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16 WACHOVIA CAPITAL FINANCE
17 CORPORATION (Western)

18 UNITED STATES BANKRUPTCY COURT
19 CENTRAL DISTRICT OF CALIFORNIA
20 LOS ANGELES DIVISION

21 *In re:*

22 ESTYLE, INC., a Delaware
23 corporation, dba babystyle, Cadeau,
24 and Cadeau Designs,

25 Debtor.

Case No. 2:08-bk-13518-SB

Chapter 11

**OBJECTION OF WACHOVIA
CAPITAL FINANCE
CORPORATION (WESTERN) TO
DEBTOR'S THIRD MOTION FOR
INTERIM AND FINAL ORDERS
AUTHORIZING DEBTOR (a) TO
CONDUCT STORE CLOSING
SALES, (b) TO DISCONTINUE
OPERATIONS AT CERTAIN
STORES, AND (c) GRANTING
ANCILLARY AND OTHER RELIEF**

Date: May 27, 2008

Time: 11:00 a.m.

Courtroom: 1575

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1 **I. INTRODUCTION¹**

2 The latest piecemeal attempt by debtor eStyle, Inc. (“Debtor”) to close its
3 retail stores reflects a fundamental shift in Debtor’s business plan that raises
4 critical questions as to the viability of any purported reorganization, the validity of
5 Debtor’s continued use of cash collateral, and the (lack of) adequate protection of
6 Debtor’s senior secured creditor, Wachovia Capital Finance Corporation (Western)
7 (“Wachovia”). Debtor’s Third Motion for Interim and Final Orders Authorizing
8 Debtor (a) To Conduct Store Closing Sales, (b) To Discontinue Operations at
9 Certain Stores, and (c) Granting Ancillary and Other Relief (the “Third Store
10 Closing Motion”) seeks authority to close seven of Debtor’s retail stores, in
11 addition to the eight stores that Debtor has already obtained permission to close. In
12 the two months that this case has been pending:

- 13 ■ Debtor has closed or has sought to close nearly two-thirds of its
14 twenty-three retail stores;
- 15 ■ Debtor has fallen substantially short of the revenue projections on
16 which it had based its requests (over Wachovia’s objections) for use
17 of cash collateral, including (i) total net cash receipts from direct to
18 consumer and retail store sales that are 16.15% below budget for the
19 post-petition period and 21.28% below budget for the most recent
20 reported week, and (ii) net cash flow that is 84.87% below budget for
21 the most recent reported week;
- 22 ■ Debtor has not provided new weekly budgets or projections for a
23 revised business plan that involves the operation of only eight (or
24 fewer) retail stores; it is impossible to determine (a) whether Debtor

25
26 ¹ Debtor consented to an extension to May 21, 2008 for Wachovia to file and serve
27 this Objection and supporting declarations. With apologies to the Court for any
28 inconvenience, Wachovia represents that it is transitioning this matter to new
counsel, who believed that it was important to take a little more time to familiarize
themselves with the facts in this case so that the information they present to the
Court will be accurate.

1 intends to utilize all of the cash collateral previously authorized by the
2 Court based on a 15-store model, or (b) Debtor's anticipated losses,
3 cash flow, and rate of depletion of collateral under its most recent new
4 model;

- 5 ■ Debtor's reported cash and inventory have fallen by over \$1.1 million
6 during the post-petition period, from \$7.6 million as of March 29 to
7 \$6.5 million as of May 10, 2008;²
- 8 ■ Debtor has burned through \$840,000 in cash over the most recent
9 reported two-week period, without even paying \$90,000 that had been
10 budgeted for sales tax;
- 11 ■ At the same time that Debtor seeks to close more stores, Debtor
12 increased its inventory by over \$46,000 in the most recent reported
13 week, and exceeded the inventory budget by over \$48,000 for the
14 most recent reported two-week period, without explaining how it
15 plans to sell that inventory while eliminating its retail outlets;
- 16 ■ Debtor's Chief Executive Officer, Robert S. Kelleher ("Kelleher"), on
17 whose declarations Debtor's motions for use of cash collateral and
18 other "first day" motions were based, has resigned;
- 19 ■ Debtor's Chief Financial Officer, Yvonne Besvold, has been
20 terminated and her role has apparently been assumed by Debtor's
21 Controller (without a replacement for the Controller); and
- 22 ■ Despite the cursory declaration submitted by Debtor's President,
23 Emilia Fabricant ("Fabricant"), in support of the Third Store Closing
24 Motion, and notwithstanding Debtor's retention of Kibel Green, Inc.
25 as a business consultant, Debtor has not identified the individuals who
26

27
28 ² The March 29 figure reflected a post-petition writedown of Debtor's inventory [Van Meter Decl., ¶ 7.b, n.1], whereby Debtor acknowledged that it had previously overvalued its inventory by approximately \$1.3 million.

1 now purport to exercise Debtor's business judgment and have elected
2 to pursue Debtor's current business plan.

3 In light of the foregoing circumstances, Wachovia cannot determine whether
4 it is adequately protected, and the assumptions on which this Court may have
5 based any prior interim finding of adequate protection no longer apply. At the very
6 least, Debtor's continued use of cash collateral must be conditioned on the
7 submission of a new budget that (a) reflects the closing of seven additional stores
8 pursuant to the Third Store Closing Motion, and (b) demonstrates adequate
9 protection to Wachovia.

10 Although Wachovia does not necessarily object to liquidation sales, the
11 closing of seven stores cannot occur in a vacuum. Indeed, if Debtor is unable
12 effectively to reorganize, as appears increasingly likely (and as Wachovia had
13 predicted in its prior objections to use of cash collateral), the optimal plan for the
14 estate and all of its creditors would be to close all fifteen of the remaining retail
15 stores, and to conduct liquidation or store closing sales through each of those
16 stores, rather than to continue a piecemeal liquidation process that increases the
17 expenses to the estate and decreases the ultimate proceeds of stale inventory.
18 Accordingly, without more information concerning Debtor's business plan, budget
19 and prospects for reorganization, Debtor should not be permitted to use
20 Wachovia's cash collateral, particularly not for what appears to be the gradual
21 dissipation of any equity cushion that Wachovia may have had.

22 To the extent that the Court nonetheless may be inclined to grant the Third
23 Store Closing Motion as an interim measure without addressing the larger issues
24 concerning the substantial changes in Debtor's business plan and prospects for
25 reorganization, at a minimum, Wachovia should receive adequate protection
26 payments in the form of paydowns in the amount of all proceeds from all of
27 Debtor's store closing sales, net only of the expenses incurred at the closing stores
28

1 themselves (*i.e.*, no deductions for general corporate overhead, professional fees,
2 etc.).

3 **II. DEBTOR CANNOT BE PERMITTED TO PROCEED WITH AN**
4 **INTERIM OR PARTIAL LIQUIDATION AT WACHOVIA'S**
5 **EXPENSE**

6 **A. Debtor's Own Argument Demonstrates the Need for Immediate**
7 **and Total Liquidation.**

8 The Third Store Closing Motion, for which Debtor sought and obtained an
9 order shortening time, emphasizes the need to act quickly to close and liquidate
10 another seven stores. The same urgency, however, may well exist with respect to
11 the eight remaining stores. In support of the Third Store Closing Motion, Debtor
12 argues that:

- 13 ■ The seven stores now to be closed “cannot be operated profitably”
14 [Motion 1:24; Fabricant Decl., ¶ 6];
- 15 ■ “[T]he continued operation of these stores may be of no benefit to the
16 estate and would create additional and substantial administrative
17 expense claims” [Motion 1:26-27; Fabricant Decl., ¶ 6];
- 18 ■ “Continued operations would deplete the assets of the estate and
19 require substantial additional funding that is simply not available”
20 [Motion 10:5-7];
- 21 ■ “Debtor has been unsuccessful in its efforts to obtain additional
22 financing from shareholders and third parties to support its efforts to
23 complete the repositioning” [Motion 5:3-5];
- 24 ■ “Additionally, some of the inventory at the stores designated for
25 closure is seasonal and will decline in value unless store closure sales
26 are conducted promptly” [Motion 2:1-3; see also Motion 7:17-19;
27 Fabricant Decl., ¶ 6];

- 1 ■ “The Stores are currently stocked with seasonal merchandise which
2 can be sold at an optimal price during June and July, 2008. If the
3 commencement of the Store Closing Sales is delayed, the
4 Merchandise will grow stale and its realizable value will decrease.”
5 [Motion 8:16-19];
- 6 ■ “[T]he risk of inventory ‘shrink’ will increase substantially if the sale
7 process is delayed” [Motion 8:21-22];
- 8 ■ “The impact of general weakness in the economy and recent declines
9 in mall traffic has [sic] negatively impacted sales in the Debtor’s
10 stores” [Motion 5:1-2]; and
- 11 ■ “The Debtor has determined, as of this time, that its business
12 operations at the Stores are not profitable and that the Store Closing
13 Sales are the best and most orderly and efficient manner of winding
14 up operations at those stores while generating a fair return to the
15 Debtor’s estate” [Motion 9:3-6].

16 Debtor does not show that the situation at the eight remaining stores is any
17 better. Debtor has not demonstrated that the inventory at the eight remaining
18 stores is less likely to grow stale or carries a lesser risk of inventory shrink. Debtor
19 has not established that it has obtained or can obtain financing necessary to acquire
20 inventory and to operate the eight remaining stores, or that they will be able to
21 withstand a weak economy or declines in mall traffic. Therefore, the issue that the
22 Court should consider is not whether to allow Debtor to close seven stores, but
23 whether all of Debtor’s stores should immediately be closed and liquidated.

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1 **B. Debtor Has Substantially Failed to Meet Its Own Revenue**
2 **Projections.**

3 Debtor's own figures tell the story of its accelerating deterioration in the two
4 months that it has operated as a debtor in possession. The most recent figures that
5 Debtor has provided show that for the week ending May 10, 2008:³

- 6 ■ Net cash receipts from direct to consumer ("DTC") sales were 46.63%
7 below the figure set forth in Debtor's cash collateral budget;
- 8 ■ Total DTC receipts were 51.57% below budget;
- 9 ■ Net cash receipts from retail sales were 21.28% below budget;
- 10 ■ Liquidation receipts were 27.43% below budget;
- 11 ■ Total net cash receipts from DTC sales and retail stores were 35.04%
12 below budget;
- 13 ■ Net cash flow was 84.87% below budget; and
- 14 ■ At the same time, expenses for salaries, wages and benefits were
15 456.50% above budget, and total cash payments were 16.63% above
16 budget.

17 Similarly, Debtor's reported results for the week ending May 3, 2008⁴
18 indicate that:

- 19 ■ Net cash receipts from DTC sales were 31.59% below budget;
- 20 ■ Total DTC receipts were 38.67% below budget;
- 21 ■ Net cash receipts from retail sales were 19.17% below budget;
- 22 ■ Liquidation receipts were 37.11% below budget; and
- 23 ■ Total net cash receipts from DTC sales and retail stores were 29.29%
24 below budget;

25 Indeed, Debtor's cumulative post-petition results for the period from March
26 23 to May 10, 2008⁵ show that overall, Debtor's net cash receipts from DTC sales

27
28 ³ See Van Meter Decl., ¶¶ 4-6 & Exs. A-B.

⁴ See Van Meter Decl., ¶¶ 4-6 & Exs. A-B.

1 have been 21.71% below budget, total DTC receipts have been 27.88% below
2 budget, and total net cash receipts from DTC sales and retail stores have been
3 16.15% below budget.

4 In addition, Debtor has been burning through cash, even while failing to pay
5 necessary expenses, and continues to dissipate Wachovia's collateral. As of March
6 29, 2008, Debtor had reported a total of over \$7.6 million of cash (\$1,133,895) and
7 inventory (\$6,508,579) [Van Meter Decl., Ex. D]. In Debtor's most recent report,
8 as of May 10, 2008, total cash and inventory had fallen to \$6.5 million [Van Meter
9 Decl., Ex. A]. In addition, in the most recent reported two-week period, Debtor
10 depleted its cash by over \$840,000, from \$1,611,554 as of April 27 to \$770,487 as
11 of May 10, 2008, and the decline would have been even worse had Debtor paid
12 budgeted expenses such as \$90,000 in sales tax [id.].

13 In the meantime, as it seeks to close seven more stores, Debtor increased its
14 inventory by over \$46,000 between May 3 and May 10, 2008, and exceeded its
15 inventory budget by over \$48,000 for the two-week period ending May 10 [id.].
16 Debtor has not explained how it intends to sell that additional inventory when it is
17 planning to shut down even more of its retail outlets.

18 Since Debtor has continually failed to meet its revenue projections, and its
19 performance in the most recent weeks has further deteriorated, there is no reason to
20 believe that Debtor can successfully operate the eight stores that it presently
21 intends to maintain. Debtor has not even submitted a proposed weekly budget
22 setting forth its projected results based on operation of only eight stores [Van
23 Meter Decl., ¶ 8]. Rather than permitting Debtor to delay, at the expense of
24 Wachovia and other creditors, the inevitable orderly liquidation of all of Debtor's
25 assets, the Court should direct the immediate liquidation of all remaining stores to
26 maximize the recovery for the estate and its creditors.

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⁵ See Van Meter Decl., ¶ 7 & Ex. C.

1 **C. Debtor Cannot Show That Wachovia Is Adequately Protected.**

2 Without a budget showing that Wachovia will be adequately protected even
3 as Debtor closes seven stores but continues to operate the remaining eight stores,
4 Debtor cannot be permitted to use cash collateral. In obtaining this Court's
5 permission (over Wachovia's objection) to use cash collateral, Debtor had
6 submitted an itemized weekly budget premised on the operation of fifteen stores.
7 As it is, Debtor has fallen well short of that budget. Debtor has not submitted a
8 new itemized weekly budget demonstrating how it intends to operate with only
9 eight stores. Debtor certainly is not entitled to a presumption that Wachovia will
10 be adequately protected if Debtor proceeds with its stripped down operations.

11 Debtor has the burden of proving that Wachovia will be adequately
12 protected if the Debtor is allowed to use cash collateral. In re XB-1 Associates, 27
13 B.R. 827, 832 (Bkrcty. S.D.N.Y. 1983) . A cursory, unsupported budget is wholly
14 inadequate to establish adequate protection. As the Bankruptcy Court stated in
15 Bankwest, N.A. v. Todd, 49 B.R. 633, 638 (D.S.D. 1985):

16 “While the question of whether adequate protection exists in a
17 particular case depends upon the nature of the collateral and the
18 nature of the debtor's proposed use of that collateral, it is
19 plainly not enough for a debtor to make predictions, write them
20 down, and offer them as exhibits showing adequate protection.”

21 An equity cushion alone does not constitute adequate protection when the
22 debtor is not likely to reorganize, and the collateral that may presently appear to
23 provide an equity cushion will be dissipated through the debtor's continued
24 operations:

25 “The existence of an equity cushion alone can constitute
26 adequate protection. *In re Mellor*, 734 F.2d 1396 (9th Cir.
27 1984); *In re Lane*, 108 B.R. 5 (Bankr.D.Mass. 1989) and cases
28 cited therein; *In re Grant Broadcasting of Phila., Inc.*, 75 B.R.

1 819, 8234-24 (E.D.Pa. 1987). We believe it improper to look at
2 valuation of assets in a vacuum. While the present value of a
3 debtor's assets may be sufficient to constitute adequate protec-
4 tion, a debtor's future operational plans may result in a rapid
5 deterioration of the collateral. Where an equity cushion is
6 insufficient in size or likely to erode, it cannot, standing alone,
7 constitute adequate protection. *See In re Liona Corp.*, 68 B.R.
8 761, 767 (Bankr.E.D.Pa. 1987).

9 "We view the issues in the present matter as: 1) Whether
10 the value of the Debtor's assets exceed the amount of its
11 secured obligations, thus providing an equity cushion for the
12 Lenders, and 2) If an equity cushion exists, whether that equity
13 cushion provides the Lenders with sufficient adequate
14 protection"

15 *In re Sharon Steel Corp.*, 159 B.R. 165, 169 (Bkrctcy.W.D.Pa.
16 1993).

17 If there is no reasonable chance of reorganization, "there is no point in
18 jeopardizing the creditor's cash collateral." *In re American Sweeteners, Inc.*, 2000
19 Bankr. LEXIS 788, *14 (Bkrctcy. E.D. Pa. 2000).

20 As reflected by Debtor's efforts in just the last two months to close two-
21 thirds of its stores, and its failure to meet its prior cash collateral budget, Debtor's
22 chances of rehabilitation are, at best, highly speculative. Thus, liquidation value is
23 the "appropriate yardstick" for measuring the value of the collateral to determine
24 whether Wachovia is adequately protected. *In re Sharon Steel Corp.*, 159 B.R. at
25 169; see also *In re Schwinn Bicycle Co.*, 192 B.R. 477, 486-487 (Bkrctcy. N.D. Ill.
26 1996) (holding that "the liquidation value method is the proper valuation standard
27 for the purpose of this case because the Debtor was not financially viable, was in
28 severe financial distress and was on its 'deathbed'", and "[t]o treat such a company

1 as a going concern would be misleading and would, in fact, fictionalize the
2 company's true financial condition."); In re Middleton Place Associates, 1993
3 Bankr. LEXIS 2171, *41 (Bkrcty. E.D. Pa. 1993) ("If reorganization is unlikely or
4 the collateral is unnecessary, the collateral will eventually be liquidated or sold ...
5 making liquidation value appropriate.").

6 Moreover, costs of liquidation should be considered in determining
7 liquidation value. As the court explained in In re Pitts, 2 B.R. 476 (Bkrcty. C.D.
8 Cal. 1979):

9 "A basic ingredient of the secured creditor's bargain is the right
10 to resort to the collateral, if necessary, in payment and
11 discharge of the debt. However, the expenses incident to
12 foreclosure and sale are also in integral part of this bargain . . .
13 The base figure in any realistic analysis of the secured
14 creditor's position must be the aggregate of (i) the amount of
15 principal, interest, and other permissible charges to date of sale,
16 plus (ii) the costs of foreclosure and sale."

17 Id., 2 B.R. at 477-478; see also In re Elco Logging Corp., 42 B.R. 9, 12 (Bkrcty. D.
18 Ore. 1983) (quoting Pitts; when foreclosure and resale related expenses were taken
19 into account, there was little, if any, equity cushion to provide plaintiff with
20 adequate protection).

21 Not only has Debtor failed to show that Wachovia is adequately protected,
22 but Wachovia has recently obtained a valuation of Debtor's inventory suggesting
23 that little or no equity cushion exists. The valuation by Great American
24 Group Advisory and Valuation Services, L.L.C. ("Great American") as of May 16,
25 2008 [Friedman Decl., Ex. G] indicates that the liquidation value of Debtor's
26 inventory, net of sale expenses, is 39.5% of cost. Since Debtor's own reports show
27 that total inventory at cost was \$5.7 million as of May 10 and, per budget, is
28 expected to decline to \$5.1 million by May 24, 2008 [Van Meter Decl., Ex. A], the

1 expected liquidation value is about \$2 million, or roughly equal to the debt that
2 Debtor admittedly owes to Wachovia. Without any substantial equity cushion, and
3 with Debtor ultimately headed for liquidation, it cannot now be said that Wachovia
4 is adequately protected. Thus, rather than close stores or hold store closing sales
5 on a piecemeal basis, the remaining 15 stores should all be liquidated now.

6 **III. CONCLUSION**

7 For the foregoing reasons, Wachovia respectfully requests that the Court
8 direct Debtor to close all fifteen of its remaining retail stores, and to conduct
9 liquidation or store closing sales through each of those stores, and/or to deny
10 Debtor the further use of cash collateral.

11 In the alternative, at the very least, Wachovia respectfully requests that the
12 Court (a) condition Debtor's continued use of cash collateral on the submission of
13 a new budget that (i) reflects the closing of the seven stores that are the subject of
14 the Third Store Closing Motion and (ii) demonstrates adequate protection to
15 Wachovia, and (b) require Debtor to make adequate protection payments to
16 Wachovia in the amount of all proceeds from all of Debtor's store closing sales,
17 net only of the expenses incurred at the closing stores themselves (*i.e.*, no
18 deductions for general corporate overhead, professional fees, etc.).

19
20 DATED: May 21, 2008

LEO D. PLOTKIN
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21
22
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PROOF OF SERVICE

STATE OF CALIFORNIA, COUNTY OF LOS ANGELES

I am employed in the County of Los Angeles, State of California. I am over the age of 18 and not a party to the within action; my business address is 815 Moraga Drive, Los Angeles, California 90049.

On May 21, 2008, I served the documents described as **OBJECTION OF WACHOVIA CAPITAL FINANCE CORPORATION (WESTERN) TO DEBTOR'S THIRD MOTION FOR INTERIM AND FINAL ORDERS AUTHORIZING DEBTOR (a) TO CONDUCT STORE CLOSING SALES, (b) TO DISCONTINUE OPERATIONS AT CERTAIN STORES, AND (c) GRANTING ANCILLARY AND OTHER RELIEF** on the interested parties in this action by placing a true copy thereof in sealed envelope(s) addressed as follows:

PLEASE SEE THE ATTACHED SERVICE LIST

(By Email) I had such document electronically submitted pursuant to the email addresses attached on the service list with no system administrator error returned.

(Federal) I declare that I am employed in the office of a member of the bar of this court at whose direction the service was made.

Executed May 21, 2008, at Los Angeles, California.


Heidi Petrilli

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2 U.S.B.C., Central District of California, Los Angeles Division
3 Chapter 11 Case No. 2:08-bk-13518-SB

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