Docket #0134 Date Filed: 08/07/2019

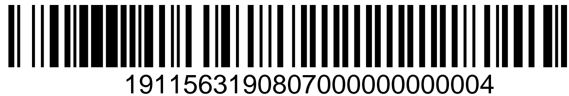
UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	:	Chapter 11
EMERGE ENERGY SERVICES LP, et al.,[1]	:	Case No. 19-11563 (KBO)
	:	(Jointly Administered)
Debtors.	:	

COMBINED OBJECTION OF MARKET AND JOHNSON, INC., STOUT EXCAVATING GROUP LLC, AND A-1 EXCAVATING, INC. TO DEBTORS' MOTION (I) PURSUANT TO 11 U.S.C. §§ 105, 361, 362, 363, AND 364 AUTHORIZING THE DEBTORS TO (A) OBTAIN SENIOR SECURED PRIMING SUPERPRIORITY POSTPETITION FINANCING, (B) GRANT LIENS AND SUPERPRIORITY EXPENSE STATUS, (C) USE CASH COLLATERAL OF PREPETITION SECURED PARTIES AND (D) GRANT ADEQUATE PROTECTION TO PREPETITION SECURED PARTIES; (II) SCHEDULING A FINAL HEARING PURSUANT TO BANKRUPTCY RULES 4001(b) and 4001(c); AND (III) GRANTING RELATED RELIEF

Pursuant to 11 U.S.C. §§ 361, 362, 363, and 364, and Fed. R. Bankr. P. 4001(c), Market and Johnson, Inc. ("M&J"), Stout Excavating Group LLC ("Stout"), and A-1 Excavating, Inc. ("A-1" and, collectively with M&J and Stout, the "Creditors"), who are creditors in this case, through its undersigned counsel, objects to the Debtors' Motion (I) Pursuant to 11 U.S.C. § 105, 361, 362, 363 and 364 Authorizing the Debtors to (A) Obtain Senior Secured Priming Superpriority Post-Petition Financing, (B), Grant Liens and Superpriority Administrative Expense Status, (C) Use Cash Collateral of Prepetition Secured Parties and (D) Grant Adequate Protection to Prepetition Secured Parties; (II) Scheduling a Final Hearing Pursuant to Bankruptcy Rules 4001(b) and

[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are: Emerge Energy Services LP (2937), Emerge Energy Services GP LLC (4683), Emerge Energy Services Operating LLC (2511), Superior Silica Sands LLC (9889), and Emerge Energy Services Finance Corporation (9875). The Debtors' address is: 5600 Clearfork Main Street, Suite 400, Fort Worth, Texas 76109.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4001(c); and (III) Granting Related Relief (the "Motion"). (Doc. No. 20). In support of their objection, the Creditors assert as follows:

JURISDICTION AND VENUE

1. The above-captioned debtors and debtors-in-possession (collectively, the "Debtors"), including Superior Silica Sands, LLC ("Superior"), each filed for relief under chapter 11 of the bankruptcy code on July 15, 2019 (the "Petition Date"). Each of the Debtors have continued to operate their respective businesses and manage their respective properties as debtors-in-possession in accordance with 11 U.S.C. §§ 1107(a) and 1108.

2. This Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157(b) and 1334(b), and this is a core proceeding under 28 U.S.C. § 157(b)(2).

3. Venue is proper in this Court pursuant to 28 U.S.C. § 1409(a).

4. On July 30, 2019, the Office of the United States Trustee for the District of Delaware appointed an Official Committee of Unsecured Creditors (the "Committee") in this case.

5. The Creditors have not waived and may not be deemed to have waived any rights to have final orders in non-core matters and/or matters entitled to adjudication by a judge authorized under Article III of the U.S. Constitution entered only after de novo review by a District Court Judge.

6. On July 17, 2019, the Court conducted a hearing and entered an interim order (the "Interim Order") granting the Motion. (Doc. No. 64). As of the date of this objection, it does not appear the Debtors have not submitted a proposed final order.

7. The Creditors do not oppose the proposed use of cash collateral. They do object to certain provisions of the proposed debtor-in-possession financing, as more fully set forth below.

This objection is premised upon the Motion's failure to comply with the provisions of 11 U.S.C. §§ 361, 362, 363, and 364, and is interposed pursuant to Fed. R. Bankr. P. 4001(c).

PARTIES AND GENERAL BACKGROUND

8. The Debtors, through the operations of Superior, engage in the mining, processing, and distribution of silica sand for use in hydraulic fracturing (or "fracking") of oil and gas wells. Superior has silica mining facilities in Wisconsin, Texas, and Oklahoma.

9. M&J is a construction management company. M&J contracted with Superior to provide construction management and general contracting services for mines located in Bexar County, Texas, and Kingfisher County, Oklahoma.

10. Stout is a mining and excavation company. Stout contracted with Superior to provide mining services at the Bexar County mine and excavation services at the Oklahoma facility.

11. A-1 is a mining and excavation company. A-1 contracted with Superior to provide mining services at Superior's mining facilities in Barron County, Wisconsin.

12. On January 3, 2019, M&J filed a lien affidavit in Bexar County, Texas, asserting a statutory and constitutional lien against the real estate and improvements associated with the Bexar County mine. M&J's lien under Chapter 53 of the Texas Property Code and Article 16, Section 37 of the Texas Constitution secures payment of $4,850,087.00. In addition to the amounts specifically identified in the lien affidavit, M&J is owed an additional $3,952,072.22 for work on the Bexar County mine.

13. On January 25, 2019, M&J filed a lien affidavit in Oklahoma asserting a mechanic's or materialmen's lien pursuant to 42 Okla. Stat. 141, *et seq.*, for work performed in constructing the dry plant portion of the Oklahoma mining facility. In its original lien claim, M&J asserted a

claim for $3,220,478.00. M&J subsequently filed a revised affidavit asserting a claim in the amount of $3,957,088.00.

14. As of the Petition Date, Stout was owed at least $3,271,853.45 by Superior for mining services, together with additional damages for breach of a mining services agreement. Stout holds statutory mining lien rights under Texas Property Code § 56.001, *et seq.*, which provides a lien to secure payment for labor or services related to mineral activities (including "digging" a "mine or quarry"). The lien rights cover approximately $2,478,853.00 of Stout's claim. The statutory lien is upon the land where the labor was performed, the buildings, and "other material, machinery, and supplies used for mineral activities and owned by the owner of the property." *See* Texas Property Code § 56.003. The lien arises upon the accrual of indebtedness and the lien may be secured (or maintained) by filing an affidavit with the county clerk of the county in which the property is located. *See* Texas Property Code § 56.021.[2]

15. As of the Petition Date, A-1 was owed at least $1,195,911.89 by Superior for mining services performed prior to the petition date, together with additional damages for breach of a mining services agreement. A-1 holds statutory mining lien rights under Wis. Stat. § 779.35, which provides a lien for any person who performs labor or services for the purpose of mining minerals. The lien rights cover approximately $712,000 of A-1's total claim and the lien is upon all personal property "connected with the mining" and the interests in "any real estate connected with the mining, smelting, or manufacturing business." Under Wis. Stat. § 779.38, the mining lien rights arise from the date the labor is performed. In order to maintain the lien as to real estate, a

[2] As a result, Stout's lien rights were acquired before the date of perfection within the meaning of 11 U.S.C. § 546(b)(1)(A) and the act of filing a lien claim as required by Texas law is excepted from the automatic stay under 11 U.S.C. § 362(b)(3). Stout anticipates filing its lien claim to maintain its statutory lien rights.

claim must be filed in the office of the clerk of the circuit court for the county in which the real estate is located.[3]

16. As indicated in the Motion and supporting declarations, the Debtors commenced work on the Oklahoma sand facility in late 2018. The Debtors assert they "discontinued" work on the Oklahoma project in January of 2019 after incurring approximately $15.3 million in expenses, of which $7.3 million (including substantial sums owed to M&J) remain unpaid.

17. As noted above, M&J performed the general contracting services for construction of the "dry" plant on the Oklahoma mine. Based upon its review of the status of the project, it appears the dry plant is virtually complete and literally a few weeks away from being operational. The wet plant, however, was still in the middle of the construction process when the Debtors opted to discontinue their efforts.

18. The Motion and related supporting documentation appear to suggest that there may be little more than nominal value associated with the Oklahoma mine. However, as indicated above, the dry plant could be rendered operational in short order. The real estate owned by Superior consists of a 40-acre parcel which houses the dry plant and the partially constructed wet plant. The Debtors also still hold mineral lease rights for several hundred acres of adjoining real estate. Even without a functional wet plant, an operator could utilize the dry plant as soon as it was completed. As a result, the Creditors submit that the Oklahoma mine may have *substantial* value whether it is kept as part of a going-concern valuation of the Debtors or sold to a third party.[4]

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[3] As a result, A-1's lien rights were acquired before the date of perfection within the meaning of 11 U.S.C. § 546(b)(1)(A) and the act of filing a lien claim as required by Wisconsin law is excepted from the automatic stay under 11 U.S.C. § 362(b)(3). A-1 anticipates filing its lien claim to maintain its statutory lien rights.

[4] The Creditors recognize valuation is not a critical issue for determination at the present juncture; however, they believe these details may provide context as to the overall posture of the case.

THE DEBTOR-IN-POSSESSION FINANCING REQUEST

19. As part of their first day orders in this case, the Debtors' Motion requested that the court authorize postpetition secured debtor-in-possession financing in an aggregate principal amount of up to $7,500,000 on an interim basis and a total of $35,000,000 on a final basis. The Court granted interim relief as requested and set a final hearing on the Debtors' Motion for August 14, 2019. A copy of the proposed Senior Secured Priming and Superpriority Debtor-in-Possession Credit and Security Agreement (the "DIP Financing Agreement") was provided to creditors along with the Notice of the Interim Order (Doc. No. 78).

20. In the Motion, the Debtors asserted that they were parties to certain first and second lien obligations with HPS Investment Partners LLC as administrative and collateral agent on behalf of the "First Lien Prepetition Lenders" and the "Second Lien Prepetition Noteholders."

21. In the Motion, the Debtors (except for Emerge Energy Services GP LLC and Emerge Energy Services Finance Corporation) asserted they owed the First Lien Prepetition Lenders "not less than $66,710,000, plus accrued and unpaid interest and fees with respect thereto."

22. In the Motion, the Debtors (except for Emerge Energy Services GP LLC and Emerge Energy Services Finance Corporation) asserted they owed the Second Lien Prepetition Noteholders "not less than $215,755,307, plus accrued and unpaid interest and fees with respect thereto."

23. In the Motion, the Debtors asserted that the First Lien Prepetition Lenders and the Second Lien Prepetition Noteholders (collectively, the "Prepetition Lenders") were secured creditors holding liens on the "Prepetition Collateral" identified in the respective loan documents.

24. In the Motion, the Debtors asserted that the "Prepetition Collateral" – which was not expressly delineated in any particular detail – nonetheless "comprises *substantially all* of the Debtors' assets." [Emphasis added].

25. The Debtors did not submit, as part of the Motion or supporting declarations, the loan documents evidencing the Prepetition Lenders' claims, any account history or other calculation of the amounts due, or proof of perfection of any of the Prepetition Lenders' purported secured claims.

26. In the Motion, the Debtors justified the request for DIP financing upon their lack of cash and insufficient sources of working capital to carry on their business. They also asserted the proposed postpetition facility was the best option available and that new credit was otherwise unavailable without providing HPS Investment Partners LLC, now in its capacity as agent for the DIP Lenders (i.e., the Prepetition Lenders), the superpriority claims and liens on DIP Collateral as identified in the DIP loan documents.

27. Among the required components of the DIP Financing Agreement are the following:

a. A first lien on unencumbered property, including avoidance actions;

b. Priming liens on Prepetition Collateral;

c. Adequate protection payments to the Prepetition Lenders;

d. Releases of any claims against the Lenders and their Agent;

e. Provisions authorizing relief from the automatic stay upon default;

f. Waivers of rights under § 506(c);

g. A provision that the "equities of the case" exception of § 552(b) will not apply to the Prepetition Lenders' secured claims; and

h. Mandated compliance with the Restructuring Support Agreement (the "Restructuring Agreement").

28. As to that last item, it should be noted the Restructuring Agreement, which was entered into by the Debtors and the lenders prior to the filing of this case, effectively dictates the anticipated outcome of this bankruptcy.[5] For example, the Debtors' proposed plan, which was filed on July 25, 2019, conforms to its terms. Those terms include a proverbial "death trap" in which a distribution will be provided to unsecured creditors only if they vote in favor of the plan, and even then as a diluted pro rata share in a small portion of the equity of the proposed reorganized debtors. If unsecured creditors vote to reject they plan, they are projected to receive nothing on their claims.

29. The Debtors' ability to propose or implement a plan which deviates from the terms of the Restructuring Agreement (or the current proposed plan) appears to be severely constrained. For example, the Debtors are obligated to (i) support and promptly consummate the "transaction" as defined; (ii) not take any action that is "inconsistent with, or is intended or is reasonably likely to interfere with or impede or delay consummation of" the transaction; and (iii) not file or otherwise pursue a chapter 11 plan that is "inconsistent" with the terms of the Restructuring Agreement. *See* Exhibit B to Declaration of Bryan M. Gaston in Support of Chapter 11 Petitions and First Day Pleadings (Doc. No. 14) at p.7, ¶ 5.

30. As part of the Restructuring Agreement, the Debtors appointed a special restructuring committee consisting of members selected from a roster of candidates approved by the Prepetition Lenders. This committee is tasked with implementing the Restructuring Agreement.

31. The Restructuring Agreement provides that it may be terminated by the Creditors if the Debtors enter into an "Alternative Transaction" (defined as a competing plan of

[5] To date, it does not appear the Debtors have sought court approval of the Restructuring Agreement itself.

reorganization or other restructuring, the sale of material assets, or other merger, consolidation, refinancing, or the like which the special restructuring committee determines "in good faith" maximizes value). It may also be terminated if the Debtors file any motion or other pleading indicting an intention to support or pursue any plan of reorganization which is "inconsistent in any material respect" with the Restructuring Agreement or the related term sheet.

BASIS FOR OBJECTION

32. The Debtors accurately assert that entry into a postpetition lending facility is generally governed by the business judgment standard. *In re Trans World Airlines, Inc.*, 163 B.R. 964, 974 (Bankr. D. Del. 1994). But to say that the Debtors think the DIP Financing Agreement is reasonable under the circumstances is not enough. Instead, the Debtors' business judgment remains constrained by the concept that debtors are given latitude and their judgment is authorized (or honored) only so long as the financing agreement "does not contain terms that leverage the bankruptcy process and powers" or its purpose "is not so much to benefit the estate as it is to benefit a party-in-interest." *In re Ames Dep. Stores, Inc.*, 115 B.R. 34, 40 (Bankr. S.D.N.Y. 1990).

33. For the reasons which follow, the Creditors submit that the DIP Financing Agreement *does* inappropriately leverage the bankruptcy process and tilts the playing field far too much for the benefit of the Prepetition Lenders to the exclusion of other interested parties. Final approval of the Motion should only be granted to the extent these issues are resolved.

I. The Threshold Concerns – Asset Value and Lien Priority

34. The fundamental premises ostensibly justifying the Debtors' Motion and approval of the DIP Financing Agreement are logically summed up as follows:

i) The debts owed to the First Lien Prepetition Lenders and the Second Lien Prepetition Noteholders total more than $280,000,000.

ii) The collateral securing these obligations consists of "substantially" all of the Debtors' assets.

iii) The going-concern value of the operation (and the assets) is less than $280,000,000.

iv) *Therefore*, no other creditor really has a basis for complaining about the terms by which these lenders provide postpetition credit to the Debtors, because pretty much everything was their collateral to start with.

35. The Creditors dispute the premises which lead to this conclusion. Specifically, they question the going concern valuation asserted by the Debtors and the Lenders and anticipate the accurate valuation of the Debtors' assets will be a substantive issue in this case. Just as importantly, they challenge whether the Lenders actually have valid first priority liens on "substantially" all of the Debtors' prepetition assets.

36. Notwithstanding the assertions in the Debtors' Motion, neither the First Lien Prepetition Lenders nor the Second Lien Prepetition Noteholders appears to hold a recorded mortgage against the real estate associated with the Oklahoma mining facility (which includes the real estate and any improvements constructed thereon – namely, the dry plant constructed by M&J as well as the wet plant at least partially constructed by others) or certain parcels of real estate in Wisconsin associated with the Wisconsin mining operations.

37. Subsequent to the filing of this case, the Creditors conducted a title search of the Oklahoma mine parcel. Superior took title to the parcel in question on October 1, 2018. A title search of the property going back as far as October 1, 2015, reflects that there no liens against the property *other than* those of M&J and various other construction lien claimants, all of which were filed in 2019.

38. In addition, the Creditors have performed a title search of the real property associated with Superior's facility in Barron County, Wisconsin. Several of those parcels likewise

do not appear to have mortgages in favor of either the First Lien Prepetition Lenders or the Second Lien Prepetition Noteholders. To the extent the Prepetition Lenders do not hold a prepetition priority lien on these mining-related properties, A-1 holds statutory mining lien rights against them which would be prior to any lien interests granted pursuant to the DIP Financing Agreement.

39. As outlined above, M&J and Stout also hold liens or lien rights against the facility in Bexar County, Texas. The relative priority of these rights has not yet been definitively determined.

40. The Creditors recognize that the Debtors' proposed DIP Financing Agreement and the Interim Order acknowledge the possibility that other creditors *might* hold superior lien interests in some portion of the Debtors' assets. For example, ¶ 13(a)(iii) of the Interim Order provides that the DIP lenders will receive *junior* liens upon property to the extent that, as of the Petition Date, the property was subject to "valid, perfected and unavoidable liens senior to the Prepetition Liens in existence immediately prior to the Petition Date." Likewise, the DIP Financing Agreement recognizes the possible existence of "Prior Permitted Liens" which would include certain valid, perfected, and unavoidable liens in favor of third parties. *See* § 7.2 and definitions of "Permitted Encumbrances" and "Prior Permitted Liens."

41. In addition, the Creditors note that pursuant to ¶ 26 of the Interim Order, the Debtors' stipulations are not binding upon the Creditors for a period of 75 days after entry of the Interim Order so as to permit certain "Challenges" to be lodged. These Challenges would include objections to the stipulated valuation of assets as well as issues of lien priority.

42. However, for the avoidance of doubt, the Creditors have not stipulated to valuation and do not consent to the priming of any lien or interest they hold in the collateral which secures their liens. This objection is filed specifically to preserve and reserve all issues as to lien priority,

including that the Debtors' assets might include assets which are covered by superior liens of third parties, including the Creditors, and to avoid any suggestion that they may have waived the right to dispute the assertions contained in the Debtors' Motion that the Prepetition Collateral (and therefore the DIP Collateral) consists of "substantially" all of the Debtors' assets. The Debtors' Motion does not propose – and the Creditors have not received – any form of adequate protection within the meaning of 11 U.S.C. § 361 which would justify the priming of their liens. *See* 11 U.S.C. § 364(d)(1)(B) (secured credit may be authorized if there is adequate protection of the interest of the holder of the lien on the property of the estate on which such senior or equal lien is proposed to be granted).

II. The Unqualified Right to Credit Bid

43. In the Debtors' Motion, they indicate that the DIP Agent will have the right to credit bid up to the full amount of the DIP Obligations in any sale of the DIP Collateral, and the Prepetition Noteholders will likewise have the right to credit bid up to the full amount of the prepetition obligations in connection with a sale of any DIP Collateral. As more fully noted in the Debtors' Motion, the DIP Lenders exercise of their "*unqualified right to credit bid up to the full amount of the outstanding DIP Obligations* (including any accrued interest) in *any sale of the Collateral* (or any part thereof) may include, with the consent of the applicable Prepetition Agent on behalf of the applicable Prepetition Secured Party, *a credit bid of the Prepetition Obligations*." [Emphasis Added]. This language is mirrored in ¶ 38 of the Interim Order.

44. 11 U.S.C. § 363(k) provides that at a sale of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the holder of such claim "may bid at such sale, and, if the holder of such claim purchases such property, such holder may

offset such claim against the purchase price of such property." Notably, the statute itself does not delineate the precise mechanisms by which credit bids can be made.

45. The Debtors' Motion and the DIP Financing Agreement both define the DIP Collateral to include those assets which might be subject to a *junior* lien in favor of the DIP Lenders (i.e., property which is thus subject to *superior* liens in favor of third parties). Conceptually, a junior creditor cannot "pay" a senior lender through a credit bid – the senior creditor receives nothing of value through such a transaction. In general, the claims of senior lenders must be satisfied in *some* fashion.

46. The Creditors therefore object to these provisions and submit that the DIP Financing Agreement should only be approved if the final order provides that to the extent any lien priority disputes have not been resolved before approval of a sale or confirmation of the plan, the DIP Lenders must account for the Prior Permitted Liens in some fashion. By way of example: perhaps they may only credit bid as against Collateral which is not subject to Prior Permitted Liens; or any successful credit bids remain subject to such liens; or the DIP Lenders must contribute cash into escrow, post a bond, or otherwise establish a reserve for the payment or full satisfaction of any senior third party liens on the Debtors' assets. Regardless, the Creditors oppose approval of any agreement which seemingly allows the DIP Lenders to hold an "unqualified right" to credit bid without adequately accounting for the interests of senior lenders (or Prior Permitted Liens). At a minimum, the final order should provide that credit bids may be entered in conformity with § 363(k), and all issues related to the manner in which credit bids may impact any Prior Permitted Liens are reserved for later determination.

III. Mandated Compliance with the Restructuring Agreement

47. The DIP Financing Agreement provides an affirmative covenant that the Debtors (or the "Credit Parties") "shall remain in compliance at all times with the Restructuring Agreement." *See* § 6.15 of the DIP Financing Agreement. It also provides the Debtors will not seek "to take any action that is prohibited by the terms of this Agreement or the Other Documents." *See* § 7.19(b). The Restructuring Agreement falls under the broad definition of "Other Documents." The failure to comply with the Restructuring Agreement is therefore also an event of default that triggers relief from the automatic stay. *See* §§ 10.5 and 11.1 of the DIP Financing Agreement.

48. To date, the Debtors have not directly requested that the Court approve the Restructuring Agreement. However, approval of the DIP Financing Agreement clearly incorporates mandated compliance with its terms. Ostensibly, the Restructuring Agreement provides that the Debtors' obligation to support and consummate the transfer of ownership to the Prepetition Lenders in accordance with the stated term sheet is subject to their "applicable fiduciary duties." As a practical matter the DIP Financing Agreement makes it very difficult for the Debtors to even negotiate with other creditors for fear that doing so might lead to a default and the termination of postpetition credit. Indeed, even deviating from the restructuring timeline found in the Restructuring Agreement's term sheet could potentially result in default. *See* ¶ 6 and p. 6 of Appendix I of Restructuring Agreement (termination occurs if the transaction is not "consummated *in accordance with* this Agreement and the Term Sheet," the latter of which contains a detailed in-court restructuring timeline).

49. The challenge of deviating from the terms of the Restructuring Agreement in any potential plan is made abundantly clear by additional provisions of the DIP Financing Agreement

which provide that the filing of any plan which is "not an Approved Chapter 11 Plan" is also an event of default that not only terminates the financing but results in relief from the stay. *See* §10.7(b) of the DIP Financing Agreement. An "Approved Chapter 11 Plan" is defined to mean a plan which is acceptable to the DIP Lenders (i.e., the Prepetition Lenders) in their "sole and absolute discretion."

50. The Creditors submit that compliance with the Restructuring Agreement should not be mandated unless and until that agreement is itself approved by the Court – especially where there is not yet any evidence that the deal memorialized in the term sheet is, in fact, the best deal available for all creditors. As noted above, the point at which courts stop deferring to a debtors' business judgment in the context of postpetition financing is where the proposed agreement attempts to excessively leverage the bankruptcy process or it is designed more to benefit a party-in-interest than the estate. *Ames Dep. Stores, Inc.*, 115 B.R. at 40; *see also In re Inkeepers USA Trust*, 442 B.R. 227, 235 (Bankr. S.D.N.Y. 2010) (termination events in plan support agreement which triggered not only termination of "support" for restructuring but also halted use of cash collateral and lifted the stay allowed lender to wield an "unacceptable" amount of power over the fate of the cases). In a similar vein, the Creditors submit that while the broad grant of relief from the stay to be exercised in the DIP Lenders' sole discretion is itself an excessive leveraging of the process, tying defaults (and stay relief) to another separate agreement which is not even before the Court for approval should not be permitted.

IV. The Effect of Self-Interested Releases on Potential Derivative Standing

51. Section 2.21 of the DIP Financing Agreement provides that the Debtors will release the Lenders and their Agent of all claims, including those arising under Sections 541 through 550 of the bankruptcy code. Paragraph 26 of the Interim Order provides that the Debtors' stipulations

and agreements will be immediately binding on the Debtors "in all circumstances and for all purposes," but they will not be binding on *third parties* for a "Challenge Period" consisting of seventy-five (75) days from entry of the Interim Order for creditors other than the Committee, and, for the Committee, sixty (60) days after its appointment. During the Challenge Period, these third parties are entitled to determine whether to raise claims against the Prepetition Lenders.

52. Paragraph 7 of the Interim Order indicates that the Debtors' releases are effective as of the date of the final order but are "subject" to the provisions of Paragraph 26, including the expiration of the Challenge Period. The Interim Order also indicates the existence of the Challenge Period does not itself constitute a grant of derivative standing or authority to pursue claims belonging to the Debtors or their estates.

53. The DIP Financing Agreement and the Interim Order do not clearly delineate what happens if the Committee or other third parties determine that they believe the Debtors in fact held a "Challenge" to the Lenders' claims as of the Petition Date. The Creditors submit that the final order should indicate how the Committee or third parties should present requests for derivative standing or authority to pursue claims or causes of action which belong to the Debtors or their estates. In the alternative, the final order should at a minimum confirm that the right of third parties to seek such relief (and to pursue such claims on behalf of the Debtors or their estates) is preserved notwithstanding the effectiveness of the releases as to the Debtors themselves.

V. Filing Proofs of Claim

54. The Debtors recently filed a motion to establish September 9, 2019, as the general bar date for the filing of proofs of claim. (Doc. No. 117).

55. Paragraph 33 of the Interim Order indicates that the Prepetition Agents will not be required to file proofs of claim to assert claims on behalf of the Prepetition Lenders. Instead, "[t]he

statements of claim . . . set forth in this Interim Order, together with any evidence accompanying the Motion and presented at the Interim Hearing, are deemed sufficient to and constitute proofs of claim in respect of such debt and such secured status." The Creditors acknowledge that a declaration was filed in support of the first day motions by Bryan Gaston on behalf of the Debtors, and the Debtors have made various stipulations regarding their entry into prepetition obligations, the amounts owed, and the purported perfection of liens. However, the Creditors do not believe the Prepetition Lenders have themselves substantially complied with the bankruptcy rules regarding proofs of claim.

56. Fed. R. Bankr. P. 3001(c)(1) provides that when a claim, or an interest in property of the debtor securing the claim, is based on a writing, *a copy of the writing shall be filed with the proof of claim.* Likewise, Rule 3001(d) provides that if a security interest in property of the debtor is claimed, the proof of claim *shall* be accompanied by evidence that the security interest has been perfected.

57. As outlined above, preliminary title searches indicate that the Lenders may not, in fact, hold valid, perfected, first position liens on "substantially" all of the Debtors' assets. To the extent the Lenders are excused from complying with Rule 3001 and are not required to provide copies of the loan documents and evidence of perfection of their liens, the Creditors submit the process of assessing their claims during the "Challenge Period" is potentially made more difficult insofar as third parties may now be required to engage in discovery to get information which should normally be provided as part of a proof of claim. The Creditors submit the Prepetition Lenders should not be excused from filing proofs of claim unless they have substantially complied with the provisions of Rule 3001 as to the provision of documents which support the claim and evidence perfection of liens.

VI. Liens on Avoidance Actions

58. The DIP Financing Agreement and the Interim Order reflect that the DIP Lenders will receive liens upon the proceeds of all avoidance actions.

59. As outlined above, the basic framework of this case is one in which, prior to the filing, the Debtors agreed with the Prepetition Lenders to a transaction in which the Lenders' claims would be partially transferred into equity in a reorganized entity. The Debtors then selected a Special Committee fashioned from the Prepetition Lenders' nominees to carry out the terms of that transaction. The Prepetition Lenders are, in effect, financing the Debtors' operations pending their acquisition of the company.

60. The Creditors submit that granting the DIP Lenders (who are, in reality, the Prepetition Lenders) a security interest in all avoidance actions effectively immunizes them from the potential consequences of their own actions (or inactions) while affording minimal – if any – benefit to other creditors. In general, avoidance actions should inure to the benefit of unsecured creditors. Further, to the extent *the Prepetition Lenders* are themselves subject to avoidance actions, those recoveries should be for the benefit of *other* creditors, not the Prepetition Lenders in their role as the "DIP Lender" who is providing the interim financing before they effectuate a takeover of the Debtors. Again, the Creditors submit that these provisions veer beyond what might be appropriately judged within the scope of the Debtors' business judgment, and are instead provisions by which the DIP Lenders hope to leverage the bankruptcy process in their favor.

VII. Waiver of §§ 506(c) and 552(b)

61. Paragraph 16 of the Interim Order provides that any and all payments remitted to the DIP Agent on behalf of the DIP Lenders pursuant to the DIP Financing Agreement will be irrevocable and received free and clear of any charge, assessment, or other liability, including,

without limitation, "any claim or charge arising out of or based on, directly or indirectly, sections 506(c) or 552(b)."

62. 11 U.S.C. § 506(c) provides that a trustee may recover from property securing an allowed secured claim "the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim."

63. The purpose of § 506(c) is remarkably narrow – it allows a trustee (and not other creditors or parties in interest) to charge administrative costs and expenses to the collateral securing a claim under certain equitable grounds – namely, that the holder of the claim benefited from it. *See Hartford* Underwriters *Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 14 (2000). The Creditors submit neither the Debtors nor the DIP Lenders have demonstrated *why* it is appropriate, at this point of the case, to deviate from the balance struck by the code. Instead, this provision is merely another illustration of the ways in which the DIP Lenders seek to tip the process in their favor before the case has even begun.

64. Likewise, 11 U.S.C. § 552(b) provides that to the extent a prepetition security interest extends to property acquired by the debtor prior to the commencement of the case and to proceeds, products, offspring, or profits of such product, then the security interest will extend to such proceeds, product, offspring or profits acquired by the estate after the commencement of the case "to the extent provided by such security agreement and by applicable nonbankruptcy law, except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise."

65. Section 552 was intended to strike "an appropriate balance between the rights of secured creditors and the rehabilitative purposes of the Bankruptcy Code." *In re Tower Air, Inc.*, 268 B.R. 404, 408 (Bankr. D. Del. 2001) (citing *United Va. Bank v. Slab Fork Coal Co.*, 784 F.2d

1188 (4th Cir. 1986). In general, it is limited to chapter 11 cases in which the evidence establishes that the lender is oversecured and will obtain a windfall from collateral that has appreciated in value as a result of the debtor-in-possession's use of other assets of the estate (which otherwise would normally go to general creditors). *Tower Air*, 268 B.R. at 404.

66. In this case, the Debtors and the Prepetition Lenders both appear to assert that the lenders are *undersecured*, rather than oversecured. They are seeking to obtain DIP financing from those very same lenders pending consideration of a plan that transfers the Debtors' assets to the lenders without much (if any) distribution to unsecured creditors based upon the argument that this is still the best possible deal to be had.

67. If those assertions prove inaccurate, and if it turns out the lenders are actually *oversecured* and there is a basis for invoking the "equities of the case" to limit the extent to which their liens attach to proceeds, products, offspring, or profits acquired by the estate after the commencement of the case, such a determination is properly made *when the facts can be ascertained*. The Creditors submit it is simply too early in this case to justify altering the "appropriate balance" struck by § 552(b), and the Debtors have not made a sufficient demonstration as to why the Court should not reserve the right to make such an inquiry at a later date.

CONCLUSION

For the foregoing reasons, the Creditors request entry of an order (i) conditioning final approval of the Motion in accordance with this objection or otherwise denying approval of the Motion; and (ii) granting such other relief as the Court deems appropriate.

Date: August 7, 2019
Wilmington, DE

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CERTIFICATE OF SERVICE

I, Elihu E. Allinson III, do hereby certify I am not less than 18 years of age and that on this 7th day of August 2019, I caused copies of the within *Combined Objection of Market and Johnson, Inc., Stout Excavating Group LLC, and A-1 Excavating, Inc. to Debtors' Motion (I) Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, and 364 Authorizing the Debtors to (A) Obtain Senior Secured Priming Superpriority Postpetition Financing, (B) Grant Liens and Superpriority Expense Status, (C) Use Cash Collateral of Prepetition Secured Parties and (D) Grant Adequate Protection to Prepetition Secured Parties; (II) Scheduling a Final Hearing Pursuant to Bankruptcy Rules 4001(b) and 4001(c); and (III) Granting Related Relief* to be served upon the parties listed below via U.S. Mail, First Class, postage pre-paid. All other parties who have signed up for electronic filing in this case will receive electronic notice via CM/ECF.

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