

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:)	
)	Chapter 11
)	
EMERGE ENERGY SERVICES LP, <i>et al.</i> , ¹)	Case No. 19-11563 (KBO)
)	
Debtors.)	(Jointly Administered)
)	
)	Hearing Date: August 14, 2019 at 11:00 a.m. (ET)
)	Objection Deadline: August 12, 2019 at 5:00 p.m. (ET)
)	(extended by agreement)
)	Re: Docket No. 9

**OBJECTION OF THE OFFICIAL COMMITTEE OF
UNSECURED CREDITORS TO DEBTORS’ OMNIBUS MOTION FOR
ENTRY OF AN ORDER AUTHORIZING THE DEBTORS TO (I) REJECT
CERTAIN RAILCAR LEASE AGREEMENTS *NUNC PRO TUNC*
TO THE PETITION DATE, AND (II) ENTER INTO PROPOSED
NEW RAILCAR LEASE AGREEMENTS EFFECTIVE AS OF THE PETITION DATE**

The Official Committee of Unsecured Creditors (the “*Committee*”) of the above captioned debtors and debtors in possession (the “*Debtors*”), by and through its undersigned proposed counsel, Kilpatrick Townsend & Stockton LLP and Potter Anderson & Corroon LLP, hereby files this objection (the “*Objection*”) to the *Debtors’ Omnibus Motion for Entry of an Order Authorizing the Debtors to (I) Reject Certain Railcar Lease Agreements Nunc Pro Tunc to the Petition Date, and (II) Enter into Proposed New Railcar Lease Agreements Effective as of the Petition Date* (the “*Motion*”) [D.I. 9]. In support of this Objection, the Committee respectfully states as follows:

¹ The Debtors in these 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.



PRELIMINARY STATEMENT²

1. Less than one month from the Petition Date, the Debtors are seeking authority to enter into the New Railcar Leases, potentially saddling the Debtors' estates with tens of millions of dollars in administrative claims or more at a time when the Debtors' go-forward business plan, including the necessity of the New Railcar Leases as part of such go-forward business plan, has yet to be properly vetted by Committee. The Committee has only been in existence for 13 days and is only starting to receive diligence from the Debtors. While the Committee supports a comprehensive and viable reorganization, at this time, the Committee has not been provided with sufficient information or definitive lease documentation so as to support the relief requested in the Motion. The Committee's professionals have not seen the terms of the leases to be rejected and did not even receive the Term Sheets with respect to the New Railcar Leases until the evening of Thursday, August 8, 2019. The Term Sheets are not attached to the Motion due to, among other things, the proprietary nature of the pricing, and the Debtors, [REDACTED]. [REDACTED]. As a result, the only information the creditors and, for that matter, this Court have about the terms of the New Railcar Leases is incomplete and scant at best. Moreover, since neither the Committee nor the Court have the benefit of reviewing the New Railcar Leases, the Court is being asked to approve as-yet undrafted documents which may contain terms that are inconsistent with the Terms Sheets or have additional terms not detailed in the Term Sheets that can have a material negative impact on the Debtors' stakeholders.

2. What the Committee has ascertained from the Motion, the Debtors' other filings and the Term Sheets, which it has had for less than two-full business days, is that five out of eight

² Capitalized terms used but not otherwise defined in the Preliminary Statement shall have the meanings ascribed to them below.

of the Debtors' Wisconsin facilities, for which the railcars are used, are currently idle and demand for northern white sand produced in Wisconsin remains low. Based upon the Debtors' own filings, significant concerns are raised regarding the viability of the go-forward business at the Debtors' Wisconsin facilities. Indeed, the Debtors' plan of reorganization filed on July 25, 2019 does not address what the Debtors' plans are for the Wisconsin facilities; rather, the Debtors' reorganization seems to be centered around the San Antonio facility, which is not even fully operational. The Debtors are clearly uncertain as to the viability of the Wisconsin facilities at this juncture [REDACTED]

[REDACTED]. As such, the Committee is left questioning the necessity and benefit of the as yet undrafted New Railcar Leases at this time and cannot sit idly by while the Debtors seek to potentially impose significant administrative claims on these estates for New Railcar Leases that may prove unnecessary for the Debtors' reorganization. The Committee, therefore, requests that the Court deny the Motion or, in the alternative, continue the Motion until a later date when there is more certainty surrounding the Debtors' go-forward business and the fate of the Wisconsin facilities.

BACKGROUND

I. General Background

3. On July 15, 2019 (the "*Petition Date*"), each of the Debtors filed voluntary petitions for relief under chapter 11 of title 11 of the United States Code (the "*Bankruptcy Code*") in the United States Bankruptcy Court for the District of Delaware (the "*Bankruptcy Court*"). Pursuant to sections 1107(a) and 1108 of the Bankruptcy Code, the Debtors continue to operate their businesses and manage their properties as debtors in possession. No trustee or examiner has been appointed in the Chapter 11 Cases.

4. On July 16, 2019, the Debtors filed the Motion seeking authorization to reject certain of the Debtors' railcar leases (the "***Old Railcar Leases***") effective as of the Petition Date and enter into new railcar leases (the "***New Railcar Leases***"). As described more fully in the Motion, there has been a sharp decline in the demand for northern white sand ("***NWS***"), which the Debtors produce through their operations in Wisconsin. As a response to a market shift away from NWS to in-basin sand, the Debtors purchased sites in Oklahoma and Texas for new facilities and operations.³ Disclosure Statement ¶¶ II.B.2, II.D.1; Gaston Declaration ¶¶ 16, 29, fn. 8. Due to a continued depression in the NWS market, the Debtors closed their New Auburn, Wisconsin dry facility on May 31, 2019. *Disclosure Statement for the Joint Plan of Reorganization for Emerge Energy Services LP and its Affiliate Debtors Under Chapter 11 of the Bankruptcy Code* ("***Disclosure Statement***") ¶ II.B.5 [D.I. 99]. Three of the Debtors' five Wisconsin wet facilities and two of the Debtors' three Wisconsin dry facilities now remain idle. *Declaration of Bryan M. Gaston, Restructuring Officer of the Debtors, in Support of Chapter 11 Petitions and First Day Pleadings* ("***Gaston Declaration***") ¶ 13 [D.I. 2]. Further, frac sand can only be washed during eight months of the year at the Debtors' Wisconsin facilities due to the inability to wash frac sand in extreme cold. Disclosure Statement ¶ VI.C.14. Therefore, the Debtors only operate in Wisconsin during the spring and summer months. Gaston Declaration ¶ 13.

5. As a result of the continued depression in the NWS market, the Debtors have experienced an over-supply of lease railcars required to ship NWS from Wisconsin to the Debtors' customers across North America. Such over-supply results in significant monthly costs for railcars that are not in use. The Debtors determined "that certain of their railcar leases were on above-

³ Despite incurring \$15.2 million in costs to construct a facility at the Oklahoma site, the Debtors discontinued construction in January 2019. Gaston Declaration ¶ 29 fn. 8.

market terms that were unfavorable and/or burdensome of the Debtors and unnecessary for the Debtors' business." Motion ¶ 9.

II. Term Sheets

6. The Motion does not attach the proposed New Railcar Leases nor does it attach the term sheets for the New Railcar Leases (the "*Term Sheets*").⁴ In fact, while the Term Sheets, attached hereto as **Exhibit A**, outline the broad parameters of the parties' business understanding, they are not complete documents with fulsome contractual terms; [REDACTED]

[REDACTED]. Neither the Committee nor the Court know or can be certain [REDACTED]

[REDACTED]

[REDACTED].

7. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

⁴ The Committee only received the Term Sheets in the evening on August 8, 2019 (less than 24 hours prior to the Committee's then-scheduled objection deadline of August 9, 2019 at 4:00 p.m. (ET)) and the related letter agreements on the evening on August 9, 2019. Despite the Debtors' assertion in the Motion that the New Railcar Leases will be provided to the Court, the United States Trustee, and the Committee, [REDACTED]. Motion ¶ 14, fn. 7. The Committee received the Term Sheets on a professionals' eyes only basis. The Committee is filing a motion to seal under Local Rule 9018-1(d) contemporaneously with the filing of this Objection due to the confidential and commercially sensitive nature of the information contained in the Term Sheets.

[REDACTED]

[REDACTED]

OBJECTION

I. The Motion Should be Denied or Continued Until it is Clear That the New Railcar Leases are Necessary for the Debtors' Reorganization.

A. It is Premature to Saddle the Estates with Potentially Massive Administrative Claims.

8. While the Committee understands assumption or rejection is an exercise of the Debtors' business judgment, here, the Debtors entry into new contracts outside of the ordinary course of business dictate a more cautious approach as the potentially massive postpetition administrative claim resulting from the New Railcar Leases could be significantly more than any administrative claim resulting from the Debtors continuing to operate under the Old Railcar Leases. Moreover, [REDACTED]

[REDACTED]

[REDACTED]. Prudence would dictate that given the potential economic impact to the Debtors' estates from the New Railcar Leases that [REDACTED]

[REDACTED].

9. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED].⁶ As the Debtors propose to enter into the New Railcar Leases postpetition, such damages likely constitute tens of millions of dollars or more in administrative claims.

10. In less than four weeks, the Debtors will seek approval of the Disclosure Statement and authority to solicit the Plan. Thereafter, the Debtors will swiftly seek confirmation of the Plan with the goal of emerging from chapter 11 a mere 100 days from the Petition Date. Should the Debtors determine in the next few short weeks that the best course of action regarding the Wisconsin facilities, which are primarily idle, is to dispose of such facilities, the [REDACTED]

[REDACTED]

[REDACTED]. Such damages arising from the Debtors entry into the postpetition New Railcar Leases would likely constitute administrative claims. The Debtors could be required to pay such claims in full pursuant to section 1129(a)(9)(A) of the Bankruptcy Code in order to confirm the Plan. Based upon the information available to the Committee, including a DIP budget which provides that the \$35 million in new money debtor-in-possession financing is fully utilized by the end of the initial 18-week period from the Petition Date, it is quite possible that the [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]. The inability to pay massive administrative claims in full could either crater

[REDACTED]

these Chapter 11 Cases and the Debtors' business or soak up any unencumbered value that exists in the Debtors' estates (presently the Committee believes there is at least unencumbered value in the Kingfisher County, Oklahoma property and has not even begun in earnest its investigation of the lenders' liens). Moreover, if the Chapter 11 Cases were to convert to chapter 7, the administrative claims related to the New Railcar Leases would still be required to be paid ahead of general unsecured creditors and may be paid with unencumbered value.

11. Since the Debtors filed a Disclosure Statement and must comply with section 1129 of the Bankruptcy Code in order to confirm the Plan contemplated thereby, the Debtors will need to demonstrate that they can pay all administrative claims as part of satisfying the feasibility test. As a result, the Committee believes it is appropriate at this juncture for this Court to consider the wisdom of entering into New Railcar Leases that could result in potentially massive administrative claims that the Debtors may not need to incur due to the lack of clarity on the future of the Wisconsin facilities. The Debtors' potential inability to pay such administrative claims due to the tight budget and liquidity situation would likely render the Plan filed with the Disclosure Statement non-feasible and unconfirmable. *See, e.g., In re Am. Cap. Equip., LLC*, 688 F.3d 145, 154 (3d Cir. 2012) (finding that "a bankruptcy court may address the issue of plan confirmation where it is obvious at the disclosure statement stage that a later confirmation hearing would be futile because the plan described by the disclosure statement is patently unconfirmable"). As discussed below, the Committee submits that there are viable alternatives to the relief requested in the Motion which protect the Debtors and the stakeholders from a potentially significant administrative claim, [REDACTED], and allow the Debtors to continue to operate while they determine what the best path forward is for the Wisconsin facilities.

B. The Debtors Can Continue to Operate Under the Old Railcar Leases to Avoid Incurring Increased Administrative Claims.

12. Although the proposed order attached to the Motion provides that the order does not provide for the assumption of any lease, sublease or contract pursuant to section 365 of the Bankruptcy Code, generally, “post-petition contracts are treated the same as assumed contracts.” *In re Tex. Wy. Drilling, Inc.*, 486 B.R. 746, 755 (Bankr. N.D. Tex. 2013); *see also In re Merry-Go-Round Enters., Inc.*, 180 F.3d 149, 156 (4th Cir. 1999) (“[A]n assumed lease is functionally analogous to a postpetition lease.”). A postpetition breach of a postpetition lease gives rise to an administrative claim. *In re Merry-Go-Round Enters., Inc.*, 208 B.R. 637, 643-45 (Bankr. D. M.D. 1997) (finding that a debtor’s postpetition breach of a postpetition lease results in an administrative claim in favor of a landlord).

13. The Debtors assert, as part of their justification to enter into the New Railcar Leases, that the Debtors “will continue to incur administrative expenses arising under the [Old] Railcar Leases without any corresponding benefit to their estates.” Motion ¶¶ 19, 29. The Committee disagrees. In *In re Mid Region Petroleum, Inc.*, the Tenth Circuit Court of Appeals dealt with a substantially similar issue: whether railcar lessors are entitled to an administrative claim for railcars that the debtor possessed but did not use. 1 F.3d 1130, 1133 (10th Cir. 1993). The court did not allow an administrative claim in connection with the unused railcars. The court held that administrative expenses must *benefit* the debtor in the operation of its business. *Id.*; *see also* 11 U.S.C. § 503(a)(1) (allowing administrative expenses for the “actual, necessary costs and expenses of preserving the estate”); *In re Hechinger Inv. Co. of Delaware*, 298 F.3d 219, 226 (3d Cir. 2002) (holding that “[a]n expense incurred ‘in exchange for something that is not beneficial to the estate cannot be considered as an expense necessary for preserving the estate.’”) (quoting 2 COLLIERSON BANKRUPTCY § 503-18). The use of the words “actual” and “necessary” in

reference to administrative expenses “indicate that the estate must accrue a real benefit from the transaction for the claim is being filed.” *Broadcast Corp. of Ga. v. Broadfoot*, 54 B.R. 606, 611 (N.D. Ga. 1985). It is not enough that a debtor have access to the railcars, because the “mere potential of benefit to the estate does not satisfy this requirement.” *Id.*; see also *In re Energy Future Holdings Corp.*, 588 B.R. 371, 385-86 (Bankr. D. Del. 2018) (denying applicant’s administrative claim and stating that the applicant carries a “heavy burden” of demonstrating that the costs and fees provided an actual benefit to the estate and were necessary to preserve the value of estate assets).

14. Mere possession does not satisfy this requirement. *Mid Region Petroleum, Inc.*, 1 F.3d at 1133. In fact, a debtor’s continued possession of leased property “could be perceived as burdensome to the estate as the estate did not benefit from possession[.]” *In re Templeton*, 154 B.R. 930, 934 (Bankr. W.D. Tex. 1993); see also *In re Yost*, 54 B.R. 818, 821 n.9 (Bankr. W.D. Ky. 1985) (“It takes no great insight to perceive that rental expenses of property that is not beneficial to the Chapter 11 debtor, are not ‘actual, necessary costs and expense of preserving the estate. The reasoning behind this distinction “is the need to minimize the administrative dispersal of the estate’s limited assets, in order to protect the unsecured creditors’ interest . . . [f]urther, the threshold requirement that the expense be ‘necessary’ . . . prevents creditors seeking priority over their fellow unsecured creditors from taking advantage of a troubled entity.” *Broadfoot*, 54 B.R. at 611; see also *In re Enron Corp.*, 279 B.R. 79 (Bankr. S.D.N.Y. 2002). There are three lines of thought regarding this issue, as explained in *In re Bridgeport Plumbing Prods., Inc.*, 178 B.R. 563, 566-67 (Bankr. M.D. Ga. 1994). They are: (i) actual use; (ii) contract/lease value; and (iii) nature of property and its use. The third approach is particularly applicable when “the use of the property can be divided into discreet, leasable units[.]” *Id.* at 567.

15. Here, the costs of the unused railcars as discreet, leasable units can be determined and such railcars are not providing any benefit to the Debtors postpetition, and are, in fact, detrimental to the Debtors' estates. The costs associated with extraneous railcars cannot be said to be an actual, necessary cost and expense of preserving the estate. Accordingly, it does not appear to the Committee that there is an urgent need to enter into the New Railcar Leases. *See In re Exide Technologies*, 340 B.R. 222, 247-48 (Bankr. D. Del. 2006), *rev'd on other grounds*, 607 F.3d 957 (3d Cir. 2010) (noting that the views of the Official Committee of Unsecured Creditors was a significant factor in analyzing the debtors' proposed rejection); *see also Wheeling–Pittsburgh Steel Corp. v. West Penn Power Co. (In re Wheeling–Pittsburgh Steel Corp.)*, 72 B.R. 845, 850 (Bankr. W.D. Pa. 1987) (in upholding the debtor's decision to reject, the court noted that “quite significantly, the official committee of unsecured creditors, which has been very active in this case, supports the debtor's decision to reject the Contract. It cannot be supposed that the committee of unsecured creditors, which is duty bound to act in the best interests of unsecured creditors, would support a decision which is inimical to the best interests of the debtor's estate and unsecured creditors”).

16. The Debtors should continue to operate under the Old Railcar Leases without incurring any administrative claim for the costs associated with railcars that remain idle and unused by the Debtors postpetition, instead of entering into the New Railcar Leases thereby potentially exposing the estates to significant administrative claims for the costs of the New Railcar Leases [REDACTED]. Accordingly, the Motion should be denied, or, in the alternative, should be continued until it becomes clear that the Debtors intend to continue operations in Wisconsin and require the New Railcar Leases for the Debtors' go-forward business.

II. The Term Sheets Should be Modified to Mitigate the Magnitude of Any Potential Administrative Claim and to Clarify the Lessors' [REDACTED]

17. If the Court is not inclined to deny or continue the Motion, the Committee respectfully requests that the Court include the following language in the order granting the Motion, which will clarify that any potential administrative claim is limited to the actual use of those railcars utilized by the Debtors from the Petition Date until termination or breach of such New Railcar Lease:

Upon termination or breach of any of the New Railcar Leases or the Term Sheets, the Lessors shall not be entitled to any administrative claim for future obligations under the New Railcar Leases or the Term Sheets from the date of termination or date of breach until the end of the term of each of the New Railcar Leases.

18. The Lessors may have significant rejection damage claims that may be classified as General Unsecured Claims under the Plan. [REDACTED]

[REDACTED]

[REDACTED]

19. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

RESERVATION OF RIGHTS

20. The Committee reserves its right to amend, modify and/or supplement this Objection in all respects and on any additional grounds, including based on further information requested, and to make any additional arguments at the hearing on the Motion.

WHEREFORE, the Committee respectfully requests that the Court deny the Motion and grant such other and further relief as the Court deems just and proper.

[Remainder of Page Left Intentionally Blank]

Dated: August 12, 2019
Wilmington, Delaware

POTTER ANDERSON & CORROON LLP

/s/ Aaron H. Stulman

Jeremy W. Ryan (DE Bar No. 4057)
Christopher M. Samis (DE Bar No. 4909)
L. Katherine Good (DE Bar No. 5101)
Aaron H. Stulman (DE Bar No. 5807)
1313 North Market Street, Sixth Floor
P.O. Box 951
Wilmington, DE 19801
Telephone: (302) 984-6000
Facsimile: (302) 658-1192
Email: jryan@potteranderson.com
csamis@potteranderson.com
kgood@potteranderson.com
astulman@potteranderson.com

-and-

KILPATRICK TOWNSEND & STOCKTON LLP

Todd C. Meyers (admitted *pro hac vice*)
David M. Posner (admitted *pro hac vice*)
Kelly Moynihan (admitted *pro hac vice*)
The Grace Building
1114 Avenue of the Americas
New York, NY 10036
Telephone: (212) 775-8700
Facsimile: (212) 775-8800
Email: tmeyers@kilpatricktownsend.com
dposner@kilpatricktownsend.com
kmoynihan@kilpatricktownsend.com

-and-

KILPATRICK TOWNSEND & STOCKTON LLP

Lenard M. Parkins (admitted *pro hac vice*)
700 Louisiana Street, Suite 4300
Houston, TX 77002
Telephone: (281) 809-4100
Facsimile: (281) 929-0797
Email: lparkins@kilpatricktownsend.com

*Proposed Counsel to the Official Committee of Unsecured
Creditors of Emerge Energy Services LP, et al.*

Exhibit A

REDACTED