UNITED STATES BANKRUPTCY COURT DISTRICT OF NEW JERSEY	
Caption in Compliance with D.N.J. LBR 90004-2(c) **Otterbourg P.C.** 230 Park Avenue New York, NY 10169 (212) 661-9100 David M. Posner (*pro hac vice* application pending) Jessica M. Ward Kevin Zuzolo (*pro hac vice* application pending) *Proposed Counsel to the Official Committee of Unsecured Creditors*	
In re: MEE Apparel LLC, *et al.* Debtors-in-Possession	Chapter 11 Case No. 14-16484-CMG (Jointly Administered)

OBJECTION OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS TO DEBTORS' (A) PROPOSED BIDDING PROCEDURES AND (B) DIP FINANCING MOTION

TO: THE HONORABLE CHRISTINE M. GRAVELLE,
UNITED STATES BANKRUPTCY JUDGE:

The Official Committee of Unsecured Creditors (the "Committee") of MEE Apparel LLC, et al. (the "Debtors"), by and through its undersigned proposed counsel, submits this objection (the "Objection") to the Debtors'

- *Motion for an Interim and Final Order: (I) Authorizing the Debtors to Obtain Post-Petition Financing Pursuant to 11 U.S.C. Sections 105, 361, 362, 364(c) and 364(e); (II) Authorizing Use of Cash Collateral; (III) Scheduling a Final Hearing Pursuant to Fed. R. Bankr. P. 4001; and (IV) Granting Other Related Relief* [Docket No. 17] (the "DIP Motion"); and

- *Motion for an Order pursuant to 11 U.S.C. §§ 363 and 365 and Fed. R. Bankr. P. 2002, 6004 and 6006: (1) Approving a "Stalking Horse" Asset Purchase Agreement for the Sale of Substantially All the Debtors' Assets; (2) Approving Bidding Procedures and Form, Manner and Sufficiency of Notice Thereof; (3) Scheduling (A) an Auction Sale and (B) a Hearing to Consider Approving the Highest and Best Offer; (4) Authorizing the Debtors to Sell Substantially All Their Assets Free and Clear of Liens, Claims, Encumbrances, and Interests and to Assume and Assign Related Executory Contracts and Unexpired Leases;*

and (5) Granting Other Related Relief [Docket No. 26] (the "Sale Motion").

In support of the Objection, the Committee respectfully represents as follows:

PRELIMINARY STATEMENT[1]

1. The Committee was organized only one week ago and has substantial concerns about the path that these Chapter 11 Cases are taking. There are significant questions that surround these cases and they all center around one individual: Seth Gerszberg ("Gerszberg"). Gerszberg owns and controls (directly or indirectly) the Debtors, Suchman, LLC ("Suchman") (the Debtors' prepetition secured lender, DIP Lender, and proposed stalking horse purchaser), and other entities that have entered into various prepetition transactions with the Debtors. These cases may be nothing more than a further mechanism for Gerszberg to move assets and liabilities among his web of controlled entities. The Committee must be afforded additional time to understand the prepetition transactions, the proposed restructuring transactions, and the Debtors' exit strategy to determine if these Chapter 11 Cases will benefit any stakeholder other than Gerszberg. The Committee is concerned that the Chapter 11 Cases may have been filed so that Gerszberg can acquire the assets cleared of certain unwanted burdens and liabilities which are all personal to Gerszberg.

2. Through the proposed DIP Financing provided by Suchman, Gerszberg has dictated a timeline for these cases that appears to be based on nothing more than an arbitrary set of deadlines designed to place maximum pressure on all other parties. The Debtors have already failed to meet the originally proposed milestones for entry of an order retaining an investment banker and entry of the Bidding Procedures Order. The proposed milestone of May 17, 2014 for the Debtors to

[1] Capitalized terms used but not otherwise defined in the Preliminary Statement shall have the meanings ascribed to such terms in the Objection. Capitalized terms not defined in the Objection shall have their respective meanings in the DIP Motion or Sale Motion, as applicable.

conduct an auction, close a sale, and have the DIP Facility mature or be paid off shortly thereafter leaves only one month for the Committee to complete its fiduciary duties and determine the best strategy for maximizing value for unsecured creditors. The Debtors would like all stakeholders and this Court to believe that the insider sale to Suchman is the only viable reorganization strategy. It may be that the proposed sale is in the best interests of the Debtors' estate, but, at this moment, that is far from clear to the Committee. It is abundantly clear, however, that unsecured creditors will stand behind alleged insider secured debt of approximately $27 million if the Debtors' restructuring strategy is followed through. The Committee would be ill-advised to give Suchman all of the protections it seeks through the DIP Facility and the Section 363 sale without a thorough investigation of the various transactions that involve Gerszberg on every side.

3. There is no justification for such a compressed time frame that leaves inadequate time to address the concerns of various constituencies. Certain landlords have already objected to the sale and correctly noted that the Bidding Procedures do not afford sufficient time to address adequate assurance of performance or the additional protections afforded to shopping center leases. The Debtors appear to be well aware of the challenges that they face as the Debtors have set forth extensive briefing in the Sale Motion regarding their alleged right to deviate from the use provisions in the Debtors' leases. The landlords apparently disagree. The issues surrounding the use clause restrictions will be significant to both Suchman as the proposed stalking horse bidder and any other potential purchaser that may be interested in submitting a bid. It is also of significant concern to other creditors in assessing the viability of the Debtors' business plan going forward. These cases require adequate time to address these issues either through negotiations with the landlords or litigation before the Bankruptcy Court. Based on discussions with the Debtors' advisors, the Committee believes a delay of approximately four weeks will not have a

material negative impact on the Debtors' liquidity and will allow the Committee and other stakeholders to give the necessary attention to the various issues in these cases.

4. The Bidding Procedures also permit a problematic credit bidding mechanism that will not maximize value for the Debtors' estates. Pursuant to the Bidding Procedures, Suchman is entitled to credit bid the full amounts of its Expense Reimbursement claim and the Debtors' outstanding obligations under the DIP Facility and the Existing WF Credit Facility. Accordingly, Suchman's potential credit bid could be over $27 million and Suchman's current stalking horse bid includes a credit bit of $11.3 million. Permitting Suchman to credit bid up to $27 million will undoubtedly chill bidding and perhaps freeze out any other interested parties entirely. For a variety of reasons discussed below, the Committee believes that Suchman should not be entitled to credit bid.

5. A credit bid of Suchman's DIP claims is particularly disturbing because the Committee is unsure that a real DIP Facility is even being provided in these cases. Pursuant to the Factoring Agreements, Suchman was required to pledge cash of $6 million to guarantee the obligations of the Debtors under the Factoring Facility.[2] Suchman's commitment to provide the DIP Facility requires that the Factor release $5 million of the Cash Dominion to be used as part of the DIP Facility. It appears Suchman is simply replacing its own obligation to hold cash collateral to guarantee the obligations under the Factoring Facility and transferring it to the Debtors as an alleged DIP Facility. Suchman's Cash Dominion pledge would not have been available to use as a credit bid for the Debtors' assets and, therefore, it seems entirely inappropriate that Suchman be permitted to use the DIP Facility as a credit bid.

6. The DIP Financing is also problematic for various other reasons. The DIP Final Order requires that the Debtors maintain a collateral base securing the obligations owed to the

[2] It should be noted that Gerszberg also personally guaranteed the Factoring Agreements.

Factor of not less than $1 million in cash collateral and $8 million in inventory. The Committee's financial advisors believe that the Debtors may have difficulty maintaining the $8 million inventory level and this is an obvious concern since such levels may not have been necessary if Suchman had not reduced its Cash Dominion pledge. In addition, the Committee has various concerns about certain forecasted payments – most notably are significant salary payments to Gerszberg family members. The Gerszbergs must cease using their controlled entities as their personal piggy bank and the Committee must analyze the intercompany transactions that have been commonplace for so long. The only way to maximize value for all stakeholders is to slow these cases down and review additional restructuring alternatives. A quick sale to an insider of the Debtors serves no interest other than Gerszberg's own self-interest.

7. As described in more detail below, the Committee objects to various other provision of the proposed DIP Facility, including, among other things: (a) the granting of liens on proceeds of avoidance actions and leases; (b) the waiver of Bankruptcy Code sections 506(c); and (c) other problematic and miscellaneous provisions. If not resolved in a manner that is acceptable to the Committee, these issues may put the interests of general unsecured creditors (and the estate) at a serious disadvantage at the outset of these cases. As such, the Committee requests that the Court only approve the DIP Facility and Bidding Procedures subject to appropriate modifications to address the concerns raised in this Objection.

BACKGROUND

8. On April 2, 2014 (the "Petition Date"), the Debtors filed the DIP Motion. The DIP Motion sought approval of a priming subordinated senior secured super-priority postpetition extensions of credit in an aggregate principal amount not to exceed $7 million (the "DIP Facility"). On April 7, 2014, following a preliminary hearing on the DIP Motion, the Court entered an order

approving the DIP Motion on an interim basis (the "Interim DIP Order"). A final hearing is scheduled for April 21, 2014 at 10:00 a.m. (ET) to approve the DIP Facility on a final basis (the "Final DIP Order")

9. On April 2, 2014, the Debtors filed the Sale Motion. Part I of the Sale Motion requests approval of the proposed bidding procedures (the "Bidding Procedures") set forth in the Sale Motion. Also, on April 2, 2014, the Debtors requested a hearing on the Bidding Procedures on shortened notice on or before April 17, 2014. On April 8, 2014, the Debtors filed a proposed order approving the Bidding Procedures [Docket No. 70]. A hearing on the Bidding Procedures was scheduled for April 15, 2014 and was subsequently adjourned to April 21, 2014 at 10:00 a.m. (ET).

10. On April 10, 2014, the United States Trustee for the District of New Jersey appointed the Committee pursuant to Section 1102(a)(1) of the Bankruptcy Code. The Committee is comprised of the following members: Simon Property Group, Inc.; American Cargo Express; Ningbo Morning Garments, Co.; Argix Direct, Inc.; and GGP Limited Partnership.

OBJECTION TO THE BIDDING PROCEDURES

11. The Committee does not support the approval of the Bidding Procedures because, as currently drafted, the Bidding Procedures provide inadequate time for the Committee to conduct its investigation and address important issues in these cases. The Bidding Procedures also provide the stalking horse bidder with credit bid rights that are inappropriate and may chill bidding. The Committee has shared its concerns with respective counsel to the Debtors and Suchman in an effort to achieve a consensual resolution. However, due to the deadline for objections and the fact that it appears unlikely that all of the Committee's concerns will be resolved consensually, it is necessary for the Committee to file this Objection and request that this

Court deny approval of the Bidding Procedures absent the revisions and modifications described herein.

A. The Proposed Sale is Subject to Heightened Scrutiny Because the Stalking Horse Bidder is an Insider

12. The Bankruptcy Code defines "insider" as an "affiliate or insider of an affiliate [of the debtor] as if such affiliate were the debtor." 11 U.S.C. § 101(31)(E). In the present case, Suchman, the stalking horse bidder, is owned by Gerszberg who is also the indirect owner of the Debtors. The proposed sale to Suchman is therefore an insider transaction.

13. As stated by courts in this circuit and others, transactions involving insiders are subject to a heightened level of scrutiny. *See Crown Vill. Farm, LLC v. Arl. L.L.C.* (*In re Crown Vill. Farm, LLC*), 415 B.R. 86, 93 (Bankr. D. Del. 2009) (holding that "[t]he sale process will be under the close scrutiny of the Court as required where the stalking horse is an insider"). Accordingly, insider transactions cannot be approved unless they are the product of an "arm's length bargain" with "inherent fairness" from the viewpoint of interested parties. *Pepper v. Litton*, 308 U.S. 295, 306-07 (1939); *see also Brewer v. Erwin & Erwin P.C.* (*In re Marquam Inv. Corp.*), 942 F.2d 1462, 1466 (9th Cir. 1991) (applying "rigorous scrutiny" to an insider's transactions with a bankrupt corporation).

14. Given the multiple roles of Gerszberg and Suchman in these chapter 11 cases, including those of stalking horse bidder, prepetition secured lender, and DIP lender, the inherent conflicts in these chapter 11 cases are pervasive. As a result, the Court must evaluate the proposed sale transaction under the heightened scrutiny standard to ensure the sale and Bidding Procedures comply with the "inherent fairness" standard described above.

15. As currently formulated, the milestone in the DIP Facility requiring an Auction on or prior to May 17, 2014 does not afford the Committee sufficient time to carry out its fiduciary

duties, determine whether the proposed transactions are the product of arm's length negotiations, and complete its investigation. Indeed, the Committee's challenge period under the Final DIP Order will not expire until June 9, 2014. It is currently anticipated that the Committee will need the full duration of its challenge period to evaluate all of the prepetition transactions, potential causes of action, and value maximizing alternatives for these Chapter 11 Cases. The Committee is unaware of any compelling reason why the quick sale to an insider must be completed even before the Committee's challenge period expires.

16. The timeline also does not afford the interested parties a fair opportunity to participate in the Auction. The Debtors only retained their investment banker, Innovation Capital, LLC ("Innovation"), shortly before the Petition Date. The Committee understands that Innovation has begun contacting potentially interested parties to solicit interest in the Debtors' assets. Since no prepetition marketing process occurred, interested third parties must be afforded adequate time to conduct due diligence, formulate bids and procure the necessary financing to participate in the sale process. If the sales process is intended to be a true market test of the value of the Debtors' assets, the procedures must be fair, reasonable, and appropriate. The Committee submits that the proposed timeline should be extended by at least four weeks to provide a level playing field for all interested bidders.

17. The Committee understands the very real possibility that there may be no other viable or interested third party purchaser for the Debtors' assets and that extending the sales process may not result in additional bidders. Nonetheless, the sales process must be slowed to afford the Committee the opportunity to conduct adequate due diligence and determine whether Suchman should be walking away with the company free and clear.

B. The Stalking Horse Bidder Should Not Be Entitled to Credit Bid

18. Bankruptcy Code section 363(k) permits the holder of an allowed secured claim to credit bid the full face amount of its claim when the collateral securing such claim is sold outside the ordinary course of business. A secured creditor's ability to credit bid, however, is within the discretion of the court and is not absolute. Under the plain language of section 363(k), a creditor's right to credit bid may he abrogated for "cause." 11 U.S.C. § 363(k); *see also In. re N.J. Affordable Homes Corp.*, No. 05-60442 (DHS), 2006 Bankr. LEXIS 4498, at *59 (Bankr. D.N.J. June 29, 2006) (noting that a bankruptcy court retains the authority to deny a secured creditor the ability to credit bid for "cause"). The term "cause" is not defined in the Bankruptcy Code and is left to the courts to determine on a case-by-case basis. *Id.* (finding that cause is "intended to be a flexible concept enabling a court to fashion an appropriate remedy on a case-by-case basis").

19. The Bankruptcy Court for the District of Delaware recently limited the right of a secured creditor to credit bid "for cause" on the basis that bidding would be chilled if the secured creditors' credit bid was not capped. *In re Fisker Auto. Holdings, Inc.*, No. 13-13087(KG), 2014 Bankr. Lexis 230, *14 (Bankr. D. Del. Jan. 17, 2014). Here, the Debtors acknowledge the *Fisker* decision and attempt to distinguish it in the Sale Motion by asserting that the "concerns that the court in Fisker confronted simply do not apply here." Sale Motion ¶ 33, n.3. In fact, the situation in *Fisker* is strikingly similar to the situation in these cases. In *Fisker*, the debtors were also attempting to accomplish a sale of all their assets to an insider over a period of 45 days that included the Thanksgiving, Christmas, and New Year holidays. *Fisker* at *14. *The Fisker* court was never provided with a satisfactory reason for the speed of the sale and the Court believed that the rushed process was inconsistent the notions of fairness in the bankruptcy process. *Id.* As a result, the bankruptcy court reduced the amount of the secured creditor's credit bid from $75 million to $25 million. In these cases, there also appears to be no reason to rush the completion of

the sale other than for the benefit of Suchman. The Committee and other constituencies are being similarly denied the fairness of the bankruptcy process by the Debtors' desire to rush the sales process over a holiday period.

20. The Debtors assert that critical to the *Fisker* holding was the fact that there was a dispute with respect to whether the secured creditor had a properly perfected lien on the assets. Sale Motion ¶ 33, n.3 The Debtors further state that Suchman "clearly has a lien on *all* of the assets it is acquiring under its credit bid and there can be no reasonable dispute as to the validity of Suchman's liens." *Id.* This attempt to distinguish *Fisker* misses the mark completely. First, while the disputed liens were considered by the court in reaching its conclusion, the court was equally persuaded that cause existed to limit the credit bid due to the fast paced sales process and chilling effect on bidding. Second, just as in *Fisker*, it is unclear in these cases what the amount of Suchman's allowed secured claim, if any, will ultimately be. The Committee has not yet received any documents to even begin to test the validity of all of the liens of Suchman. The Committee must also investigate whether Suchman's insider claims should be subject to recharacterization or equitable subordination. As described herein, the Committee has already questioned whether Suchman is providing a DIP Facility or whether Gerszberg is just shifting his obligations from one entity to another. The Debtors' conclusory statements regarding the validity and extent of Suchman's liens abrogate the investigation and challenge rights that the Committee is afforded under the Final DIP Order. Suchman should not be entitled to credit bit its claims until the Committee has had an opportunity to conduct its investigation and such period is not scheduled to expire until, at least, June 9, 2014.

21. For the foregoing reasons, the Committee respectfully requests that this Court deny approval of the Bidding Procedures absent the modifications described herein.

OBJECTION TO THE DIP MOTION

A. The DIP Facility Does Not Comport with the Legal Standard for Postpetition Financing

22. The Debtors may obtain postpetition financing on a super priority claim basis only if, *inter alia*, they cannot obtain "unsecured credit allowable under section 503(b)(1)" of the Bankruptcy Code. *See* 11 U.S.C. § 364(c). In addition, a court must review the terms of a debtor-in-possession facility to determine whether those terms are fair, reasonable and adequate given the circumstances of the debtor and the proposed lender. *See, e.g., In re Aqua Assocs.*, 123 B.R. 192, 195-96 (Bankr. E.D. Pa. 1991) *citing In re Crouse Group, Inc.*, 71 B.R. 544, 549 (Bankr. E.D. Pa. 1987) (holding that proposed financing should be beneficial and reasonable); *In re Ames Dep't Stores, Inc.*, 115 B.R. 34, 37 (Bankr. S.D.N.Y. 1990) (court should focus on terms of proposed financing to determine whether they are reasonable); *In re Tenney Vill. Co., Inc.*, 104 B.R. 562, 568 (Bankr. D.N.H. 1989) (debtor-in-possession financing terms must not "pervert the reorganizational process from one designed to accommodate all classes of creditors and equity interests to one specifically crafted for the benefit" of the secured creditor).

23. The proposed DIP Facility is by no means a typical chapter 11 financing transaction. Rather, it is another example of the prepetition practice of Gerszberg to transfer assets and liabilities among his companies in whatever manner seems appropriate to Gerszberg at a given time. The Debtors' prepetition secured indebtedness includes approximately $6 million outstanding under a Factoring Facility. DIP Motion ¶ 10. To secure repayment of the Factor Facility, the Debtors granted the Factor a blanket security interest in and lien against all assets of the Debtors. *Id.* ¶ 8. As additional security for the Factoring Facility, Gerszberg and entities he owns and controls provided guarantees of the Debtors' obligations. *Id.* ¶ 9. Additionally, Suchman pledged to the Factor an aggregate of $6 million in cash (the "Cash Dominion") as security for the Debtors' liabilities and

obligations under the Factoring Facility. *Id.*

24. Pursuant to the Interim DIP Order, the Debtors have obtained the consent of the Factor to release $5 million of the Cash Dominion in connection with Suchman's commitment to provide the DIP Facility. Interim DIP Order ¶ 8(d). Therefore, Suchman's so-called DIP Facility consists primarily of funds it was already holding to guarantee the Debtors' obligations under the Factoring Facility. Most troublesome is the fact that the Debtors are now required to maintain a collateral base securing the Factor's indebtedness of not less than $1 million in cash collateral and $8 million in inventory. *Id.* Accordingly, the reality of the DIP Facility is that Suchman has relieved itself of the obligation to hold $6 million in cash collateral as security for the Debtors' Factoring Facility and foisted that obligation upon the Debtors in the form of an obligation to maintain higher inventory levels.

25. As discussed in further detail below, the Committee submits that all of the protections afforded in the DIP Facility (some of which may be typical in other cases) are unwarranted in these cases because Suchman is not actually extending new credit to the Debtors. Suchman has overreached through the proposed DIP Facility in the following ways: (a) the proposed liens on and superpriority claims in the Debtors' avoidance actions and proceeds from leasehold interests are unwarranted and prejudicial to unsecured creditors and the estate; (b) the waiver of Bankruptcy Code section 506(c) is inappropriate; and (c) miscellaneous provisions such as payments to family members, waiver of marshaling, and broad releases are inappropriate given the facts and circumstances of these chapter 11 cases.

B. The Proposed Liens on and Claims in The Debtors' Avoidance Actions and Proceeds of Leases are Unwarranted.

26. According to the Interim DIP Order, Suchman was granted liens on and superpriority

claims in the proceeds of the Debtors' chapter 5 causes of action (the "Avoidance Actions")[3] and the Debtors' leasehold interests (to the extent permitted by the underlying lease documents) and the proceeds thereof (the "Lease Proceeds"). Interim DIP Order ¶ 11(a). In addition, Suchman was granted adequate protection liens on and superpriority claims in the Avoidance Actions and Lease Proceeds. *Id.* ¶ 11(c). As discussed below, without modification, these proposed "protections" are inappropriate and plainly contrary to the interests of the Debtors' estates and unsecured creditors.

27. It is well established that causes of action brought under chapter 5 of the Bankruptcy Code should be preserved for the benefit of unsecured creditors. *See Buncher Co. v. Official Comm. of Unsecured Creditors of GenFam Ltd. P'ship IV*, 229 F.3d 245, 250 (3d Cir. 2000) ("The purpose of fraudulent conveyance law is to make available to creditors those assets of the debtor that are rightfully part of the bankruptcy estate, even if they have been transferred away."); Bankruptcy Rule 4001(c)(1)(B)(xi) (specifically requiring disclosure of financing terms providing for liens on avoidance actions). The intent behind the avoidance power is to allow the debtor-in-possession to recover certain payments on behalf of all creditors. *In re Integrated Testing Prods. Corp.*, 69 B.R. 901, 904 (D.N.J. 1987) (finding that only the trustee, acting on behalf of all of the creditors, has a right to recover payments made as preferences).

28. Furthermore, avoidance actions are not a debtor's property, but rather are rights that may be exercised to benefit a debtor's creditors. *See Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery (In re Cybergenics Corp.)*, 226 F.3d 237, 243-45 (3d Cir. 2000) *rev'd en banc*, 330 F.3d 548 (3d Cir. 2003) (holding that fraudulent transfer claims belong to creditors and that a Chapter 11 debtor-in-possession does not acquire its creditors' fraudulent

[3] This is an "extraordinary provision" under the Court's Guidelines for Cash Collateral and Financing Requests.

transfer claims as a result of filing for bankruptcy); *In re Sweetwater*, 55 B.R. 724, 731 (D. Utah 1985), *rev'd on other grounds*, 884 F.2d 1323 (10th Cir. 1989) ("The avoiding powers are not 'property' but a statutorily created power to recover property"). Indeed, numerous courts severely restrict a debtor-in-possession's ability to pledge avoidance actions as security for post-petition financing. *See In re Roblin Indus., Inc.,* 52 B.R. 241, 243 (Bankr. W.D.N.Y. 1985) (DIP financing not approved where condition of extending loan is debtor's waiver of avoidance actions against lenders in violation of their fiduciary duties); *Official Comm. of Unsecured Creditors v. Gould Electronics Corp. (In re Gould Electronics Corp.)*, 1993 U.S. Dist. LEXIS 14318, *12 (N.D. Ill., Sept. 22, 1993) (vacating bankruptcy court order approving post-petition financing "to the extent that the order assigned to the bank a security interest in the debtor's preference actions").

29. In the present case, the DIP Collateral includes the Debtors' Avoidance Actions which is an asset that should be preserved for the benefit of general unsecured creditors. As a result, the proposed DIP liens and Superpriority Claims in the Debtors' Avoidance Actions should be stricken from the Final DIP Order. Similarly, the Final DIP Order should carve out any proposed DIP liens on and Superpriority Claims in the Lease Proceeds. To the extent that these assets were unencumbered prepetition, Suchman should not be permitted to "grab" these assets as part of the DIP Facility to the detriment of the unsecured creditors.

C. The Proposed Bankruptcy Code Section 506(c) Waiver Should Not Be Permitted in this Case

30. The Committee objects to the proposed waiver of the Debtors' rights to recover the reasonable, necessary costs and expenses of preserving or disposing of property securing an allowed secured claim of Suchman and to any waiver of section 506(c) rights with respect to the Suchman. Interim DIP Order ¶ 17. By waiving their rights under section 506(c) of the Bankruptcy Code, the Debtors are essentially agreeing to pay for any and all expenses associated with the

preservation of the Suchman's collateral out of general unsecured creditor recoveries or administrative and priority recoveries. Such waivers have been found unenforceable on the basis that they provide a windfall to the secured creditor at the expense of unsecured claimants. *See, e.g., In re Lockwood Corp*., 223 B.R. 170 (B.A.P. 8th Cir. 1998) (citation omitted); *Kivitz v. CIT Group/Sales Fin., Inc.*, 272 B.R. 332, 334 (D. Md. 2000) (section 506(c) of the Bankruptcy Code exists so that unsecured creditors are not required to bear the cost of protecting collateral that is not theirs and to require the secured party to bear the costs of preserving or disposing its own collateral); *In re Ridgeline Structures, Inc.*, 154 B.R. 831, 832 (Bankr. D. N.H. 1993) (waiver of rights pursuant to section 506(c) of the Bankruptcy Code without regard to party's action or inaction is against public policy and unenforceable *per se*); *McAlpine v. Comerica Bank-Detroit (In re Brown Bros., Inc.)*, 136 B.R. 470, 474 (W.D. Mich. 1991) (cash collateral order unenforceable to the extent its provisions attempted to immunize postpetition lender from surcharge payment obligations pursuant to section 506(c) of the Bankruptcy Code).

31. The proposed waiver of section 506(c) rights is particularly egregious in these cases because they are undoubtedly being run primarily for the benefit of Gerszberg – the individual who is the Debtors, the lender, and the licensor of intellectual property to the Debtors. Eliminating the ability to surcharge Suchman's collateral pursuant to section 506(c) of the Bankruptcy Code will foist all of the costs associated with the chapter 11 process onto the estate and the unsecured creditors. A debtor's right to surcharge a secured lender's collateral is designed to protect creditors and the Committee submits that the estates should not be forced to bear such a burden. For the foregoing reasons, the Committee respectfully submits that the section 506(c) waiver should be eliminated from the Final DIP Order.

D. Miscellaneous Objectionable Provisions in the DIP Facility

32. In addition to the objections and requested modifications discussed above, there are several additional provisions of the DIP Motion that the Committee objects to:

- **Payments to Gerszberg and Family Members.** The DIP Budget includes payments to Seth Gerszberg, Emily Holton (Wife) and Rose Gerszberg (Mother). The Committee does not understand the necessity of paying Seth Gerszberg when a CRO has been retained at $75,000/month to operate the Debtors' business. Similarly, the Committee requires additional information to determine whether payments to Ms. Holton and Ms. Gerszberg are necessary and appropriate.

- **Financial Covenant Test.** The DIP financial covenant test, which is based on a rolling 4-week look back test, does not allow the Debtors to defer budgeted items to future weeks during certain test periods. In addition, the cash receipts covenant is also inappropriate because an event of default would be created even if cash receipts were higher by 20% (which actually would be a positive event). DIP Credit Agreement § 6.02.

- **Releases.** The Interim DIP Order provides for broad releases of Gerszberg, Suchman, and all related entities with respect to all causes of action upon expiration of the Committee's challenge period. ¶ 20(b). Such a broad release to insiders is entirely inappropriate in a Final DIP Order especially when there is no assurance at this time that the Debtors will be confirming a chapter 11 plan. Assuming the requisite showing is made and standards are met, such releases may only be granted as part of a chapter 11 plan. Any release granted upon the expiration of the Committee's challenge period should be limited to causes of action relating to the extent, validity, priority, or enforceability of the prepetition liens.

- **The Bankruptcy Milestones.** As noted above, the DIP Facility provides for aggressive milestones related to the sale of the Debtors' assets, including conducting an auction by May 17, 2014. The Committee believes that the unnecessarily rushed process is inappropriate and may inhibit the maximization of recoveries for general unsecured creditors. The Committee submits that the milestones should be adjourned by at least four weeks so as to permit the Committee, which was only formed **seven days ago**, to complete its investigation and determine if the proposed sale to Suchman is in the best interests of the Debtors' estates.

- **Marshaling Waiver.** The Interim DIP Order provides that Suchman shall not be subject to the equitable doctrine of marshaling with respect to any of its collateral. ¶ 17. The facts of these cases weigh heavily against the approval of this waiver. These cases were clearly commenced for the benefit of Gerszberg and Suchman, admitted insiders of the Debtors, with the intent of selling the company pursuant to a very aggressive timetable.

RESERVATION OF RIGHTS

33. The Committee reserves the right to raise further and other objections to the Sale Motion and the DIP Motion prior to or at the hearing in the event the Committee's objections raised herein are not resolved prior to such hearing.

CONCLUSION

WHEREFORE, the Committee respectfully requests that the Court deny the Sale Motion and DIP Motion, or, in the alternative, approve the Sale and DIP Motion after making the modifications described herein and grant other and further relief as is just and proper.

Dated: April 17, 2014

Respectfully submitted,

/s/ Jessica M. Ward

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