UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re:	)	Chapter 11
	)	
GULF PACKAGING, INC.,[1]	)	Case No. 15-15249
	)	
Debtor.	)	Hon. Pamela S. Hollis
	)	
	)	
	)	

LIMITED OBJECTION OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS TO THE PROPOSED FINAL ORDER ON DEBTOR'S MOTION TO (A) USE CASH COLLATERAL, AND (B) GRANT ADEQUATE PROTECTION AND PROVIDE SECURITY AND OTHER RELIEF TO FCC, LLC d/b/a FIRST CAPITAL, AS LENDER

The Official Committee of Unsecured Creditors (the "*Committee*") of Gulf Packaging, Inc. (the "*Debtor*"), by and through its undersigned proposed counsel, hereby submits this limited objection (the "*Objection*") to the proposed final order with respect to the motion (the "*Motion*") of Gulf Packaging, Inc. (the "*Debtor*") for authority to (a) use cash collateral, and (b) grant adequate protection and provide security and other relief to FCC, LLC d/b/a First Capital, as lender ("*FCC*"). In support of this Objection, the Committee states as follows:

PRELIMINARY STATEMENT

The Committee understands the Debtor's use of cash collateral is crucial to the success of this chapter 11 case, but several of the proposed terms imposed by FCC are contrary to the Bankruptcy Code and unworkable under the circumstances. Indeed, while the Motion makes clear that FCC is undoubtedly over-secured, the proposed cash collateral order includes several provisions that would only be appropriate in instances where the lender can prove a substantial diminution in the value of its collateral.

[1] The last four digits of the Debtor's tax identification number are 5030.

As set forth in more detail below, the Committee opposes the use of cash collateral on the terms contained in the proposed final order because:

- FCC requests superpriority administrative expenses, which would allow it to effectively cure any deficiencies in its pre-petition liens;
- FCC seeks to encumber chapter 5 causes of action without sufficient justification, and these causes of action should be preserved for the benefit of unsecured creditors;
- The proposed order would require the Debtor to deposit all cash collateral into an account held in FCC's name and would allow FCC to apply cash collateral to satisfy FCC's pre-petition indebtedness; and
- The proposed order would waive the estate's right to seek a surcharge of FCC's collateral, pursuant to section 506(c) of the Bankruptcy Code, yet this waiver would constitute a windfall for FCC.
- The Debtor and FCC propose to pay $62,500.00 to an insider out of FCC's cash collateral in the approved budget.
- The budget fails to provide the Committee with sufficient funds to fulfill its statutory duties.

RELEVANT FACTUAL AND PROCEDURAL HISTORY

The Debtor filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code on April 29, 2015 (the "*Petition Date*"). The Debtor's bankruptcy filings disclose that it has at least ten affiliated entities in which GPI has no direct ownership interest.

In 2012, GPI and the affiliated entities sought to effectuate an operational "roll-up" into the Debtor in order to take advantage of synergies and minimize costs. In furtherance of its contemplated roll-up, the Debtor entered into that certain Loan and Security Agreement dated as of March 31, 2014 between the Debtor and FCC (as amended, the "*FCC Facility*"). The FCC Facility was guaranteed by several of the Debtor's affiliates.

As of the Petition Date, the Debtors assert $9 million (the "*Pre-Petition Debt*") is owed to FCC under the FCC Facility. FCC claims that the FCC Facility is secured by substantially all of

the Debtor's assets, which consist of $8.55 million in accounts receivable and inventory with a booked value of $7.6 million.

As summarized in the Motion, the Debtor seeks the entry of a final order that would authorize the use of cash collateral, subject to several provisions, including:

- Adequate protection in the form of a superpriority administrative expense, pursuant to section 507(b) of the Bankruptcy Code;
- Liens on chapter 5 causes of action;
- Requiring all cash collateral to be deposited into an account held in FCC's name and allowing FCC to use any cash collateral it receives to pay the Pre-Petition Debt.
- A waiver of any party to seek to surcharge FCC's collateral under section 506(c) of the Bankruptcy Code.
- A budget which includes payments to an insider, over $30,000 per week for the Debtor's counsel, $25,000 per week for Debtor's financial advisor and $10,000 for the Committee's counsel.

A final hearing on the Motion is set for May 26, 2015.

OBJECTIONS

The Committee submits the proposed conditions for the Debtor's use of FCC's cash collateral are objectionable because the proposed order: (i) grants FCC adequate protection in the form of a superpriority administrative expense, despite the fact that FCC is clearly over-secured; (ii) grants FCC liens on chapter 5 causes of action, without justification; (iii) requires the Debtor to deposit all cash collateral into an account held in FCC's name, and also allows FCC to apply any cash collateral to the Pre-Petition Debt, and it is inevitable that FCC will receive cash collateral because the lockbox is in the name of FCC; (iv) waives the right of any party to seek to surcharge FCC's collateral; (v) allows a carveout for insider payments from funds which would otherwise be available to general unsecured creditors; and (vi) provides a carveout for the Committee that is not sufficient to fulfill its statutory duties. Each of these objections is

discussed in more detail below.

I. There Is No Basis to Grant FCC Superpriority Administrative Expenses

The proposed order seeks to grant FCC adequate protection in the form of superpriority administrative expenses, pursuant to section 506(b). This is improper because FCC is unquestionably oversecured, thus negating the need for this type of protection.

Section 363(c)(2) provides that a trustee may not use a party's cash collateral unless the party consents or the court authorizes such use. 11 U.S.C. § 363(c)(2). Section 363(e) conditions the use of cash collateral on the trustee providing adequate protection to all parties with an interest in such cash collateral. 11 U.S.C. § 363(e) Section 361 of the Bankruptcy Code provides that, when adequate protection is required, such adequate protection may be provided by:

> (1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property;
>
> (2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease or grant results in a decrease in the value of such entity's interest in such property; or
>
> (3) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

11 U.S.C. § 361.

"Adequate protection, as defined in the Bankruptcy Code, was intended by Congress to prevent, during the pendency of a bankruptcy case, against a loss in the value of a secured creditor's interest in property of the bankruptcy estate." *In re Elk Grove Village Petroleum*, 510 B.R. 594, 604 (Bankr. N.D. Ill. 2014); *see also In re Markos Gurnee P'ship*, 252 B.R. 712, 716 (Bankr. N.D. Ill. 1997). If the value of a secured creditor's interest is not declining during the bankruptcy case, then the creditor may not be entitled to adequate protection. *In re Settlers'*

Housing Service, Inc., 505 B.R. 483, 495 (Bankr. N.D. Ill. 2014) (discussing adequate protection in connection with section 362). The creditor must prove a decline in value in order to establish a *prima facie* case for adequate protection. *See In re Gunnins Ctr. Apts., LP*, 320 B.R. 391, 396 (Bankr. D. Colo. 2005).

FCC has not provided any evidence to establish a decline in the value of its collateral. And as previously stated, the Pre-Petition Debt totals $9 million and the value of FCC's collateral exceeds $16 million. *FCC, therefore, has an equity cushion of nearly 50%.* Based on its failure to show any decline in the value of its collateral and the substantial equity cushion in this case, there is simply no basis to provide FCC with *any* adequate protection.

Courts have consistently held that substantial equity cushions, such as FCC's, are sufficient forms of adequate protection. *See In re Dynaco Corp.*, 162 B.R. 389, 398 (Bankr. D. N.H. 1993) (finding 17% equity cushion sufficient); *In re Mellor*, 734 F.2d 1396, 1401 (9th Cir. 1984) (finding 20% equity cushion sufficient adequate protection); *In re Steffens*, 275 B.R. 570,577 (Bankr. D. Colo. 2002) (an equity cushion of 20% or more in collateral generally will be sufficient to adequately protect a lender's claim). In such instances, over-secured creditors are not entitled to other forms of adequate protection. *See In re Berry Good, LLC*, 2008 WL 5191741, at *1 (Bankr. D. Az. Dec. 10, 2008) (stating if lender is oversecured, "it need not be paid any type of 'adequate protection' under § 361, because it is protected by an equity cushion.") (citing *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assoc., Ltd*, 484 U.S. 365, 370 (1988); *see also In re Gallegos Research Group, Corp.* 193 B.R. 577, 584 (Bankr. D. Co. 1995) (stating "[o]versecured creditors may not be entitled to cash payments or postpetition liens because they are adequately protected through the existence of a value cushion.").

FCC could also use the superpriority administrative expense to cure any security interest

defects. Should this Court allow FCC to obtain a superpriority administrative expense, FCC would be insulated from any deficiencies in its security interests because it could rely on its superpriority expense to backstop any perfection issues. The Court should not authorize this request. There is no justification to grant FCC any adequate protection beyond replacement liens. FCC's request for a superpriority expense should thus be denied.

II. There Is No Basis To Grant FCC A Lien On Chapter 5 Causes Of Action

Courts often refuse to grant liens on chapter 5 causes of actions because "neither a trustee in bankruptcy, nor a debtor-in-possession, can assign, sell or otherwise transfer the right to maintain a suit to avoid a preference." *See In re Texas General Petroleum Corp. v. Evans (In re Texas General Petroleum Corp.),* 58 B.R. 357, 35 (Bankr. S.D. Tex. 1986). In fact, even when in exchange for valuable consideration and where contracts explicitly provide for the assignment of an avoidance action, certain courts have refused to give any effect to such assignment. *See United Capital Corp. v. Sapolin Paints, Inc. (In re Sapolin Paints, Inc.),* 11 B.R. 930, 937 (Bankr. E.D. N.Y. 1981).

Chapter 5 causes of actions should be reserved for the benefit of the general unsecured creditors and administrative claimants. Allowing FCC to take a lien in them is not only unjustified, as further adequate protection is not necessary under the circumstances, it is unfair to the unsecured creditors and violates the priority scheme of the Bankruptcy Code.

Neither FCC nor the Debtor have even attempted to articulate a need to encumber chapter 5 causes of action. Again, there is no evidence suggesting that the value of FCC's collateral has declined or is declining. This provision would deprive the estate of an asset that is traditionally reserved for the benefit of unsecured creditors without any justification for doing so. As such, the Committee requests that the Court strike this provision from the proposed order.

III. FCC Should Not Be Authorized To Hold Cash Collateral And Pay The Pre-Petition Debt.

The proposed order would allow FCC to apply any cash collateral it receives against its Pre-Petition Debt. There is no basis to allow the Debtor to pay FCC's Pre-Petition Debt at this juncture, and the Committee should be allowed to complete its investigation of FCC's liens before any payment is made on account of the Pre-Petition Debt.

The payment of FCC's Pre-Petition Debt is especially troublesome in this case because the proposed order requires the Debtor to deposit all cash collateral into the Blocked Account (as that term is defined in the order) and the Blocked Account ***is held in FCC's name***. Accordingly, FCC will receive all cash collateral, such as accounts receivable, and can then use that cash collateral to pay its own prepetition claim. The proposed order provides FCC with far too much control and would allow the lender to pay itself before the Committee has had the opportunity to investigate the validity of FCC's liens.

The Debtor should not be authorized to pay FCC's Pre-Petition Debt until the Committee has completed its investigation, and the Blocked Account should not be in the name of FCC.

IV. The Proposed Order Should Not Waive the Estate's 506(c) Rights

The proposed order precludes the estate from asserting any right to surcharge FCC's collateral pursuant to section 506(c) of the Bankruptcy Code. Section 506(c) states:

> The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim, including the payment of all ad valorem property taxes with respect to the property.

11 U.S.C. § 506(c). Waiving this right requires the estate to pay for any and all expenses associated with the preservation and disposition of FCC's collateral. This would include all expenses "that absent the costs expended, the property would yield less to the creditor than it

does as a result of the expenditure." *Brookfield Prod. Credit Ass'n v. Borron*, 738 F.2d 951, 952 (8th Cir. 1984) (citations omitted). "[I]mmunizing agreements, prohibiting surcharge payment obligations under Section 506(c), are unenforceable on the basis that such provisions 'would operate as a windfall to the secured creditor at the expense of administrative claimants.'" *In re Lockwood Corp.*, 223 B.R. 170, 175 (8th Cir. BAP 1998) (citing *In re Hen House Interstate, Inc.*, 150 F.3d 868, 870-71 (8th Cir. 1998)).

The biggest beneficiary of this case is FCC, because the assets are being liquidated with the stated purpose of paying off the FCC loan in full. The Debtor has even proposed to use certain non-employee sales people to attempt to sell the inventory at or near market value. The cost of these sales people is more than the cost of a liquidator and includes the payment of pre-petition claims in exchange for their continued efforts to sell the inventory. Similarly, the Debtor is collecting the receivables in the ordinary course of business, instead of shutting down its operations and selling the accounts or having a liquidator collect them. All of these creditors are working hard for the benefit of the estate and should receive the protection Congress intended to provide to parties transacting business with a debtor-in-possession when enacting section 506(c).

All of the Debtor's expenditures directly benefit FCC, improve the value of FCC's collateral, and improve the possibility of FCC's recovery. Because FCC is so over-secured, the Court may enter an order allowing the use of FCC's cash collateral without FCC's consent. Any argument that FCC is conditioning the use of its cash collateral on receiving section 506(c) waivers is not compelling.

The proposed order should thus be modified to remove the section 506(c) waiver.

V. Insider Payments Should Not Be Included in the Cash Collateral Budget

Typically, lenders do not allow their collateral to be expended to pay insiders during a Chapter 11 bankruptcy case and regulate the use of the cash to prevent such payments. In this case, FCC is allowing a carveout from its cash collateral to pay $62,500 to Xsys. Xsys is a company owned by Arman Sarkisian, the Debtor's former Chief Executive Officer. Mr. Sarkisian executed the FCC loan documents on behalf of the Debtor upon which FCC's secured claim is based.

The Committee does not know the extent of FCC's relationship with Mr. Sarkisian, but objects to any post-petition payment to insiders, including Mr. Sarkisian's company Xsys, until those relationships can be investigated. Any "carveout" allowed in the budget should be for the benefit of non-insider administrative claimants or general unsecured claims. While FCC is over-secured, there does not appear to be enough assets to pay off general unsecured creditors in full, so every dollar flowing to an insider is one less dollar available for the general unsecured creditors of the estate who dealt with the Debtor at arms' length.

VI. The Committee Carveout Should Be Increased To A Level Commensurate With the Debtor's Professionals

The cash collateral budget provides the Debtor's counsel with a carveout of more than $30,000 per week, the Debtor's financial advisor with $25,000 per week, but allots only $10,000 per week to the Committee. The Committee carveout should be increased to $30,000 per week.

Section 1103 of the Bankruptcy Code, charges the Committee with great responsibilities to oversee the restructuring process on behalf of the general unsecured creditors. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 235, 401 (1978) ("creditors' committees will be 'the primary negotiating bodies for the formulation of a plan of reorganization,' will represent the class of creditors from which they are selected, will provide 'supervision of the debtor in possession and

of the trustee, and will protect their constituents' interests."). The Committee cannot sufficiently fulfill its statutory duties when the Debtor's professionals are provided more than *five times* the carveout allotted to the Committee.

Several courts have recognized the need for adequate representation of unsecured creditors and the need to ensure the process is not dominated by a secured lender or the debtor. For example, the Honorable Peter J. Walsh of the U.S. Bankruptcy Court for the District of Delaware has stated that "[t]he carveout for committee professionals and the limited period to challenge the lender's prepetition secured position is important." Open Letter of the Hon. Peter J. Walsh to Delaware Bankruptcy Counsel, ¶ 12, Apr. 2, 1988. This carveout is the price of admission to the bankruptcy court to obtain the benefits of preserving the assets of the estate, which preservation typically first benefits secured parties. *See id*. "Absent such protection, the collective rights and expectations of all parties-in-interest are sorely prejudiced." *See In re Ames Dept. Stores*, 115 B.R. 34, 38 (Bankr. S.D.N.Y. 1990). The *Ames Dept. Stores* court further reasoned:

> A failure to provide a reasonable sum for professionals has, in other cases before this Court, left estates, creditors' committees and trustees without the assistance of counsel and the Court without the adversary system contemplated by Congress in 1978 when it, in enacting the Bankruptcy Code, recast the role of bankruptcy judges principally to one of resolving disputes.

Id. at 40.

Although the Committee does not presently intend to use $30,000 per week to represent the interests of its constituents, the Committee nonetheless must preserve its ability to adequately represent unsecured creditors throughout the entire chapter 11 case, and the proposed budget covers a period of more than two months. The Committee, moreover, may determine it must retain its own financial advisor, should the need arise at a later date. Accordingly, the Committee objects to the entry of a final order unless and until the budget contains an

appropriate carveout of $30,000 per week for Committee professionals, with the reservation of rights to request more in the future, if necessary.

CONCLUSION

The Committee submits that the proposed order authorizing the use of cash collateral should be modified in accordance with the objections raised herein.

Dated: May 22, 2015

OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF GULF PACKAGING, INC.

By: /s/ Shelly A. DeRousse
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