IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF MISSISSIPPI
SOUTHERN DIVISION

IN RE:

MISSISSIPPI PHOSPHATES CORPORATION, et al.

CASE NO. 14-51667-KMS
(Chapter 11)

Debtors

LIMITED OBJECTION OF HYDROVAC INDUSTRIAL SERVICES, INC. TO DEBTOR'S MOTION FOR INTERIM AND FINAL ORDERS PURSUANT TO SECTIONS 105, 361, 362, 363, 364 AND 507 OF THE BANKRUPTCY CODE AND FEDERAL RULES OF BANKRUPTCY PROCEDURE 2002, 4001 AND 9014 (I) AUTHORIZING THE DEBTORS TO INCUR POST-PETITION SENIOR SECURED SUPERPRIORITY INDEBTEDNESS; (II) AUTHORIZING USE OF CASH COLLATERAL; (III) GRANTING POST-PETITION PRIMING AND SENIOR PRIORITY SECURITY INTERESTS AND SUPERPRIORITY CLAIMS; (IV) GRANTING ADEQUATE PROTECTION; (V) MODIFYING THE AUTOMATIC STAY; AND (VI) SCHEDULING A FINAL HEARING ON THE MOTION [DKT. NO. 14]

Creditor Hydrovac Industrial Services, Inc. ("Hydrovac") files this Limited Objection to the Debtor's *Motion for Interim and Final Orders Pursuant to Sections 105, 361, 362, 363, 364 and 507 of the Bankruptcy Code and Federal Rules of Bankruptcy Procedure 2002, 4001 and 9014 (I) Authorizing the Debtors to Incur Post-Petition Senior Secured Superpriority Indebtedness; (II) Authorizing Use of Cash Collateral; (III) Granting Post-Petition Priming and Senior Priority Security Interests and Superpriority Claims; (IV) Granting Adequate Protection; (V) Modifying the Automatic Stay; and (VI) Scheduling a Final Hearing on the Motion* [Dkt. No. 14] (the "DIP Motion"). In support, Hydrovac would state as follows:

1. Debtor Mississippi Phosphates Corporation (the "Debtor") filed its petition for relief under Chapter 11 of Title 11 (the "Bankruptcy Code") on October 27, 2014 (the "Petition Date"). That same day, the Debtor filed the Motion, seeking authority to incur post-petition secured financing and granting certain post-petition priming and superpriority liens. An

Unsecured Creditors Committee was appointed on the date of this objection. The Debtors have not filed their schedules or statement of financial affairs.[1]

2. On October 29, 2014, the Court entered its *Interim Order Under Sections 105, 361, 362, 363, 364 and 507 of the Bankruptcy Code and Federal Rules of Bankruptcy Procedure 2002, 4001 and 9014 (I) Authorizing the Debtors to Incur Post-Petition Senior Secured Superpriority Indebtedness; (II) Authorizing Use of Cash Collateral; (III) Granting Post-Petition Priming and Senior Priority Security Interests and Superpriority Claims; (IV) Granting Adequate Protection; (V) Modifying the Automatic Stay; and (VI) Scheduling a Final Hearing on the Motion*. Dkt. No. 66. The Final Hearing on the Final Order is scheduled for November 18, 2014.

3. On November 10, 2014, the Debtor filed its *[Proposed]Final Order Under Sections 105, 361, 362, 363, 364 and 507 of the Bankruptcy Code and Federal Rules of Bankruptcy Procedure 2002, 4001 and 9014 (I) Authorizing the Debtors to Incur Post-Petition Senior Secured Superpriority Indebtedness; (II) Authorizing Use of Cash Collateral; (III) Granting Post-Petition Priming and Senior Priority Security Interests and Superpriority Claims; (IV) Granting Adequate Protection; and (V) Modifying the Automatic Stay.* Dkt. No. 143 (the "Proposed Final Order").

4. Hydrovac is a creditor of the Debtor listed on the Debtor's *List of Twenty Largest Unsecured Creditors*. Dkt. No. 2, and as amended, Dkt. No. 46. Hydrovac objects to the entry of the Proposed Final Order to the extent that the Final Order: a) grants the Debtor in Possession Lender a lien, security interest or superpriority claim to any avoidance actions of the Debtor or proceeds thereof; b) grants the Debtor in Possession Lender a lien, security interest or

[1] Presently the Debtors are not required to file their schedules or statement of financial affairs until December 10, 2014. *See Order Granting Motion to Extend Deadline to File Schedules or Provide Required Information*, Dkt. No. 139.

superpriority claim that may affect any setoff or recoupment rights of unsecured creditors; and c) approves a budget which prevents meaningful representation of the unsecured creditors committee.

I. The Final Order Should Expressly Exclude Avoidance Actions as Being Subject to any DIP Lender Security Interest.

5. The Debtor's Motion and the Interim Order proposed granting the DIP Lender a first-priority perfected security interest in avoidance actions and proceeds therefrom. *See Motion,* Dkt. No. 14, at 6; Interim Order, Dkt. 66 at 9. The Debtor's Proposed Final Order submitted November 10, 2014 [Dkt. 143] purports to remove the term "avoidance actions" from the illustrative list of assets of the Debtor and the estate to which DIP Liens would attach. However, this list is prefaced by the statement "includ[ed], without limitation." The Proposed Final Order goes on to list three specific interests that are expressly not subject to the DIP Liens, but this list of exclusions does not include avoidance actions or proceeds therefrom. The Debtor's deletion of "avoidance actions" from the non-exclusive list of proposed encumbered estate assets and interests does not preclude by order any later efforts to encumber or lay claim to proceeds which should benefit the estate and unsecured creditors, not the DIP Lender. Thus, the Court should require that avoidance actions be included in the list of those interests expressly not subject to the DIP Liens.

6. Under no circumstances should avoidance actions or proceeds therefrom be subject to the DIP Liens or other priority rights granted to the DIP Lender. Avoidance actions are statutorily created powers that allow the debtor to recover property for the benefit of creditors. The Fifth Circuit has noted that proceeds recovered in avoidance actions should not benefit the reorganized debtor; rather, the proceeds should benefit the unsecured creditors. *See Matter of Tex. Gen. Petroleum Corp.,* 52 F.3d 1330 (5th Cir. 1995) (court concluded that the

proceeds from the fraudulent conveyance action belonged to the Liquidating Trust which acted for the benefit of the unsecured creditors). Further, numerous courts have approved interim/final orders that excluded DIP liens on avoidance actions. *See In re Tal-Port Indus. LLC.*, 2008 WL 5997995 (Bankr. S.D. Miss.) (Judge Neil Olack ordered that security for DIP financing does not include any avoidance actions and any proceeds therefrom); *Official Comm. of Unsecured Creditors v. Goold Elecs. Corp. (In re Goold Elecs. Corp.)*, 1993 WL 408366 (N.D. Ill.) (finding bankruptcy court order approving post-petition financing invalid "to the extent that the order assigns to the bank a security interest in the debtor's preference actions"); *In re Integrated Testing Prods. Corp.*, 69 B.R. 901 (D.N.J. 1987) (holding that prepetition secured creditor was not entitled to proceeds of sale of collateral recovered as preference because to allow the secured creditor to "claim these preferences would frustrate the policy of equal treatment of creditors under the Code.").

7. Courts consistently recognize that the avoidance actions are rights held by the estate for the benefit of all creditors. *See Official Comm. of Unsecured Creditors of Cybergenics Corp. ex rel. Cybergenics Corp v. Chinery (In re Cybergenics Corp.)*, 226 F.3d 237, 243-44 (3d Cir. 2000) (avoidance actions are rights held by the estate for the benefit of all creditors); *In re Sweetwater*, 55 B.R. 724, 735 (D. Utah 1985) (avoiding powers are meant to benefit creditors generally and promote equitable distribution among all creditors). The Congressional intent of allowing a trustee or debtor-in-possession to avoid preferential payments is not to take that money and give it to a post-petition lender, but to provide for a more equitable distribution of the debtors' assets among unsecured creditors. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 177-78 (1977) (Bankruptcy law permits avoidance of preferences for two purposes: to discourage creditors "from racing to the courthouse to dismember the debtor during his slide into

bankruptcy," and in order to "facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor. Any creditor that received a greater payment than others of his class is required to disgorge so that all may share equally.'). Failing to expressly exclude the proceeds of avoidance actions from the DIP Liens could result in unsecured creditors – the intended beneficiaries of the avoidance actions – to receive little if any recovery.

8. Accordingly, the Court should modify the Final Order to expressly exclude avoidance actions from the proposed DIP Liens.

II. The Final Order Should Expressly Exclude from the DIP Lender's Liens and Security Interests Any Interests that May Affect Setoff or Recoupment Rights of All Creditors

9. Also included in the list of estate assets proposed to be encumbered by the DIP Liens are "all rights to payment," "all causes of actions," and related assets and interests. The Final Proposed Order expressly excludes from the Collateral subject to the DIP Liens "any rights of setoff or recoupment of Interoceanic Corporation ("IOC")" as defined in the Order. [Dkt. No. 143 at 10-11]. Hydrovac does not object to IOC's rights of setoff or recoupment being expressly excepted from the DIP Liens, as it would not be proper to subject such rights to the DIP Liens in any respect. However, by expressly excluding one creditor's right of setoff or recoupment, if any, from the DIP Liens, by implication the Order subjects all other creditors' rights of setoff or recoupment, if any, to the DIP Liens. Encumbering another creditors' right of setoff or recoupment protected under 11 U.S.C. § 553 is improper and should not be authorized. Thus, the Final Order should expressly exclude any liens or interests that may affect any right of setoff or recoupment of all creditors.

10. The express language of Bankruptcy Code Section 553(a) provides, in pertinent part, that "except as otherwise provided in this section and in sections 362 and 363 of this title,

this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case." 11 U.S.C. § 553(a). Thus, the plain language of the Bankruptcy Code provides that a creditor's setoff rights, if any, cannot be affected by an order approving post-petition financing under Section 364, or by any other provision of the Code other than Sections 362 and 363.

11. Mississippi Bankruptcy Courts have recognized the protection afforded a creditor's setoff rights under Section 553, holding that only Sections 362 and 363 affect a creditor's right of setoff. In *In re England Motor Company*, 426 B.R. 178 (Bankr. N.D. Miss. 2010), the Trustee contended that its hypothetical judgment lien creditor status under Section 544 could prime a creditor's setoff rights in deposit accounts. Judge Olack disagreed, and held that "once established, and except for those exceptions enumerated in Section 553, *[a creditor's] setoff is not subject to challenge by any other provision of the Bankruptcy Code*, including Section 544." *In re England Motor Company*, 426 B.R. at 194; *see also In re Morgan*, 77 B.R. 81 (Bankr. S.D. Miss. 1987) (except for specific exceptions enumerated in section 553, setoff rights shall not be denied by another code section where the debts are mutual and have come into existence before the commencement of the case).

12. The Proposed Final Order proposes creating priming liens on all estate assets, including without limitation "all rights to payment" and "all causes of actions" pursuant to Section 364(d), but excluding "any rights of setoff or recoupment of Interoceanic Corporation ("IOC")." As shown above, this is improper because Section 553 preserves every creditors' setoff rights against all rights provided in the Bankruptcy Code, subject only to Sections 553, 362 and 363. If Congress had intended to subject setoff rights to priming liens of DIP lenders, it

would have included Section 364(d) among those exceptions expressly identified in Section 553. Accordingly, this Court's Final Order should exclude all rights of setoff and/or recoupment of all creditors from any liens or security interests granted to the DIP Lenders.

III. The DIP Loan / Cash Collateral Budget Prevents Meaningful Representation of the Unsecured Creditors Committee

13. The United States Trustee appointed an unsecured creditors committee pursuant to Bankruptcy Code Section 1102 (the "Committee") at 1:27 p.m. on November 12, 2014, consisting of seven members. No organizational meeting of the Committee has been held, and the Committee has yet to evaluate retention of counsel or a financial advisor for the Committee. The budget proposed by the Debtor and DIP Lender, however, is inadequate and will hinder the effectiveness of the Committee in representing the interests of unsecured creditors. Specifically, the budget appears to allocate $142,000.00 for "Creditor Costs" (presumably for Committee counsel and advisors), while allocating $1,745,500.00 for "Debtor Costs – Legal and other Services." The Committee should have an opportunity to organize, select counsel and address the Committee's anticipated expense with the Court prior to the approval of a final budget.

VI. Other Grounds

14. Hydrovac reserves the right to assert other and additional grounds at the hearing on Debtor's Motion.

ACCORDINGLY, Hydrovac Industrial Services, Inc. requests that the Final Order be modified to include the modifications set out herein, and to hold in abeyance the approval of a final budget pending the Committee retaining counsel. Hydrovac Industrial Services, Inc. requests such other relief as the Court may deem just and proper.

DATED: November 12, 2014.

Respectfully submitted,

HYDROVAC INDUSTRIAL SERVICES, INC.

By: */s/ James A. McCullough, II*
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CERTIFICATE OF SERVICE

I hereby certify that I have this day filed the foregoing document via the Court's ECF System, which served a copy on all counsel of record, including:

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