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11 **UNITED STATES BANKRUPTCY COURT**  
12 **CENTRAL DISTRICT OF CALIFORNIA**  
13 **LOS ANGELES DIVISION**

13 In re ) Case No. 13-bk-27689-WB  
14 )  
14 COLOREP, INC., ) Chapter 11  
15 a California corporation, *et al.*, ) (Jointly Administered)  
16 )  
16 Debtors. ) **SUPPLEMENTAL MEMORANDUM OF**  
17 ) **POINTS AND AUTHORITIES IN**  
17 Tax I.D. Nos. 94-3055026 (Colorep, Inc.) and ) **SUPPORT OF DEBTORS' MOTION FOR**  
18 54-1200596 (Transprint USA, Inc.) ) **ORDER PURSUANT TO BANKRUPTCY**  
18 ) **CODE SECTIONS 105, 363, AND 365**  
19 ) **APPROVING SALE OF THE DEBTORS'**  
19 ) **ASSETS FREE AND CLEAR OF**  
20 ) **INTERESTS**

20 ) **Hearing Date**

21 )  
21 ) DATE: October 3, 2013  
22 ) TIME: 10:00 A.M.  
22 ) PLACE: Courtroom 1475  
23 ) 255 East Temple Street  
23 ) Los Angeles, CA 90012  
24 )

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1 **MEMORANDUM OF POINTS AND AUTHORITIES**

2 **I.**

3 **INTRODUCTION**

4 Colorep, Inc. ("Colorep") and Transprint USA, Inc. ("Transprint," and together with  
5 Colorep, the "Debtors"),<sup>1</sup> the debtors and debtors in possession in the above-captioned bankruptcy  
6 proceedings, hereby submit this supplemental memorandum of points and authorities in support of  
7 the Debtors' request for approval of a sale of substantially all of the Debtors' assets (the "Acquired  
8 Assets") pursuant to the procedures approved by the Court in the *Order: (A) Approving Sale and Bid*  
9 *Procedures for the Sale of Substantially All Assets of the Debtor; (B) Scheduling an Auction and*  
10 *Hearing to Consider the Sale and Approve the Form and Manner of Notice Related Thereto;*  
11 *(C) Establishing Procedures Relating to the Assumption and Assignment of Certain Contracts; and*  
12 *(D) Granting Other Related Relief* [Docket No. 109] (the "Sale Procedures Order"). After having  
13 completed and satisfied the procedures set forth in the Sale Procedures Order (the "Sale  
14 Procedures"), the Debtors seek authority to sell, pursuant to the terms and conditions of the Asset  
15 Purchase Agreement, dated October 3, 2013 (the "APA"),<sup>2</sup> the Acquired Assets to Meserole, LLC  
16 ("Meserole") and Fuller Smith Capital Management, LLC ("Fuller Smith"), or any permitted  
17 assignee, free and clear of all liens, claims, and interests under Bankruptcy Code sections 363(b),  
18 (k), and (f). Moreover, as part of the Debtors' proposed sale of the Acquired Assets to the Buyer (the  
19 "Sale"), the Debtors seek authority to assume and assign certain executory contracts and unexpired  
20 leases (the "Assigned Contracts") to the Buyer under Bankruptcy Code sections 365(b) and (f).

21 As explained in detail below, the proposed Sale and assignment of the Assigned  
22 Contracts to the Buyer is supported by the sound business judgment of the Debtors, is in the best  
23

24 <sup>1</sup> The proposed Sale, as that term is defined herein, will include any assets owned by non-debtor  
25 Beta Color, LLC ("Beta Color"), a California limited liability company wholly owned by  
26 Colorep. The Debtors do not believe Beta Color owns any assets that are included in the  
27 proposed Sale, as defined below. Nonetheless, Beta Color is a party to the APA, as defined  
28 herein, and to the extent assets of Beta Color are being purchased by the Buyer, as defined  
herein, the assets will be included in the proposed Sale.

<sup>2</sup> The parties have reached an agreement in principle and are in the process of finalizing the APA  
and it will be submitted to the Court at or prior to the hearing. .



1 interests of the Debtors' estates and creditors, and is consistent with all applicable provisions of the  
2 Bankruptcy Code and Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules").

3 **II.**

4 **SUMMARY OF FACTS**

5 **A. Petition Date and Jurisdiction.**

6 On July 10, 2013 (the "Petition Date"), the Debtors commenced the above-captioned  
7 chapter 11 cases (the "Chapter 11 Cases") by filing voluntary petitions under chapter 11 of the  
8 Bankruptcy Code.

9 Pursuant to Bankruptcy Code sections 1107(a) and 1108, the Debtors are continuing  
10 to manage their financial affairs as debtors in possession. No official committee, trustee, or  
11 examiner has been appointed in either of the Chapter 11 Cases.

12 This Court has jurisdiction over these Chapter 11 Cases and this motion pursuant to  
13 28 U.S.C. §§ 1334 and 157(b), and venue is proper in this district pursuant to 28 U.S.C. §§ 1408 and  
14 1409.

15 **B. General Background.**

16 The Debtors are companies engaged in the business of industrial printing in the textile  
17 industry. The Debtors hold, and have applied for, the patents for a process for dyeing and decorating  
18 fabric, which is novel because the process does not result in water pollution and significantly reduces  
19 energy use, costs and time from design to market.

20 Beginning in 2007, Colorep licensed this technology to manufacturers and resellers.  
21 At the end of 2007, Colorep acquired Transprint, a privately held, employee-owned company, with  
22 headquarters and manufacturing facilities in Harrisonburg, Virginia. In addition to their production  
23 and manufacturing facility in Harrisonburg, Virginia (the "Harrisonburg Factory"), the Debtors  
24 maintain sales operations in Charlotte, North Carolina and New York, New York. The Debtors also  
25 own proprietary designs and trademarks. Although the Debtors' operations are geographically  
26 dispersed, and each of the Debtors have different asset bases and different creditor constituencies,  
27 the business of the Debtors is conducted in a centralized manner as parts of a unified whole. It is  
28

1 partially for this reason that, as explained below, the Debtors' assets were marketed as a package,  
2 rather than in separate pools of assets specific to each Debtor.

3 The factual background relating to the commencement of the Chapter 11 Cases is set  
4 forth in detail in the *Declaration of Mark A. Fox in Support of Emergency First Day Motions*  
5 [Docket No. 13], filed on July 11, 2013.

6 **C. Prepetition Loan and Security Agreement with Meserole.**

7 In or around June 2011, in response to significant cash flow restraints, the Debtors  
8 entered into that certain Loan and Security Agreement and related documents (as amended,  
9 supplemented and modified, the "Prepetition Loan Agreement") with Meserole. Pursuant to the  
10 Prepetition Loan Agreement, Colorep had the ability to access up to \$25 million on the terms and  
11 conditions set forth in the Prepetition Loan Agreement (the "Prepetition Loan"). Meserole asserts a  
12 first priority secured lien on substantially all of the Debtors' tangible and intangible assets as security  
13 for the Prepetition Loan.

14 Meserole has filed a Proof of Claim against the Debtors [Claim No. 14-1], alleging  
15 that, as of the Petition Date, the Debtors owe Meserole \$20,083,057.80 under the Prepetition Loan,  
16 secured by the Debtors' real and personal property.

17 The Debtors have conducted an investigation as to the validity and priority of the  
18 liens Meserole contends secure the Prepetition Loan (the "Prepetition Loan Collateral"). Based on  
19 the Debtors' investigation, the Debtors believe Meserole has a first priority lien on all of the Debtors'  
20 real and personal property against which it asserts an interest, except with respect to, among other  
21 potential issues, perfection of certain of the intellectual property assets and commercial tort claims,  
22 and documentation with respect to modifications of the Prepetition Loan, for which the Debtors have  
23 raised a challenge with Meserole pursuant to the terms and conditions of the Final DIP Order,  
24 thereby preserving such challenges.<sup>3</sup>

25 Specifically, with respect to the Debtors' Harrisonburg Factory, the Debtors have  
26 identified only one deed of trust recorded with the Rockingham County Recorder of Deeds, other

27 <sup>3</sup> Meserole disputes the challenges with respect to the intellectual property, and with respect to any  
28 issues related to the documentation of the Prepetition Loan, and its amendments. .

1 than deeds of trust which secure obligations that have been paid or otherwise satisfied. This deed of  
2 trust was recorded on August 15, 2011 in favor of Meserole. The Debtors have also identified six  
3 (6) individuals or entities asserting interests in the Harrisonburg Factory junior to the deed of trust of  
4 Meserole, having recorded money judgments against the Debtors in the Commonwealth of Virginia  
5 subsequent to August 15, 2011 (the "Harrisonburg Junior Lienholders").

6 The Debtors also own personal property, consisting of, among other things,  
7 intellectual property, equipment, inventory, cash and account receivables (the "Personal Property").  
8 The Debtors' investigation has uncovered only two UCC-1 financing statements filed by parties prior  
9 to the filing of the UCC-1 financing statement by Meserole (the "2010 Liens"). The Debtors' records  
10 show that the obligations secured by the 2010 Liens were satisfied in full as part of the Prepetition  
11 Loan from Meserole, and no amounts were owing to the holders of the 2010 Liens as of the Petition  
12 Date. The Debtors have also identified a number of individuals or entities (together with the  
13 Harrisonburg Junior Lienholders, the "Junior Lienholders") that have filed UCC-1 financing  
14 statements or obtained judgment liens against the Debtors' assets subsequent to Meserole's perfection  
15 of its security interest in the Personal Property.

16 Based on the foregoing, except as stated above, the Debtors believe Meserole's  
17 Prepetition Loan is secured by a valid first priority lien on substantially all of the Debtors' Personal  
18 Property and real property.

19 **D. DIP Financing.**

20 As set forth more fully in the *Final Order (A) Authorizing Debtor to Obtain*  
21 *Postpetition Financing; (B) Granting Superpriority Expense Claims and Priming Liens; and*  
22 *(C) Granting Other Relief Under 11 U.S.C. §§ 105, 361, 362, 363, 364 and 507(b), F.R.B.P. 2002*  
23 *and 4001; and LBRs 2002-1 and 4001-2* [Docket No. 134] (the "Final DIP Order"), the Debtors  
24 entered into an agreement with Meserole, pursuant to which Meserole, or any successor, agreed to  
25 provide postpetition financing to the Debtors in the amount of \$2.5 million (the "DIP Financing"),  
26 and consented to the Debtors' use of cash collateral, pursuant to a set budget. The DIP Financing is  
27 secured by a security interest in all of the Debtors' tangible and intangible property, except for  
28 avoidance actions (the "DIP Financing Lien"). Through the DIP Financing, the Debtors have been

1 able to operate in the ordinary course of business, thereby preserving the going concern value of the  
2 Debtors' assets.

3 On September 5, 2013, Meserole filed a notice with the Court, stating that:

4 (i) "Meserole had assigned to Fuller Smith Capital Management LLC, the rights and responsibilities  
5 as DIP Agent under the Final DIP Order"; (ii) "Meserole has further assigned 100% of the DIP  
6 Loans then outstanding to Saviva FS 1 LP ("Saviva"), in which Meserole holds an interest as a  
7 limited partner"; and (iii) Saviva is now the "DIP Lender" under the Final DIP Order.<sup>4</sup>

8 As of September 30, 2013, the DIP Financing has matured and the DIP Lender  
9 advanced aggregate DIP Loan advances totaling \$2.5 million. The DIP Agent agreed to forbear  
10 from exercising rights and remedies under the Final DIP Order and the Pre-Petition Lender has  
11 consented to the use of its cash collateral through October 4, 2013.

12 **E. Compliance with the Sale Procedures.**

13 On August 12, 2013, the Court entered the Sale Procedures Order, setting forth  
14 procedures for the Debtors to, among other things, market and provide notice of a sale of the  
15 Debtors' assets and the potential assumption and assignment of executory contracts to interested  
16 parties. The Debtors have satisfied all of the obligations set forth in the Sale Procedures Order, as  
17 specifically described below.

18 On August 13, 2013, the Debtors served the *Notice of Auction and Sale Hearing* on  
19 all of the Debtors' known creditors [Docket No. 125] (the "Creditors Notice"), notifying such  
20 creditors that, among other things, September 18, 2013 (the "Bid Deadline") was the deadline for  
21 parties to submit bids for the purchase of the Debtors' assets, and that the Court would hold a hearing  
22 on the Debtors' proposed Sale on September 26, 2013 (the "Sale Hearing").

23 On August 15, 2013, the Debtors served the *Notice of Sale Procedures, Auction Date*  
24 *and Sale Hearing* (the "Sale and Bid Procedures Notice") on all parties required to be notified under  
25 the Sale Procedures Order, including but not limited to all known parties asserting a security interest  
26

27  
28 <sup>4</sup> See *Notice of Assignment of DIP Agency* [Docket No. 171].

1 in any of the Debtors' assets, all parties to prepetition litigation with the Debtors, and environmental  
2 authorities in the states in which the Debtors conduct business [Docket No. 139].

3 On August 27, 2013 and September 9, 2013, the Debtors filed and served the *Notice*  
4 *to Counterparties to Executory Contracts and Unexpired Leases That May Potentially be Assumed*  
5 *and Assigned* [Docket No. 161] (the "Original Cure Notice") and the *First Supplemental Notice to*  
6 *Counterparties to Executory Contracts and Unexpired Leases That May Potentially be Assumed and*  
7 *Assigned* [Docket No. 173] (the "First Supplemental Cure Notice"), respectively. On September 13,  
8 2013, the Debtors filed and served a *Second Supplemental Notice to Counterparties to Executory*  
9 *Contracts and Unexpired Leases That May Potentially be Assumed and Assigned* [Docket No. 182]  
10 (the "Second Supplemental Cure Notice", and together with the Original Cure Notice and the First  
11 Supplemental Cure Notice, the "Cure Notice"). The Second Supplemental Cure Notice served the  
12 Cure Notice on parties that were served with the Original Cure Notice, but for which the Debtors  
13 received returned mail. The Cure Notice provided notice to all known counterparties to executory  
14 contracts and unexpired leases (the "Contract Counterparties") the amounts necessary to cure  
15 outstanding defaults under Bankruptcy Code section 365(b)(1) (the "Cure Amounts"), and the  
16 procedures for objecting to the Debtors' proposed Cure Amounts and to the assumption and  
17 assignment of any executory contracts or unexpired leases.

18 As set forth in the Creditors Notice and the Sale and Procedures Notice, September  
19 18, 2013 was the deadline for objections to the sale of the Debtors' assets free and clear of liens,  
20 claims, and interests, or to the proposed Cure Amounts. Meserole filed a limited objection to the  
21 proposed Sale [Docket No. 191], which limited objection is not applicable as it was conditioned on  
22 Meserole's not being permitted to credit bid the Prepetition Loan, which as described below, the  
23 Debtors have allowed for purposes of the Sale described herein. Only one party, L.H. Charney 1410  
24 Broadway LLC ("L.H. Charney") filed an objection to the Cure Amounts [Docket No 190].<sup>5</sup> The  
25

26 <sup>5</sup> The Debtors received a number of informal responses to the Debtors' proposed Cure Amounts.  
27 One informal response was resolved by the Debtors stipulating to an increased amount of the  
28 subject Cure Amounts. See Docket No. 185. Any other informal responses were received for  
executory contracts or unexpired leases that will not be assigned to the Buyer under the proposed  
Sale, and therefore do not affect the relief requested herein.

1 objection by L.H. Charney need not be decided in connection with the proposed Sale, as L.H.  
2 Charney is not a party to an Assigned Contract.

3 On September 20, 2013, the Debtors served on all Contract Counterparties to a  
4 contract or lease that the Buyer desires the Debtors to assume and assign in connection with the Sale  
5 (the Assigned Contracts), a notice that the Debtors intend to assume and assign such contracts or  
6 leases to the Buyer under Bankruptcy Code section 365(f) (the "Assumption Notice") [Docket No.  
7 194]. No Contract Counterparties filed an objection to the assignment of their respective contracts  
8 or leases by September 24, 2013, as required under the Sale Procedures Order.

9 Having provided the above notice, the Debtors, pursuant to the Sale Procedures  
10 Order, have provided "sufficient notice of the Debtors' proposed Sale of the Assets free and clear of  
11 all liens, claims, interests and encumbrances, the contemplated assumption and assignment of each  
12 [Assigned] Contract and the proposed amount of the Cure [Amounts] with respect to each such  
13 [Assigned] Contract, and no additional notice of such contemplated transactions need be given."  
14 Sale Procedures Order ¶ 13.

15 **F. The Sale Process.**

16 Having decided that a sale of substantially all of the Debtors' assets would be in the  
17 best interests of the Debtors' estates, the Debtors have engaged in a marketing process designed to  
18 generate maximum value for the Debtors' assets. In order to implement such a marketing process,  
19 the Debtors engaged Hilco IP Services LLC d/b/a Hilco Streambank ("Hilco") to act as the

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21 The Debtors also received communication from counsel for the Department of Justice (the  
22 "DOJ"), expressing concerns about the Debtors' ability to sell the Harrisonburg Factory free and  
23 clear of certain environmental exposure. The Debtors and the DOJ have agreed to resolve this  
issue by including the following, or substantially similar, language in any order approving the  
proposed Sale:

24 Nothing in this Order or in any sale agreement entered into pursuant to this  
25 Order: (a) releases, nullifies, precludes or enjoins the enforcement of any  
26 liability (including for penalties, damages, cost recovery or injunctive relief  
27 to a governmental unit under police and regulatory statutes or regulations  
28 (including but not limited to environmental laws or regulations) that any entity  
would be subject to as the owner, lessor, lessee, controller or operator of  
property that is sold or transferred pursuant to this Order, (b) authorizes the  
transfer to the purchaser of any governmental licenses, permits, registrations,  
authorizations or approvals without compliance with all applicable legal  
requirements under the law governing such transfers.

1 exclusive agent for the marketing and sale of the Debtors' assets. As explained in detail in the  
2 *Declaration of Gabe Fried in Support of Debtors' Motion for Order Pursuant to Bankruptcy Code*  
3 *Sections 105, 363, and 365 Approving Sale of the Debtors' Assets Free and Clear of Interests* (the  
4 "Fried Declaration"), filed contemporaneously herewith, Hilco is an advisory firm specializing in the  
5 marketing, sale and valuation of assets similar to those of the Debtors.<sup>6</sup>

6 Commencing on or about August 19, 2013, Hilco launched a marketing campaign and  
7 contacted approximately 115 potentially interested parties, including strategic buyers, financial  
8 buyers, and capital providers.<sup>7</sup> Of the parties contacted, twelve (12) signed confidentiality  
9 agreements and received access to a data room which included comprehensive information as to the  
10 identity, descriptions, and, in some cases, potential value of the Debtors' assets.<sup>8</sup> This process  
11 created a fair, open and competitive process pursuant to which interested parties had the opportunity  
12 to conduct diligence with respect to the Debtors' assets, and to bid for the purchase of such assets.

13 Despite Hilco's extensive marketing efforts, no potential purchasers, aside from the  
14 Buyer, made any formal bid for the Debtors' assets, and no prospective buyer satisfied the criteria,  
15 established in the Sale Procedures Order, to make a "Qualified Bid."<sup>9</sup>

16 **G. The Agreement with the Buyer.**

17 During the course of these cases, Meserole advised the Debtors that it, acting alone or  
18 in concert with others, intended to make a bid for the assets of the Debtors, and would use its  
19 prepetition and post petition claims for a "credit bid."<sup>10</sup> On September 15, 2013, the Debtors  
20 received a proposed Asset Purchase Agreement from Meserole and Fuller Smith, as purchasers  
21 (collectively, the "Buyer"). Subsequently, on the Bid Deadline, the Debtors received another  
22 proposed agreement from the same parties. Pursuant to the APA, Meserole and Fuller Smith intend  
23 to assign their rights and interests under the APA to AirDye Solutions, LLC.<sup>11</sup> The Debtors and the

24 <sup>6</sup> Fried Declaration, ¶ 3.

25 <sup>7</sup> *Id.* at ¶ 7.

26 <sup>8</sup> *Id.* at ¶ 9.

27 <sup>9</sup> *Id.*

28 <sup>10</sup> Katz Declaration, ¶ 21.

<sup>11</sup> *Id.*

1 prospective Buyer engaged in extensive negotiations covering a wide variety of terms and  
2 conditions regarding the proposed purchase agreement. As a result, the Debtors and the Buyer  
3 reached an agreement, as reflected in the APA, which the Debtors believe will provide the best  
4 possible outcome for their respective estates.

5 The consideration the Debtors shall receive in exchange for the Acquired Assets (the  
6 "Purchase Price"), is summarized as follows:

7 (a) a credit bid in the amount of \$20 million consisting of:

8 (i) a credit bid by Fuller Smith of \$250,000 of the amount outstanding under  
9 the DIP Financing (the "DIP Financing Credit Bid"); and

10 (ii) a credit bid by Meserole of the outstanding amount owing under the  
11 Prepetition Loan in the amount equal to \$20 million less the DIP Financing Credit Bid, which  
12 amount is \$19,750,000;

13 (b) the Buyer's payment of all Cure Amounts for all Assigned Contracts and the  
14 assumption of the "Assumed Liabilities," as that term is defined in the APA; and

15 (c) the payment of \$25,000.

16 Under the terms of the APA, the Assumed Liabilities the Buyer has agreed to assume  
17 and pay include, without limitation, (i) certain unpaid operating expenses and payables incurred by  
18 the Debtors after the Petition Date in the ordinary course of business, (ii) certain unpaid but yet to  
19 be incurred operating expenses of the Debtors, (iii) certain pre-petition wage claims owed to the  
20 Debtors' employees and non-cash PTO obligations owned to Transferred Employees and (iv) certain  
21 other administrative expenses, including certain professional fees, and also include those expenses  
22 and obligations listed on Schedule 2.3(f) to APA. The liabilities assumed by the Buyer will result in  
23 the payment of virtually all of the administrative expense claims incurred by the Debtors in the  
24 ordinary course of business, certain administrative professional fees and certain pre-petition priority  
25 wage and PTO obligations of the Debtors to their employees..<sup>12</sup>

26  
27  
28 <sup>12</sup> Katz Declaration, ¶ 22-23.



1 As a result of the Purchaser's assumption of the forgoing claims and obligations of the  
2 Debtors a significant amount of claims will be satisfied. In addition, the Debtors will retain certain  
3 assets, including certain claims and causes of action, and insurance relating thereto.

4 As a result of the Credit Bid, a significant portion of the Prepetition Loan will be  
5 satisfied and the Debtors will have no remaining obligations with respect thereto. In addition, as part  
6 of the APA, any remaining amount of the DIP Financing and Prepetition Loan not satisfied pursuant  
7 to the Credit Bid, \$2,500,000 (the "Remaining Lender Claim"), will be treated solely as unsecured  
8 claim against the Debtors and their respective estates. The Remaining Lender Claim will be entitled  
9 to share passively as an unsecured creditor and have the right to share in any distributions to  
10 unsecured creditors if and when such distribution are made to unsecured creditors by the Debtors,  
11 their estates or any legal representative thereof. In addition, the Remaining Lender Claim can be  
12 used for the purpose of asserting such claim as a defense, offset, recoupment or similar right or  
13 defense against any Person asserting a claim or cause of action that is derivative of the Debtors'  
14 rights or those of the Debtors' estates which have been transferred and assigned to the Purchaser  
15 pursuant to this Agreement.<sup>13</sup>

16 As demonstrated in the *Declaration of Robert D. Katz in Support of Debtors' Motion*  
17 *for Order Pursuant to Bankruptcy Code Sections 105, 363, and 365 Approving Sale of the Debtors'*  
18 *Assets Free and Clear of Interests* (the "Katz Declaration"), the proposed Sale to the Buyer is the  
19 product of a good faith marketing process and arms length negotiations, resulting in meaningful  
20 benefit to the Debtors' estates. The Debtors, therefore, request the Court approve the proposed Sale  
21 of the Acquired Assets to the Buyer free and clear of all liens, claims, and interests under  
22 Bankruptcy Code sections 363(b), (k), and (f), and authorize the assignment of the Assigned  
23 Contracts to the Buyer under Bankruptcy Code section 365(f).

24  
25  
26  
27  
28 <sup>13</sup> Katz Declaration, ¶ 24.

1 III.

2 ARGUMENT

3 A. The Debtors' Proposed Sale of Their Assets is Supported by Reasonable  
4 Business Judgment.

5 Bankruptcy Code section 363 provides, in pertinent part, that a trustee or debtor in  
6 possession, "after notice and a hearing, may use, sell or lease, other than in the ordinary course of  
7 business, property of the estate . . . ." *See also* 11 U.S.C. § 1107(a). Approval of a sale is generally  
8 appropriate if the court finds that the transaction represents a reasonable business judgment by the  
9 debtor. *In re Wilde Horse Enters.*, 136 B.R. 830, 841 (Bankr. C.D. Cal. 1991); *In re Global*  
10 *Crossing Ltd.*, 295 B.R. 726, 743 (Bankr. S.D.N.Y. 2003); 3 Collier on Bankruptcy ¶ 363.02 [4]  
11 (16th ed. 2013) ("In determining whether to approve a proposed sale under section 363, courts  
12 generally apply standards that . . . represent essentially a business judgment test.").

13 In the Ninth Circuit, "cause" exists for authorizing a sale of estate assets if it is in the  
14 best interest of the estate, and a business justification exists for authorizing the sale. *In re Walter*, 83  
15 B.R. 14, 19–20 (B.A.P. 9th Cir. 1988); *In re 240 North Brand Partners, Ltd.*, 200 B.R. 653, 659  
16 (B.A.P. 9th Cir. 1996); *In re Fleetwood Enters.*, No. 09-14254, 2010 Bankr. LEXIS 5256, at \*4–5  
17 (Bankr. C.D. Cal. Dec. 2, 2010). In determining whether a sale satisfies the business judgment  
18 standard, courts have looked to whether: (1) there is a sound business reason for the sale;  
19 (2) accurate and reasonable notice of the sale is given to interested persons; (3) the sale yields an  
20 adequate price (*i.e.*, one that is fair and reasonable); and (4) the parties to the sale have acted in good  
21 faith. *Slates v. Reger (In re Slates)*, No. 12-1168, 2012 WL 5359489, at \*11 (B.A.P. 9th Cir. Oct.  
22 31, 2012).

23 Bankruptcy Code section 363 does not require that the court substitute its business  
24 judgment for that of the debtor. *See, e.g., Simantob v. Claims Prosecutor, LLC (In re Lahijani)*, 325  
25 B.R. 282, 289 (B.A.P. 9th Cir. 2005) ("stating that a trustee's decision to authorize a sale of assets "is  
26 afforded deference, particularly where business judgment is entailed in the analysis or when there is  
27 no objection"); *In re Ionosphere Clubs, Inc.*, 100 B.R. 670, 676 (Bankr. S.D.N.Y. 1989) (court will  
28 not substitute a hostile witness's business judgment for debtor's unless testimony "established that

1 [the debtor] has failed to articulate a sound business justification for its chosen course"). Rather, the  
2 court should ascertain whether the debtor has articulated a valid business justification for the  
3 proposed transaction. *See, e.g., In re 240 North Brand Partners, Ltd.*, 200 B.R. at 659. This is  
4 consistent with "the broad authority to operate the business of the debtor . . . [which] indicates  
5 Congressional intent to limit court involvement in business decisions by a trustee . . . [so that] a  
6 court may not interfere with a reasonable business decision made in good faith by a trustee." *In re*  
7 *Airlift Int'l, Inc.*, 18 B.R. 787, 789 (Bankr. S.D. Fla. 1982).

8 **1. Sound Business Judgment Exists.**

9 As set forth above, the Debtors have determined that selling their assets pursuant to  
10 the Sale Procedures provided the best opportunity to maximize value for the Debtors' estates.  
11 Subsequent to the Petition Date, the Debtors, with the assistance of Hilco, have marketed their assets  
12 as a going concern. The Debtors believe that, given the limits of time and financing imposed by  
13 their DIP Lender, they have made a reasonable and good faith effort to market their assets.

14 Despite the Debtors' marketing efforts, they did not receive any bid for the purchase  
15 of the Assets except for the bid of Meserole and Fuller Smith, which bid consists largely of a credit  
16 bid based on amounts owing under the DIP Financing and the Prepetition Loan. The Buyer has also  
17 agreed to satisfy the Cure Amounts for the Assigned Contracts, benefiting certain of the Contract  
18 Counterparties to the Debtors' executory contracts and unexpired leases, and to assume certain other  
19 liabilities and to provide additional consideration as described in Part II.G. hereof. Such claims and  
20 liabilities likely would not be satisfied if the Debtors were not able to close the proposed Sale.

21 In sum, through the proposed Sale, the Debtors will, through the assumption and  
22 payment of the Assumed Liabilities by the Buyer, satisfy certain administrative claims and expenses  
23 against their estates and certain priority claims that would not be satisfied in the absence of the  
24 proposed Sale. In addition, the Debtors estates will retain certain assets and be relieved of any  
25 remaining obligations with respect to the Prepetition Loan and the DIP Financing, other than the  
26 Remaining Lender Claim. Moreover, by selling the Acquired Assets while operating as a going  
27 concern, the Debtors the jobs of at least 77 of its current employees will be preserved.

28

1           **2. Accurate and Reasonable Notice Has Been Given to Interested Parties.**

2           As set forth in Part II.E. hereof, the Sale Procedures Order provided specific notice  
3 requirements in connection with the Debtors' marketing and sale of the Acquired Assets. All such  
4 requirements have been timely satisfied by the Debtors.

5           **3. The Price for the Acquired Assets is Fair and Reasonable.**

6           The adequacy of a purchase price is generally the function of whether the price was  
7 reached in good faith. *In re Apex Oil Co.*, 92 B.R. 847, 874 (Bankr. E.D. Mo. 1988) (holding that  
8 the consideration was adequate where it was negotiated in good faith); *In re Embrace Sys. Corp.*,  
9 178 B.R. 112, 123 (Bankr. W.D. Mich. 1995) (denying motion to sell where there was no evidence  
10 that the asset was diligently or sufficiently marketed). As long as a sale appears to enhance the  
11 debtor's estate, court approval of a debtor in possession's decision to sell its property should only be  
12 withheld if the debtor's judgment is clearly erroneous, too speculative, or contrary to the provisions  
13 of the Bankruptcy Code. *E.g.*, *GBL Holding Co. v. Blackburn/Travis/Cole, Ltd.*, 331 B.R. 251  
14 (Bankr. N.D. Tex. 2005); *In re Lahijani*, 325 B.R. 282, 288–89 (B.A.P. 9th Cir. 2005) (recognizing  
15 that section 363(b) sales should approved where "optimal value is realized by the estate" and that a  
16 debtor's business judgment in completing a sale is ordinarily "afforded deference," particularly  
17 where an auction process is employed).

18           The proposed sale is the result of the good faith, arms length negotiations between the  
19 Debtors and the Buyer. The Sale Procedures afforded a process whereby the Debtors would hold a  
20 live auction for their assets if they received more than one "Qualified Bid." Despite the Debtors' and  
21 Hilco's best efforts, the only offer received for the purchase of the Debtors' Acquired Assets came  
22 from Meserole and Fuller Smith, on behalf of the Buyer. Nonetheless, the Debtors were able to  
23 negotiate a deal that includes the assumption by the Purchaser of certain significant liabilities and  
24 claims against the estates and the release of claims, in addition to Meserole's credit bid, which is  
25 beyond what the Debtors could have realized for the benefit of their creditors in the absence of the  
26 Sale.

27           The Debtors believe the purchase price under the proposed Sale is fair and  
28 reasonable, and in the best interests of the Debtors' estates.

1           **4. The Debtors and the Buyer Have Acted in Good Faith.**

2           Although Bankruptcy Code section 363(b) does not explicitly require it, courts have  
3 found that a finding of "good faith" is necessary to approve a debtor's sale of property. *E.g., Thomas*  
4 *v. Namba (In re Thomas)*, 287 B.R. 782, 785 (B.A.P. 9th Cir. 2002); *In re Ewell*, 958 F.2d 276, 281  
5 (9th Cir. 1992). Whether a proposed sale is in "good faith" focuses principally on the element of  
6 special treatment of the debtor's insiders in the sale transaction. *In re Ewell*, 958 F.2d at 281.

7           In the present case, the proposed Sale of the Acquired Assets is in "good faith." The  
8 Debtors have decided to sell the Acquired Assets to the Buyer only after marketing such assets an  
9 attempt to reach all potential purchasers. Moreover, even after the deadline for submission of  
10 "Qualified Bids" and having received no such bid other than that submitted on behalf of the Buyer,  
11 the Debtors engaged in arms length negotiations with the Buyer as to the ultimate sale price and  
12 terms reflected in the APA. These negotiations resulted in substantial benefit to the Debtors' estates.

13           For these reasons, the Debtors and the Buyer<sup>14</sup> have acted in good faith. Accordingly,  
14 and for the additional reasons stated above, the proposed Sale is supported by the Debtors' sound  
15 business judgment and should be approved by the Court.

16           **B. The Sale of the Acquired Assets Should Be Free and Clear of All Liens, Claims,  
17 Encumbrances, and Other Interests.**

18           Bankruptcy Code section 363(f) provides that the Court may authorize a sale of  
19 property of the estate, "free and clear of any interest in such property of an entity other than the  
20 estate," if:

- 21           (1) applicable nonbankruptcy law permits sale of such property  
22           free and clear of such interest;
- 23           (2) such entity consents;
- 24           (3) such interest is a lien and the price at which such property is to  
25           be sold is greater than the aggregate value of all liens on such  
26           property;
- 27           (4) such interest is in *bona fide* dispute; or

28           <sup>14</sup> Evidence of the Buyer's good faith and ability to close the Sale and to satisfy its future  
obligations under the APA is provided in the *Declaration of Daniel Fuller in Support of Debtors'*  
*Motion for Order Pursuant to Bankruptcy Code Sections 105, 363, and 365 Approving Sale of*  
*the Debtors' Assets Free and Clear of Interests* (the "Buyer Declaration").

1  
2 (5) such entity could be compelled, in a legal or equitable  
3 proceeding, to accept a money satisfaction of such interest.

4 *Accord In re Namco Capital Group, Inc.*, No. CV 10-0766 GAF, 2011 U.S. Dist. LEXIS 65607, at  
5 \*3 (C.D. Cal. June 7, 2011) ("Section 363(f) allows the trustee to 'sell property under subsection (b)  
6 or (c) of this section free and clear of any interest in such property of an entity other than the estate'  
7 in certain enumerated circumstances.").

8 A condition of the proposed Sale is that the Court enter an order providing for the sale  
9 to be free and clear of all liens, claims, encumbrances, and other interests. The Debtors believe that  
10 entry of such an order in these cases is consistent with the law and with this Court's authority. Thus,  
11 as is demonstrated below, the Acquired Assets should be sold to the Buyer free and clear of all liens,  
12 claims, encumbrances, and other interests, including but not limited to the 2010 Liens and those of  
13 the Junior Lienholders, under Bankruptcy Code section 363(f).

14 **1. The Acquired Assets Should Be Sold Free and Clear of Interests Under  
15 Bankruptcy Code Section 363(f)(2).**

16 Bankruptcy Code section 363(f)(2) provides that property can be sold free and clear  
17 of an "interest in such property" if the holder of the interest "consents." The Bankruptcy Code does  
18 not define "consent," but courts have found that "consent may be express or may be implied from  
19 circumstances surrounding the sale." *E.g.*, 3 Collier on Bankruptcy ¶ 363.06[3] (16th ed. 2013).  
20 More specifically, courts, including from within the Ninth Circuit and the Central District of  
21 California, have found that lienholders should be deemed to have consented to a sale free and clear  
22 of their interests if they are given adequate notice and fail to object. *E.g.*, *In re Blixseth*, No. 09-  
23 60452, 2011 Bankr. LEXIS 1451, at \*42 (Bankr. D. Mont. Apr. 20, 2011) ("deem[ing] the lack of  
24 objection by holders of liens and interests, after notice, as their implied consent to the sale free and  
25 clear of liens") (citing *FutureSource, LLC v. Reuters, Ltd.*, 312 F.3d 281, 285 (7th Cir. 2002)); *In re*  
26 *Associated of L.A.*, No. 10-22784, 2010 Bankr. LEXIS 4073, at \*3 (Bankr. C.D. Cal. Jul. 15, 2010)  
27 (same).  
28

1 In the present case, the Debtors, on August 15, 2013, provided notice to Junior  
2 Lienholders and the parties asserting the 2010 Liens that the Debtors intend to sell their assets free  
3 and clear of all liens and interests, and of the time and place of the Sale Hearing. No Junior  
4 Lienholders or holders of the 2010 Liens have filed any objection to the relief requested by the  
5 Debtors. Accordingly, having been provided with reasonable notice and having not objected, the  
6 Junior Lienholders and holders of 2010 Liens should be deemed to consent to the sale free and clear  
7 of their respective interests under Bankruptcy Code section 363(f)(2).

8 **2. The Acquired Assets Should Be Sold Free and Clear of the 2010 Liens**  
9 **Under Bankruptcy Code Section 363(f)(4).**

10 Bankruptcy Code section 363(f)(4) provides that a debtor's property may be sold free  
11 and clear of an "interest" if "such interest is in bona fide dispute." "Bona fide dispute" is not defined  
12 by statute, but courts have generally found that a "bona fide dispute exists where there is an  
13 'objective basis for either a factual or a legal dispute as to the validity of the claim.'" *Melcher v.*  
14 *Richardson*, No. 11-00342, 2012 U.S. Dist. LEXIS 45521, at \* 3 (N.D. Cal. Mar. 31, 2012) (quoting  
15 *Liberty Tool & Mfg. v. Vortex Fishing Sys., Inc. (In re Vortex Fishing Sys., Inc.)*, 277 F.3d 1057,  
16 1064 (9th Cir. 2001)); accord 3 Collier on Bankruptcy ¶ 363.06[5]. A court does not need "to  
17 determine the outcome of any dispute, only its presence or absence." *Melcher*, 2012 U.S. Dist.  
18 LEXIS at \*4 (quoting *In re Busick*, 831 F.2d 745, 750 (7th Cir. 1987)).

19 A bona fide dispute exists with respect to the 2010 Liens. Although the Debtors'  
20 investigation as to the priority of the Prepetition Loan Collateral uncovered certain liens of record on  
21 applicable government registries, the Debtors' records show that the claims purportedly secured by  
22 these interests were satisfied prior to the Petition Date. Accordingly, there is an "objective basis" for  
23 a factual and legal dispute as to the validity of the claims secured by the 2010 Liens. For this reason,  
24 the Debtors' Assets should be sold free and clear of the 2010 Liens under Bankruptcy Code section  
25 363(f)(4).

1           **3. The Acquired Assets Should Be Sold Free and Clear of the Interests of**  
2           **Junior Lienholders Under Bankruptcy Code Section 363(f)(5).**

3           The Acquired Assets should be sold free and clear of any "interests" or liens junior to  
4 the liens asserted by Meserole and Fuller Smith, including but not limited to those asserted by the  
5 Junior Lienholders. Such relief is warranted under Bankruptcy Code section 363(f)(5) and  
6 applicable nonbankruptcy law.

7           Bankruptcy Code section 363(f)(5) allows for a debtor's property to be sold free and  
8 clear of an interest if the entity holding such interest "could be compelled in a legal or equitable  
9 proceeding to accept a money satisfaction of such interest."

10           Courts have interpreted section 363(f)(5) to allow a debtor to sell property free and  
11 clear junior "out of the money" liens, where state law provides for such a result if the sale price for  
12 the property is not sufficient to satisfy senior debt. *E.g., In re Jolan, Inc.*, 403 B.R. 866, 870 (Bankr.  
13 W.D. Wash. 2009) ("Because there are in Washington legal and equitable proceedings by which  
14 lienholders may be compelled to accept money satisfactions, [section] 363(f)(5) here permits a sale  
15 free and clear of liens, with the liens attaching to the proceeds, notwithstanding that those proceeds  
16 may be insufficient to pay all liens."); *In re Boston Generating, LLC*, 440 B.R. 302, 333 (Bankr.  
17 S.D.N.Y. 2010) ("[T]he Court finds that because the Second Lien Lenders could be compelled under  
18 state law to accept general unsecured claims to the extent the sale proceeds are not sufficient to pay  
19 their claims in full, section 363(f)(5) is satisfied.").

20           In *Clear Channel Outdoor, Inc., v. Knupfer (In re PW, LLC)*, 391 B.R. 25 (9th Cir.  
21 BAP 2008), the Ninth Circuit Bankruptcy Appellate Panel ("B.A.P.") refused to permit a sale free  
22 and clear of a junior lienholder's interest, when the sale proceeds would not be sufficient to pay the  
23 junior lienholder in full. The court considered the application of section 363(f)(5), holding that it  
24 requires three factors: (1) a proceeding that exists or could be brought, (2) in which the nondebtor  
25 could be compelled to accept money to satisfy the nondebtor's claimed interest, and (3) the  
26 nondebtor have such an interest. *Id.* at 41. In other words, there must be "an available type or form  
27 of legal or equitable proceeding in which a court could compel [the interest holder] to release its lien  
28 for payment of an amount that was less than full value of [the interest holder's] claim." *Id.* at 45-46.



1 The proponents of the sale in *Clear Channel*, however, failed to identify any such proceeding  
2 under applicable nonbankruptcy law. *Id.* at 46 ("Neither the Trustee nor [first lien holder] has  
3 directed us to any such proceeding under nonbankruptcy law, and the bankruptcy court made no  
4 such finding."). As noted in a subsequent decision applying the B.A.P.'s holding in *Clear Channel*:

5 The careful reader will have noted that, after pointing out that  
6 appellees had not shown the existence of a qualifying proceeding, the  
7 [*Clear Channel*] Panel did not continue with the familiar appellate  
8 rubric "nor have we found any such authority." Rather, it exercised its  
9 prerogative to limit its ruling to the arguments presented by the parties,  
as might be expected when it was not evident that they had argued  
anything but [cram down of the lien under section] 1129 to the  
bankruptcy court.

10 *In re Jolan, Inc.*, 403 B.R. at 869.

11 Applying Washington law, the court in *Jolan* determined that there were various  
12 "legal and equitable proceedings by which lienholders may be compelled to accept money  
13 satisfactions." *Id.* at 870. Specifically, the bankruptcy court looked to three different methods in  
14 which property could be sold or transferred free and clear of a junior lienholder's interest: (i) "a  
15 senior secured party's disposition of collateral . . . under the default remedies provided in part VI of  
16 Article 9, Secured Transactions, of Washington's Uniform Commercial Code"; (ii) "a receiver may  
17 sell free and clear . . . with the liens attaching to the proceeds"; and (iii) "were the trustee proposing  
18 to sell real property, judicial and nonjudicial foreclosures in Washington operate to clear junior  
19 lienholders' interests, and their liens attached to proceeds in excess of the costs of sale and the  
20 obligation or judgment foreclosed." *Id.* at 869–70. Accordingly, the court in *Jolan* held that  
21 "[section] 363(f)(5) . . . permits a sale free and clear of liens, with the liens attaching to the proceeds,  
22 notwithstanding that those proceeds may be insufficient to pay all liens." *Id.*

23 Here, all of the factors set forth in *Clear Channel* and *Jolan* for a sale free and clear  
24 of any liens junior to those of Meserole and Fuller Smith, including those of the Junior Lienholders,  
25 are satisfied. First, any lien against the Acquired Assets, whether obtained by filing UCC-1  
26 statements or properly perfecting a judgment lien under state law, constitutes in "interest" that can be  
27 sold free and clear of under Bankruptcy Code section 363(f)(5). *Clear Channel*, 391 B.R. at 41–42  
28 ("We believe that Congress intended 'interest' to have an expansive scope.").

1           Second, there are legal and equitable proceedings available under applicable state law  
2 which parallel the proceedings discussed in *Jolan*, and provide a mechanism to compel a junior  
3 lienholder to take a money judgment in satisfaction of its lien. Specifically, the Acquired Assets are  
4 located in either California, New York, Virginia, or North Carolina, and the known liens asserted  
5 against the Acquired Assets have been perfected in either of these states. Under California, New  
6 York, Virginia, and North Carolina state law, a junior lienholder, either in a foreclosure of real  
7 property or personal property, can be compelled to accept money satisfaction of their liens, even if  
8 the proceeds of any disposition of such property is insufficient to satisfy junior claims in full. *See*  
9 Cal. Com. Code §§ 9608, 9615 (2013); *Caito v. United Cal. Bank*, 576 P.2d 466, 469 (Cal. 1978)  
10 ("Following a foreclosure sale and satisfaction of the obligation of the creditor who forecloses,  
11 subordinate liens against the foreclosed property attach to the surplus proceeds in order of their  
12 priority."); N.Y. U.C.C. §§ 9-608, 9-615 (McKinney 2001); N.Y. Real Prop. Acts. §§ 1354, 1371  
13 (McKinney 2002); Va. Code Ann. §§ 8.9A-608, -615, 55-59.4 (2013); N.C. Gen. Stat. §§ 25-9-608,  
14 -615, 45-21.31 (2013).

15           The Debtors seek authority to sell the Acquired Assets to the Buyer, which is the  
16 assignee of Meserole and Fuller Smith. As explained above, Meserole and Fuller Smith are the  
17 holders of senior secured liens on all of the Acquired Assets in an amount exceeding the Purchase  
18 Price. Based on the above nonbankruptcy precedent, legal or equitable proceedings exist whereby  
19 all parties asserting liens junior to those of Meserole and Fuller Smith against the Acquired Assets,  
20 could be compelled to accept a money satisfaction of any such liens. With respect to the proposed  
21 Sale, there are no anticipated proceeds to which such junior liens may attach, but this does not  
22 change the fact that such entities asserting junior liens against the Acquired Assets "could be  
23 compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest." *See*  
24 11 U.S.C. § 363(f)(5); *accord In re Jolan, Inc.*, 403 B.R. at 870; *In re Boston Generating, LLC*, 440  
25 B.R. at 333.

26           For the foregoing reasons, the Debtors respectfully request the Court approve the Sale  
27 of the Acquired Assets free and clear of all "interests."  
28

1 **C. The Buyer is Entitled to Good Faith Purchaser Status Pursuant to Bankruptcy**  
2 **Code Section 363(m).**

3 Bankruptcy Code section 363(m) provides that "[t]he reversal or modification on  
4 appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property  
5 does not affect the validity of a sale or lease under such authorization to an entity that purchased or  
6 leased such property in good faith . . . ." *See also Mann v. Alexander Dawson, Inc.*, 907 F.2d 923,  
7 926 (9th Cir. 1990) ("[A]n appeal of a bankruptcy court's ruling on a foreclosure action [or sale]  
8 generally cannot affect the rights of a good faith purchaser of the foreclosed property, unless the  
9 debtor [or other complaining party] stays the foreclosure [or other] sale pending an appeal."). "[T]he  
10 primary goal of the mootness rule [embodied in section 363(m)] is to protect the interest of a good  
11 faith purchaser . . . of the property, thereby assuring finality of sales." *Onouli-Kona Land Co. v.*  
12 *Estate of Richards (In re Onouli-Kona Land Co.)*, 846 F.2d 1170, 1173 (9th Cir. 1988) (quotations  
13 omitted). Lack of good faith for purposes of Bankruptcy Code section 363(m) is generally  
14 determined by the existence of fraudulent conduct or insider dealing during the sale process. *See,*  
15 *e.g., In re Exennium, Inc.*, 715 F.2d 1401 (9th Cir. 1983).

16 The protection of Bankruptcy Code section 363(m) is warranted in these cases  
17 because the proposed Sale is the product of arms length, good faith negotiations between the  
18 Debtors, on the one hand, and the Buyer, on the other, each of which has been represented by  
19 experienced professionals. The Buyer is not an insider of the Debtors, and the Debtors are unaware  
20 of any circumstances that would suggest that the negotiation process was tainted by fraud or  
21 collusion. As such, the Court should find that the Buyer is a "good faith purchaser." Accordingly,  
22 the proposed Sale free and clear of all interests is entitled to the protections of Bankruptcy Code  
23 section 363(m). *See In re Namco Capital Group, Inc.*, 2011 U.S. Dist. LEXIS 65607 at \*7-8 ("A  
24 sale that involves lien-stripping under [section] 363(f) is still by its terms a sale under subsection (b)  
25 or (c). A reversal of the bankruptcy court's authorization to sell free and clear amounts to a  
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1 'modification on appeal' of the authorization to sell. . . . [S]uch a reversal would be plainly contrary  
2 to the mandate of [section] 363(m) . . . ."<sup>15</sup>

3 **D. The Court Should Approve the Assumption and Assignment of the Assigned**  
4 **Contracts to the Buyer.**

5 In order to assign a contract or lease, a debtor must assume the contract or lease under  
6 Bankruptcy Code section 365(b) and provide adequate assurance of future performance under  
7 section 365(f)(2). The Debtors have satisfied the requirements for assuming and assigning the  
8 Assigned Contracts.

9 **1. The Court Should Approve the Assumption by the Debtors of the**  
10 **Assigned Contracts.**

11 Under Bankruptcy Code section 365(a), a debtor generally "may assume or reject any  
12 executory contract or unexpired lease of the debtor." 11 U.S.C. § 365(a). Though not expressly  
13 stated in section 365(a), it is well settled that a court should authorize the assumption or rejection of  
14 an executory contract when there is a "sound business purpose" that justifies the requested action.  
15 *See, e.g., In re G.I. Indus.*, 204 F.3d 1276 (9th Cir. 2000); *In re Klein Sleep Prods.*, 78 F.3d 18 (2d  
16 Cir. 1996). In essence, this test amounts to a "business judgment" test. *In re Pomona Valley Med.*  
17 *Group, Inc.*, 476 F.3d 665, 670 (9th Cir. 2007) ("[A] bankruptcy court applies the business judgment  
18 rule to evaluate a debtor-in-possession's decision to reject the contract.") (alterations omitted); *In re*  
19 *Sharon Steel Corp.*, 872 F.2d 36, 40 (3d Cir. 1989); *Richmond Leasing Co. v. Capitol Bank, N.A.*,  
20 762 F.2d 1303 (5th Cir. 1985); *Dai-Ichi Kangyo Bank, Ltd. v. Montgomery Ward Holding Corp. (In*  
21 *re Montgomery Ward Holding Corp.)*, 242 B.R. 147 (D. Del. 1999).

22 A debtor satisfies the "business judgment" test when it decides, in good faith, that the  
23 assumption or rejection may benefit the estate. *In re Pomona Valley Med. Group, Inc.*, 476 F.3d at  
24 670; *In re Chipwich, Inc.*, 54 B.R. 427, 430–31 (Bankr. S.D.N.Y. 1985); *Commercial Fin. Ltd. v.*

25 <sup>15</sup> In *Namco Capital Group, Inc.*, the California district court specifically rejected the B.A.P.'s  
26 opinion in *Clear Channel*, which held that Bankruptcy Code section 363(m) does not apply to  
27 the lien stripping portion of a sale under section 363(f). *In re Namco Capital Group, Inc.*, 2011  
28 U.S. Dist. LEXIS 65607 at \*7. In doing so, the district court joined a long list of courts that have  
rejected *Clear Channel's* interpretation of section 363(m). *Id.* at \*4–7 (collecting cases rejecting  
the B.A.P.'s holding in *Clear Channel*).

1 *Hawaii Dimensions, Inc. (In re Hawaii Dimensions, Inc.)*, 47 B.R. 425, 427 (D. Haw. 1985).

2 Bankruptcy courts generally approve a debtor's decision on assumption or rejection absent a showing of  
3 bad faith, abuse of discretion, or a clear demonstration that the assumption or rejection will not benefit  
4 the estate or creditors. *In re Pomona Valley Med. Group, Inc.*, 476 F.3d at 670; *In re Prime Motors*  
5 *Inns*, 124 B.R. 378 (Bankr. S.D. Fla. 1991); *In re Chipwich*, 54 B.R. at 430–31.

6 In a situation where a debtor is assuming a contract in connection with a sale  
7 transaction pursuant to which it will be assigned, the scope of review should be even more limited  
8 because of the negligible exposure to the estate. Where the assumption is solely to facilitate  
9 assignment, the estate has virtually no exposure to either general unsecured or administrative claims.  
10 Although the assumption does create an administrative liability for all obligations under the  
11 Assigned Contracts, the estate is not liable for any breach of the Assigned Contracts occurring after  
12 the assignment. *See* 11 U.S.C. § 365(k). Moreover, the assumption and assignment eliminates any  
13 general unsecured claim for damages.

14 **2. The Debtors Have Satisfied All Other Applicable Provisions of**  
15 **Bankruptcy Code Section 365 Regarding Assumption of the Assigned**  
16 **Contracts.**

17 In addition to the business judgment test, section 365(b)(1) of the Bankruptcy Code  
18 provides that:

19 If there has been a default in an executory contract or unexpired lease  
20 of the debtor, the trustee may not assume such contract or lease unless,  
at the time of assumption of such contract or lease, the trustee

- 21 (A) cures, or provides adequate assurance that the trustee will  
22 promptly cure, such default . . . ;  
23 (B) compensates, or provides adequate assurance that the trustee  
24 will promptly compensate, a party other than the debtor to such  
contract or lease, for any actual pecuniary loss resulting from  
such default; and  
25 (C) provides adequate assurance of future performance under such  
26 contract or lease.

27 Pursuant to the Court-approved Sale Procedures, the Debtors served all known  
28 Contract Counterparties to executory contracts or unexpired leases with a Cure Notice, which,

1 among other things, advised the Contract Counterparties of the Cure Amounts reflected in the  
2 Debtors' books and records. The Cure Notice also stated that any Contract Counterparties must  
3 object to the Debtors' proposed Cure Amounts by September 18, 2013. The Debtors received no  
4 responses or objections from Contract Counterparties to the Assigned Contracts as to the proposed  
5 Cure Amounts. Accordingly, the Debtors have given all Contract Counterparties the opportunity to  
6 object to the Cure Cost that must be satisfied prior to the assumption or assignment of any of the  
7 Assigned Contracts.

8 Under the terms of the APA, the Buyer has agreed to pay the Cure Amounts for all  
9 Assigned Contracts upon closing of the Sale. Accordingly, the cure requirements of Bankruptcy  
10 Code section 365(b)(1) have been satisfied for all Assigned Contracts.

11 **3. The Court Should Approve the Assignment of the Assigned Contracts to**  
12 **the Buyer, as the Buyer Has Provided Adequate Assurance of Future**  
13 **Performance.**

14 Bankruptcy Code section 365(f)(2) provides that an executory contract or unexpired  
15 lease of a debtor may be assigned "only if . . . adequate assurance of future performance by the  
16 assignee of such contract or lease is provided . . . ." *Accord In re Three A's Holdings, L.L.C.*, 364  
17 B.R. 550, 559 (Bankr. D. Del. 2007) ("As a general proposition, for a debtor to obtain court  
18 authority to assume and assign a lease, it must only provide adequate assurance that the proposed  
19 assignee will perform in accordance with the lease terms."). The Bankruptcy Code does not provide  
20 a precise definition of "adequate assurance of future performance" but bankruptcy courts have  
21 recognized that this provision "means that the proposed assignee [should have] the ability to satisfy  
22 the financial obligations imposed by the [contract or] lease. **An absolute guarantee, such as a**  
23 **letter of credit, is not required to meet this standard.**" *In re Tech Hifi, Inc.*, 49 B.R. 876, 879  
24 (Bankr. D. Mass. 1985) (emphasis added); *In re PRK Enters., Inc.*, 235 B.R. 597, 302 (Bankr. E.D.  
25 Tex. 1999) (recognizing that "adequate assurance can be demonstrated by establishing a foundation  
26 that is nonspeculative and sufficiently substantive") (quotations omitted); *In re Bygaph, Inc.*, 56 B.R.  
27 596, 605–06 (Bankr. S.D.N.Y. 1986) (finding adequate assurance of performance present in light of  
28 assignee's "personal financial resource and his express willingness to devote sufficient funding to the

1 new restaurant [subject to the lease] to give it a strong likelihood of succeeding", and the assignee's  
2 experience in the industry").

3 Evidence of the Buyer's ability and intent to perform under the Assigned Contracts is  
4 provided in the Buyer Declaration. In sum, the Buyer is an entity formed specifically for the  
5 purpose of purchasing and operating the Acquired Assets as part of a going concern. Net of all Cure  
6 Amounts and other costs to be paid as part of the closing of the Sale, the Buyer will have significant  
7 capital available to cover any ongoing operating expenses and the liabilities it has agreed to assume.  
8 The Buyer has been very selective in electing which executory contracts and leases it intends to  
9 acquire, thereby minimizing the overhead costs that have historically burdened the Debtors' cash  
10 flow. Thus, the Buyer believes it will be able to minimize operating losses, and fund its operating  
11 expenses through ordinary business operations.

12 Moreover, the Contract Counterparties to the Assigned Contracts have all received  
13 notice of the Debtors' intent to assign the contracts to the Buyer, and have been provided an  
14 opportunity to object to such assignment prior to the Sale Hearing. The Debtors have received no  
15 such objection.

16 Accordingly, the Debtors respectfully request that the Court find that the Debtors  
17 have satisfied all requirements of Bankruptcy Code section 365 for the assumption and assignment  
18 of the Assigned Contracts to the Buyer.

19 **E. The Court Should Waive the Fourteen Day Stay of the Sale Order.**

20 As set forth above, as of September 30, 2013, the DIP Financing has matured and the  
21 DIP Lender advanced aggregate DIP Loan advances totaling \$2.5 million. The DIP Agent agreed to  
22 forbear from exercising rights and remedies under the Final DIP Order and the Pre-Petition Lender  
23 has consented to the use of its cash collateral through October 4, 2013. The Debtors currently do not  
24 have access to any additional financing and the Debtors have exhausted their availability under the  
25 DIP Financing. If the sale of the Acquired Assets cannot be consummated immediately following  
26 the Sale Hearing, it is unlikely that the Debtors can generate sufficient cash flow to operate or even  
27 use such limited cash absent consent of the Pre-Petition Lender. Accordingly, the Debtors request  
28 that the automatic fourteen (14) day stay under Bankruptcy Rules 6004(h) and 6006(d) be waived.

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**IV.**

**CONCLUSION**

The Debtors respectfully request entry of an order: (i) approving the Debtors' sale of the Acquired Assets to the Buyer, or any authorized assignee, under the terms of the APA, free and clear of all interests under Bankruptcy Code sections 363(b), (k), and (f); (ii) finding that the Buyer, or any authorized assignee, is a good faith purchaser within the meaning of Bankruptcy Code section 363(m); (iii) authorizing the assumption and assignment of the Assigned Contracts to the Buyer, or any authorized assignee; (iv) authorizing the Debtors, and their respective officers and employees, to execute all applicable documents and take all actions necessary to complete the Sale; and (v) granting such other relief as the Court deems to be just and proper.

Date: October 2, 2013

/s/ Michael S. Neumeister  
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Michael S. Neumeister  
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PROFESSIONAL CORPORATION  
  
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