

UNITED STATES BANKRUPTCY COURT
DISTRICT OF ARIZONA

In re: ACCIPITER COMMUNICATIONS, INC., d/b/a ZONA COMMUNICATIONS, Debtor.	Case No.: 2:14-bk-04372-GBN (Chapter 11)
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**UNITED STATES' RESPONSE TO COMMITTEE'S OBJECTION
TO EXTENT OF ADEQUATE PROTECTION LIENS**

Well prior to March 28, 2014 ("Petition Date"), the United States, acting through the Rural Utilities Service ("RUS") of the United States Department of Agriculture ("USDA"), perfected liens on all property (except vehicles) of Debtor Accipiter Communications, Inc. ("Debtor"). Because this interest expressly covered Debtor's accounts receivable and associated proceeds, and because Debtor has admitted that virtually all of its cash comes from accounts receivable, the August 18, 2014 Objection to the Extent of Adequate Protection Liens (Docket No. 91) (the "Objection" or "Obj.") filed by the Official Committee of Unsecured Creditors (the "Committee") lacks merit, and RUS should be permitted to continue to receive adequate protection substantially of a kind reflected in the Court's May 6, 2014 Interim Stipulated Order Authorizing Use Of Cash Collateral And Granting Adequate Protection (Case docket number 53), May 16, 2014 Stipulated Order Authorizing Use Of Cash Collateral And Granting Adequate Protection (Case docket number 62), and July 14, 2014 Second Stipulated Order Authorizing Use Of Cash Collateral And Granting Adequate Protection (Case docket number 76) (each, a "Cash Collateral Order").

FACTS

RUS Loans, Deferral of Principal Payments, Debtor Default and Bankruptcy

To pursue the federal objective of building networks for rural telecommunications, the United States, through RUS, made three loans (collectively, the “RUS Loans”) to Debtor for it to construct and operate a telecommunications network in rural areas of Arizona’s Maricopa and Yavapai Counties. *See* March 28, 2014, Declaration of Patrick Sherrill in Support of First Day Pleadings (“Sherrill Decl.”) ¶¶ 5, 19-28. To secure the RUS Loans, Debtor pledged all its property except vehicles (the “Collateral”). Oct. 13, 2005 Restated Mortgage, Security Agreement and Financing Statement (the “Security Agreement” or “S.A.”) at Granting Clause, pages 3-5, attached as Exhibits 4 and 5 to Proof of Claim Filed by United States (Claim No. 29) (the “Proof of Claim”). Specifically, Debtor pledged “a continuing security interest and lien *in all property, assets, rights, privileges, licenses and franchises of the [Debtor] of every kind and description, real, personal or mixed, tangible and intangible*, of the kind or nature specifically mentioned herein, or any other kind or nature now owned or hereafter acquired or arising by the [Debtor].” S.A. at 3.

Among other property, in the Security Agreement, Debtor pledged:

All [its] right, title, and interest . . . in, to, and under *all personal property* and fixtures of every kind and nature, *including* without limitation . . . instruments (such as promissory notes or chattel paper, electronic or otherwise), documents, *accounts (such as deposit accounts* or trust accounts pursuant hereto or to a loan agreement), . . . general intangibles (such as *payment intangibles*), supporting obligations, contract rights or *rights to the payment of money*

S.A. Granting Clause IV.

To perfect RUS’s lien on Debtor’s real property, the Security Agreement was filed in the office of Recorder of Deeds for Maricopa and Yavapai County, Arizona. To perfect RUS’s security interest in Debtor’s personal property, UCC-1 Financing Statements describing the Collateral were filed with the Office of the Secretary of State

in the State of Nevada. *See* UCC-1 attached as Ex. 10 to Proof of Claim. Debtor subsequently defaulted on the RUS Loans and is now in bankruptcy.

Payments on Accounts Receivable As Source for Debtor's Cash

Debtor's cash appears to come from payments it has received on accounts receivable. **Debtor has forthrightly conceded, "[E]ssentially all the Debtor's cash comes from accounts receivable"** Debtor's March 28, 2014 Emergency Motion For Interim And Final Orders Authorizing The Use Of Cash, Docket No. 10 (the "Motion" or "Mo.") at 10. More specifically, Debtor's President and Chief Executive Officer admits, "The Debtor's principal sources of cash flow stem from the sale of telecommunications and related services and USF subsidies," ("USF Subsidies"), *i.e.*, payments from the Universal Service Fund ("USF") regulated by the Federal Communications Commission ("FCC"). Sherrill Decl. ¶ 51; *see* Debtor's proposed budget (Docket No. 10-1) (the "Proposed Budget") (projecting that 99.998 percent of Debtor's income during the thirteen weeks addressed by the Proposed Budget will come from "Customer Revenue" and "NECA/USF."¹). Cash from these sales and subsidies arise from payments on accounts receivable.

With RUS's permission, pursuant to the Cash Collateral Orders, Debtor has used this cash. In exchange, RUS received replacement liens in all post-petition collateral to secure any prepetition diminution of cash collateral ("Adequate Protection Liens") as well as monthly Adequate Protection Payments, generally in an amount equal to the interest that otherwise would accrue each month on the RUS Loans. In the Objection, the Committee contests the Adequate Protection Liens.

¹ The "NECA/USF" income line of the Proposed Budget appears to refer to payments that Debtor hopes to receive either from the National Exchange Carriers Association ("NECA") or from USF. *See* Sherrill Decl. ¶¶ 4(a), 6, 11-13, 51.

ARGUMENT

I. RUS HAS A VALID, PERFECTED, PRE-PETITION LIEN ON ALL OF DEBTOR'S ASSETS EXCEPT VEHICLES, INCLUDING ACCOUNTS RECEIVABLE

RUS has a valid, perfected, pre-petition lien on all of Debtor's assets except vehicles, including accounts receivable.² First, the Security Agreement gives RUS a security interest in accounts receivable by expressly providing RUS with an interest in payment intangibles and rights to monetary payments. A creditor has an enforceable security interest in accounts receivable if the security agreement "provides a description of the collateral" that "reasonably identifies the collateral." *See* Ariz. Rev. Stat. Ann. § 47-9203(B); Ariz. Rev. Stat. Ann. § 47-9108(B). Generally, "[a] description of collateral reasonably identifies the collateral if it identifies the collateral by: . . . (2) Category. . . ." Ariz. Rev. Stat. Ann. § 47-9108.

The Security Agreement's description of the Collateral satisfies the requirements concerning specificity. *See* Ariz. Rev. Stat. Ann. § 47-9108(B).³ The Security Agreement (at Granting Clause IV) specifically identifies as RUS's security "general intangibles (such as payment intangibles)" and "contract rights or rights to the payment of money" as such terms are defined in the UCC. Accounts receivable clearly fall under the definitions of general and payment intangibles, and they are also generally seen as Debtor's rights to

² RUS has not claimed to have a perfected prepetition interest in vehicles or deposit accounts. RUS has not located any deposit account control agreement it may have had with Debtor. Even without an effective deposit account control agreement, a lender with a perfected security interest in accounts receivable and proceeds has a perfected interest in cash consisting of these proceeds. *In re CHA Hawaii, LLC*, 426 B.R. 828, 836 (Bankr. D. Haw. 2010).

³ This Response primarily relies on Arizona UCC provisions, which are identical on all material points to the Nevada UCC.

payment of money. *See* Ariz. Rev. Stat. Ann. § 47-9102(42); Ariz. Rev. Stat. Ann. § 47-9102(61); Ariz. Rev. Stat. Ann. § 47-9102(3).

For similar reasons, the Collateral extends to USF subsidies because they qualify as payment intangibles and so also general intangibles. *See In re Sunberg*, 35 B.R. 777 (S.D. Iowa 1983), *aff'd*, 729 F.2d 561 (8th Cir. 1984) (holding that subsidies to farmer were general intangibles such that lender had a security interest in them).

Moreover, RUS has perfected its interest in Debtor's accounts receivable and other personal property. To determine whether an entity's interest is perfected, Arizona law looks to the laws of the state where Debtor is located, which for a corporation is its state of incorporation. Accipiter was incorporated in Nevada, Sherrill Decl. ¶ 3, and so that state's laws govern perfection. *See* Ariz. Rev. Stat. Ann. § 47-9301(1); Ariz. Rev. Stat. Ann. § 47-9307(E). Under Nevada law, to perfect a security interest in the accounts receivable, a financing statement must be filed with Nevada's Office of the Secretary of State. *See* Nev. Rev. Stat. § 104.9310(1); Nev. Rev. Stat. § 104.9501(2); Nev. Rev. Stat. 104.9315(4). RUS has complied with these requirements. *See* Proof of Claim Ex. 10

II. RUS'S LIEN EXTENDS TO DEBTOR'S CASH BECAUSE VIRTUALLY ALL OF IT CONSISTS OF PROCEEDS OF ACCOUNTS RECEIVABLE OR OTHER PLEDGED PROPERTY

RUS's lien also extends to Debtor's cash. Under the UCC, a security interest extends to any identifiable proceeds of collateral if the original interest was perfected and, if proceeds are commingled, to the extent such proceeds can be traced. *See* Nev. Rev. Stat. § 104.9315. "[A] creditor's security interest may extend to any or all funds in a deposit account where the funds are 'proceeds' of collateral covered by a security interest." *Stoumbos v. Kilimnik*, 988 F.2d 949, 957 (9th Cir. 1993); *see also In re Skagit*

Pacific Corp., 316 B.R. 330, 337 (B.A.P. 9th Cir. 2004) (same). The UCC defines “proceeds” as “[w]hatever is acquired upon the sale, lease, license, exchange or other disposition of collateral; . . . [w]hatever is collected . . . on collateral; [and] [r]ights arising out of collateral” Ariz. Rev. Stat. § 47-9102(64). Moreover, “Section 552(b) [of the Bankruptcy Code] provides that if a pre-petition security interest encumbers collateral and its proceeds, any proceeds of that pre-petition collateral remain subject to the security interest even if they are received post-petition.” *In re Skagit Pacific Corp.*, 316 B.R. at 335.

Tracing is unnecessary here because by Debtor’s admission, Debtor derives virtually all of its revenue from its accounts receivable, either in the form of telecommunications sales and services to its customers or from its USF subsidy. Debtor concedes that “essentially all the Debtor’s cash comes from its accounts receivable.” *See Sherrill Decl.* ¶ 51. Thus, RUS had a perfected security interest in essentially all of Debtor’s cash as of the Petition Date. Should the Court believe tracing is required, it should grant RUS sufficient opportunity to discover the sources of Debtor’s cash.

III. THE COMMITTEE HAS NOT SHOWN THAT RUS IS ADEQUATELY PROTECTED

Standing alone, the Adequate Protection Payments RUS has received under the Cash Collateral Orders do not provide the adequate protection required by 11 U.S.C. § 361. (In the Objection, the Committee does not dispute that RUS may continue to receive such payments.) The Objection does not suggest, much less prove, that the Collateral has a value more than sufficient to cover the debt to RUS of approximately \$20.9 million. For example, the Committee does not offer any valuation of Debtor’s

assets, as of the Petition Date or otherwise. Debtor's circumstances offer ample reason for worry that the value of the Collateral may suffer a post-petition decline. For example, the FCC's recent notice of proposed rulemaking, *Connect America Fund, ETC Annual Reports and Certifications, Establishing Just and Reasonable Rates for Local Exchange Carriers; Universal Service Reform—Mobility Fund; Developing an Unified Inter-carrier Compensation Regime*, 79 Fed. Reg. 39196-01 (July 9, 2014), has the potential to impact adversely the value of the Collateral.

CONCLUSION

For the foregoing reasons, the Court should overrule the Objection and permit RUS to continue to have adequate protection of the kind afforded by the Cash Collateral Orders.

Dated: August 19, 2014

Respectfully submitted

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CERTIFICATE OF SERVICE

I, Lloyd H. Randolph, hereby certify that on the 19th day of August, 2014, I caused notice of the foregoing UNITED STATES' RESPONSE TO COMMITTEE'S OBJECTION TO EXTENT OF ADEQUATE PROTECTION LIENS to be served electronically through the Court's ECF system upon those who have entered an appearance in this proceeding, and a courtesy copy of such papers to be served on the parties listed below in the manner indicated.

Dated: August 19, 2014

/s/ Lloyd H. Randolph
Lloyd H. Randolph

Via electronic mail

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