Docket #0162 Date Filed: 08/10/2019

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	)	Chapter 11
	)	
	)	Case No. 19-11563 (KBO)
EMERGE ENERGY SERVICES LP, *et al.*,[1]	)	
	)	Jointly Administered
Debtors.	)	
	)	**Hearing Date: August 14, 2019 at 11:00 a.m.**
	)	**Re: Docket Nos. 20 and 64**

OBJECTION OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS TO DEBTORS' MOTION (I) PURSUANT TO 11 U.S.C. §§ 105, 361, 362, 363 AND 364 AUTHORIZING THE DEBTORS TO (A) OBTAIN SENIOR SECURED PRIMING SUPERPRIORITY POSTPETITION FINANCING, (B) GRANT LIENS AND SUPERPRIORITY ADMINISTRATIVE EXPENSE STATUS, (C) USE CASH COLLATERAL OF PREPETITION SECURED PARTIES AND (D) GRANT ADEQUATE PROTECTION TO PREPETITION SECURED PARTIES; (II) SCHEDULING A FINAL HEARING PURSUANT TO BANKRUPTCY RULES 4001(b) AND 4001(c); AND (III) GRANTING RELATED RELIEF

The Official Committee of Unsecured Creditors (the "***Committee***") of the above captioned debtors and debtors in possession (the "***Debtors***"), by and through its undersigned proposed counsel, Kilpatrick Townsend & Stockton LLP and Potter Anderson & Corroon LLP, hereby files this objection (the "***Objection***") to the *Debtors' Motion (I) Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, and 364 Authorizing the Debtors to (A) Obtain Senior Secured Priming Superpriority Postpetition Financing, (B) Grant Liens and Superpriority Administrative Expenses Status, (C) Use Cash Collateral of Prepetition Secured Parties and (D) Grant Adequate Protection to Prepetition Secured Parties; (II) Scheduling a Final Hearing Pursuant to Bankruptcy Rules 4001(b) and 4001(c); and (III) Granting Related Relief* [D.I. 20] (the "***DIP Motion***" and the DIP

[1] The Debtors in these cases, along with the last four digits of each Debtor's federal tax identification number, are: Emerge Energy Services LP (2937), Emerge Energy Services GP LLC (4683), Emerge Energy Services Operating LLC (2511), Superior Silica Sands LLC (9889), and Emerge Energy Services Finance Corporation (9875). The Debtors' address is 5600 Clearfork Main Street, Suite 400, Fort Worth, Texas 76109.

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financing facility contemplated therein, the "***DIP Facility***").[2] In support of this Objection, the Committee respectfully states as follows:

PRELIMINARY STATEMENT[3]

1. The DIP Lenders, who are one in the same as the Prepetition Secured Parties, are seeking to provide a DIP Facility consisting of new-money and roll-up loans as a means to effectuate their pre-negotiated Restructuring Support Agreement (the "***RSA***"), which will turn over substantially all of the reorganized Debtors' equity to the Prepetition Secured Parties. Pursuant to the proposed Plan and attendant RSA, even if the Prepetition Secured Parties are determined to be oversecured, the Prepetition Secured Parties are slated to receive, among other things, 95% of the reorganized Debtors' equity (and possibly 100% of the equity) and broad sweeping releases, all within eighty-five (85) days of the Petition Date. Unsecured creditors, in contrast, are slated to share in 5% of the reorganized Debtors' equity and out-of-the-money warrants, but only if such creditors vote in favor of the Plan. While objections to the Plan contemplated by the RSA are for another day, the Debtors' overall strategy for these cases—which is undoubtedly driven by the DIP Lenders/Prepetition Secured Parties—is to run roughshod over unsecured creditors at lightning speed leaving existing management and the lenders with virtually all of the potentially significant upside to the business while unsecured creditors owed as much as $**300 million** or more (when rejection damages are added to the pot) are left with at most a few pockets full of sand.

2. As discussed herein, the DIP Facility is inextricably tied to the RSA in that they each contain, among other things, value-destructive cross-defaults. For example, if the Debtors

[2] Capitalized terms used herein but not otherwise defined herein shall have the meaning ascribed to them in the DIP Motion.

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

attempt to exercise the fiduciary out under the RSA, such action would trigger an event of default under the RSA which, in turn, triggers a default under the DIP Facility. With this structure in place, approval of the DIP Facility would render the restructuring set forth in the RSA and the related Plan a *fait accompli.*

3. As if that were not enough, the Prepetition Secured Parties will also use the DIP Facility to, among other things, (a) effectuate a "creeping" roll-up of as much as $66.7 million in prepetition debt; (b) relend such rolled-up amounts to the Debtors with the same protections that are afforded to new-money DIP loans; (c) encumber all previously unencumbered property on account of both the new-money loans and the Roll-Up Loans, including (i) the assets of Emerge Services Finance Corporation ("***ESFC***"), a Debtor that was not subject to any of the Prepetition Debt or the Prepetition Liens; and (ii) **assets encumbered by the Prepetition Secured Parties' Prepetition Liens that are subsequently avoided**; (d) eliminate the risk of a cram-down by way of the proposed Roll-Up Loans; (e) receive payment of all professional fees without any cap; (f) receive payment of excessive DIP fees for minimal new money loans; (g) lock these cases into overly restrictive milestones; and (h) obtain sections 506(c) and 552(b) and marshaling waivers. All of this relief, if granted, would be overreaching, unnecessary and unduly prejudicial to unsecured creditors. Indeed, unless the one-sided Interim Order (and presumably Final Order) is modified to address the issues and objections raised herein, entry of the Final Order may deprive unsecured creditors of substantial unencumbered value less than one month after the commencement of these chapter 11 cases.

4. Adding insult to injury, the Interim Order (and presumably the proposed Final Order) also inappropriately restricts the Committee's ability to discharge its fiduciary duties by, among other things, providing an inadequate Challenge Period during which the Committee must

not only investigate the Prepetition Secured Parties' liens and claims ***but also*** causes of action or claims ***against*** such parties (which parties appear to have hand-picked a special committee that makes all restructuring-related decisions for the Debtor)[4]; and (b) seek and obtain standing to commence a challenge[5]. These restrictions prevent the Committee from validating the Prepetition Secured Parties' position that they have enforceable and valid liens on substantially all of the Debtors' assets and asserting any claims or causes of action against the Prepetition Secured Parties.

5. Prior to filing the Objection, the Committee engaged in negotiations with the Debtors and the Prepetition Secured Parties in an attempt to resolve the Committees issues with the Final Order. While such negotiations hopefully remain ongoing, the parties were not able to agree to the form of a Final Order, which necessitated the filing of this Objection.

6. For the reasons set forth herein, the Court should condition approval of the DIP Motion on a final basis upon the Debtors substantially revising the Final Order and DIP Credit Agreement so as to address the serious concerns discussed in this Objection including: (a) the overreaching liens and superpriority claims in connection with the Roll-Up Loans; (b) the proposed encumbrance of avoidance proceeds, claims under the Debtors' D&O insurance policies, commercial tort claims, and any proceeds or property of the foregoing; (c) the cross-defaults between the RSA and DIP Facility; (d) the truncated Challenge Period and related terms; (e) the

[4] Prior to the Petition Date, the board of directors of Emerge Energy Services GP LLC (which is wholly owned by the Debtors' ultimate equity owner, Insight Equity) delegated the powers to approve and implement the terms of the proposed restructuring to a special restructuring committee of the board created pursuant to the RSA (the "***Special Restructuring Committee***"). The Special Restructuring Committee consists of two members that were appointed by the Debtors from a slate of candidates acceptable to the Noteholders, who are one in the same with the DIP Lenders. *See Declaration of Bryan M. Gaston, Restructuring Officer of the Debtors, in Support of Chapter 11 Petitions and First Day Pleadings* [D.I. 14] (the "***First Day Declaration***") at ¶ 33.

[5] The Committee's professional fee budget related to all challenge efforts is limited to $35,000.

restrictive case milestones; (f) the proposed section 506(c), 552(b), and marshaling waivers; and (g) the excessive DIP Fees.

BACKGROUND

7. On July 15, 2019 (the "***Petition Date***"), the Debtors commenced voluntary cases under chapter 11 of title 11 of the United States Code (the "***Bankruptcy Code***"). The Debtors continue to operate their businesses and manage their properties as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

8. On July 17, 2019, the Court entered its *Interim Order (I) Authorizing Debtors (A) to Obtain Postpetition Financing Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, and 364 and (B) to Utilize Cash Collateral Pursuant to 11 U.S.C. § 363, (II) Granting Adequate Protection to Prepetition Secured Parties Pursuant to 11 U.S.C. §§ 361, 362, 363, 364 and 507(b) and (III) Scheduling Final Hearing Pursuant to Bankruptcy Rules 4001(b) and (c)* (the "***Interim Order***") [D.I. 64].

9. On July 30, 2019, pursuant to Section 1102 of the Bankruptcy Code, the United States Trustee for the District of Delaware appointed the Committee [D.I. 111]. The Committee consists of the following five members: (i) Trinity Industries Leasing Company; (i) The Andersons, Inc. an Ohio Corporation; (iii) Iron Mountain Trap Rock Co.; (iv) Greenbrier Leasing Company, LLC; and (v) BMT Consulting Group, LLC.

10. On July 30, 2019, the Committee selected Kilpatrick Townsend & Stockton LLP and Potter Anderson & Corroon LLP as its proposed co-counsel. On August 2, 2019, the Committee selected Province, Inc. as its proposed financial advisor and Miller Buckfire as its proposed investment banker.

11. The objection deadline for the DIP Motion was originally August 7, 2019 at 4:00

p.m. (ET). The Debtors agreed to extend the objection deadline for the Committee to August 1, 2019 at 11:59 p.m. (ET). A hearing to approve the DIP Motion on a final basis is scheduled for August 14, 2019 at 11:00 a.m. (ET).

OBJECTION

12. Courts routinely recognize that "[d]ebtors in possession generally enjoy little negotiating power with a proposed lender, particularly when the lender has a prepetition lien on cash collateral." *In re Defender Drug Stores, Inc*., 145 B.R. 312, 317 (9th Cir. BAP 1992). As a result, courts are hesitant to approve financing terms that are considered harmful to an estate and its creditors. *See, e.g., In re Ames Dep't Stores, Inc.*, 115 B.R. 34, 40 (Bankr. S.D.N.Y. 1990) (noting that "the court's discretion under section 364 is to be utilized on grounds that permit reasonable business judgment to be exercised so long as the financing agreement does not contain terms that leverage the bankruptcy process and powers or its purpose is not so much to benefit the estate as it is to benefit a party-in-interest"). Thus, while certain favorable terms may be permitted as a reasonable exercise of the debtor's business judgment, bankruptcy courts have not approved financing arrangements that convert the bankruptcy process from one designed to benefit all creditors to one designed for the sole (or primary) benefit of the lender. *See, e.g., Ames,* 115 B.R. at 38; (citing *In re Tenney Vill. Co.,* 104 B.R. 562, 568 (Bankr. D.N.H. 1989)) (holding that the terms of a postpetition financing facility must not "pervert the reorganizational process from one designed to accommodate all classes of creditors . . . to one specially crafted for the benefit" of one creditor).

13. The Interim Order, and presumably the Final Order, includes a number of provisions that (a) prejudice the rights and powers that the Bankruptcy Code confers on the Court, the Debtors, and the Committee, (b) unjustifiably benefits the DIP Lenders/Prepetition Secured

Parties at the expense of the Debtors' unsecured creditors, and (c) are likely to give the DIP Lenders/Prepetition Secured Parties undue control over these cases.

I. The Liens and Claims on Account of the Roll-Up Loans Are Unwarranted and Overreaching

14. The Committee recognizes that roll-ups are approved by courts in certain situations based upon the unique facts and circumstances of a case. Here, however, the DIP liens and superpriority claims related to the Roll-Up Loans are overreaching and detrimental to all creditors, save the DIP Lenders/Prepetition Secured Parties. As discussed above, the DIP Facility contemplates a "creeping roll-up" of the Prepetition Revolving Credit Obligations from cash proceeds from the sale of any Prepetition Collateral or the proceeds from receivables. Such rolled up amounts will then be deemed borrowed by the Debtors on a dollar-for-dollar basis under the DIP Facility. Despite the Roll-Up Loans being characterized as DIP borrowings, the economic reality of the Roll-Up Loans is that they are tantamount to the consensual use of cash collateral. Notwithstanding this important distinction, the DIP Lenders are requesting that the Roll-Up Loans be afforded the same DIP liens and superpriority claims as if they were new money financing, but they are not.

15. If the DIP liens and superpriority claims on account of the Roll-Up Loans are approved as currently proposed, the Roll-Up Loans will encumber all of the Debtors' unencumbered assets, namely (a) assets of the Debtor obligors under the Prepetition Secured Debt that were previously unencumbered; (b) encumbered assets that become unencumbered as a result of a successful Challenge by the Committee (or any other party); and (c) the assets of ESFC, a Debtor that was not previously subject to any of the Prepetition Debt or the Prepetition Liens. Such a result would essentially guarantee that unsecured creditors will not see a penny on account of the Debtors' unencumbered assets.

16. Given that these cases were clearly commenced for the benefit of the Prepetition Secured Parties/DIP Secured Parties, the DIP Lenders' efforts to scoop up all of the Debtors' unencumbered assets on account of the Roll-Up Loans is overreaching and inconsistent with the protections afforded to the use of cash collateral, which is all that is being provided by the so-called Roll-Up Loans. Accordingly, the Committee objects to the DIP Lenders being granted any DIP liens or superpriority claims on account of the Roll-Up Loans on any unencumbered assets except to secure a superpriority adequate protection claim for diminution in value, if any, provided that the Debtors are required to marshal encumbered assets before unencumbered assets. These superpriority adequate protection claims and the new money portion of the DIP Facility are the only claims that can properly be secured by any unencumbered assets.

II. The DIP Liens and Superpriority Claims and Adequate Protection Liens and Claims on Account of the New Money Loans Should Not Encumber Avoidance Proceeds, Commercial Tort Claims, Claims Under the Debtors' D&O Insurance Policies, or Proceeds or Property of the Foregoing

17. The Committee objects to the DIP Lenders being granted any DIP liens and superpriority claims or adequate protection liens and claims on avoidance proceeds, commercial tort claims, claims under the Debtors' D&O Insurance Policies, and proceeds or property of the foregoing, even to secure the new money and superpriority diminution in value claims.

18. With respect to the proposed liens and claims on avoidance proceeds, such relief is fundamentally at odds with the unique purposes served by avoidance actions. Avoidance actions are distinct creatures of bankruptcy law designed to benefit, and ensure equality of distribution among, general unsecured creditors. *See Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery (In re Cybergenics Corp.*), 226 F.3d 237, 244 (3d Cir. 2000), *rev'd en banc*, 330 F.3d 548 (3d Cir. 2003) (identifying underlying intent of avoidance powers to recover valuable assets for estate's benefit); *In re Tribune Co.*, 464 B.R. 126, 171 (Bankr. D. Del. 2011) (noting

"that case law permits all unsecured creditors to benefit from avoidance action recoveries"). The Debtors have not provided any justification for the extraordinary grant of liens on avoidance proceeds, or for the potential payment of superpriority claims with the proceeds of avoidance actions. To the contrary, there is no legal basis for this Court to grant the DIP Lenders a lien on avoidance proceeds. Accordingly, avoidance proceeds should be wholly excluded from the DIP Collateral and reserved for the benefit of the Debtors' unsecured creditors. With respect to any DIP liens and superpriority claims or adequate protection liens and claims against the Debtors' D&O insurance policies and commercial tort claims, those assets were likely unencumbered prepetition and they should continue to remain unencumbered postpetition for the benefit of unsecured creditors who, under the existing Plan, may receive no recovery whatsoever.

III. The Cross-Default Provisions in the DIP Facility and RSA Give the DIP Secured Parties Undue Control Over These Cases

19. The fiduciary out is illusory because, should the Debtors determine that an alternative restructuring proposal is in the best interest of the estates and terminate the RSA, the DIP Lenders may (a) declare an event of default under the DIP Facility immediately, without notice, application or motion, hearing before or order of the Court, (b) declare all obligations under the DIP Facility immediately due and payable, (c) immediately terminate and restrict any right of the Debtors to use cash collateral; and (d) upon five days' written notice, exercise all rights and remedies, including foreclosure upon the DIP Collateral, without further notice or order from the Court. *See* DIP Credit Agreement §§ 10.7(c) and 11.1(a), Interim Order at ¶ 14(d). Accordingly, any termination of the RSA and as a result, the DIP Facility—even if consistent with the exercise of the Debtors' fiduciary duties—would result in dire consequences for these estates and its stakeholders.

20. Furthermore, although the RSA does not contain a "no-shop" provision, the

existence of the cross-defaults and tight case milestones effectively creates a restrictive "no-shop" provision. Indeed, the First Day Declaration makes no mention of the Debtors looking outside of their own capital structure with regard to an in-court restructuring of the Debtors' balance sheet and business operations. Rather, the First Day Declaration provides that the Debtors and their restructuring advisors engaged with only Insight Equity (the Debtors' ultimate equity owner) and the Prepetition Secured Parties. *See* First Day Declaration at ¶ 32. Why now, with a cross-default looming over any exercise of the Debtors' fiduciary out, would the Debtors "shop" for restructuring alternatives, if they have not apparently done so to date? Furthermore, even if the Debtors were to exercise their fiduciary out, they are still liable for the breach of the RSA: "no termination of this Agreement shall relieve any Party from liability for its breach or non-performance of its obligations hereunder prior to the date of such termination." RSA at ¶ 6(e). Therefore, approval of the Final Order in its current form would be tantamount to (a) approving the assumption of the RSA without compliance with the provisions of section 365 of the Bankruptcy Code; and (b) confirming a plan of reorganization without compliance with the provisions of section 1129 of the Bankruptcy Code.

21. For the foregoing reasons, this Court should deny the DIP Motion to the extent that the DIP Facility provides cross-defaults with the RSA and effectively nullifies the Debtors' fiduciary out, improperly granting control of these cases to the Prepetition Secured Parties/DIP Secured Parties. At a minimum, in the event a DIP default is triggered as a result of the Debtors exercising their fiduciary out, the DIP Lenders' exercise of remedies should not extend beyond the ability to terminate lending. For the DIP Lenders to be able to exercise "all remedies", including the ability to foreclose, is inappropriate and value-destructive.

III. The Proposed Adequate Protection Package is Unwarranted

22. The Interim Order provides an overly generous adequate protection to the Prepetition Secured Parties in the form of (a) all accrued and unpaid interest and fees at the ***default rate***, as provided under the Prepetition Revolving Credit Agreement; and (b) all reasonable and documented fees, out-of-pocket expenses, and disbursements incurred by the Prepetition Secured Parties, without any cap. *See* Interim DIP Order at ¶ 18(d). However, it is not clear that the Prepetition Secured Parties are oversecured, a necessary predicate for the payment of postpetition interest. *See In re Residential Capital, LLC*, 508 B.R. 851, 853 (Bankr. S.D.N.Y. 2014) ("The Bankruptcy Code entitles *oversecured* creditors to postpetition interest[.]") (emphasis added). In fact, the Dunayer Declaration states that, "Houlihan has concluded, however, that the going-concern value of the Debtors' assets fall significantly short of the total outstanding obligations under the Prepetition Facilities." *See Declaration of Adam Dunayer in Support of Motion (I) Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, and 364 Authorizing the Debtors to (A) Obtain Senior Secured Priming Superpriority Postpetition Financing, (B) Grant Liens and Superpriority Administrative Expenses Status, (C) Use Cash Collateral of Prepetition Secured Parties and (D) Grant Adequate Protection to Prepetition Secured Parties; (II) Scheduling a Final Hearing Pursuant to Bankruptcy Rules 4001(b) and 4001(c); and (III) Granting Related Relief* at ¶ 9 [D.I. 21] (the "***Dunayer Declaration***")[6].

23. For these reasons, the Committee requests that the Final Order exclude any payment of postpetition interest to the Prepetition Secured Parties until a final determination is made as to (a) the value of the Debtors' assets; and (b) the validity of the Prepetition Liens. At a minimum,

[6] By the filing of this Objection, the Committee is not agreeing with the value conclusion contained in the Dunayer Declaration and expressly reserves the right to contest same.

the Committee requests that the default rate not be utilized in calculating the postpetition interest payments and that the Final Order make clear that any adequate protection payments be subject to recharacterization as payments on principal in the event the Prepetition Lenders are undersecured.

IV. The Challenge Period and Related Terms Constrain the Committee's Ability to Appropriately Discharge its Fiduciary Duties

24. The DIP Facility contains substantial constraints on the ability of the Committee to discharge its fiduciary duties. Specifically, the terms of the Interim Order limit the time during which the Committee may investigate a litany of liens and claims related to the Prepetition Secured Parties, file a motion to obtain standing, obtain the requisite standing, and commence a challenge to (60) calendar days after the appointment of the Committee (the "***Challenge Period***")[7]. This timeframe is unacceptable and unworkable because the Challenge Period applies not only to the liens and claims of the Prepetition Secured Parties (the "***Prepetition Lien Matters***"), ***but also*** any claims or causes of action that may be asserted ***against*** the Prepetition Secured Parties (*i.e.*, lender liability claims and claims related to a valuation of the Debtors' assets) (the "***Prepetition Claim and CoA Matters***"). Given that the Interim Order (and presumably the Final Order) includes a broad sweeping plan-like release of the Prepetition Secured Parties, the Committee, the only estate fiduciary who has not granted such a release, must have a reasonable amount of time to investigate whether such a release is appropriate or whether there are viable claims or causes of action against such parties.[8] *See* Interim Order at ¶ 7.

[7] The Committee was appointed on July 30, 2019. Sixty (60) calendar days from the appointment of the Committee is September 28, 2019. *See* Interim Order at ¶ 26.

[8] The Committee also objects to the proposed investigation budget, which is currently set at $35,000. Interim Order at ¶ 27. This provision clearly seeks to shield the Prepetition Secured Parties, who are also the DIP Secured Parties, by unduly limiting the resources available to the Committee to investigate potential claims against such parties. Therefore, the Committee requests that an additional $40,000 be made available to the Committee for its analysis of Prepetition Lien Matters and that no cap be placed on the Committee's investigation into the Prepetition Claim and CoA Matters

25. The Committee also objects to the requirement that it obtain standing prior to the expiration of the Challenge Period if it wishes to pursue a challenge. *See* Interim Order at ¶ 26. The process by which the Committee may obtain standing to pursue such a cause of action will likely take a reasonable amount of time. As such, and given the proposed case milestones and thin investigation budget for the Committee, the Committee should not be required to expend the time and expense necessary to obtain standing prior to commencing a challenge. Indeed, courts have previously approved financing agreements that grant standing to creditors' committees without the need for a standing motion. *See, e.g.*, *In re Phoenix Payment Sys., Inc.*, No. 14-11848 (Bankr. D. Del. Sept. 3, 2014); *In re Am. Safety Razor, LLC*, No. 10-12351 (Bankr. D. Del. Aug. 27, 2010) at ¶ 6; *see also In re Quebecor World (USA) Inc.*, No. 08-10152 (Bankr. S.D.N.Y. Apr. 1, 2008) ¶ 21; *In re Dana Corp.*, Case No. 06-10354 (Bankr. S.D.N.Y. Mar. 29, 2006) ¶ 25.[9]

26. In light of the complexity of these cases and the speed at which they are progressing, the Committee requests that the Final Order be revised such that: (a) the Challenge Period for the Prepetition Lien Matters be 90 days from the appointment of the Committee; (b) the Challenge Period for the Prepetition Claim and CoA Matters be through and until the later of (i) 90 days from the appointment of the Committee; and (ii) the hearing to confirm a chapter 11 plan; (c) the investigation budget be increased to $75,000 for Prepetition Lien Matters only and that no cap be placed on the Committee's investigation into the Prepetition Claim and CoA Matters; and (d) the Committee be granted automatic standing to commence a Challenge or, alternatively, that upon the filing of a standing motion, the Challenge Period be automatically tolled until three (3) business days after this Court rules on such motion.

[9] In the event the Committee is required to obtain standing, the Challenge Period should be automatically tolled upon the filing of a standing motion until three (3) business days after this Court rules on such motion.

V. The DIP Milestones Must by Extended by at Least Thirty (30) Days

27. Pursuant to the milestones set forth in the DIP Credit Agreement and RSA:

- within 37 days of the Petition Date, the Debtors shall have a hearing to approve the Disclosure Statement Hearing (the "***Disclosure Statement Hearing Deadline***");
- within 60 days of the Petition Date, the Debtors shall have filed a motion seeking rejection of any railcar leases designated by the Debtors and with the consent of the Required Lenders (as defined in the DIP Credit Agreement);
- within 35 days after the Disclosure Statement Hearing Deadline, the Debtors shall have a hearing to seek confirmation of the Plan (the "***Confirmation Hearing Deadline***"); and
- within the earlier of (i) 15 days after the Confirmation Deadline; and (ii) 100 days after the Petition Date, the Effective Date of the Plan shall have occurred.

See DIP Credit Agreement § 6.16; RSA Term Sheet at Appendix I.

28. The Committee, which was formed only 11 days ago, should have an opportunity to, among other things, vet the Debtors' prepetition marketing efforts; independently test the market for interest in the Debtors' assets; understand and analyze the go-forward business plan; perform a valuation analysis; investigate the Prepetition Secured Parties' alleged liens and claims; investigate potential claims against the Prepetition Secured Parties, including claims related to the apparent mandate that the board abdicate its duties in favor of hand-picked proxies for the Prepetition Secured Parties; understand the prepetition negotiations and analyses regarding entry into the RSA; analyze tax-related issues that may be driving the structure of the Plan; analyze the insider releases contained in the Plan; and analyze other Plan provisions including the rationale for inexplicably providing consideration to equity despite the woeful consideration provided to general unsecured creditors.

VI. The Waivers of Sections 506(c) and 552(b) of the Bankruptcy Code and Related Provisions are Unwarranted and Not Supported by the Record

29. The Debtors are seeking a waiver of the estates' right to surcharge collateral pursuant to section 506(c) of the Bankruptcy Code, as well as a marshaling waiver and a waiver of the estates' right under section 552(b) of the Bankruptcy Code. These waivers are entirely inappropriate at this time, and in any event, not justified by the record.

A. Surcharge Rights Under Section 506(c) Should Not be Waived

30. The Interim Order provides that subject to entry of the Final Order, neither the DIP Collateral nor Prepetition Collateral shall be subject to any surcharge pursuant to section 506(c) of the Bankruptcy Code. *See* Interim Order at ¶ 16. Section 506(c) of the Bankruptcy Code is a rule of fundamental fairness for all parties in interest and provides that secured creditors shall share the burden of satisfying administrative expenses where funds are expended for the purpose of preserving and selling their collateral. Section 506(c) ensures that the cost of liquidating a secured lender's collateral is not paid from unsecured recoveries. *See, e.g.*, *Precision Steel Shearing v. Fremont Fin. Corp. (In re Visual Indus., Inc.)*, 57 F.3d 321, 325 (3d Cir. 1995) (stating, "section 506(c) is designed to prevent a windfall to the secured creditor"). As such, the Debtors' unilateral waiver of Bankruptcy Code section 506(c) would eliminate a further avenue of recovery for the Debtors' estates and foist the costs of the Debtors' reorganization onto unsecured creditors.

31. By waiving the estates' section 506(c) rights, the Debtors are agreeing to pay for any and all expenses associated with the preservation and disposition of the collateral of the DIP Secured Parties and the Prepetition Secured Lenders. Here, such a waiver is highly inappropriate given that these cases are being run as a vehicle for the exclusive benefit of the Prepetition Secured Parties. Indeed, if these cases proceed according to the RSA as currently proposed, the Prepetition Secured Parties will reap almost all of the benefit of these cases with unsecured creditors being

relegated to a *de minimis* recovery, if any. Courts have routinely rejected similar surcharge waivers under these circumstances. *See In re AFCO Enters., Inc.*, 35 B.R. 512, 515 (Bankr. D. Utah 1983) ("When the secured creditor is the only entity which is benefited by the trustee's work, it should be the one to bear the expense. It would be unfair to require the estate to pay such costs where there is no corresponding benefit to unsecured creditors."); *see also* Transcript of Hearing at 20-21, *In re Mortgage Lenders Network USA, Inc.,* No. 07-10146 (PJW) (Bankr. D. Del. Mar. 27, 2007) [D.I. No. 346]; Transcript of Hearing at 212-13, *In re Energy Future Holdings Corp.,* No. 14-10979 (CSS) (Bankr. D. Del. June 5, 2014) [D.I. No. 3927]; *Hartford Fire Ins. Co. v. Norwest Bank Minn., N.A. (In re Lockwood Corp.)*, 223 B.R. 170, 176 (B.A.P. 8th Cir. 1998).

32. While the Committee suspects that the Debtors are hopeful (or perhaps cautiously optimistic) that the budget captures all of the expenses that will be incurred in the administration of these cases, there can be no assurance at this early juncture that the administrative expenses of these cases will be paid by the Debtors in the ordinary course. Furthermore, if an event of default is called under the DIP Facility, the budgeted amounts that were incurred and not paid at such time could remain unpaid. For these reasons, the Court should not approve a section 506(c) waiver at this time.

B. The Equities of the Case Exception Under 552(b) and Marshaling Rights Must be Preserved

33. The Debtors' willingness to waive their rights under section 552(b) is, at best, premature. The Court should also not permit a section 552(b) waiver before allowing parties in interest – including the Committee – to properly examine the "equities of the case". S*ee Sprint Nextel Corp. v. U.S. Bank Nat'l Ass'n (In re TerreStar Networks, Inc.)*, 457 B.R. 254, 272-73 (Bankr. S.D.N.Y. 2011) (denying request for 552(b) waiver as premature because factual record was not fully developed). If unencumbered assets are used to increase the value of the secured

creditors' collateral, unsecured creditors should be able to argue that such value inures to them, and not to secured creditors. *See In re Metaldyne*, No. 09-13412 (MG) 2009 WL 2883045, at *6 (Bankr. S.D.N.Y. June 23, 2009) (holding, in the context of a proposed 552(b) waiver, that "the waiver of an equitable rule is not a finding of fact…and the Court, in its discretion, declines to waive prospectively an argument that other parties in interest may make"); *see also In re iGPS Co. LLC*, No. 13-11459 (KG) 2013 WL 4777667, at *5 (Bankr. D. Del. July 1, 2013) (no waiver of the "equities of the case" exception with respect to creditors committee). In the alternative, any section 552(b) waiver should be subject in all respects to the Committee's challenge rights.

34. The Debtors also should not waive any rights with respect to the marshaling doctrine in the Final Order. Such favorable treatment, which would enable the Prepetition Secured Parties to "cherry pick" the collateral they want to liquidate most expeditiously is unwarranted under the circumstances of these cases where the DIP Lenders are receiving excessive fees and liens on assets previously unencumbered prepetition. Accordingly, marshalling rights should be preserved for the Committee.[10] *See, e.g., In re Newcorn Enters. Ltd.*, 287 B.R. 744, 750 (Bankr. E.D. Mo. 2002) (granting unsecured creditors' committee derivative standing to bring marshaling claim against secured lender, and thereby increase payout to unsecured creditors, where debtor refused to do so); *Official Comm. Of Unsecured Creditors v. Hudson United Bank (In re America's Hobby Ctr., Inc.)*, 223 B.R. 275, 287 (Bankr. S.D.N.Y. 1998) ("[S]tanding in the shoes of the debtor in possession, the Committee can assert [marshaling] claim.").

[10] As noted above, marshaling should be required before the new money portion of the DIP Facility and Adequate Protection Claims are satisfied from previously unencumbered assets, including assets encumbered by the Prepetition Secured Parties' prepetition liens that are subsequently avoided.

VII. The Proposed DIP Fees are Excessive

35. In the context of a $35 million new money DIP Facility, the proposed DIP fees are excessive and should be reduced. The proposed DIP fees include:

Commitment Fee:	**1.00%**
Closing Fee	**3.00%**
DIP Fee (if DIP replaced)	**5.00%**

36. With these fees in place, the "all in" financing cost is effectively 18%. It is self-evident that these fees, which are for a DIP facility that furthers the DIP Lenders' agenda of effectuating the restructuring set forth in the RSA, are excessive and insulting from the perspective of unsecured creditors who are slated to receive a *de minimis* recovery, if any. At a bare minimum, the Committee requests that the 5% DIP Fee be reduced to 2.5%.

VIII. Other Objectionable Provisions

37. The Committee also objects to the provisions referenced below and requests that the Final Order be amended accordingly. The Committee notes that by objecting to these provisions in bullet point format, the Committee is by no means suggesting that these objections are either technical or minor in nature.

- Deposit/Security Accounts. The Final Order should make clear that with respect to deposit or securities accounts being within the "control" of the Prepetition Secured Parties, the term "control" is as defined in the Uniform Commercial Code. *See* Interim Order at ¶ 6(d).

- Release. The plan-like release is overbroad for a DIP financing order and should be stricken. *See* Interim Order at ¶ 7.

- Indemnity. The indemnity provisions in favor of the DIP Agent and DIP Lenders needs to be limited to their respective capacities as such. *See* Interim Order at ¶ 8(f).

- Section 364(e) Good Faith Finding. The Debtors' stipulation that the DIP Obligations are deemed to have been extended by the DIP Secured Parties in good faith, as that term is used in section 364(e) of the Bankruptcy Code, needs to be subject to the Committee's challenge rights. *See* Interim Order at ¶ 8(f).

- Material Modifications. Any material modifications, amendments, updates and

supplements to the Approved Budget need to be subject to further Court approval. *See* Interim Order at ¶ 8(i).

- Remedies Notice Period. The Remedies Notice Period should be elongated to five ***business*** days' notice. *See* Interim Order at ¶ 14(d).

- Information Rights. The Committee should receive the same reporting at the same time as the DIP Lenders. *See* Interim Order at ¶ 18(e).

- Use of Proceeds/Carve-Out. The Interim Order prohibits the use of proceeds or access to the Carve-Out for efforts related to: (i) "preventing, hindering, or otherwise delaying the . . . enforcement or realization on the [Prepetition Debt];" and (ii) "seek[ing] to modify any of the rights and remedies granted to the Prepetition Secured Parties, the DIP Agent . . . under this Interim Order". *See* Interim Order at ¶¶ 11(k) and 27. The Final Order should include an overarching provision providing that nothing in the order shall limit the use of proceeds or the Carve Out with respect to fees and expenses incurred by the Committee in contesting the DIP Motion prior to entry of the Final Order, contesting the Disclosure Statement, Plan, or credit bid, or any other action adverse to the Prepetition Secured Parties/DIP Secured Parties other than investigating or asserting a challenge.

- Limitation of Liability. The limitations of liability in favor of the DIP Agent and DIP Lenders needs to be limited in their respective capacities as such. *See* Interim Order at ¶ 31.

- Credit Bidding. The Committee echoes the objection from Market and Johnson, Inc., Stout Excavating Group LLC, and A-1 Excavating, Inc. [D.I. 134] regarding the Prepetition Secured Parties' ability to credit bid their claims without properly accounting for possible senior liens such as Prior Permitted Liens. *See* Interim Order at ¶ 38.

- Section 503(b)(9) Claims. So as to ensure administrative solvency, the DIP Lenders should fund a segregate account not subject to the control or liens of the DIP Secured Parties or the Prepetition Secured Parties with funds sufficient to pay all allowed claims arising under section 503(b)(9) of the Bankruptcy Code.

IX. Objectionable Provisions in DIP Credit Agreement

38. The Committee also objects to the provisions in the DIP Credit Agreement referenced below and requests that as a condition to approval of the DIP Motion, the DIP Credit Agreement be revised accordingly.

- Roll-Up Loans. The terms Pre-Petition Loans and Prior Lender Obligations encompasses the entirety of the Prepetition Debt, not just the Prepetition Revolver Obligations. So as to be consistent with the DIP Motion, Interim Order, and proposed Final Order, the DIP Credit

Agreement needs to be clear that the Roll-Up only applies to the Prepetition Revolver Obligations. *See* DIP Credit Agreement § 6.16.

- Cross-Defaults. As the entire of the Prepetition Debt is not being rolled-up, the Credit Parties will have indebtedness of more than $250,000 and, as a result, are susceptible to triggering the cross-default provisions at section 10.11. *See* DIP Credit Agreement § 10.11.

- Prohibition Language. The DIP Credit Agreement should not "prohibit any effort" by the Debtors, the Committee or other party to prime or create *pari passu* liens. While such efforts may trigger an event of default under the DIP Credit Agreement, this provision should not be the equivalent of a restriction under contempt upon Court approval of the DIP Motion and attendant DIP Credit Agreement. *See* DIP Credit Agreement § 7.2.

- Corporate Governance Default. An event of default should not be triggered if (i) the charter for the Special Committee is terminated or the Special Committee is dissolved; (ii) the chief restructuring officer for the General Partner is terminated or replaced; and (iii) the "[operational consultant]" engaged by the Special Committee is terminated or replaced; and (iv) the Permitted Holders or the board of directors of the General Partner fail to support the Approved Chapter 11 plan. *See* DIP Credit Agreement § 10.19

- DIP/RSA Cross Defaults. For the same reasons discussed in this Objection, the DIP Credit Agreement needs to remove the cross-defaults with the RSA, especially as it relates to the Debtors' exercising their fiduciary out. If the cross defaults remain as-is, the fiduciary out is effectively illusory. *See* DIP Credit Agreement §§ 10.7(c) and 11.1(a).

- Case Milestones. For the same reasons discussed in this Objection, each of the milestones contained in the DIP Credit Agreement need to be extended by at least thirty (30) days. *See* DIP Credit Agreement § 6.16.

RESERVATION OF RIGHTS

The Committee reserves its respective rights, claims, defenses, and remedies, including, without limitation, the right to amend, modify, or supplement this Objection, to seek discovery, and to raise additional objections during any further hearing on the DIP Motion.

CONCLUSION

WHEREFORE, the Committee respectfully requests that the Court (i) condition entry of an order approving the DIP Motion on a final basis unless the Final Order and DIP Credit Agreement are modified as requested in this Objection; and (ii) granting such other and further relief as the Court deems just and proper.

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Dated: August 10, 2019
Wilmington, Delaware

Respectfully submitted,

POTTER ANDERSON & CORROON LLP

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

CERTIFICATE OF SERVICE

I, L. Katherine Good, hereby certify that I am not less than 18 years of age and that on this 10th day of August 2019, I caused a true and correct copy of the foregoing *Objection of the Official Committee of Unsecured Creditors to Debtors' Motion (I) Pursuant to 11 U.S.C. §§ 105, 361, 362 and 364 Authorizing the Debtors to (A) Obtain Senior Secured Priming Superpriority Postpetition Financing, (B) Grant Liens and Superpriority Administrative Expense Status, (C) Use Cash Collateral of Prepetition Secured Parties and (D) Grant Adequate Protection to Prepetition Secured Parties; (II) Scheduling a Final Hearing Pursuant To Bankruptcy Rules 4001(B) and 4001(C); and (III) Granting Related Relief* to be served upon the parties on the attached serve list in the manner indicated.

/s/ L. Katherine Good
L. Katherine Good (DE Bar No. 5101)

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