unencumbered Cash, *see* First Day Decl. at 56-57, and only by all of the foregoing can the Debtors preserve value of their estates in an effort to maximize value for the benefit of all of their stakeholders.

41. Further, in cases where secured parties have agreed to subordinate their claims to a carve-out, as the Prepetition Secured Parties have done in these chapter 11 cases, courts in this District routinely have approved waivers of the "equities of the case" exception as part of consensual adequate protection packages. *See*, *e.g.*, *In re EWGS Intermediary, LLC*, No. 13-12876 (MFW) (Bankr. D. Del. Apr. 29, 2014) [D.I. 89, 371]; *In re Noble Logistics, Inc.*, No. 14-10442 (CSS) (Bankr. D. Del. Apr. 2, 2014) [D.I. 117]; *In re Orchard Supply Hardware Stores Corp.*, No. 13-11565 (CSS) (Bankr. D. Del. July 19, 2013) [D.I. 253]; *In re Coda Holdings, Inc.*, No. 13-11153 (CSS) (Bankr. D. Del. May 29, 2013) [D.I. 187]; *In re SP Newsprint Holdings LLC*, No. 11-13649 (CSS) (Bankr. D. Del. Jan. 25, 2012) [D.I. 388]; *In re Evergreen Solar, Inc.*, No. 11-12590 (MFW) (Bankr. D. Del. Sept 8, 2011) [D.I. 171]; *In re Urban Brands, Inc.*, No. 10-13005 (KJC) (Bankr. D. Del. Oct. 13, 2010) [D.I. 188]; *In re Visteon Corp.*, No. 09-11786 (CSS) (Bankr. D. Del. Nov. 12, 2009) [D.I. 1311].

42. Accordingly, under the facts and circumstances of these chapter 11 cases, the Debtors' decision to grant a waiver of the Bankruptcy Code section 552 "equities of the case" exception is a reasonable exercise of their business judgment. This waiver represents a reasonable "quid pro quo" for consent to use the Prepetition Collateral and the Prepetition Secured Parties' agreement to subordinate their claims to a carve-out, and the Committee's objection to such waiver should be overruled.

E. Adequate Protection Liens on Avoidance Actions are Appropriate under the Facts and Circumstances of these Cases.

43. The Committee argues that adequate protection liens on the proceeds of Avoidance Actions are inappropriate because the Prepetition Secured Parties are already protected through the grant of replacement liens on encumbered property and Bankruptcy Code section 507(b) claims. The Committee's arguments on this point are similarly misguided.

44. The proceeds of avoidance actions are the property of a debtor's estate pursuant to Bankruptcy Code section 541(a)(3). Thus, as with all other property of the estate, proceeds of avoidance actions may be pledged to secure the claims of secured creditors, including adequate protection claims. Providing adequate protection liens on previously unencumbered assets, like the proceeds of Avoidance Actions, are a customary form of adequate protection that is specifically contemplated by section 361(2) of the Bankruptcy Code. 11 U.S.C. § 361(2) ("such adequate protection may be provided by . . . (2) providing . . . ***an additional*** or replacement lien . . . .") (emphasis added).

45. Here, the Debtors exercised their sound business judgment during the arm's-length negotiations with the Prepetition Secured Parties and determined that it was appropriate to include liens on proceeds of Avoidance Actions in the Adequate Protection Package. As explained above and in the Declarations, the Adequate Protection Package provides material

benefits to the Debtors' estates, including access to Cash Collateral and all other Prepetition Collateral, while also avoiding the significant time and expense of litigation on numerous issues including the impracticalities attendant to segregation. *See* Reply, *supra*.

46. The Debtors' sound exercise of their business judgment is consistent with a number of other cases from this jurisdiction where the court approved the inclusion of liens on proceeds of avoidance actions as part of an adequate protection package. *See, e.g., In re EWGS Intermediary, LLC*, No. 13-12876 (MFW) (Bankr D. Del. Apr. 29, 2014) [D.I. 371]; *In re Noble Logistics, Inc.*, No. 14-10442 (CSS) (Bankr. D. Del. Apr. 2, 2014) [D.I. 117]; *In re Coda Holdings, Inc.*, No. 13-11153 (CSS) (Bankr. D. Del. May 29, 2013) [D.I. 187]; *In re Caribe Media, Inc.*, No. 11-11387 (KG) (Bankr. D. Del. May 24, 2011) [D.I. 78]. Accordingly, the Committee's objection should be overruled and the lien on proceeds from Avoidance Actions should be approved.

F. The Definition of "Adequate Protection Obligations" in the Final Order is Appropriate.

47. The Committee also asserts that the definition of "Adequate Protection Obligations" in the proposed Final Order is overly broad and requests that the language specifically track that of Bankruptcy Code section 507(b). *See* Obj. at 30. In so doing, the Committee relies on a series of unsubstantiated *Collier on Bankruptcy* treatise quotations to argue that a creditor is entitled to claims under Bankruptcy Code section 507(b) only to the extent that diminution in value is caused by the trustee's use of the collateral. The Committee's argument would seemingly foreclose the portion of the definition that references diminution resulting from "other decline in value" such as declining market prices of hydrocarbon commodities. *See* Final Order at 8.

48. Most courts to consider the issue, however, have found that Bankruptcy Code section 507(b) applies to "any proven, actual loss in a situation where adequate protection fails." *In re California Devices, Inc.*, 126 B.R. 82, 85, n.4 (analyzing *In re Becker*, 51 B.R. 975 (D. Minn. 1985) and citing *In re Blehm Land & Cattle Co*., 859 F.2d 137, 140–41 (10th Cir. 1988) for the statement that *Becker* is the majority view). Even courts that do not subscribe to this view have found that a superpriority claim for unforeseeable events such as market collapse (i.e., "any other decline in value") is appropriate. *See In re Cheatham*, 91 B.R. 382, 386, 388 (E.D.N.C. 1988) ("Additionally, if the loss is the result of a sudden and swift change in market forces, then the creditor's loss would also qualify for superpriority status."); *In re Callister*, 15 B.R. 521, 533 (Bankr. D. Utah 1981) *aff'd sub nom. Ingersol-Rand Fin. Corp. v. Callister*, No. 82-2249, 1984 WL 249787 (10th Cir. Apr. 16, 1984) (noting that "the property at stake and its susceptibility to market forces are factors to be considered in determining adequate protection," but finding that the creditor was entitled to superpriority status for loss due to market forces that were not readily foreseeable by the creditor).

49. In addition, courts in this District have previously recognized that a change in value of the pre-petition senior collateral can be included in the definition of "diminution in value" for purpose of granting adequate protection in the form of replacement liens and superpriority claims. *See In re KLCG Prop., LLC*, No. 09-14418, 2010 WL 5093146, at *11-12 (Bankr. D. Del. Jan. 28, 2010) (slip copy) (including change in market value in the definition of "Diminution in Value" and expressly ordering that the secured lender could pursue a section 507(b) claim related to the same). Accordingly, the Debtors submit that the definition of Adequate Protection Obligations is within the scope of applicable case law and request that the Committee's objection be overruled.

II. THE PROPOSED INVESTIGATION PERIOD COMPLIES WITH THE LOCAL RULES AND IS CONSISTENT WITH OTHER CASES IN THE JURISDICTION.

50. The Committee asserts that the period proposed by the Debtors to investigate the Prepetition Secured Parties' liens and claims—60 days after formation—is "woefully inadequate" Obj. at 35 and requests, in a footnote, that the Committee be granted automatic standing. This argument and the Committee's standing request must fail because the proposed investigation period is consistent with the Local Rules and is reasonable in light of the Debtors' diligent conduct in these proceedings.

51. As the Committee acknowledges, the challenge period set forth in the Final Order is consistent with the benchmark set forth in the Local Rules. *See* Local Rule 4001-2(a)(i)(B) ("Provisions or findings of fact that bind the estate or other parties in interest with respect to the validity, perfection or amount of the secured creditor's pre-petition lien or the waiver of claims against the secured creditor without first giving parties in interest at least seventy-five (75) days from the entry of the order and the creditors' committee, if formed, at least sixty (60) days from the date of its formation to investigate such matters."); *see also* Obj. at 36. Further, nothing in the Final Order precludes the Committee from seeking an extension of the challenge period for cause shown. Moreover, the standard set forth in Local Rule 4001-2(a)(i)(B) is not qualified by a requirement that a Committee be granted automatic standing and as such, the Committee's request with respect thereto need not be approved.

52. Further, the proposed investigation period is justified due to the Debtors' considerable diligence in ensuring that the Committee immediately had access to the information it needed to conducts its investigation. Indeed, as soon as the Committee was formed and its professionals had executed confidentiality agreements, the Debtors provided access to an electronic data room that included a comprehensive folder of the same diligence materials used

by the Debtors during their own investigation of the Prepetition Secured Parties' liens and security interests.

53. Additionally, courts in this jurisdiction routinely approve investigation periods of 60-75 days, further revealing the Committee's request to double the proposed investigation period to 120 days as unreasonable, unnecessary and inconsistent with practice in this District. *See*, *e.g.*, *In re Radio Shack Corp., et al.*, No. 15-10197 (BLS) (Bankr. D. Del. Mar. 12, 2015) [D.I. 947] (approving a challenge period of 60 days following the appointment of a creditors committee in a case involving more than $1 billion in debt); *In re Longview Power, LLC et al.*, No. 13-12211 (BLS) (Bankr. D. Del. Nov. 21, 2013) [D.I. 504] (approving a challenge period of 75 days following entry of the interim order in a case involving more than $1 billion in debt); *In re The Standard Register Company, et al.*, No. 15-10541 (BLS) (Bankr. D. Del. Apr. 16, 2015) (approving a challenge period of 75 days following the petition date) [D.I. 290]; *In re Allied Nevada Gold Corp., et al.*, No. 15-10503 (MFW) (Bankr. D. Del. Apr. 17, 2015) [D.I. 218] (approving a challenge period of 75 days following the appointment of the creditors committee); *In re Trump Entm't Resorts, Inc., et al.*, No. 14-12103 (KG) (Bankr. D. Del. Oct. 23, 2014) [D.I. 342] (approving a challenge period of 60 days following the appointment of the creditors committee); *In re Optim Energy, LLC et al.*, No. 14-10262 (BLS) (Bankr. D. Del. Mar. 6, 2014) [D.I. 144] (approving a challenge period 60 days following the appointment of the creditors committee).

54. Accordingly, and in view of the Debtors' compliance with the Local Rules and their diligence in providing materials to the Committee, the Debtors submit that the 60 day challenge period is appropriate and warranted in these cases and the Committee's request to double the time period to 120 days should be denied.

III. APPLICATION OF HEDGE TERMINATION PROCEEDS TO REPAY OBLIGATIONS UNDER THE COMBINED CREDIT AGREEMENTS IS A REASONABLE EXERCISE OF THE DEBTORS' BUSINESS JUDGMENT.

55. The Committee objects to entry of a final order approving the use of hedge termination proceeds to pay down obligations under the Combined Credit Agreements and instead asks that such an order be withheld for a period of six months "so that the parties can use that time to obtain a clearer picture of the Debtors' ultimate reorganization strategy." *See* Obj. at 40. The post-petition use of hedge termination proceeds to pay down the Debtors' obligations under the Combined Credit Agreements is a reasonable exercise of their business judgment and the Committee's request should be denied.

56. As more fully set forth in the LaGatta Declaration, before the Petition Date, QRI and its non-Debtor Canadian subsidiary, QRCI had certain hedge agreements (the "Hedges") in place with various counterparties (the "Hedge Counterparties"), all but two of whom are current lenders under the Combined Credit Agreements. *See* LaGatta Decl. at 17. The Debtors believe that the Prepetition Secured Parties have a validly perfected security interest in the proceeds (including any early termination payments arising thereunder) of the QRI Hedges and that the lenders under the Canadian Credit Agreement have a validly perfected security interest in the proceeds (including any early termination payments arising thereunder) of the QRCI Hedges. *See id.* Given the commodity price environment during the first quarter of 2015 and to date, the Hedges were a net benefit to the Debtors and any early termination of such Hedges would, and subsequently did, result in amounts owed to the Debtors. *See id.* As the Hedge Counterparties became aware of the potential commencement of these chapter 11 cases, many of them indicated, either directly or indirectly, that if the Debtors were to file chapter 11, they intended to terminate the Hedges immediately post-petition. *See id.*

57. As part of the negotiations with the Prepetition Secured Parties in connection with consensual use of Cash Collateral and the Adequate Protection Package, the Debtors determined to consent to the inclusion of language in the Interim and Final Orders to facilitate (to the extent necessary) the repayment of debt outstanding under the Combined Credit Agreements (the "First Lien Debt"). *See id.* at 19. The reasons for this were several-fold. First, facilitating the repayment of debt from the Hedge proceeds ensured that the Debtors were not subject to the "worst-case" scenario in which Hedge Counterparties terminated their Hedges post-petition and, if the Debtors did not consent to a repayment of the First Lien Debt, such Hedge Counterparties may have chosen to hold the Hedge proceeds and not pay them to the Debtors, pending a motion to lift the stay to allow for the setoff of such proceeds against pre-petition obligations. *See id.* This circumstance would result in the Debtors no longer having the benefit of the Hedges, continuing to accrue interest on the First Lien Debt, and being forced to initiate litigation to access the Hedge proceeds. *See id.* Second, the repayment of the First Lien Debt from the Hedge proceeds reduced the amount of interest accruing on the First Lien Debt. *See id.* Third, facilitating repayment of the First Lien Debt from Hedge proceeds was part of the negotiation of the Adequate Protection Package in exchange for the consensual use of Cash Collateral and, given the potential benefits to the Debtors of certainty and reduction of interest, was a concession to which the Debtors were willing to agree. *See id.* Finally, agreeing to facilitate the repayment of the First Lien Debt also helped the Debtors secure the Canadian Forbearance. *See id.*

58. Finally, in view of the fact that the Bankruptcy Code provides a safe harbor provision that would enable the Hedge Counterparties that are lenders under the Combined Credit Agreements to set off the Hedge proceeds against their outstanding debt under the Combined Credit Agreement (subject to the terms of the applicable intercreditor agreement), the

Debtors viewed the inclusion of language permitting the lifting of the automatic stay to facilitate repayment of the First Lien Debt as included in an abundance of caution and consistent with the law.

59. Accordingly, and for all of the foregoing reasons, the Debtors submit that the application of Hedge proceeds to the obligations under the Combined Credit Agreements is a reasonable exercise of their business judgment and that the Committee's request to withhold a final ruling with respect thereto for six months should be denied.

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CONCLUSION

WHEREFORE, for all of the foregoing reasons, the Debtors respectfully request that the Court (i) overrule the Objection, (ii) grant the relief requested in the Cash Collateral Motion on a final basis, and (iii) grant such other relief as may be just and proper.

Wilmington, Delaware

Date: April 22, 2015

/s/ Amanda R. Steele

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