Docket #0122 Date Filed: 7/17/2014

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	Chapter 11
SOURCE HOME ENTERTAINMENT, LLC, *et al.*,[1]	Case No. 14-11553 (KG)
	(Jointly Administered)
Debtors.	**Objection Deadline: Extended for Committee to July 17, 2014 at 1:00 p.m. (ET)** **Hearing Date: July 21, 2014 at 2:00 p.m. (ET)**
	Related Docket Nos. 12 and 45

OBJECTION OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS TO DEBTORS' MOTION FOR ENTRY OF INTERIM AND FINAL ORDERS (A) AUTHORIZING POSTPETITION USE OF CASH COLLATERAL, (B) GRANTING ADEQUATE PROTECTION TO THE SECURED PARTIES, (C) SCHEDULING A FINAL HEARING PURSUANT TO BANKRUPTCY RULE 4001(B), AND (D) GRANTING RELATED RELIEF

The Official Committee of Unsecured Creditors (the "Committee") appointed in the bankruptcy cases of the above-captioned debtors and debtors-in-possession (the "Debtors"), by its proposed undersigned counsel, hereby submits this Objection to Debtors' *Motion for Entry of Interim and Final Orders (A) Authorizing Postpetition Use of Cash Collateral, (B) Granting Adequate Protection to the Secured Parties, (C) Scheduling a Final Hearing Pursuant to Bankruptcy Rule 4001(B), and (D) Granting Related Relief* [Docket No. 12] (the "Cash Collateral Motion"),[2] and in support of this Objection states as follows:

[1] The Debtors, together with the last four digits of each Debtor's federal tax identification number are: Source Home Entertainment, LLC (8517); Directtou, Inc. (4741); RDS Logistics, LLC (0305); Retail Vision, LLC (2023); Source Interlink Distribution, LLC (3387); Source Interlink International, Inc. (1428); Source Interlink Manufacturing, LLC (7123); and Source Interlink Retail Services, LLC (6967). The location of the Debtors' corporate headquarters and the service address for all Debtors is 27500 Riverview Center Boulevard, Suite 400, Bonita Springs, Florida 34134.

[2] Capitalized terms used herein but not defined herein shall have the meaning given to such terms in the Cash Collateral Motion.

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Jurisdiction and Venue

1. This Court has jurisdiction to consider the Cash Collateral Motion and this Objection under 28 U.S.C. §§ 157 and 1334. This matter is a core proceeding within the meaning of 28 U.S.C. § 157(b). Venue of these proceedings is proper in this District pursuant to 28 U.S.C. §§ 1408 and 1409.

Background

2. On June 23, 2014 (the "Petition Date"), the Debtors commenced these cases by filing voluntary petitions for relief under chapter 11 of the Bankruptcy Code. The factual background relating to the Debtors' commencement of these cases is set forth in the *Declaration of Stephen Dubé in Support of First Day Motions* (the "First Day Declaration") [Docket No. 2].

3. The Debtors have continued in the possession of their property and are continuing to operate and manage their businesses as debtors and debtors-in-possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

4. On the Petition Date, the Debtors filed certain "First-day Motions," including the Cash Collateral Motion.

5. After a "first-day" hearing held on June 24, 2014, prior to the appointment of the Committee, the Court entered the *Interim Order (A) Authorizing Postpetition Use of Cash Collateral, (B) Granting Adequate Protection to the Secured Parties, (C) Scheduling a Final Hearing Pursuant to Bankruptcy Rule 4001(B), and (D) Granting Related Relief* [Docket No. 45] (the "Interim Order").

6. On July 10, 2014, the Office of the United States Trustee appointed the Committee pursuant to section 1102 of the Bankruptcy Code [Docket No. 107].

7. Also on July 10, 2014, the Committee selected Lowenstein Sandler LLP and Duane Morris LLP to serve as its counsel.

8. Each Debtor is a party to a Term Loan Agreement, dated as of October 4, 2013, with certain lenders (the "Term Loan Lenders") and Cortland Capital Market Services, LLC, as administrative and collateral agent ("Term Loan Agent" and collectively with the Term Loan Lenders, the "Secured Creditors" or alternately, the "Secured Parties"). See *First Day Declaration*, ¶ 16. As of the Petition Date, there was approximately $51.9 million outstanding under the term loan facility. See *id.* The Debtors' capital structure also includes a secured revolving credit facility with Wells Fargo Capital Finance, LLC,[3] and a loan from Wachovia Bank, National Association that is secured by certain real estate in Coral Springs, Florida. According to the First Day Declaration, the revolving facility and the mortgage loan are over-secured and these respective lenders enjoy an equity cushion. See *id.* at ¶ ¶ 30 and 35.

PRELIMINARY STATEMENT

9. The Committee is not opposed in principle to the Debtors' request to use Cash Collateral to preserve the saleable assets of the estates and to wind down the distribution business. However, certain provisions of the Interim Order are unduly prejudicial to the interests of unsecured creditors and, therefore, should be stricken or modified in any Final Order authorizing the Debtors' use of Cash Collateral (the "Final Order") as more particularly set forth below.

10. The Committee's meaningful participation in these chapter 11 cases is critical to a fair process, especially here where (i) the Debtors and the Secured Creditors are pursuing a quick

[3] The revolving facility provides for a revolving asset-based line of credit and a letter of credit facility. According to the First Day Declaration, there are letters of credit with a face amount of $17.5 million outstanding (but not drawn upon) under the facility that are fully collateralized by Wells Fargo holding approximately $18.5 million in cash of the Debtors.

sale of the profitable Retail Display Business owned by Debtor Source Interlink Manufacturing, LLC to insiders by a credit bid, and (ii) there was a major prepetition restructuring of the Debtors and its former affiliates involving a debt-for-equity swap among its lenders and equity holders who are in fact the same parties. These cases were filed and are being run for the primary purpose of selling the Debtors' remaining business (the Retail Display Business) to the Secured Parties. The Secured Parties are the stalking horse bidder, the equity holders of the Debtors and control the Debtors. Also, the Secured Parties are not providing any new cash to the Debtors.

11. The Committee requires sufficient time and resources to, among other things, scrutinize the sale process, purported liens and prepetition transactions, including the so-called October 2013 Restructuring. Yet the Interim Order, and the Final Order as proposed, would severely restrict rights of the Committee to obtain meaningful information about the Debtors' businesses, to conduct a full investigation of potential claims and to participate in the sale and plan process. The terms of the proposed Final Order are onerous and seek to marginalize the unsecured creditors in these cases. For the reasons set forth herein, the Committee respectfully requests that the Cash Collateral Motion be denied or the proposed Final Order modified to address the Committee's objections set forth herein and any further objections that may be raised by the Committee at the "second day" hearing.

OBJECTIONS

A. Secured Creditors' Superpriority Administrative Claims Should Not Be Payable From Proceeds of Avoidance Actions.

12. While the Interim Order does not grant the Secured Parties liens on claims and causes of action of the Debtors' estates under sections 544, 545, 547, 548, 549 and 550 of the Bankruptcy Code and the proceeds thereof (collectively, the "Avoidance Actions"), the Interim Order grants the Secured Parties adequate protection superpriority administrative claims pursuant

to sections 503(b) and 507(b) of the Bankruptcy Code, to the extent of any postpetition diminution in the value of the Secured Parties' interest in their prepetition collateral, which would be payable from the Avoidance Actions, or proceeds or property recovered in respect of the Avoidance Actions. Interim Order at ¶ 9. This is objectionable.

13. Avoidance actions are not property of a debtor's estate. *See Official Comm. of Unsecured Creditors v. Chinery (In re Cybergenics, Corp.)*, 226 F.3d 237, 244 (3d Cir. 2000) (avoidance actions are not property of the estate, but are essentially rights held by the estate for the benefit of creditors); *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").

14. Avoidance actions are therefore distinct creatures of bankruptcy law designed to ensure equality of distribution among general unsecured creditors. Because of the unique nature of avoidance actions, courts have recognized that, at least with respect to proceeds recovered pursuant to § 544(b) of the Bankruptcy Code, "empowering the trustee or debtor in possession to avoid a transaction by pursuing an individual creditor's cause of action is a method of forcing that creditor to share its valuable right with other unsecured creditors." *Cybergenics*, 226 F.3d at 244; *see also, Buncher Co. v. Official Committee of Unsecured Creditors of GenFarm Ltd. P'ship IV*, 229 F.3d 245, 250 (3d Cir. 2000) ("When recovery is sought under section 544(b) of the Bankruptcy Code, any recovery is for the benefit of all unsecured creditors, including those who individually had no right to avoid the transfer.").

15. It is unfair and prejudicial to allow the Secured Parties to be able to receive payment on superpriority claims from what may be the unsecured creditors' only source of recovery (if the Debtors' estimates of value in these cases are correct). Accordingly, proceeds of

avoidance actions should be preserved solely for the benefit of the Debtors' unsecured creditors and not subject to the Secured Parties' superpriority claims.

B. The Committee Must Be Afforded Adequate Opportunity and Resources to Investigate Liens and Claims and Should be Granted Standing to Assert Challenges.

16. While the Interim Order and proposed Final Order acknowledge the Committee's rights to challenge the Debtors' stipulations regarding liens and liability, they do not provide the Committee with a sufficient time period and resources in which to conduct its review and bring any appropriate causes of action. The Interim Order and proposed Final Order provide for a mere 60 days for the Committee to bring Challenges (the "Challenge Period"). See *Interim Order*, ¶ 4. The Committee must be provided with a sufficient time to obtain the documents necessary for a competent review of the Secured Parties' (and other secured parties') security interests and liens and to evaluate potential claims and causes of action. In addition to lien review and analysis, in October of 2013, the Debtors engaged in a substantial restructuring of their debt and equity among insiders, including a separation of affiliate companies. The Committee requires significant additional time to obtain and review documents related to the so-called October 2013 Restructuring, because this transaction is included in the broad release required under the Interim Order.

17. Thus, the Committee seeks a period of no less than 120 days from its receipt of all credit, security and restructuring documents, and all other agreements and documents necessary to complete the investigation, and, if appropriate, to contest the nature, extent, validity and priority of the Secured Parties' liens, the October 2013 restructuring, or to bring other actions. Furthermore, the Committee seeks adequate resources to fully conduct such investigation and therefore objects to the $50,000 cap on fees and expenses for Committee professionals contained in the Interim Order and the proposed Final Order. The Committee needs to be properly funded

in order to conduct a responsible investigation into, among other matters, the October 2013 Restructuring as well as the three credit facilities purportedly encumbering the Debtors' assets.

18. The Interim Order also limits the Committee's ability to assert any Challenge by first requiring the Committee to obtain an order granting it standing to assert such Challenge. It is unfair to limit the time in which the Committee may bring a Challenge and then further abridge that period by requiring that a motion to establish standing be fully litigated before the end of the Challenge Period. Courts in this district and elsewhere have routinely approved cash collateral and post-petition financing orders that grant standing to the creditors' committee without the need for a standing motion. *See, e.g., In re American Safety Razor, LLC*, Case No. 10-12351 (Bankr. D. Del. Aug. 27, 2010), *In re PCAA Parent LLC*, Case No. 10-10250 (Bankr. D. Del. Mar. 2, 2010); *In re Pliant Corp*., Case No. 0910443 (Bankr. D. Del. Mar. 20, 2009); *see also, In re Quebecor World (USA) Inc.*, Case No. 0810152 (Bankr. S.D.N.Y. Apr. 1, 2008); *In re Dana Corp*., Case No. 06-10354 (Bankr. S.D.N.Y. Mar. 29, 2006).

19. The Committee, therefore, requests that the Final Order (i) grant the Committee a Challenge Period of not less than 120 days from its receipt of all credit, security and restructuring documents, the October 2013 restructuring, and all other agreements and documents necessary to complete the investigation, and, if appropriate, to contest the nature, extent, validity and priority of the Secured Parties' liens or to bring other actions, (ii) remove any cap on fees and expenses for investigation of security interests, liens, the October 2013 Restructuring and other transactions involving the Secured Parties, and (iii) grant the Committee standing to bring Challenges.

C. There is no Justification for Disparate Treatment of Committee Professionals.

20. Del. Bankr. L.R. 4001-2 provides that financing motions must justify the inclusion of "[p]rovisions that provide disparate treatment for the professionals retained by a creditors' committee from those professionals retained by the debtor with respect to a professional fee carve-out." Del. Bankr. L.R. 4001-2(a)(i)(F).

21. In this case, the proposed Final Order would cap the fees and expenses of the Committee's lawyers and financial advisors in an aggregate amount not to exceed $100,000 per month. At the same time, the Debtors' professionals have no such cap on their fees and expenses. Interim Order at ¶ 8(c). Moreover, in the event a Carve-Out Trigger Notice is issued, Committee professionals' fees and expenses are capped at $50,000 while the Debtors' professionals are subject to an $800,000 cap. *Id.* Notwithstanding the local rule, the Debtors have provided no justification for the disparate treatment of Committee professionals.

22. The Cash Collateral Motion offers no reason, and there is no legal or equitable justification for, the inequitable treatment of Committee's professionals here. As discussed above, the facts of this case make it critical that the Committee have the time and resources to fully participate in these cases. The Final Order should be modified to remove any caps to the fees and expenses of Committee professionals.

D. The Sale Milestones are Inappropriate.

23. The Interim Order and the proposed Final Order impose deadlines for the approval of bid procedures and the sale of substantially all of the assets of Debtor Source Interlink Manufacturing, LLC and make the Debtors' failure to achieve the deadlines an "Event of Default," without providing the Committee with adequate time to evaluate the marketing process and to review and value the Debtors' businesses and the assets to be sold. Interim Order

at ¶ 11(e). In particular, the Debtors should be required to demonstrate that vigorous marketing efforts were conducted and are part of a robust sale and auction process calculated to maximize recovery for creditors of these estates. Instead, the stalking horse bidder is the Secured Parties, which parties also hold the equity of the Debtors and control the Debtors. Further, according to the Debtors' motion seeking approval of the sale and bidding procedures, [4] there was no pre-Petition Date marketing of the Retail Display Business. Only now has the Debtors' financial advisor, FTI Consulting, upon information and belief, developed a list of potential buyers and begun to market the business.

24. Furthermore, a cash collateral order should not be used as a means to lock in the terms of a plan of liquidation before the Committee has had a meaningful chance to participate in the sale and/or plan process.

25. Accordingly, the Committee respectfully submits that the milestones and deadlines regarding the sale process each need to be extended by at least 45 days. Further, the deadlines/milestones should be stricken from any Final Order to the extent that failure to meet such milestones results in an Event of Default.

E. Waiver of Rights Under Bankruptcy Code § 506(c) is Inappropriate.

26. The section 506(c) waiver serves no purpose other than to eliminate a potential avenue of recovery for the Debtors' estates by ensuring that the costs of the Debtors'

[4] The Committee has also objected on several grounds to the proposed bid procedures. See the contemporaneously filed *Objection of the Official Committee of Unsecured Creditors to the Debtors' Motion for Entry of (I) an Order (A) Approving Bidding Procedures and Bid Protections in Connection With the Sale of Certain of The Debtors' Assets, (B) Approving the Form and Manner of Notice, (C) Scheduling an Auction and a Sale Hearing, (D) Approving Procedures for the Assumption and Assignment of Contracts, and (E) Granting Related Relief and (Ii) an Order (A) Approving the Asset Purchase Agreement Between the Debtors and the Purchaser, (B) Authorizing the Sale of Certain of the Debtors' Assets Free and Clear of Liens, Claims, Encumbrances, and Interests, (C) Authorizing the Assumption and Assignment of Contracts, and (D) Granting Related Relief.*

restructuring will be borne by the unsecured creditors alone – even if the unsecured creditors receive no value. Moreover, the waiver contravenes the intent behind section 506(c) of the Bankruptcy Code. *In re Codesco, Inc*., 18 B.R. 225, 230 (Bankr. S.D.N.Y. 1982) ("The underlying rationale for charging a lienholder with the costs and expenses of preserving or disposing of the secured collateral is that the general estate and unsecured creditors should not be required to bear the cost of protecting what is not theirs.").

27. Courts routinely reject attempted waivers of surcharge rights under section 506(c) in various post-petition financing contexts. *In re Visual Indus., Inc*., 57 F.3d 321, 325 (3d Cir. 1995) ("[Section] 506(c) is designed to prevent a windfall to the secured creditor . . . . The rule 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 . . . .") (internal citation omitted); *In re The Colad Group, Inc*., 324 B.R. 208, 224 (Bankr. W.D.N.Y. 2005) (refusing to approve DIP financing with a section 506(c) waiver intact); *In re Willingham Invs., Inc*., 203 B.R. 75, 80 (Bankr. M.D. Tenn. 1996); Kivitz v. CIT Group/Sales Fin., Inc., 272 B.R. 332, 334 (D. Md. 2000) (a secured party, and not other creditors, must bear the cost of preserving or disposing of its own collateral); *In re AFCO Enters., Inc*., 35 B.R. 512, 515 (Bankr. D. Utah 1983) ("When the secured creditor is the only entity which is benefited by the trustee's work, it should be the one to bear the expense. It would be unfair to require the estate to pay such costs where there is no corresponding benefit to unsecured creditors."); *see also, In re Motor Coach Indus. Intl, Inc*., Case No. 08-12136 (Bankr. D. Del. Oct. 22, 2008) (Final Order Authorizing Debtors to Obtain Postpetition Financing) (Docket No. 244) (removing a section 506(c) waiver from the final post-petition financing order after the creditors' committee objected to its inclusion); *In re Fedders North America, Inc*., Case

No. 07-11176 (Bankr. D. Del. Oct. 5, 2007) (Final Order Authorizing Debtors to Obtain Postpetition Financing) (Docket No. 272) (a section 506(c) waiver in the interim post-petition financing order was removed from the final post-petition financing order after the creditors' committee objected to its inclusion).

28. A 506(c) waiver is especially inappropriate in this case where the Secured Parties are not providing any new cash and cash collateral is being used almost exclusively to preserve and liquidate the Secured Parties' collateral for the Secured Parties' sole benefit. Any Final Order should ensure that the Debtors' estates retain all of their rights under section 506(c) of the Bankruptcy Code.

F. A Waiver of the "Equities of the Case" Exception in Section 552(b) of the Bankruptcy Code Is Premature and Improper.

29. Neither the Debtors nor the Secured Creditors have provided any basis for curtailing the Court's power to exclude post-petition proceeds from the Secured Parties' prepetition collateral, based on the equities of the case under section 552(b) of the Bankruptcy Code.

30. Section 552(b) provides that the Prepetition Lenders' liens will attach to the proceeds of their 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). This Court cannot possibly determine what the "equities of the case" are after only a few weeks, or order the elimination today of a remedy that could be based on "equities of the case" tomorrow. *See 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). Nor should the Court enter an order which eliminates a remedy (exclusion of proceeds from a prepetition lien) that is intended to benefit unsecured creditors. If

the actions of unsecured creditors during these chapter 11 cases increase the value of the Secured Creditors' collateral, unsecured creditors should be able to argue that such value inures to them, and not to the Secured Creditors. Such an argument should not be foreclosed at this early stage in these cases. Therefore, the Committee asserts that any such waiver is premature and inappropriate at this time, and should be stricken from the Final Order.

G. The Releases of the Secured Parties are Too Broad.

31. Pursuant to the Interim Order, without prejudice to the Committee's right to investigate and commence a Challenge during the Challenge Period, the Debtors grant broad, general releases to the Secured Parties as well as "each of their respective officers, directors, employees, agents, sub-agents, attorneys, advisors and affiliates." Interim Order at ¶ E(h).

32. The Committee also objects that the releases are overbroad and appear to release all claims and causes of action (both prepetition and postpetition) of the Debtors against the Secured Parties and other parties.

33. For example, the releases would appear to release claims under 506(c) of the Bankruptcy Code which the Committee is seeking to preserve.

34. The releases are also premature. The granting of such broad, general releases by the Debtors should not be approved at this time and should be considered, if at all, in connection with confirmation of the Debtors' Plan.

35. To the extent the Court is inclined to grant releases in connection with the use of cash collateral, the Debtors should be required to justify the proposed releases and the releases should be narrowly tailored to the extent necessary as adequate protection for the use of cash collateral.

H. Fees and Expenses Received by the Secured Parties as Adequate Protection Should be Subject to Recharacterization.

36. Under the Interim Order and the proposed Final Order, the Secured Parties and the Revolving Lenders are entitled to be paid its reasonable attorneys' fees and expenses as adequate protection. Interim Order at ¶ 10. To the extent that the Court determines that the Secured Parties and/or the Revolving Lenders are not entitled to such payments under section 506(b) of the Bankruptcy Code then such payments should be recharacterized as payment(s) applied to the principal amount of indebtedness owed to such parties.

I. Information Should Be Shared With The Committee.

37. The Committee should be provided with copies of all reporting materials and other information provided to the Agents. The Committee, as the fiduciary representative of the Debtors' unsecured creditors, is entitled to receive any and all documentation and/or notices required to be provided to the Agents and the other Secured Parties or the Debtors under the Interim Order and the proposed Final Order contemporaneously with the delivery of such information to such parties.

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WHEREFORE, the Committee respectfully requests that the Court (i) deny the Cash Collateral Motion; or alternatively, (ii) enter an order that addresses the Committee's objections as set forth herein; and (iii) grant the Committee such other and further relief as the Court deems just and appropriate.

Dated: July 17, 2014
Wilmington, Delaware

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