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**Hearing Date: March 25, 2020 at 11:00 a.m.**

**UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF NEW YORK**

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*In re* : **Chapter 11**  
:   
THE McCLATCHY COMPANY, *et al.*, : **Case No. 20-10418 (MEW)**  
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Debtor. : **(Jointly Administered)**  
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**LIMITED OBJECTION OF THE UNITED STATES TRUSTEE TO THE DEBTORS’  
MOTION FOR ENTRY OF INTERIM AND FINAL ORDERS (I) AUTHORIZING THE  
DEBTORS TO OBTAIN POSTPETITION FINANCING, (II) AUTHORIZING THE  
DEBTORS TO USE CASH COLLATERAL, (III) GRANTING LIENS AND PROVIDING  
SUPERPRIORITY ADMINISTRATIVE EXPENSE STATUS, (IV) GRANTING  
ADEQUATE PROTECTION, (V) MODIFYING THE AUTOMATIC STAY, (VI)  
SCHEDULING A FINAL HEARING, AND (VII) GRANTING RELATED RELIEF**

TO: THE HONORABLE MICHAEL E. WILES,  
UNITED STATES BANKRUPTCY JUDGE:

William K. Harrington, the United States Trustee for Region 2 (the “**United States Trustee**”), by and through his undersigned counsel, hereby submits his limited objection (the “**Objection**”) to the *Debtors’ Motion for Entry of Interim and Final Orders (I) Authorizing the Debtors to Obtain Postpetition Financing, (II) Authorizing the Debtors to Use Cash Collateral, (III) Granting Liens and Providing Superpriority Administrative Expense Status, (IV) Granting Adequate Protection, (V) Modifying the Automatic Stay, (VI) Scheduling a Final Hearing, and (VII) Granting Related Relief* [ECF No. 11] (the “**Motion**”) filed by The McClatchy Company and



its affiliated debtors and debtors in possession (collectively, the “**Debtors**,” the “**Company**,” or “**McClatchy**”), seeking certain relief under title 11 of the United States Code (the “**Bankruptcy Code**”), the Federal Rules of Bankruptcy Procedure (the “**Bankruptcy Rules**”), and the Local Rules for the Southern District of New York (the “**Local Bankruptcy Rules**”).

### **PRELIMINARY STATEMENT**

The United States Trustee objects to the Motion to the extent the Debtors seek approval of the following provisions absent consent of the Committee (defined below):

- a. Broad releases for the Prepetition Secured Creditors<sup>1</sup> before the Committee has concluded its investigation of certain prepetition transactions;
- b. Milestones that unreasonably and unnecessarily compress the case;
- c. A waiver of the protections of section 506(c) of the Bankruptcy Code;
- d. Waivers of the protections of section 552(b) of the Bankruptcy Code and the equitable doctrine of marshalling;
- e. Liens on avoidance actions or the proceeds thereof; and
- f. An unduly limited challenge period and a minimal budget or carveout for professional fees related to investigations of prepetition transactions.

The United States Trustee understands that the Debtors, the Committee, and other parties are negotiating the terms of a final order allowing the Motion, which may ultimately address the concerns raised in this Objection. For the reasons set forth below, the United States Trustee respectfully requests that the Court deny those portions of the Motion identified in this Objection absent substantial modification in consultation with the Committee.

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<sup>1</sup> Capitalized terms not otherwise defined herein shall have the same meaning as set forth in the Motion.

## **BACKGROUND**

### **A. General Background**

1. On February 13, 2020 (the “**Petition Date**”), each Debtor commenced a case by filing a petition for relief under chapter 11 of the Bankruptcy Code (collectively, the “**Chapter 11 Cases**”). The Chapter 11 Cases are jointly administered.

2. The Debtors continue to operate their businesses and manage their properties as debtors and debtors in possession pursuant to Bankruptcy Code sections 1107(a) and 1108.

3. On the Petition Date, the Debtors filed the *Declaration of Sean M. Harding in Support of Chapter 11 Petitions and First Day Papers* [ECF No. 23] (the “**First Day Declaration**”).

4. On February 26, 2020, the United States Trustee appointed an official committee of unsecured creditors in the Chapter 11 Cases (the “**Committee**”). *See Notice of Appointment of Official Committee of Unsecured Creditors*. ECF No. 114.

### **B. The Motion**

5. On the Petition Date, the Debtors filed the Motion. ECF No. 11. Annexed to the Motion as Exhibit A is a proposed interim order (the “**Proposed Interim Order**”). There is no proposed final order annexed to the Motion.

6. Through the Motion, the Debtors seek approval of a DIP Facility with certain DIP Lenders, including Encina Business Credit, LLC (“**Encina**”), in the aggregate principal amount of \$50,000,000.

7. Additionally, through the Motion, the Debtors seek authority to use the cash collateral of the Prepetition Secured Lenders, which include Chatham Asset Management, LLC (together with its affiliates, “**Chatham**”).

8. The Proposed Interim Order includes certain stipulations by the Debtors (the “**Debtors’ Stipulations**”) as to the validity of the Prepetition Obligations and the Prepetition Liens. *See* Proposed Interim Order, § E. Additionally, under the Debtors’ Stipulations, the Debtors grant broad releases to the Prepetition Secured Parties. *Id.* The proposed order provides that the Debtors’ Stipulations will become valid and binding on, *inter alia*, all creditors of the Debtors, the Committee, and any trustee or fiduciary appointed in any of the Chapter 11 Cases or Successor Cases. *Id.*

9. Through the Motion, the Debtors seek approval of certain case milestones (the “**DIP Milestones**”). *See* Motion, Schedule 5.23 to Debtor-in-Possession Credit Agreement. The Milestones require the Debtors, on or before 60 days after the Petition Date, to provide written notice to Encina as to whether the Debtors are electing to pursue a chapter 11 plan or a sale of all or substantially all of the Debtors’ assets. Following this election, the Debtors are then subject to certain Plan Milestones or Sale Milestones. The Plan Milestones require the Debtors to obtain confirmation within 160 days of the Petition Date and to go effective within 180 days of the Petition Date. The Sale Milestones require the Debtors to obtain an order approving a sale transaction acceptable to Encina within 160 days of the Petition Date and to close the sale transaction within 170 days of the Petition Date.

10. Through the Motion, the Debtors seek approval of a waiver of section 506(c) of the Bankruptcy Code. Motion at 19; Proposed Interim Order at ¶ 34.

11. Through the Motion, the Debtors seek approval of a waiver of the “equities of the case” exception under section 552(b) of the Bankruptcy Code. Motion at 19; Proposed Interim Order at ¶ 36.

12. Through the Motion, the Debtors seek approval of a waiver of the equitable doctrine of marshalling or any other similar doctrine. Proposed Interim Order at ¶ 35.

13. Through the Motion, the Debtors seek to grant liens on avoidance actions and the proceeds thereof to the DIP Credit Parties. Motion at 19; Proposed Interim Order at ¶ 6.

14. The Court held a hearing on certain “first day motions” including the Motion on February 14, 2020 (the “**First Day Hearing**”).

15. Following the First Day Hearing, the Court entered the *Interim Order (I) Authorizing the Debtors to (A) Obtain Postpetition Financing and (B) Use Cash Collateral, (II) Granting (A) Liens and Providing Superpriority Administrative Expense Status and (B) Adequate Protection to Certain Prepetition Lenders, (III) Modifying the Automatic Stay, (IV) Scheduling a Final Hearing, and (V) Granting Related Relief* [ECF No. 64] (the “**Interim Order**”).

**C. Concerns Raised Regarding Prepetition Transactions**

16. On February 14, 2020, the Pension Benefit Guaranty Corporation (the “**PBGC**”) filed an objection to the Motion (the “**PBGC Objection**”). ECF No. 58. The PBGC Objection identified certain prepetition transactions between the Debtors and Chatham that purportedly “raise significant concerns of possible fraudulent transfer.” PBGC Objection at ¶ 1. The PBGC contended that the identified prepetition transactions “must be investigated before this Court enters an order releasing the parties to [the suspect prepetition transactions] and shielding [Chatham’s] claims from challenge . . .” *Id.* at ¶ 7.

17. On February 24, 2020, the Debtors filed an application to retain Togut, Segal & Segal LLP (the “**Togut Firm**”) as counsel (the “**Togut Firm Application**”). ECF No. 101. The Togut Firm Application provides that “the Togut Firm has [. . .] been tasked with conducting an investigation into the Company’s 2018 and 2019 refinancing transactions as they relate to affiliates of [Chatham] to determine if any such transactions give rise to potential avoidance claims under chapter 5 of the Bankruptcy Code.” Togut Firm Application at ¶ 15.

18. On March 3, 2020, the Committee filed an application pursuant to Bankruptcy Rule 2004 for an order authorizing the examination of the Debtors, Chatham, and Leon Cooperman (the “**2004 Application**”). ECF No. 132. In the 2004 Application, the Committee alleged that “[p]rior to the filing of [the Chapter 11 Cases], Chatham and the Debtors orchestrated a series of transactions designed to transfer near total ownership of the reorganized Debtors to Chatham free and clear of more than \$1 billion of unsecured claims.” 2004 Application at ¶ 1. The Committee further alleged that these transactions must be fully investigated by the Committee. *Id.*

### **OBJECTION**

In determining whether to approve post-petition financing, courts consider, among other things, whether the financing “is in the best interests of the estate and its creditors” and whether the terms of the transaction are “fair, reasonable, and adequate, given the circumstances of the debtor-borrower and the proposed lender.” *See In re Mid-State Raceway, Inc.*, 323 B.R. 40, 60 (Bankr. N.D.N.Y. 2005); *see also In re LA Dodgers LLC*, 457 B.R. 308, 312 (Bankr. D. Del. 2011) (citing *In re St. Mary Hosp.*, 86 B.R. 393, 401 (Bankr. E.D. Pa. 1987)).

A court will not approve a proposed financing “where it is apparent that the purpose of the financing is to benefit a creditor rather than the estate.” *In re Ames Dept. Stores, Inc.*, 115 B.R. 34,

39 (Bankr. S.D.N.Y. 1990); *see also In re Aqua Assocs.*, 123 B.R. 192, 195-98 (Bankr. E.D. Pa. 1991) (“[C]redit should not be approved when it is sought for the primary benefit of a party other than the debtor.”). Similarly, courts look with suspicion on financings that “would tilt the conduct of the bankruptcy case” or “prejudice, at an early stage, the powers and rights that the Bankruptcy Code confers for the benefit of all creditors.” *Ames Dept. Stores*, 115 B.R. at 37.

**A. The Court Should Not Prematurely Approve Releases of Chatham**

The Committee, the Debtors, and the PBGC have all highlighted the need for an investigation of certain prepetition transactions between the Debtors and certain of the Prepetition Secured Creditors including Chatham. However, through the Motion, the Debtors appear to be seeking approval of broad releases for the Prepetition Secured Creditors and stipulations as to the validity of the Prepetition Obligations and Prepetition Liens. *See* Proposed Interim Order, § E. The release provisions should not be approved, at least not until the Committee can complete its investigation of the prepetition transactions.

Moreover, as the Court pointed out during the First Day Hearing, the Prepetition Secured Creditors are merely entitled to adequate protection against diminution in the value of their collateral. Adequate protection may include: (1) cash payments to the extent the value of a secured creditor’s interest in collateral decreases; (2) replacement liens to the extent the value of a secured creditor’s interest in collateral decreases; or (3) such other relief as will result in the realization by the secured creditor of the indubitable equivalent of such entity’s interest in the collateral. *See* 11 U.S.C. § 361. As the Court explained to Chatham’s counsel at the First Day Hearing:

[. . .] to the extent you have a lien [. . .] you're entitled to adequate protection against [. . .] the possibility that the value of your lien declines. Freeing you from challenges to your liens, or from litigation that might seek to avoid your liens, isn't just protecting the value of your lien, it's enhancing your lien. It's potentially giving you a lien that you might not otherwise be entitled to. That's not adequate protection."

First Day Hearing Tr., 24:25-25:11, ECF No. 105.

Accordingly, the Court should not approve the requested releases, especially at this early stage of the case.

**B. The Court Should Not Approve the Proposed DIP Milestones Unless Materially Modified in Consultation with the Committee**

The DIP Milestones require the Debtors, on or before 60 days after the Petition Date, to provide written notice to Encina as to whether the Debtors are electing to pursue a chapter 11 plan or a sale of all or substantially all of the Debtors' assets. *See* Motion, Schedule 5.23 to Debtor-in-Possession Credit Agreement. In other words, in mid-April, shortly after substantive mediation sessions will have begun and prior to the expiration of the deadline for the Committee to challenge the validity of prepetition transactions, the Debtors will have to lock themselves into a plan path or a sale path. At the very least, this initial milestone should be extended or eliminated to allow the Committee to complete its investigation before the course of this case is prematurely determined. The Court should not approve this initial milestone or the other DIP Milestones absent material modification in consultation with the Committee.

**C. The Court Should Not Approve the Proposed Waiver of the Protections of Section 506(c) of the Bankruptcy Code**

Section 506(c) of the Bankruptcy Code permits a trustee to recover from property securing a claim, "the reasonable, necessary costs and expenses of preserving, or disposing of, such property . . ." 11 U.S.C. § 506(c). At its core, section 506(c) "is designed to prevent a windfall to



the secured creditor . . . *[Section 506(c)] understandably shifts to the secured party . . . the costs of preserving or disposing of the secured party's collateral*, which costs might otherwise be paid from the unencumbered assets of the bankruptcy estate . . . .” *Precision Steel Shearing, Inc. v. Fremont Fin. Corp. (In re Visual Indus., Inc.)*, 57 F.3d 321, 325 (3d Cir. 1995) (emphasis added).

This Court has previously expressed its reluctance approve waivers of the protections of section 506(c). *See, e.g.*, Hr’g Tr. 55:13-15, *In re Pacific Drilling S.A., et al.*, No. 17-13193 (MEW) (Bankr. S.D.N.Y. Dec. 14, 2017) [ECF No. 140] (“The truth is, there’s absolutely nothing in the Bankruptcy Code that says I even have the power to waive Section 506(c). So I won’t do it.”); Hr’g Tr. 112:22-25, *In re Relativity Media, LLC, et al.*, No. 18-11358 (MEW) (Bankr. S.D.N.Y. May 9, 2018) [ECF No. 74] (“No waiver of 506(c) or 552 in an interim order. You can ask for it in the final order, but usually I don’t give that.”). The United States Trustee requests that the Court deny those portions of the Motion seeking this relief.

**D. The Court Should Not Approve Waivers of the Protections of Section 552(b) of the Bankruptcy Code and the Equitable Doctrine of Marshalling**

Section 552(b) of the Bankruptcy Code provides that a secured lender’s lien will attach to the proceeds of its collateral “except to any extent that the court, after notice and a hearing *and based on the equities of the case*, orders otherwise.” 11 U.S.C. § 552(b) (emphasis added). The equities of the case exception contained in section 552(b) of the Bankruptcy Code is a statutory grant of power to the Court, not the Debtors. Prospective waivers of the equities of the case exception are inappropriate and should not be approved. *See, e.g., Sprint Nextel Corp. v. U.S. Bank Nat’l Ass’n (In re TerreStar Networks, Inc.)*, 457 B.R. 254, 272-73 (Bankr. S.D.N.Y. 2011) (denying request for 552(b) waiver as premature because factual record was not fully developed); *In re Metaldyne Corp.*, No. 09-13412, 2009 WL 2883045, at \*6 (Bankr. S.D.N.Y. June 23, 2009)

(declining to waive equities of the case exception in connection with approval of debtor's use of cash collateral).

“[Marshalling] requires the senior secured creditor to first collect its debt against the collateral other than that in which the junior secured creditor holds an interest, thereby leaving that collateral for the junior secured creditor's benefit.” *In re Advanced Marketing Servs., Inc.*, 360 B.R. 421, 427 n.8 (Bankr. D. Del. 2007). Marshalling “prevent[s] the arbitrary action of a senior lienor from destroying the rights of a junior lienor or a creditor having less security.” *Meyer v. United States*, 375 U.S. 233, 236 (1963).

The United States Trustee objects to the Motion to extent the Debtors seek approval of waivers of the protections of section 552(b) of the Bankruptcy Code and the equitable doctrine of marshalling.

**E. The Court Should Not Approve Liens on Avoidance Actions or the Proceeds Thereof, an Unduly Restrictive Challenge Period, or the Minimal Budget or Carveout for Professional Fees Related to Investigations of Prepetition Transactions**

The Debtors, the Committee, and the PBGC have all highlighted the need to investigate certain prepetition transactions for potential avoidance. Accordingly, the Court should not hamper the incentives for conducting such an investigation or reduce the potential recovery to unsecured creditors by approving liens on avoidance actions or the proceeds thereof. Further, the challenge period should be extended to afford the Committee sufficient time to do its job. Additionally, unless substantially increased in consultation with the Committee, the Court should not approve the proposed minimal budget or carveout for professional fees related to an investigation of prepetition transactions. Here, the Committee is tasked with conducting an investigation into prepetition transactions while preparing for and participating in a Court-ordered

mediation. The Committee should not be unduly restricted by an inadequate budget or an unnecessarily cramped challenge period.

**CONCLUSION**

For the foregoing reasons, the United States Trustee respectfully requests that the Court deny those portions of the Motion identified herein absent the consent of the Committee or substantial modification.

Dated: New York, New York  
March 18, 2020

WILLIAM K. HARRINGTON  
UNITED STATES TRUSTEE

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