IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	Chapter 11
ProSomnus, Inc., *et al.*, [1]	Case No. 24-10972 (JTD)
Debtors.	(Jointly Administered)
	Re: Docket Nos. 11, 76, and 130

DEBTORS' REPLY IN SUPPORT OF (I) CRITICAL VENDOR MOTION AND (II) ORDINARY COURSE PROFESSIONALS MOTION

1. The above-referenced debtors and debtors-in-possession (the "**Debtors**") hereby file this reply (the "**Reply**") in further support of support of their motions to (i) retain and compensate professionals used in the ordinary course of business [Docket No. 76] (the "**OCP Motion**") and (ii) authorize payment of prepetition critical vendor obligations on a final basis [Docket No. 11] (the "**Critical Vendor Motion**" and together with the OCP Motion, the "**Motions**").[2] In support of the Motions, the Debtors rely upon (i) *Declaration of Brian Dow, Chief Financial Officer of the Debtors, in Further Support of Second Day Relief* [Docket No. 110] (the "**Dow Declaration**"), which is incorporated by reference herein. For the reasons set forth below the Debtors respectfully request that the Court overrule the objection to the Motions [Docket No. 130] (the "**Objection**") filed by the Office of the United States Trustee for the District of Delaware, and grant the relief requested in the Motions.

[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number are: ProSomnus, Inc. (8216), ProSomnus Holdings, Inc. (3855), and ProSomnus Sleep Technologies, Inc. (0766). The location of the Debtors' principal place of business and the Debtors' mailing address is 5675 Gibraltar Dr., Pleasanton, California 94588.
[2] Capitalized terms not defined herein shall have the meanings ascribed to such terms in the Motions.

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Preliminary Statement

2. The Debtors have proposed a plan of reorganization that contemplates paying all creditors (other than the creditors who have consented to other treatment) a 100% recovery on their claims and emerging as a private company. But prior to effectuating this rare and positive result, the Debtors, as a publicly-traded company, must ensure that they remain fully-compliant with all applicable securities laws and regulations promulgated by the United States Securities and Exchange Commission ("**SEC**"). Compliance must occur up until the time when the Debtors can emerge from Chapter 11 and deregister. In the ordinary course of business, the Debtors employ two registered securities compliance firms (the "**SEC Compliance Providers**") that draft and audit certain routine SEC filings. The SEC Compliance Providers have advised that they cannot continue work for the Debtors without being made whole on their prepetition balances which, in the aggregate, amount to less than $300,000. The SEC Compliance Providers have a deep knowledge of the Debtors' accounting practices and operations, are only required to do work for the short time period during which compliance services will be necessary, and are two of a very limited number of providers approved to perform such work. Therefore, the Debtors do not believe that will be able to locate any other registered compliance provider that is both willing and able to assist the Debtors with filing their Form 10-Q that is due for the second quarter of 2024. Accordingly, the Debtors believe that the SEC Compliance Providers should be treated as Critical Vendors in these Chapter 11 Cases, and the Objection should be overruled.

Reply

I. The SEC Compliance Providers do not Need to be Retained Under Section 327(a).

A. The SEC Compliance Providers are neither "professional persons" nor assisting the Debtors in carrying out their duties as debtors-in-possession in these Chapter 11 Cases.

3. Section 327(a) retention is only appropriate for professional persons hired "to represent or assist the trustee in carrying out the trustee's duties under [Title 11]." Indeed, Section 327(a) provides, in full—

> Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, ***to represent or assist the trustee in carrying out the trustee's duties under this title.***

11 U.S.C. § 327(a) (emphasis added).

4. As a threshold matter, while the SEC Compliance Providers may provide accounting services from time to time, they are not being retained as "accountants" in the manner contemplated by Section 327(a), and will not be providing any "accounting" services to the Debtors. Instead, the Debtors will utilize the SEC Compliance Providers to assist them with drafting and auditing their Form 10-Q, which is due to be filed with the SEC before the conclusion of these Chapter 11 Cases. Moss Adams LLP will be working with the Debtors' management team to prepare the 10-Q, and Marcum LLP will be auditing that filing. The Debtors cannot comply with SEC regulations and file their 10-Q without these services.

5. As detailed above, because these applicable entities are not being proposed to serve as "accountants" in these Chapter 11 Cases, the only reason that the SEC Compliance Providers would need to be retained under Section 327(a) is if they are deemed to be "other professional persons" – which is similarly not the case.

6. In *In re First Merchants Acceptance Corp.*, 1997 WL 873551, at *3 (D. Del. Dec. 15, 1997), the District Court laid out a non-exhaustive list of factors for Courts to consider to determine whether an employee is a "professional" within the meaning of Section 327:

> (1) whether the employee controls, manages, administers, invests, purchases or sells assets that are significant to the debtor's reorganization, (2) whether the employee is involved in negotiating the terms of a Plan of Reorganization, (3) whether the employment is directly related to the type of work carried out by the debtor or to the routine maintenance of the debtor's business operations; (4) whether the employee is given discretion or autonomy to exercise his or her own professional judgment in some part of the administration of the debtor's estate, i.e. the qualitative approach, (5) the extent of the employee's involvement in the administration of the debtor's estate, i.e. the quantitative approach; and (6) whether the employee's services involve some degree of special knowledge or skill, such that the employee can be considered a "professional" within the ordinary meaning of the term.

7. An analysis of these factors suggests that the SEC Compliance Providers are not "professionals" within the purview of Section 327 in the first instance. They do not control, manage, administer, invest, purchase, or sell assets that are significant to the debtor's reorganization. They have not (and will not) participate in the negotiation of the Debtors' proposed disclosure statement or plan of reorganization. The securities work required of the SEC Compliance Providers is directly related to the routine maintenance of the Debtors' business operations (i.e., maintaining their SEC compliance).

8. Even assuming the SEC Compliance Providers are "professionals," there is another requirement under Section 327(a) that the Objection completely overlooks: the professional must be retained "to represent or assist the trustee in carrying out the trustee's duties under this title." Indeed, "[i]n order to be a professional subject to the retention requirements of section 327(a), a person must be hired for the purpose of reorganizing the corporation or otherwise assisting it through the Chapter 11 bankruptcy process." *In re SageCrest II,* LLC, 2011 WL 134893, at *7 (D.

Conn. Jan. 14, 2011). Put differently, "professional persons" as such term is used in Section 327(a), "is a term of art reserved for those persons who play an intimate role in the reorganization of a debtor's estate." *In re Johns-Manville Corp.*, 60 B.R. 612, 619 (Bankr. S.D.N.Y. 1986).

9. Thus, the appropriate inquiry under Section 327(a) is not whether the SEC Compliance Providers are "professionals" in the general sense—they undoubtedly are—but whether they are professional persons "represent[ing] or assist[ing] the trustee in carrying out the trustee's duties under [Title 11]." As set forth herein, they are not.

B. Imposing a disinterestedness requirement on the SEC Compliance Providers would not benefit the estate.

10. The crux of the Objection is the UST's demand that the SEC Compliance Providers must waive their prepetition claims in order to provide services to the Debtors postpetition, thereby ensuring that the SEC Compliance Providers are disinterested. The "disinterestedness" requirement for retention under Section 327(a) "serve[s] the important policy of ensuring that all professionals appointed pursuant to section 327(a) tender undivided loyalty and provide untainted advice and assistance in furtherance of their fiduciary responsibilities." *Rome v. Braunstein*, 19 F.3d 54, 58 (1st Cir. 1994). Section 327(a), by its terms, is limited to professionals who represent or assist the trustee in carrying out its duties as a debtor-in-possession. Given that a debtor-in-possession owes fiduciary obligations to the estate and the debtor's creditors, it follows that the professionals hired by that debtor-in-possession to discharge those obligations must necessarily owe similar obligations. Accordingly, the Bankruptcy Code demands that such professionals be disinterested before undertaking such work.

11. But the Bankruptcy Code also recognizes that, where, as here, a professional (assuming the SEC Compliance Providers qualify as such) is *not* assisting a debtor-in-possession discharge its duties under Title 11, these concerns are simply not present. Indeed, Section 327(e),

which contains no disinterestedness requirement, allows a debtor to retain an attorney for a "specified special purpose, *other than to represent the trustee in conducting the case*." (emphasis added).

12. Of course, as the Objection observes, the SEC Compliance Providers are not attorneys. Nevertheless, this is a rare situation where it appears that the Debtors appear to be without a remedy under the Bankruptcy Code. Strictly construed, Section 327(e) does not provide for the retention of the SEC Compliance Providers. But neither does a strict construction of the "disinterested" requirement contained within Section 327(a). Given the challenge in identifying comparable providers who are both qualified and willing to perform the securities work necessary for the Debtors to remain in compliance, the Debtors respectfully submit that, to the extent the Court does not approve the SEC Compliance Providers as Critical Vendors, it allows the Debtors to retain the SEC Compliance Providers under Section 327(e), notwithstanding that they are not attorneys.

13. The concerns that likely prompted Congress to include a disinterested requirement in Section 327(a) are simply not present here. The Debtors have a chief financial officer, a controller, and, perhaps most critically, an independent financial advisor who has been retained under Section 327(a). *See* Docket No. 115. This is not a situation where the putative Section 327(a) professional will have any input into the strategy considerations or decision-making related to the Chapter 11 Cases. In fact, the SEC Compliance Providers' services are limited to receiving and processing the company's existing information, and preparing an appropriate 10-Q in accordance with applicable law and SEC regulations.

14. Moreover, it is not clear what benefit the Debtors' estates will receive by forcing the SEC Compliance Providers to waive their prepetition claims to become disinterested. If the

SEC Compliance Providers waive their claims, they will receive a 0% recovery on their prepetition claims while every other unsecured creditor in these Chapter 11 Cases is projected to receive a 100% distribution. And they would receive this grossly disparate treatment entirely as a result of their decision to stand by their client in its time of need. The Debtors respectfully submit that such an outcome would not only be manifestly unjust to the SEC Compliance Providers, but would run counter to the purposes of Section 327 when, like much of the Bankruptcy Code, it is designed to promote equity and fairness towards all parties in interest.

II. The Court Should Approve the SEC Compliance Providers as Critical Vendors.

15. As set forth in the Critical Vendor Motion, the Bankruptcy Court derives its power to approve payment of pre-petition claims, including Critical Vendor Claims, through a combination of Sections 105 and 363 of the Bankruptcy Code, and the doctrine of necessity. As a threshold matter, the Debtors are not aware of any case law or other authority *prohibiting* the treatment of the SEC Compliance Providers as Critical Vendors, and the Objection makes no such argument.

16. While certain fragments of the Third Circuit's *Price Waterhouse*[3] opinion may appear to suggest that this Court is prohibited from looking beyond Section 327(a), the Court of Appeals' holding in *Price Waterhouse* is actually quite narrow: An accounting firm holding a prepetition claim may not be retained under Section 327(a) to assist the debtor in carrying out the Debtors' duties under the Bankruptcy Code. The Debtors do not dispute this proposition. But the utility of *Price Waterhouse* to the present case is severely limited because (i) the Debtors have not sought to retain the SEC Compliance Providers under Section 327(a); and (ii) unlike in *Price Waterhouse*, the SEC Compliance Providers are not being retained to assist the Debtors in carrying

[3] *United States Trustee v. Price Waterhouse et al.*, 19 F.3d 138 (3d Cir. 1994).

out their duties under the Bankruptcy Code. *See Price Waterhouse* at 141 (observing that Section 327(a) and 101(14) "taken together, unambiguously forbid a debtor in possession from retaining a prepetition creditor *to assist it in the execution of its Title 11 duties*.") (emphasis added). Perhaps most critically, unlike in this case, the debtors in *Price Waterhouse* did not request that the Bankruptcy Court treat Price Waterhouse as a critical vendor.

17. While the Debtors agree that Section 105 should not be used to circumvent unambiguous requirements of the Bankruptcy Code, they respectfully submit that the use of the Court's Section 105 power is appropriate here for several reasons. First, the Debtors' proposed plan of reorganization [Docket No. 86] contemplates that all unsecured creditors will be paid in full. Accordingly, treating the SEC Compliance Providers as Critical Vendors will affect only the timing of payment, and not such creditors' ultimate recovery.

18. Second, while there is virtually no harm to creditors or disruption to the proposed distribution hierarchy by treating the SEC Compliance Providers as Critical Vendors, there may be substantial consequences if the Debtors do not receive the relief they are seeking. The SEC Compliance Providers have indicated that they cannot continue to support the Debtors through the Chapter 11 Cases in the absence of being made whole on their outstanding prepetition balances. Without the services provided by the SEC Compliance Providers, the Debtors cannot file the Form 10-Q that will come due before the conclusion of these Chapter 11 Cases, essentially *guaranteeing* that the Debtors will fall out of compliance with their SEC obligations. In such a scenario, the Debtors' management will be forced to reallocate precious time and resources away from confirming their proposed plan of reorganization, and will be required to handle the resulting fallout from missing the deadline for filing their Form 10-Q. At this critical stage of the Chapter 11 Cases, the Debtors are (and must remain) laser-focused on confirming their proposed plan

within the milestones negotiated under the RSA. Accordingly, they respectfully submit that it is the best interests of the estates and all stakeholders that the SEC Compliance Providers be treated as Critical Vendors.

III. The Court Should Approve the OCP Motion.

19. On June 7, the Debtors filed a revised proposed form of order (the "**Proposed OCP Order**") [Docket No. 134]. Paragraph 3 of the Proposed OCP Order contains a detail set of procedures for retaining a professional as an Ordinary Course Professional. Importantly, entry of the Proposed OCP Order will **not** automatically approve the retention of the two professionals who appear on Exhibit 1 thereto. To the contrary, these professionals, like all ordinary course professionals, must complete an affidavit in the form attached to the Proposed OCP Order as Exhibit 2 that contains disclosures about the services to be provided, the fees for those services, and the amount of the professional's prepetition claim, if any. Once this affidavit is filed with the Court, the UST (and certain other notice parties) will have fourteen days to object to the treatment of such professional as an Ordinary Course Professional. The Debtors believe that these procedures are designed to promote efficiency in the retention process, ensure adequate disclosure to the UST and other parties in interest, and provide the UST with a meaningful period during which to assess the propriety of each proposed Ordinary Course Professional on an individual basis. Because these procedures are consistent with those that are regularly approved in this District, the Debtors respectfully request entry of the Proposed OCP Order.

[*Continued on Next Page*]

Conclusion

WHEREFORE, the Debtors respectfully request that the Court overrule the Objection, grant the relief requested the Motions, and provide the Debtors with such other and further relief as may be just and proper.

Dated: June 7, 2024
Wilmington, Delaware

Respectfully submitted,

POLSINELLI PC

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