

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

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In re:	:
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WESTPOINT STEVENS INC., <u>et al.</u>,	:
	:
Debtors.	:
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**Chapter 11
Case No.:03-13532 (RDD)
Jointly Administered**

**ORDER GRANTING MOTION OF SECOND LIEN AGENT FOR ORDER DIRECTING
RELEASE OF ESCROWED ADEQUATE PROTECTION PAYMENTS**

On May 10, 2005, Wilmington Trust Company, as successor Administrative Agent (the “Second Lien Agent”) under that certain Credit Agreement dated as of June 29, 2001, among WestPoint Stevens, Inc., Bankers Trust Company as Administrative Agent and the Lenders party thereto (“Second Lien Credit Agreement”), filed a Motion for Order Dissolving Adequate Protection Escrow, and Releasing Escrowed Adequate Protection Payments (“Adequate Protection Release Motion”).¹ In support of the allegations in the Adequate Protection Release Motion concerning the value of the collateral underlying the Second Lien Obligations (“Second Lien Collateral”) as of the Petition Date, the Second Lien Agent provided expert testimony in the form of an Affidavit of Arthur B. Newman of The Blackstone Group, L.P., sworn to on March 25, 2005 (“Newman Affidavit”).

On May 16, 2005, GSC Partners, Pequot Capital Management, Inc. and Perry Principals LLC (collectively, the “Funds”) joined in the Adequate Protection Release Motion. On June 10, 2005, Aretex LLC, (“Aretex”) also joined in the Adequate Protection Release Motion. On September 29, 2005, this Court entered a stipulation under seal resolving discovery

issues between the Funds and the Steering Committee (defined below) and containing certain information pertaining to allegations in the Adequate Protection Release Motion concerning the value of the Second Lien Collateral as of the Petition Date.

Objections

On June 6, 2005, Bank of America, N.A., as administrative agent (the “DIP Agent”) under the then-outstanding debtor-in-possession credit facility (“DIP Credit Facility”) filed an objection to the Adequate Protection Release Motion (“DIP Agent Objection”). On June 10, 2005, Contrarian Funds, LLC, Satellite Senior Income Fund, LLC, CP Capital Investments, LLC, Wayland Distressed Opportunities Fund I-B, LLC, and Wayland Distressed Opportunities Fund I-C, LLC (which defined themselves collectively as a steering committee of lenders holding first priority prepetition liens on and security interests in the Debtors’ property (the “Steering Committee”)) filed an objection (“Steering Committee Objection”) to the Adequate Protection Release Motion. Beal Bank, N.A. (the “First Lien Agent”; together with the Steering Committee, the “First Lien Objectors”) filed an objection (“Beal Objection; together with the DIP Agent Objection and the Steering Committee Objection, the “Objections”) to the Adequate Protection Release Motion on June 9, 2005, which it supplemented on September 6, 2005.

Reply

The Second Lien Agent and the Funds filed a Reply to the Objections on September 9, 2005.

¹ Capitalized terms used herein are used as defined in the Adequate Protection Release Motion.

Hearing

The Adequate Protection Release Motion, initially set for hearing on June 24, 2005, was ultimately heard October 18, 2005. At the conclusion of the October 18, 2005 hearing, the Court issued a preliminary ruling on the Adequate Protection Release Motion. The Court's ruling was preliminary because one of the two alternative bases for the ruling was premised upon the Court's Order Authorizing Sale of Substantially all of the Seller's Assets, dated July 8, 2005 as corrected by two separate orders dated July 11, 2005 (the "Sale Order"), the Steering Committee and Beal Bank's appeals of the Sale Order were *sub judice* with the United States District Court for the Southern District of New York (the "District Court"), and this Court determined, given the likelihood of an appeal of any decision on the Adequate Protection Release Motion, to withhold a final ruling pending review of the District Court's ruling on the appeal of the Sale Order. The Court's preliminary ruling (the "Preliminary Ruling") is set forth in the October 18, 2005 hearing transcript.

Subsequent Motion

On December 28, 2005, the Steering Committee filed a motion to implement the District Court's Order, entered November 16, 2005, as amended on December 7, 2005 (the "District Court Order"), which remanded the appeal of the Sale Order to this Court. In its motion, the Steering Committee contended that this Court should defer entering its ruling on the Adequate Protection Release Motion until after the conclusion of the proposed foreclosure sale of proceeds of sale of the Debtors' business. The Steering Committee also argued that the District Court Order eliminated one basis for granting the Adequate Protection Release Motion and weakened the other. The Funds filed their response to that motion and opposed such deferral. In the light of the terms of the Escrow Stipulation (defined below) and paragraph 33(c)

of this Order, the Court has determined to issue this final order on the Adequate Protection Release Motion at this time, contemporaneously with its entry of an order on remand of the District Court Order, so that, among other things, all appellate controversies in respect of the rights of the First Lien Lenders and Second Lien Lenders may be raised at the same time.

FINDINGS AND CONCLUSIONS

The Court has reviewed the Adequate Protection Release Motion, the joinders, Objections, Reply and evidence described in the preceding paragraphs, taken into account prior proceedings in these cases relevant to the disposition of the Adequate Protection Release Motion, as well as the District Court Order, and entertained the further arguments of counsel. Based on that record, the Court finds and concludes as follows:²

1. Due and proper notice of the Adequate Protection Release Motion has been given.
2. The DIP Credit Facility has been paid off and terminated. Because the DIP Agent has no remaining economic interest in the subject of the Adequate Protection Release Motion, or these cases, it no longer has standing to object to the Adequate Protection Release Motion, and the DIP Agent Objection is moot.

Entry of Adequate Protection Order

3. On June 1, 2003, the Debtors commenced these chapter 11 cases. At that time the Second Lien Lenders were owed \$165 million in principal amount under the Second Lien Credit Agreement.

²

In addition to the findings and conclusions set forth above, this Court's Preliminary Ruling is incorporated herein; provided, that, in light of the District Court Order, the alternative holding premised on the satisfaction of the First Lien debt under the Sale Order is not so incorporated.

4. On June 18, 2003, this Court entered its Final Order Pursuant To Sections 361, 363 And 364(d)(1) Of The Bankruptcy Code And Rule 4001 Of The Federal Rules Of Bankruptcy Procedure Providing The Pre-Petition Secured Lenders Adequate Protection (“Adequate Protection Order”). No appeal or motion for reconsideration was filed in respect of the Adequate Protection Order, and it became a final order.

5. The Adequate Protection Order was entered with the consent of the “Pre-Petition Secured Lenders” as defined therein. Adequate Protection Order ¶ E. Those Pre-Petition Secured Lenders included the First Lien Objectors (or their predecessors or assignors).

6. The Adequate Protection Order provided for various forms of adequate protection to be provided to the Pre-Petition Secured Lenders, including adequate protection payments to be paid on the last business day of each month to the First Lien Lenders and the Second Lien Lenders in amounts equal to the interest accrued at the non-default rate on the principal of, respectively, the First Lien Obligations and the Second Lien Obligations. Adequate Protection Order ¶ 2A.

7. The adequate protection was awarded

for and to the extent of the diminution in value of the Pre-Petition Secured Lenders’ interests in the Pre-Petition Collateral resulting from (a) the Debtors’ use of Cash Collateral and the other Pre-Petition Collateral, (b) the priming of the Pre-Petition Secured Lenders’ security interests and liens in the Pre-Petition Collateral by the DIP Agent and the DIP Lenders pursuant to the Post-Petition Credit Documents and the Final Financing Order, (c) any transfer or other distribution of the Receivables Portfolio from WPS Receivables Corporation to the Debtors, and (d) the imposition of the automatic stay pursuant to section 362 of the Bankruptcy Code....

Adequate Protection Order ¶ 2.

8. The Debtors stipulated that the Pre-Petition Secured Lenders were oversecured as of the Petition Date. Adequate Protection Order ¶ C(xii).

9. For purposes of the Adequate Protection Release Motion, it is uncontested that the Second Lien Lenders were in fact oversecured when the Debtors commenced these chapter 11 cases. The Second Lien Lenders offered evidence on the subject, including the Newman Affidavit. The First Lien Objectors allowed the testimony to be admitted, did not cross-examine Mr. Newman, and presented no contrary evidence. Mr. Newman is a veteran, expert investment banker, and his unrebutted opinion is credited.

10. The Adequate Protection Order reserved to the Official Unsecured Creditors Committee the right to bring certain challenges to the Pre-Petition Secured Lenders' liens; in the event of a successful challenge, some or all of the adequate protection could have been disgorged to the estates for the benefit of all claimants. Adequate Protection Order ¶ 3A. However, the Committee's period for the Committee to make such a challenge, expired without challenge, and no such disgorgement is available.

11. The Adequate Protection Order also reserved the right of the First Lien Lenders to file an adversary proceeding seeking a determination that

the value of the Pre-Petition Collateral, as of the Petition Date, is insufficient to render the Senior Second Lien Secured Obligations oversecured and that the adequate protection amounts previously paid and to be paid in respect of interest, fees, and expenses under this Order under or in connection with the Pre-Petition Second Lien Credit Agreement should instead be applied (in whole or in part) solely to reduction of the principal amount of the Senior Second Lien Secured Obligations

Adequate Protection Order ¶ 3B. However, no such proceeding or motion for a declaration of the Second Lien Lenders' rights under section 506(b) of the Bankruptcy Code was brought.

12. The Adequate Protection Order also provides a generic reservation to all Pre-Petition Secured Lenders to seek “additional or further adequate protection” for themselves. Adequate Protection Order ¶ 2L.

13. Finally, the Adequate Protection Order states in several locations that the rights of the Pre-Petition Secured Lenders were to remain subject to the Intercreditor Agreement.

14. The Intercreditor Agreement provides, in pertinent part:

The Second Lien Agent and the Second Lien Lenders shall be entitled to retain and apply to the Second Lien Obligations (a) any cash payments made by the Borrower as adequate protection for its use of cash collateral, provided that the amount of the cash payments does not exceed the amount of interest applicable to the Second Lien Obligations] under the Second Lien] Credit Agreement, plus fees and expenses otherwise compensable under the Second Lien Credit Agreement . . .

Adequate Protection Release Motion, Ex. A, § 2.4(g); *see also id.*, § 2.13 (identical in substance).

15. In reliance upon the Adequate Protection Order, the Pre-Petition Secured Lenders allowed the Debtors to, and the Debtors did, in fact, (1) use the Pre-Petition Secured Lenders' cash collateral, (2) impose a "priming" debtor-in-possession financing with priority over the liens of the Pre-Petition Secured Lenders, and (3) under the protection of the automatic stay, pursue a reorganization for the benefit of, among others, their unsecured creditors and the First Lien Lenders.

16. The First Lien Lenders received adequate protection payments in accordance with the Adequate Protection Order through and including August 8, 2005, the date the Debtors consummated a sale of all or substantially all their assets, paid off the DIP Credit Facility and ceased the use of cash collateral and distributed the sale proceeds directly to the First Lien Lenders, with a portion escrowed subject to further proceedings.

17. The Second Lien Lenders received adequate protection payments totaling approximately \$31 million through July, 2004. Adequate Protection Release Motion, p. 5. None of the Objections dispute the Second Lien Agent's allegations that the value of the Second Lien Collateral deteriorated while the Debtors pursued their reorganization efforts, to the point where the Second Lien Lenders became substantially undersecured, even assuming application of the adequate protection payments that they received to the principal of, instead of postpetition interest on, the Second Lien Loans. Thus, the Second Lien Collateral has decreased in value in an amount greater than the amount of the adequate protection payments received by the Second Lien Lenders. Accordingly, the Second Lien Lenders have an unfulfilled entitlement to adequate protection under the terms of the Adequate Protection Order.

Entry into Escrow Stipulation

18. On or about July 22, 2004, approximately 13 months after the Adequate Protection Order was entered, one of the First Lien Lenders, R2 Top Hat Ltd. (“R2”), holder of approximately 38% of the First Lien Loans, filed a Motion of First Lien Lenders Pursuant to 11 U.S.C. §§ 361, 362(d), 363(e) and 364(d), (a) To Grant Additional Adequate Protection to First Lien Lenders and (b) To Terminate Adequate Protection Payments to Second Lien Lenders (the “R2 Motion”).

19. R2 alleged that the value of the Debtors’ estates had deteriorated to the point that the First Lien Lenders had become “oversecured by a much smaller margin,” and it sought to stop “unnecessary” adequate protection payments to the Second Lien Lenders to protect the First Lien Lenders’ equity cushion against further erosion. R2 Motion ¶ 4. R2 contended that it was entitled to the relief requested as “additional and further adequate protection” under Paragraph 2L of the Adequate Protection Order. *See e.g., id.* ¶¶ 16, 23.

20. The R2 Motion was not litigated, because, among other reasons, the parties were fearful of the adverse effects of such litigation upon the public perception of the stability and value of the Debtors’ business. In addition, a goal of the R2 Motion was to change the direction of these cases, for example, to persuade the parties to accelerate the chapter 11 plan process or to accelerate the sale process that had not really begun at that point, both of which were arguments that R2 had made in other pleadings.³

³ Other examples of adequate protection that could have been granted to the First Lien Lenders without alteration of the Second Lien Lenders’ rights under the Adequate Protection Order include fixing a date for a plan to be filed or the collateral to be put up for auction; tighter limits on the Debtors’ use of cash, such as stricter budgets; outright sequestration of cash or even the making of an additional cash payment to the First Lien Lenders out of the estate, that would be applied to principal.

21. The Pre-Petition Secured Lenders arrived at a solution that avoided a public battle over the value of the collateral and the condition of the Debtors' business. The R2 Motion was withdrawn without prejudice pursuant to paragraph 9 of the Stipulation And Order Entered August 23, 2004, (i) Providing For Deposit Into Escrow Of Second Lien Adequate Protection Payments; (ii) Withdrawal Of Adequate Protection Motion; And (iii) Reservation Of Rights And Remedies ("Escrow Stipulation"): "Upon execution and entry of this Stipulation and Order, the [R2] Motion shall be deemed withdrawn, without prejudice to refiling at a future date." The R2 Motion was never re-filed.

22. Pursuant to the Escrow Stipulation, an escrow account (the "Adequate Protection Escrow") was established at Wells Fargo Bank, N.A. (the "Escrow Agent"), and, on the date each month when adequate protection payments came due under the Adequate Protection Order, the Debtors paid the sums due to the Second Lien Lenders (referred to in the Escrow Stipulation as "Second Lien Interest Payments") into the Escrow. Interest accrued on the funds therein and, on the date of the October 11, 2005 hearing, the amount in the Adequate Protection Escrow was approximately \$29 million.

Interpretation of the Relevant Orders and Documents

23. The resolution of the Adequate Protection Release Motion calls for the Court to interpret the Escrow Stipulation, the Adequate Protection Order and the Intercreditor Agreement, in the context of the facts described above, to determine whether the First Lien Lenders had, as of the date the Escrow Stipulation was entered, any right to terminate the Second Lien Interest Payments to the Second Lien Lenders.

Escrow Stipulation

24. The Escrow Stipulation states

The intent of the Parties is to maintain the status quo as of the date of execution of this Stipulation and Order, such that adjudication of the issues raised by and related to the Adequate Protection Motion shall be deferred until the earlier of the Sale Hearing, the Confirmation Hearing, and the Conversion Hearing, and the Parties shall retain for assertion at that time all rights, remedies, and arguments currently at their disposal. For avoidance of doubt, nothing in this Stipulation and Order was intended or shall be deemed to affect or alter the entitlement of the First Lien Lenders or the Second Lien Lenders to adequate protection under the Adequate Protection Order.

Escrow Stipulation ¶ 11. Moreover, Paragraph 17 of the Escrow Stipulation states that the Adequate Protection Order “shall remain in full force and effect”.

25. As a result of the Escrow Stipulation’s clear language, the argument of the First Lien Objectors that the Escrow Stipulation fundamentally altered the parties’ rights to the Second Lien Interest Payments, as established by the Adequate Protection Order and the Intercreditor Agreement, cannot stand. Although Paragraph 3 of the Escrow Stipulation states, in part, that “for further avoidance of doubt such deposit with the Escrow Agent of the Second Lien Interest Payments shall not constitute ‘cash payments made by the Borrower as adequate protection’ to the Second Lien Lenders such that the Second Lien Agent and Second Lien Lenders would be ‘entitled to retain and apply’ such payments to indebtedness under the Second Lien Credit Facility as otherwise contemplated by Section 2.4(g) of the Intercreditor Agreement,” it goes on to say, “unless and until the Release Order or the Release Instruction authorizes the release of funds held by the Escrow Agent to the Second Lien Agent for application to claims held by the Second Lien Lenders and then only to the extent so authorized.” Thus, the Escrow Stipulation did not terminate any rights of the Second Lien Lenders, but simply

deferred and conditioned the delivery of the Second Lien Interest Payments on the entry of a further Court order or “Release Instruction.” Thus, the entry of this Order suffices to qualify the Second Lien Interest Payments in escrow for the exception in the Intercreditor Agreement that enables the Second Lien Agent and Second Lien Lenders to retain and apply those monies under the Second Lien Credit Agreement. The contrary interpretation of the First Lien Objectors fails to account for, and cannot be reconciled with, paragraph 11 of the Escrow Stipulation quoted above, or with other provisions of the Escrow Stipulation, as discussed in the Preliminary Ruling, nor is it reasonable to believe that the Second Lien Lenders would have agreed, in the context of the case as it existed in August 2004, to the interpretation now advanced by the First Lien Objectors that their rights under the Adequate Protection Order could be eliminated.

Adequate Protection Order

26. The Adequate Protection Order is equally clear. The only right specifically reserved by the First Lien Lenders in respect of the Second Lien Interest Payments was the right to commence an adversary proceeding to challenge the oversecured status of the Second Lien Lenders at the Petition Date. That right, even if successfully exercised (and it was not), would not have resulted in halting Second Lien Interest Payments to the Second Lien Lenders, as the Adequate Protection Order expressly provided that such payments would continue to be made to the Second Lien Lenders even in that context, but would be allocated to principal, not interest, on the Second Lien Debt.

27. Moreover, the parties reserved generic right to seek “additional or further adequate protection” does not suffice as a basis for an order depriving the Second Lien Lenders of Second Lien Interest Payments. First, no evidence was presented to the Court that, as of the date the Escrow Stipulation was entered, a diminution in value had occurred in the First Lien

Lenders' collateral that would have entitled the First Lien Lenders to any form of "additional or further adequate protection." Second, assuming *arguendo* that the First Lien Lenders were entitled to some form of additional adequate protection, it does not follow that the form of such adequate protection would have consisted, then or now, of depriving the Second Lien Lenders of *their* adequate protection granted under the Adequate Protection Order, a final order. If the payment of such adequate protection on behalf of the Second Lien Lenders was inconsistent with the right of the First Lien Lenders to adequate protection (which was never established), the First Lien Lenders' remedy was either to obtain additional adequate protection from a different source or of a different nature or, if such adequate protection was not available, to obtain relief from the automatic stay under 11 U.S.C. § 362(d)(1) to exercise their remedies in the collateral. The First Lien Lenders sought neither of these things. They instead sought to have substantially all of the Debtors' assets (excluding the Adequate Protection Escrow) sold under 11 U.S.C. § 363(b) and (f), subject to higher and better offers, while preserving the status quo as to adequate protection, under the Escrow Stipulation.

28. That the Adequate Protection Order was entered upon consent of the First Lien Lenders also militates against any later modification.⁴ A request for relief from an agreed order is subject to a stricter standard, and the party seeking the relief must carry a heavier burden than with respect to a litigated order. *See U.S. v. Swift & Co.*, 286 U.S. 106, 119 (1932); *In re AMC Realty Corp.*, 270 B.R. 132, 143-46 (Bankr. S.D.N.Y. 2001); *In re AL & LP Realty Co.*, 164 B.R. 231, 234 (Bankr. S.D.N.Y. 1994).

⁴ An agreed order resolving a contested matter qualifies as a "judgment" and an "order" under the Federal Rules of Bankruptcy Procedure. *See, e.g.*, Fed. R. Bankr. P. 9021 ("Every judgment entered in an adversary proceeding or contested matter ..."); *BII v. IBI Security Service, Inc. (In re IBI Security Service, Inc.)*, 133 F.3d 205, 208-09 (2d Cir. 1998) (order approving settlement between trustee and secured creditor reviewed under Rule 9024 and general equity powers of bankruptcy court and enforced without modification).

Intercreditor Agreement

29. The Intercreditor Agreement also is clear. In section 2.4(g) it states:

The Second Lien Agent and the Second Lien Lenders shall be entitled to retain and apply to the Second Lien Obligations (a) any cash payments made by the Borrower as adequate protection for its use of cash collateral, provided that the amount of the cash payments does not exceed the amount of interest applicable to the Second Lien Obligations under the Second Lien Credit Agreement, plus fees and expenses otherwise compensable under the Second Lien Credit Agreement . . .

Section 2.13 of the Intercreditor Agreement is identical in substance. The Intercreditor Agreement provides no limitation or qualification of the right of the Second Lien Lenders to receive and retain the Second Lien Interest Payments; Section 2.13 instead provides that adequate protection payments are an express exception to the First Lien Lenders' right to receive all payments of Second Lien Indebtedness until the First Lien Indebtedness has been paid in full in cash. Therefore, because both the Escrow Stipulation and the Adequate Protection Order expressly provide that the relative rights of the parties under the Intercreditor Agreement remain intact as of the date of such orders, and as of such dates the Second Lien Lenders were entitled to payment of adequate protection in the form of Second Lien Interest Payments, the Second Lien Lenders may under the Intercreditor Agreement receive and retain the Second Lien Interest Payments the Debtors made into escrow each month.

District Court Order

30. Although it concludes that the First Lien Indebtedness has not been satisfied as a result of the sale of the collateral and the distribution of the sale proceeds, the District Court Order does not affect the Second Lien Lenders' right to the Adequate Protection Escrow. The District Court Order did not find that the First Lien Lenders were not adequately protected by their replacement liens in the sale proceeds (including in the approximately \$95 million of securities that this Court found exceeded the amount of the First Lien Indebtedness). Nor did the District Court Order interpret the Second Lien Lenders' rights under the Adequate Protection Order or the Escrow Stipulation of under the Intercreditor Agreement as that document relates to the foregoing orders.

31. Based on the foregoing findings and conclusions, it is hereby ORDERED that:

(a) The Objections are overruled.

(b) The Adequate Protection Release Motion is granted to the extent provided herein.

(c) This Order constitutes an order under paragraph 5(a) of the Escrow Stipulation. Consequently, the Escrow Agent under the Escrow Stipulation is directed to release all funds in the Adequate Protection Escrow to the Second Lien Agent in accordance with and subject to the terms of the Escrow Stipulation and the Escrow Agreement. For the avoidance of doubt, the Escrow Agent shall not release such funds, however, unless and until this Order “remains in full force and effect after either (i) the time to appeal, seek reconsideration, or other review of such order has expired; or (ii) any appeal or request for reconsideration or other review has been finally resolved with no further appeal, reconsideration or other review available” (Escrow Stipulation ¶ 5(b)) and the Escrow Agent receives the certification and/or “Release

Order” specified in paragraph 5(c) of the Escrow Stipulation and section 2(c) of the Escrow Agreement.

Dated: April 13, 2006
New York, New York

/s/ Robert D. Drain
UNITED STATES BANKRUPTCY JUDGE