UNITED STATES BANKRUPTCY COURT
DISTRICT OF KANSAS

In re:	**)**	**In Proceedings Under Chapter 11**
	)	
GATEWAY ETHANOL, L.L.C.,	**)**	**Case No. 08-22579-DLS**
	)	
Debtor.	**)**	

OBJECTION OF NOBLE AMERICAS CORP. TO DEBTOR'S MOTION FOR ORDER PURSUANT TO 11 U.S.C. §§ 105(a), 363 AND 365 (1) APPROVING AUCTION AND BID PROCEDURES; (2) APPROVING REIMBURSEMENT EXPENSE; (3) APPROVING FORM AND MANNER OF NOTICE; (4) AUTHORIZING SALE OF ASSETS FREE AND CLEAR OF LIENS, CLAIMS AND ENCUMBRANCES, SUBJECT TO HIGHER OR BETTER OFFERS; AND (5) APPROVING ASSUMPTION AND ASSIGNMENT OF CERTAIN EXECUTORY CONTRACTS AND UNEXPIRED LEASES

Noble Americas Corp., a creditor that holds both secured and unsecured claims in the above-captioned bankruptcy case ("Noble"), by and through its undersigned legal counsel, hereby respectfully submits this Objection to the Debtor's Motion for Order Pursuant to 11 U.S.C. §§ 105(a), 363 and 365 (1) Approving Auction and Bid Procedures; (2) Approving Reimbursement Expense; (3) Approving form and Manner of Notice; (4) Authorizing Sale of Assets Free and Clear of Liens, Claims and Encumbrances, Subject to Higher or Better Offers; and (5) Approving Assumption and Assignment of Certain Executory Contracts and Unexpired Leases filed with the Court on an expedited basis on October 24, 2008 (the "Sale Procedures Motion") and, in connection therewith, represents as follows:

BACKGROUND

A. General.

1. The Chapter 11 debtor, Gateway Ethanol, L.L.C. (the "Debtor"), was formed to construct and operate a facility located in Pratt, Kansas to produce denatured, anhydrous ethanol alcohol and other products (the "Ethanol Plant"). The construction of the Ethanol Plant has not

been fully completed to date due to, among other things, substantial and persisting disputes that the Debtor has had with its contractor, Lurgi, PSI, Inc. ("Lurgi"). The Ethanol Plant "is currently not operating, but remains lightly staffed pending a contemplated sale of the plant" in connection with the Debtor's Chapter 11 bankruptcy filing. See Affidavit of Frederick Loomis, dated Oct. 3, 2008, at 3, attached to Debtor's DIP Financing Motion, dated on or about October 8, 2008. In other words, the Ethanol Plant has been moth-balled for about 7 months and, as explained by the Debtor, is not currently functioning.

2. Further, the Debtor has been embroiled in disputes with its prepetition plant lender and proposed DIP lender, Dougherty Funding LLC ("Dougherty"). Dougherty commenced a foreclosure action under non-bankruptcy law seeking to promptly recover and liquidate its collateral, which precipitated the Chapter 11 bankruptcy.

3. Prior to the instant bankruptcy filing, but subsequent to the Debtor's prepetition financing arrangements with Dougherty, the Debtor commenced litigation against Lurgi in multiple state court proceedings (collectively, the "Lurgi Litigation") seeking to recover substantial damages (the "Lurgi Claims") arising out of claims against Lurgi for, among other things, delayed construction of the Ethanol Plant, construction defects, breach of fiduciary duty, tortious interference with contract and business expectancy, slander of title and other related relief—some or all of which are commercial tort claims not covered by Dougherty's prepetition liens. The Lurgi Litigation remains currently pending and the damages arising out of the Lurgi Claims represent substantial claims and, together with other causes of action, constitute available assets of the bankruptcy estate to the extent not previously encumbered. Creditors may also have independent claims against Lurgi.

4. Noble is one of the largest, if not the largest, unsecured creditor in this bankruptcy case. Indeed, Noble's unsecured claim, which arises from various financing, credit and lease arrangements with the Debtor, is likely to exceed $11.7 million. Noble is also owed sums under its secured credit facility.

5. In addition to the liens that Noble has on certain collateral that appears to be subject to the Sale Procedures Motion, the Ethanol Plant is also encumbered by various mortgages, liens and encumbrances of other parties as briefly outlined in the papers that have been filed by the Debtor with the Court.

B. <u>The Chapter 11 Bankruptcy Case</u>.

6. The Debtor commenced the above-referenced Chapter 11 bankruptcy proceeding on October 5, 2008 (the "Petition Date") and, on an expedited basis, sought approval of a new debtor-in-possession financing arrangement with Dougherty for the express purpose of bridging to a credit bid sale transaction (the "DIP Financing Motion"). The sale transaction as engineered and compelled by the DIP financing will be tantamount to a federal foreclosure action in the event Dougherty prevails in credit bidding its allowed claim. Noble interposed a number of objections and voiced significant concerns about the contemplated postpetition financing arrangement and the direction of the bankruptcy case that will be dictated by the financing (the "Objections"). Those Objections remain outstanding.

7. The Debtor has not filed its bankruptcy schedules as of yet and no committee of creditors has been appointed. The first meeting of creditors is currently scheduled for November 10, 2008. In light of the forgoing, the United States Trustee, creditors and other parties in interest have had virtually no ability at this point to conduct more than a minimal level of inquiry

into the value of assets, claims and other matters that impact the fundamental fairness of the transactions contemplated by the Sale Procedures Motion.

STANDARDS

8. This Chapter 11 bankruptcy case has been filed for the express purpose of consummating the immediate liquidation of the Debtor. The Debtor's Sale Procedures Motion seeks authority to establish bidding procedures to liquidate *all* of the assets of the Debtor free and clear of all liens, claims and interests in what has been set up to be a loan-to-own credit bid transaction. Even previously unencumbered assets of the bankruptcy estate, such as commercial tort claims and avoidance actions, are now expected to be subject to the sale.

9. The sale of the Ethanol Plant, has been structured to meet, as Debtor's counsel characterized it, the "tight timelines for the contemplated Section 363 process" dictated by the DIP Financing Documents. See Sale Procedures Motion, ¶ 24, at 7. As currently planned, the sale will be concluded in little more than 45 days with the "Purchaser" acquiring all assets of the bankruptcy estate free and clear of existing liens and interests. Thereupon, the Chapter 11 case almost certainly will be promptly converted to a no-asset Chapter 7 case.

10. The fundamental purpose of Chapter 11 is to provide a collective proceeding for rehabilitating the debtor for the benefit of all of its creditors. See Pioneer Investment Servs. Co. v. Brunswick Assocs. Ltd. Partnership, 507 U.S. 380, 389 (1993) ("Whereas the aim of a Chapter 7 liquidation is the prompt closure and distribution of the debtor's estate, Chapter 11 provides for reorganization with the aim of rehabilitating the debtor and avoiding forfeitures by creditors."). Chapter 11 was further intended to govern situations where the potential for a meaningful recovery exists for unsecured creditors. See, e.g., In re Fremont Battery Co., 73 B.R. 277 (Bankr. N.D. Ohio 1987). This is clear from the text and structure of the Bankruptcy Code itself.

See, e.g., 11 U.S.C. § 1125 (disclosure statement); § 1126 (voting); § 1129 (best interests of creditors test).

11. A bankruptcy court has the authority to approve proposed sales outside of the ordinary course of business under § 363(b) of the Code upon appropriate notice and hearing; however, the burden is on the *debtor* to establish that the transaction is "fair and equitable," supported by sound business justification and in the best interests of the estate. See In re Phoenix Steel Corp., 82 B.R. 334 (Bankr. D. Del. 1987); WBQ Partnership v. Commonwealth of Virginia Dep't of Medical Assistance Servs., 189 B.R. 97 (Bankr. E.D. Va. 1995). Bankruptcy sales under § 363 must be scrutinized closely by the court in cases where all, or substantially all, of the assets of a Chapter 11 debtor are being liquidated due to the dangers associated with providing "the functional equivalent of an order confirming a conventional chapter 11 reorganization plan" without the protections inherent in the confirmation process. Western Auto Supply Co. v. Savage Arms, Inc. (In re Savage Indus., Inc.), 43 F.3d 714, 720 n.9 (1st Cir. 1994) (special bankruptcy scrutiny warranted in liquidations under Chapter 11). Indeed, a particularly weighty burden should be placed on the debtor where the proposed transaction is a credit bid transaction sponsored by a DIP lender who is armed with an advantage in all aspects of the bidding process and sale. See In re Moonraker Assocs., Ltd., 200 B.R. 950 (Bankr. N.D. Ga. 1996) (noting the problems and chilling effect that a credit bid transaction can have on a sale). The sale, in order to enjoy the significant benefits that bankruptcy confers, must be demonstrably more than the functional equivalent of a *fata compli* foreclosure sale conducted at the expense of the estate and general creditors.

12. Courts have refused to approve § 363 sales where the predominant business justification for the sale is the appeasement of a major creditor and no distribution to unsecured

creditors is likely to be produced from the sale. See Committee of Equity Security Holders v. Lionel Corporation (In re Lionel Corporation), 722 F.2d 1063 (2d Cir. 1983). See, e.g., In re Encor Healthcare Assocs., 312 B.R. 52 (Bankr. E.D. Pa. 2004) (refusing to approve sale at issue in Chapter 11 *sua sponte* since sale would benefit only the secured creditor); In re Fremont Battery Co., 73 B.R. 277, 279 (Bankr. N.D. Ohio 1987) (proposed sale of substantially all assets to satisfy claim of a single creditor not approved under § 363(b)). See generally, Van Huffel v. Harkelrode, 284 U.S. 225 (1931); In re Riverside Inv. Partnership, 674 F.2d 634 (7th Cir. 1982)(Bankruptcy Act case law opining that bankruptcy courts should not order sales of property free and clear of liens unless the sale proceeds will fully compensate secured lienholders and produce some equity for the general creditors).

OBJECTIONS

The following constitute the objections of Noble to the Sale Procedures Motion, Bidding Procedures and Proposed Order:

A. Noble's Interests in Collateral Are Not Adequately Protected.

13. As outlined in Noble's Objections to the DIP Financing Motion, Noble has a first priority security interest in certain items of Collateral, including all cash collateral, to secure existing indebtedness that remains outstanding and is not adequately protected. 11 U.S.C. §§ 361, 363. Section 363(c)(4) of the Bankruptcy Code requires the debtor in possession to segregate and account for any cash collateral in the its care, custody or control. Section 363(e) provides that any time, on request of an entity with an interest in property that is proposed to be sold, the court shall prohibit or condition such sale as is necessary to provide adequate protection. In the proposed Asset Purchase Agreement (the "APA"), the Purchaser (as defined in the APA) is acquiring, among other things, all "cash." Noble objects to the extent that the

Debtor has not turned over cash collateral in its possession to Noble or provided adequate protection with respect to its interest therein under the APA and otherwise. In addition, Noble has a priority security interest in all rights in the Commodity Account and the Deposit Account (as defined in the Noble credit agreements). The APA should at a minimum be modified to exclude any interest in such accounts from the APA or otherwise adequately protect Noble's interest therein.

B. "Purchaser" Protection/Expense Reimbursement Is Not Appropriate.

14. In connection with the DIP Financing Motion, Dougherty, as DIP lender, seeks the following compensation: (1) Origination Fee in the amount of $104,856; and (b) $215,000 in 'estimated' legal fees, all of which are intended to be priority secured obligations under the DIP. Now, as part of the proposed APA, Dougherty, as "Buyer" or "Purchaser," seeks an expense reimbursement of $250,000 in order to be "induced" to credit bid its debt and recover the collateral in this Chapter 11 proceeding (the "Expense Reimbursement"). These amounts are to be accorded "superpriority administrative expense claim" status under the Sale Procedures Motion "senior to all other administrative expense claims." The Expense Reimbursement and related priority are simply inappropriate in the event a bid beyond the credit bid is not realized and to the extent it is in addition to the fees already included in the DIP. The bankruptcy estate and its general creditors should not be forced to bear the burden of sale and recovery costs on collateral in a Chapter 11 bankruptcy proceeding.

C. Compelling Showing of Benefit to the "Estate" Is Necessary Predicate.

15. The credit bid transaction contemplated in this Chapter 11 case is an all asset liquidation of an Ethanol Plant that is not currently operating. The Debtor and its creditors are subject to an expedited § 363 sale process dictated by the DIP financing arrangement. As noted

above, it is incumbent upon the Debtor to satisfy a heightened standard of scrutiny under the circumstances in order ensure that the purposes and protections intended to be afforded creditors in Chapter 11 are not unfairly manipulated or usurped. Indeed, a compelling justification should be present where, as here, absolutely no discernable economic benefit to the estate's general creditors is apparent from the contemplated credit bid transaction.

D. Unencumbered Assets Should Not Be Part of Any (Foreclosure) Sale.

16. The DIP lender is the primary beneficiary of the DIP financing and the credit bid sale. The vast majority of the administrative expenses that are expected to arise in this case and set forth in the Budget submitted in connection with the pending DIP Financing Motion are directly attributable to collateral preservation costs and professional fees. Indeed, the Budget that forms the basis for the DIP loan reflects, among other things, that: (a) a substantial portion of labor costs are attributable to employees that provide 24/7 security services for the Ethanol Plant; (b) professional fees and loan costs of $1,154,856 comprise 22% of the financing; and (c) the substantial real property tax payment set forth in the Budget of $3,272,930 comprises 64% of the financing (the payment of which produces substantial tax rebates running in favor of Dougherty or the Purchaser under the APA that are not reflected in the Budget) will not even arise until a post-closing period (unless advanced as a prepayment by the lender under the DIP financing documents "in its sole discretion")—it will, upon closing, become an obligation of the Purchaser. Little, if any, of the fees, costs and expenses in the Budget are attributable to sustaining the operations of the debtor-in-possession or benefiting the bankruptcy estate.

17. The value of commercial tort claims and other causes of action, including the Lurgi Claims and Avoidance Actions, that are presently assets of the bankruptcy estate should, under the circumstances, be preserved for the benefit of the estate's general unsecured creditors

to the extent such assets are not subject to Dougherty's preexisting liens. The liens of the DIP lender should be confined to its state law collateral. Fundamental fairness in this case dictates that unencumbered assets should not be subject to the sale (or any priming or administrative priority under §§ 364 and 503) unless a commensurate economic benefit to the estate's general unsecured creditors is obtained from the sale process. Otherwise, this case is nothing more than a federal foreclosure action.

E. Schedule of Other Excluded Assets Is Too Narrow.

18. The APA and/or Schedule 1.2(c) should be amended to make clear that any railcars owned by a third-party and located on or about the Premises, if any, including railcars made available to the Debtor by Noble or any other party are also Excluded Assets.

F. The Bid Procedures Should Be Modified to Increase Transparency.

19. The Auction and Bid Procedures, if approved at all, should be modified to, at a minimum, allow counsel for Noble access to information, such as a review of the bids and expressions of interest and other relevant information relating to the Auction and sale process, upon reasonable request, in order to foster a more transparent review of the sale process. Noble's legal counsel should be permitted the same access to the process and information as currently afforded a creditors' committee under the Bid Procedures.

G. Proposed Court Order Should Be Modified.

20. To the extent the Court approves the Sale Procedures Motion, the Proposed Order should be modified to reflect the objections set forth herein. Specifically, paragraphs 4, 5 and 12 (proposed provisions allowing the Expense Reimbursement) should be deleted in their entirety. The last sentence of Paragraph 3 and the first sentence of Paragraph 9 (provisions approving sale) are more appropriately reserved for an order approving a sale, rather than a sale *procedures*

order. Subsection (vi) of Paragraph 16, requiring objectors to produce "all evidence" in support of any objection is overbroad and should be stricken. Similarly, there is no compelling justification for relief from the operation of the 10-day period imposed by Bankruptcy Rules 6004(h) and 6006(d) in the event that Dougherty is successful in the credit bid of its allowed claim under § 363(k).

Reservation of Rights

Noble hereby reserves the right to supplement this objection and raise additional objections to the terms of any sale and advance them fully in connection with any sale motion seeking final approval.

For the foregoing reasons, and subject to satisfactorily addressing Noble's objections, the Debtor's Sale Procedures Motion should be in all things DENIED.

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