UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF FLORIDA
MIAMI DIVISION
www.flsb.uscourts.gov

In re:

ADINATH CORP. and SIMPLY FASHION STORES, LTD.[1],	**Chapter 11 Cases**
	Case No. 15-16885
Debtors.	**Jointly Administered**
_____/	

OBJECTION OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS TO DEBTOR'S MOTION PURSUANT TO SECTIONS 105(a), 363 AND 365 OF THE BANKRUPTCY CODE AND BANKRUPTCY RULES 6004 AND 6006 FOR APPROVAL OF DEBTOR'S ENTRY INTO AN AGENCY AGREEMENT FOR THE CONDUCT OF STORE-CLOSING SALES

The Official Committee of Unsecured Creditors (the "Committee") of Adinath Corp. and Simply Fashion Stores, Ltd., as debtors and debtors-in-possession (the "Debtors"), by and through its proposed counsel Cooley LLP, hereby submits this objection ("Objection") to the Debtors' motion, pursuant to sections 105(a), 363 and 365 of the Bankruptcy Code seeking, *inter alia*, approval of the Debtor's entry into an agency agreement (the "Agency Agreement") to conduct store closing sales (the "Store Closing Sales") and dispose of its inventory, furniture, fixtures and equipment (the "Sale Motion"). In furtherance of the Objection, the Committee respectfully represents as follows:

[1] The Debtors in these cases, along with the addresses and last four digits of each Debtor's federal tax identification number are: (i) Adinath Corp., 2110 N.W.95th Avenue, Miami FL 33172 (4843); and (ii) Simply Fashion Stores, Ltd., 2500 Crestwood Boulevard, Birmingham, AL 35210 (6230).

PRELIMINARY STATEMENT

Through the Sale Motion, the Debtors seeks approval to commence a full-chain liquidation, a mere *three weeks* after the commencement of this case, pursuant to an Agency Agreement that delivers no benefit to any party other than JNS INVT, LLC ("JNS"), an investment vehicle of the Debtors' equity holders that received millions from the Debtors as their financial condition deteriorated over the last several months, including $2 million as the company stood on the very precipice of a fire sale liquidation. If the Court were to approve the sale as proposed, which is projected to generate a mere $4.4 million proceeds (barely enough to pay the DIP in full and fund the Debtors' budget), it would enable the Debtors' purported secured creditor to use chapter 11 to liquidate collateral solely for their benefit without paying all of the necessary costs of administration or providing any opportunity for a meaningful and disinterested review of the multitude of insider and related-party transactions that appear to have been the hallmark of the Debtors' prepetition operations.

As is more fully set forth in the Committee's objection to the DIP facility, while the Debtors' inventory, furniture, fixtures and equipment are not its sole asset, JNS is seeking a waiver of the Debtors' section 506(c) rights and new liens and superpriority claims on the Debtors' remaining unencumbered assets, including the proceeds of avoidance actions and leasehold interests and the proceeds, if any, generated by the sale of so-called "augmented goods" by the Agent.[2] In exchange for this enhanced collateral package, JNS provided the Debtors with "financing" (that in actuality is nothing more than the partial repayment of amounts it stripped from the company in the two weeks preceding the commencement of these cases) sufficient only to bridge these estates to a fast-track liquidation. In so doing, JNS has deprived

[2] All capitalized terms not expressly defined herein shall be given the meanings ascribed to them in the Agency Agreement.

the estates of the resources necessary to conduct even a perfunctory postpetition marketing process or an investigation of the web of transactions between the Debtors and entities controlled by or related to the Shah family. The disappointing purchase price that will likely be received for the Debtors' inventory, coupled with JNS's failure to fund a budget sufficient to guarantee an orderly and honest chapter 11 process, means that absent some action by this Court, administrative creditors may be worse off than they were at the beginning of these cases, and no distribution will be available for the Debtors' general unsecured creditors.

The Committee submits this Objection because the Debtors have failed to demonstrate any benefit to the Debtors' estate from the Store Closing Sales other than a benefit to JNS. **If the Store Closing Sales are approved today, the proceeds should be retained by the Debtors to ensure the payment of the costs of these chapter 11 cases and a potential guaranteed distribution to general unsecured creditors. No proceeds should be distributed to JNS until either the Committee's investigation of JNS, the Shah family and their related entities is completed or a challenge brought by the Committee to the validity of JNS's secured claims is overruled by final order of the Court.**

BACKGROUND

1. On April 16, 2015 (the "Petition Date"), the Debtors filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code with this Court. Since the Petition Date, the Debtors have remained in possession of their assets and have continued to operate and manage their business as debtors-in-possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

2. On April 22, 2015, the United States Trustee for the Southern District of Florida (the "US Trustee") appointed the Committee consisting of the following five members: (i)

Rosenthal & Rosenthal, Inc.; (ii) The CIT Group/Commercial Services, Inc.; (iii) Olem Shoe Corporation; (iv) Louise Paris, Ltd.; and (v) PPI Apparel Group. The next day, the Committee then selected Cooley LLP as its lead counsel, Gray Robinson, P.A as its local counsel, and CBIZ MHM, LLC as its financial advisor.

3. On April 17, 2015, the Debtors filed the Sale Motion, pursuant to which they seek, *inter alia*, authorization to liquidate all of its inventory and certain other assets pursuant to the Agency Agreement.

4. The Agency Agreement entitles the Debtors to receive a cash payment equal to 27.5% of the Retail Price of its inventory, in addition to payments for the sale of the Debtors' furniture, fixtures and equipment. Retail Price means, with respect to each item of merchandise, the lower of the lowest (i) ticketed price, (ii) marked price, (iii) shelf price, (iv) merchandise file price, (v) other file price as reflected in the Debtors' books and records for such items, and (vi) promotional price for such merchandise. See Agency Agreement, § 5.3. In the event that the Retail Price for a particular item of merchandise at one particular store is lower than the Debtors' expectations as set forth in their pricing files (or the Retail Price offered to customers at all of their other stores), then the value of that item for the purposes of calculating the Guaranteed Amount is the lower amount for that item across the Debtors' entire chain[3].

5. The Agency Agreement obligates the Agent to satisfy some, but not all, of the expenses associated with the Store Closing Sales. See Agency Agreement, § 4.1. All sale-

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[3] The Committee objects to the Sale Motion to the extent that the calculation of Retail Price does not provide for a mechanism to prevent one-store pricing or mismarking of merchandise from artificially reducing the Guaranteed Amount. It is standard for agency agreements to limit purchase price adjustments as a result of "lower of" pricing discrepancies to only those items of merchandise in the offending store. The failure to do so here could significantly reduce the Guaranteed Amount projected to be received by the Debtors.

related expenses associated with the protection and disposition of JNS's collateral that are not assumed by the Agent in connection with the Store Closing Sales must be borne by the Debtors' estate, and include section 503(b)(9) claims, expenses associated with the operation of the Debtors' distribution center and corporate headquarters, possible WARN Act liability and the post-sale wind-down of these chapter 11 estates.

6. The purchase price under the Agency Agreement is subject to a number of potential reductions that are standard for liquidation agreements of this type, including (i) downward adjustments in the event that the value of the Debtors' inventory is below a minimum threshold ($16 million at retail value) and unanticipated inventory shrink on a postpetition basis; and (ii) deductions for breaches of the Debtors' representations and warranties related to the (a) accuracy of the Debtors' pricing files and ticketing and marketing practices, (b) Debtors' promotional activity and discounting, and (c) the consistency of the mix (i.e., category, style, brand and description) of the Debtors' merchandise. A breach of one or more of these covenants could lead to a significant reduction in the presumed face amount of the purchase price.

7. In the event that the "Proceeds" of the Sale exceed the sum of (i) the Guaranteed Amount; (ii) the expenses of the sale; (iii) a fee to the Agent equal to 2% of the Retail Value of the Debtor's inventory, all remaining Proceeds of the Store Closing Sales shall be shared by the Debtors and the Agent.

8. Upon information and belief, the Proceeds realized by the estates in connection with the Store Closing Sales will not be sufficient to satisfy the vast majority of the Debtors' prepetition obligations to JNS. Moreover, in the event that the proceeds generated by the Store Closing Sales are insufficient to pay the sale-related expenses that are not assumed by the Agent, such obligations are likely to remain unsatisfied, leaving the estate administratively insolvent.

OBJECTION

The Debtors Failed to Meet Their Burden of Proving that the Proposed Sale Will Maximize Value for the Estate

9. In determining whether to authorize the use, sale or lease of property of the estate outside the ordinary course of business, courts require a debtor to show that a sound business purpose justifies such actions. See generally In re Lionel Corp., 722 F.2d 1063, 1071 (2d Cir. 1983); In re United Health Care Sys., 1997 U.S. Dist. LEXIS 5090 (D.N.J. 2007); In re Delaware & Hudson Railway Co., 124 B.R. 169, 176 (D. Del. 1991).

10. The Second Circuit in Lionel held that while there need not be a showing of an emergency situation for selling substantially all of the debtor's assets:

> there must be some articulated business justification, **other than appeasement of major creditors**, for using, selling, or leasing property out of the ordinary course of business before the bankruptcy judge may order such disposition under section 363(b).

In re Lionel Corp., 722 F.2d at 1070 (emphasis added). No such business justification exists in this case, aside from the obvious appeasement of JNS.

11. The Lionel court further cautioned that a "bankruptcy judge must not blindly follow the hue and cry of the most vocal special interest groups; rather, he should consider all salient factors pertaining to the proceeding and, accordingly, act to further the diverse interests of the debtor, creditors and equity holders, alike." In re Lionel Corp., 722 F.2d at 1071. Not only did the Lionel court caution bankruptcy judges against being swayed solely by the support of vocal constituents, but it also identified relevant factors bankruptcy judges might consider, as follows:

a. the proportionate value of the asset to the estate as a whole;

b. the amount of elapsed time since the filing;

c. the likelihood that a plan of reorganization will be proposed and confirmed in the near future;

d. the effect of the proposed disposition on future plans of reorganization;

e. the proceeds to be obtained from the disposition vis-à-vis any appraisals of the property;

f. which of the alternatives of use, sale or lease the proposal envisions; and

g. whether the asset is increasing or decreasing in value.

Id. at 1071.

12. Applying the factors identified by the Lionel court mandates denial of the Sale Motion in this case as the Debtor proposes to sell (i) all of the Debtors' inventory, its primary and most valuable asset, (ii) only three weeks from the Petition Date, (iii) with no likelihood of a plan of reorganization in the future. Consequently, under the Lionel standard, the proposed sale is not permitted under section 363(b).

13. The factors identified by the Lionel court underscore the fundamental purpose of section 363(b) as a mechanism by which a bankruptcy judge may approve a transaction that achieves one of the most fundamental goals of the chapter 11 process: to expeditiously and effectively partition a company's past problems from its future prospects. Unlike a chapter 11 plan, a section 363(b) sale can position the debtor to consummate critical and time-sensitive transactions without first suffering through the often prohibitive time and expense of the plan confirmation process.

14. A section 363(b) sale, however, is not a chapter 11 plan substitute. It is well established by courts applying the long-standing Lionel standard that "section 363(b) is not to be utilized as a means of avoiding Chapter 11's plan confirmation procedures. Where it is clear that the terms of a section 363(b) sale would preempt or dictate the terms of a Chapter 11 plan, the

proposed sale is beyond the scope of section 363(b) and should not be approved under that section." In re Westpoint Stevens, Inc., 333 B.R. 30, 52 (S.D.N.Y. 2005); In re The Babcock & Wilcox Co., 250 F.3d 955, 960 (5th Cir. 2001) ("The provisions of § 363 … do not allow a debtor to gut the bankruptcy estate before reorganization or to change the fundamental nature of the estate's assets in such a way that limits a future reorganization plan."). The Sale Motion, if approved by the Court, authorizes and directs the Debtors to liquidate the prepetition collateral (i.e. inventory) for the sole benefit of JNS, leaving virtually no assets remaining for other creditors, and would undoubtedly improperly determine or preempt plan issues in the context of a section 363(b) sale.

15. If approved by this Court, the Store Closing Sales (in conjunction with the terms of the Debtors' DIP facility) would undoubtedly authorize the Debtors to create an estate incapable of confirming a chapter 11 plan of liquidation. Non-insider general unsecured creditors, whose claims will likely exceed $10 million when rejection damage claims are included, have little to no chance of recovery once the Agency Agreement is consummated and the DIP facility is approved.

16. In spite of the foregoing, the Debtors now seek authorization to commence the very same section 363 sale process cautioned against by Lionel and its progeny – one that inherently seeks to circumvent chapter 11's plan confirmation requirements without the consent of the Committee and to the detriment of all creditors other than JNS. The Debtors' proposed sale process should not be so authorized.

17. Moreover, courts that have considered the propriety of section 363 sales run for the exclusive benefit of secured creditors have found such use unwarranted and improper. See In re Encore Healthcare Assocs., 312 B.R. 52 (Bankr. W.D. Pa. 2004) (applying Lionel standard

and finding no business justification as sole purpose of section 363 sale was to liquidate assets for benefit of secured creditor); In re Fremont Battery Co., 73 B.R. 277 (Bankr. W.D. Ohio 1987) (applying Lionel standard and finding no business reason to justify sale, the proceeds of which would, at best, benefit only one creditor). Both the Encore Healthcare and Fremont Battery courts applied the Lionel standard and found that no business reason justifies a proposed sale which would, at best, benefit secured creditors and "not create proceeds which would inure to the benefit of the unsecured creditors." In re Fremont Battery Co., 73 B.R. at 279. This Court should not permit the Debtors to abuse the chapter 11 process, as no business reason exists to justify the sale other than to placate JNS.

RESERVATION OF RIGHTS

18. The Committee reserves all of its rights to object to any and all modifications to the proposed Store Closing Sales resulting from the auction currently scheduled for May 5, 2015.

WHEREFORE, the Committee respectfully requests that the Court issue an order (i) sustaining the Committee's objection and denying the Sale Motion; and (ii) granting such additional relief as is just and proper.

Dated: May 4, 2015

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true copy hereof has been furnished this 4th day of May, 2015 to all parties in interest by the Court's CM/ECF service maintained in this case.

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