

IN THE UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

FILED
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U.S. BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
COLUMBUS, OHIO

In re:

In Proceedings Under Chapter 11

JOHNSON RUBBER COMPANY, INC. et al., Case No.: 07-19391

Debtors.

JUDGE RANDOLPH BAXTER

MEMORANDUM OF OPINION AND ORDER

Johnson Rubber Company and its parent holding company, J.R. Holding Corporation, a Delaware corporation, (the “Debtors”), seek authorization to enter into a postpetition financing agreement with J.P. Morgan Chase Bank pursuant to § 364(c)(3) of the Bankruptcy Code. *11 U.S.C. § 364(c)(3)*. Objections to such relief were filed by the Official Committee of Unsecured Creditors and by the CIT Group / Business Credit, Inc. (“CIT”)¹. A consortium of automotive manufacturers inclusive of Toyota Motor Engineering and Manufacturing North America, Inc., Honda of America Manufacturing, Inc., DTR Industries, Inc. and DTR Tennessee, Inc., and Ford Motor Company, along with J.P. Morgan Chase Bank, filed briefs in support of the requested postpetition financing.

This Court acquires core matter jurisdiction over this matter pursuant to 28 U.S.C. §§ 157(a), (b)(1), (b)(2), 28 U.S.C. § 1334 and General Order No. 84 of the District.

Upon conclusion of a duly noticed evidentiary hearing, the following findings of fact and conclusions of law are hereby rendered.

¹The objection filed by the Official Committee of Unsecured Creditors was withdrawn verbally at the commencement of the evidentiary hearing, leaving CIT as the sole objectant.

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Co-Debtor Johnson Rubber Company, Inc. is a provider of engineered polymer products to the automotive, road and bridge, casket and recreational marine industries. It is a sole source, just-in-time supplier of its products to customers. Originally founded in 1895 under the name Udall-Shellito Company, through several name changes, product iterations, and changes in ownership, the present Debtors corporation was established as a Delaware corporation in December of 2005. Headquartered in Middlefield, Ohio, the Debtors operate a second manufacturing facility in North Baltimore, Ohio, with approximately 500 salaried and hourly employees. Reportedly, the Debtors generated \$60 million in sales in 2006. The Debtors manufacture products for passenger cars, light trucks, commercial trucks, vans and recreational vehicles and sells directly to original equipment manufacturers and first and second tier automotive suppliers.

Prepetition, on December 8, 2005, the newly formed Debtors financed its operational and capital expenditures through a financing facility with CIT. This facility provided the Debtors two term loans and a revolver loan. As of the bankruptcy filing date, the Debtors acknowledge an outstanding prepetition debt to CIT in the aggregate principal amount of approximately \$13 million, exclusive of accrued interest, fees, costs and certain expenses thereon. The Debtors further stipulate that such obligation constitutes a legally binding and enforceable obligation of the Debtors within the terms of the relevant loan documents.

During a prepetition audit of the Debtors' books and records on or about August 17, 2007, CIT determined that the Debtors' collateral base was significantly less than what was presented on the Debtors' borrowing base certificate. In response, the Debtors retained an outside financial consultant to commence an internal review of its financial records. The consultant not only

confirmed CIT's findings but discovered greater financial discrepancies. This occurrence led to the dismissal of the Debtors' Chief Financial Officer and an extension of the professional services of the financial consultant. Additionally, to avoid disruptions to its financing arrangement with CIT and production obligations to its automotive customers, the Debtors entered into certain forbearance, accommodation, and access agreements with CIT and the Automotive Customers (collectively, the "Customer Agreements"). These Customer Agreements, as extended, expired prepetition on December 10, 2007. The Debtors filed their petition for voluntary relief under Chapter 11 of the Bankruptcy Code on December 11, 2007.

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The issue before this Court is whether the Debtors have satisfied the required elements for postpetition financing under § 364(c) of the Bankruptcy Code.

Debtors seek to restructure their finances postpetition through the execution of a proposed lending agreement with J.P. Morgan Chase Bank. The present motion, pursuant to § 364(c) of the Bankruptcy Code, endeavors to extend such an arrangement previously approved by the Court on an emergency interim basis.

CIT opposes the requested relief solely on the basis that the subject financial agreement between Debtors and J.P. Morgan Chase Bank fails to provide CIT adequate protection on its superior lien position.

Postpetition financing is addressed under § 364 of the Bankruptcy Code. *11 U.S.C. § 364*.
11 U.S.C. § 364 provides:

§ 364. Obtaining credit

(a) If the trustee is authorized to operate the business of the debtor under section 721, 1108, 1203, 1204, or 1304 of this title [11 USCS § 721, 1108, 1203, 1204, or 1304], unless the court orders otherwise, the trustee may obtain unsecured credit and incur unsecured debt in the ordinary course of business allowable under section 503(b)(1) of this title [11 USCS § 503(b)(1)] as an administrative expense.

(b) The court, after notice and a hearing, may authorize the trustee to obtain unsecured credit or to incur unsecured debt other than under subsection (a) of this section, allowable under section 503(b)(1) of this title [11 USCS § 503(b)(1)] as an administrative expense.

(c) If the trustee is unable to obtain unsecured credit allowable under section 503(b)(1) of this title [11 USCS § 503(b)(1)] as an administrative expense, the court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt--

(1) with priority over any or all administrative expenses of the kind specified in section 503(b) or 507(b) of this title [11 USCS § 503(b) or 507(b)];

(2) secured by a lien on property of the estate that is not otherwise subject to a lien; or

(3) secured by a junior lien on property of the estate that is subject to a lien.

(d) (1) The court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt secured by a senior or equal lien on property of the estate that is subject to a lien only if--

(A) the trustee is unable to obtain such credit otherwise; and

(B) there is adequate protection of the interest of the holder of the lien on the property of the estate on which such senior or equal lien is proposed to be granted.

(2) In any hearing under this subsection, the trustee has the burden of proof on the issue of adequate protection.

Id.

As noted, subsections (a) and (b) authorize a court to approve a request for postpetition financing on an unsecured basis, if obtainable. The burden of proof, in each instance is reposed in

the movant to show, by a preponderance of the evidence, that reasonable efforts have been expended by the movant to obtain financing on an unsecured basis. The Code, however, does not require such a demonstration of unsecured financing where circumstances reasonably dictate that such efforts would be to no avail. Subsections (c) and (d) both allow the court to approve postpetition financing on a secured basis and in a manner which would be most protective of the debtor's bankruptcy estate. Ascendingly, the movant must demonstrate to the Court's satisfaction that lesser protective measures of the estate's property is unavailing. That is, a credit extension on an unsecured basis is not available under subsections (a) and (b), and the only way that the debtor can restructure its financing is by offering the postpetition lender a collateralized interest in estate property.

Herein, the testimony of the Debtors' Chief Executive Officer and Chief Financial / Chief Restructuring Officer was credible. Both came into the Debtors' employ in 2005 after the Debtors were spun from Duratech. At that time, the books and records were "in shambles". (CFO Welch, Direct Examination). This comment was unrefuted by any testimony or other evidence to the contrary. Currently, the Debtors are pursuing the accomplishment of a distress sale, with the Debtors displaying a negative EBITDA². Throughout these proceedings, CIT maintains that it is a fully secured creditor on the subject indebtedness, while the Debtors and the Committee of Unsecured Creditors assert that CIT is undersecured. The totality of these circumstances suffice to demonstrate persuasively that the likelihood of Debtors' pursuit of postpetition financing on an unsecured basis under § 364(a) and (b) would be fruitless.

At the close of the evidentiary hearing, Debtors' counsel argued that the Debtors were no longer pursuing postpetition financing under § 364(d) but, rather, were seeking such relief only under

² Earnings Before Interest, Taxes, Depreciation, and Amortization.

§ 364(c) of the Bankruptcy Code.

By comparison, these two subsections of § 364 provide:

(c) If the trustee is unable to obtain unsecured credit allowable under section 503(b)(1) of this title [11 USCS § 503(b)(1)] as an administrative expense, the court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt--

(1) with priority over any or all administrative expenses of the kind specified in section 503(b) or 507(b) of this title [11 USCS § 503(b) or 507(b)];

(2) secured by a lien on property of the estate that is not otherwise subject to a lien; or

(3) secured by a junior lien on property of the estate that is subject to a lien.

(d) (1) The court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt secured by a senior or equal lien on property of the estate that is subject to a lien only if--

(A) the trustee is unable to obtain such credit otherwise; and

(B) there is adequate protection of the interest of the holder of the lien on the property of the estate on which such senior or equal lien is proposed to be granted.

(2) In any hearing under this subsection, the trustee has the burden of proof on the issue of adequate protection.

Id.

Notably, § 364(d) provides expressly for a movant to provide adequate protection, *inter alia*, whereas § 364(c) contains no such requirement. Herein, CIT, a self-acknowledged fully secured lender, seeks adequate protection payments for the Debtors' continued use of the collateralized security interest which was negotiated between itself and the Debtors postpetition.

CIT Group, a prepetition secured lender, opposes the Debtors motion for final approval of a postpetition financing proposal negotiated between Debtors and J.P. Morgan Chase Bank. CIT argues that the subject financing arrangement fails to adequately protect its alleged superior lien position. As proposed, CIT would receive periodic payments of \$100,000.00 as adequate protection

payment for its collateral located at Debtors' two operating facilities. As support, CIT exhibits a prepetition Access Agreement and an Accommodation Agreement as guidance for its belief that an adequate protection payment of \$100,000.00 monthly is insufficient. It is unrefuted that the terms of both such agreements expired prepetition, with no enforceable obligations remaining on either document postpetition. Therein, CIT received periodic payments substantially greater than what is proposed in the present postpetition financing proposal.

Under the Bankruptcy Code, the term adequate protection is addressed under § 361 which provides:

When adequate protection is required under section 362, 363, or 364 of this title [11 USCS § 362, 363, or 364] of an interest of an entity in property, such adequate protection may be provided by--

- (1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title [11 USCS § 362], use, sale, or lease under section 363 of this title [11 USCS § 363], or any grant of a lien under section 364 of this title [11 USCS § 364] results in a decrease in the value of such entity's interest in such property;
- (2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or
- (3) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title [11 USCS § 503(b)(1)] as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

11 U.S.C. § 361.

The concept of adequate protection is derived from the Fifth Amendment to the U.S. Constitution and generally is offered to protect against diminution of a secured party's collateralized

interest. As noted by one court:

Th[e] statutory scheme [of section 361] indicates that adequate protection is intended to encompass a broad range of creditor interests and does not mandate an interpretation of the creditors' interest as the whole of the economic bargain...Although the concept of adequate protection is certainly intended to protect a creditor's interest in the collateral, it is clearly susceptible to differing applications over a wide range of fact situations.

In re Briggs Transp. Co., 780 F.2d 1339, 1345 (8th Cir. 1985)

Notwithstanding its earlier request for postpetition financing under § 364(d) of the Code, Debtors orally stated at the evidentiary hearing herein that they only seek such relief under § 364(c)(3) of the Code. Section 364(c)(3) allows for financing to be obtained on a secured basis postpetition, where unsecured credit is not obtainable. Such credit can be obtained by offering the proposed lender: 1) a superpriority administrative expense claim; 2) a lien on estate property which is not subject to a lien; or 3) a junior lien on estate property which is subject to a lien. Clearly, no adequate protection requirement is mandated under § 364(c)(3) of the Code.

CIT's quest for enhanced adequate protection payments is based upon its receipt of such payments under certain prepetition written agreements which expired prepetition. Once a bankruptcy petition is filed, however, a new legal entity is created as defined under § 541 of the Code. As such, CIT's reference to prepetition non-executory agreements simply have no bearing on this Court's determination of a need for adequate protection for CIT postpetition. This is particularly so where the evidence clearly reflects no meaningful diminution of CIT's collateral. (Debtors' Exhibits A, B, C and D; CEO Price, Direct Examination; and CFO Welch, Cross Examination). Herein, CIT holds a blanket lien on all of Debtors' prepetition assets, including patents, (Debtors' Exhibit F; CEO Price, Direct Examination); CIT requested the 2007 appraisals and modified Debtors' outstanding

loans, accordingly, *Id.*; all of the subject collateral is fully insured by Debtors; and all collateral is maintained as a budgeted item, in addition to the existence of an ongoing preventive maintenance program on the machinery and equipment. Additionally, no counter-appraisals were introduced into evidence by CIT to demonstrate a diminished value of its collateral.

Further, the undisputed testimony of CFO Welch reflects that, although insurance is in place on the subject collateral, there is no requirement for the Debtors to do so under any existing agreements with CIT. It is further uncontested that CIT is a named secured party on the insurance policies in force. (CFO Welch, Direct Examination; CIT Exhibits A, B, D-1, D-2, D-3, D-4 and D-5). Both operating facilities at Middlefield, Ohio and at North Baltimore, Ohio are fully insured by Debtors; no reduction has been applied to Debtors' maintenance budget; and monthly adequate protection payments to CIT by Debtors is in the amount of \$100,000.00. Further, the relative machinery and equipment appraised values on the 2005 and 2007 appraisal reports are virtually the same. It is further observed that, as of the petition filing date, interest owed by Debtors on the subject revolver loan is being defrayed at a rate of prime plus 2, while a higher fixed rate of interest applies to the two outstanding term loans the Debtors have with CIT. (CFO Welch, Cross Examination). The totality of these factors evince strongly that CIT is adequately protected postpetition on its secured interest. It is also uncontested that, as further security, CIT is entitled to receive replacement liens on its prepetition collateral. Upon consideration of the Debtors' financial status as set forth above, it is inconceivable that any lender would provide postpetition financing to them on an unsecured basis. Indeed, its proposed lender has declined to offer Debtors unsecured financing. The Official Committee of Unsecured Creditors, who generally suffer the brunt of losses in bankruptcy proceedings, is supportive of the relief sought herein. Its earlier filed objection was

withdrawn.

Accordingly, the Debtors' motion for postpetition financing under § 364 (c)(3) is hereby granted. The objection of CIT is hereby overruled. Each party is to bear its respective costs.

IT IS SO ORDERED.

Dated, this 5th day of
February 2008


JUDGE RANDOLPH BAXTER
UNITED STATES BANKRUPTCY COURT

IN THE UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
CLEVELAND

In re:

In Proceedings Under Chapter 11

JOHNSON RUBBER COMPANY, INC. *et al.*,

Case No.: 07-19391

Debtors.

JUDGE RANDOLPH BAXTER

JUDGMENT

At Cleveland, in said District, on this ____ day of February, 2008.

A Memorandum of Opinion and Order having been rendered by the Court in this matter, IT IS THEREFORE ORDERED, ADJUDGED AND DECREED that the Debtors' motion for postpetition financing under § 364 (c)(3) is hereby granted. The objection of CIT is hereby overruled. Each party is to bear its respective costs.

IT IS SO ORDERED.

Dated, this 6th day of
February 2008



JUDGE RANDOLPH BAXTER
UNITED STATES BANKRUPTCY COURT