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WACHOVIA CAPITAL FINANCE CORPORATION (WESTERN)  
7

8 **UNITED STATES BANKRUPTCY COURT**  
9 **CENTRAL DISTRICT OF CALIFORNIA**  
10 **LOS ANGELES DIVISION**

11  
12 In re:  
13 ESTYLE, INC., a Delaware corporation, dba  
babystyle, Cadeau, and Cadeau Designs,  
14  
Debtor.

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

Chapter 11

**WACHOVIA CAPITAL FINANCE CORPORATION'S OBJECTION TO DEBTOR'S (I) EMERGENCY MOTION PURSUANT TO SECTION 363(C) OF THE BANKRUPTCY CODE AND RULE 4001(B) OF THE FEDERAL RULES OF BANKRUPTCY PROCEDURE FOR INTERIM AND FINAL ORDERS AUTHORIZING USE OF CASH COLLATERAL; (II) EMERGENCY MOTION FOR ORDER AUTHORIZING PAYMENT OF CUSTOMS DUTIES AND CERTAIN PREPETITION CLAIMS OF SHIPPERS, FREIGHT HANDLERS, WAREHOUSERS AND CUSTOM BROKERS; AND (III) NOTIFICATION OF VIOLATION OF THE AUTOMATIC STAY**

Date: March 21, 2008  
Time: 10:00 a.m.  
Place: Courtroom 1575  
255 E. Temple Street  
Los Angeles, CA 90012

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1 **TO THE HONORABLE SAMUEL L. BUFFORD, UNITED STATES BANKRUPTCY**  
2 **JUDGE, THE DEBTOR, ITS COUNSEL, AND ALL PARTIES IN INTEREST:**

3 Wachovia Capital Finance Corporation (Western) (“Wachovia”), secured lender of debtor  
4 and debtor-in-possession eStyle, Inc. d/b/a babystyle, Cadeau, and Cadeau Designs (“Debtor”),  
5 hereby objects (the “Objection”)<sup>1</sup> to Debtor’s (i) Emergency Motion Pursuant to Section 363(c)  
6 of the Bankruptcy Code and Rule 4001(b) of the Federal Rules of Bankruptcy Procedure for  
7 Interim and Final Orders Authorizing Use of Cash Collateral (Docket No. 13) (the “Cash  
8 Collateral Motion”); and (ii) Emergency Motion for Order Authorizing Payment of Customs  
9 Duties and Certain Prepetition Claims of Shippers, Freight Handlers, Warehousemen and Custom  
10 Brokers (Docket No. 4) (the “Critical Vendor Motion”), and comments on the Debtor’s other  
11 first day motions, as follows:

12 **I. INTRODUCTION**

13 The Debtor commenced this case without having had any prior discussions with  
14 Wachovia. Indeed, the Court was aware of the petition before the Debtor first discussed the  
15 matter with Wachovia. Accordingly, Wachovia’s comments and objections are preliminary. As  
16 a result, based on the Debtor’s behavior, for which Wachovia is in no way responsible, there has  
17 not been any discussion of any agreement with its senior secured lender concerning the use of the  
18 Cash Collateral. Now, the Debtor presents the Court, and Wachovia, with an emergency which  
19 its tactics created. This seems particularly irresponsible since the Debtor also admits that such  
20 use is essential. The Debtor apparently chose to gain what it could by shock and awe, in the  
21 form of nine emergency motions, to reasoned discussions. It was not practical for Wachovia to  
22 negotiate a cash collateral agreement in thirty-six hours, which is the time between the Debtor’s  
23 announcement of its chapter 11 filing and this hearing. The Debtor forced this cash collateral  
24 dispute through its surreptitious tactics.

25  
26 <sup>1</sup> As the Cash Collateral Motion and Critical Vendor Motion seeks preliminary and interim  
27 relief, this Objection is filed as a preliminary matter, in order to suggest to the Court certain  
28 provisions that should be included in any interim order. Wachovia reserves its right to  
supplement this objection or to file objections to the future use of cash collateral.

1 Debtor contends that it should be permitted to use the Cash Collateral because  
2 Wachovia's claims are oversecured. It offers replacement liens, but on a dramatically declining  
3 collateral base. The Debtor, which has never made a penny of profit, and which lost almost  
4 \$1,000,000 per month last year, projects it will be able to dramatically reduce those losses.  
5 However, based on the Debtor's projections for the first thirteen weeks of operations, the nearly  
6 \$1,000,000 of Wachovia's alleged equity cushion will erode. In other words, the Debtor's plan  
7 is to lose another million dollars.

## 8 **II. BACKGROUND**

9 On March 19, 2008 (the "Petition Date"), the Debtor filed its voluntary petition for relief  
10 under Chapter 11 of title 11 of the United States Code (the "Bankruptcy Code"). The Debtor is  
11 currently operating its business as a debtor-in-possession pursuant to sections 1107 and 1108 of  
12 the Bankruptcy Code. No examiner, trustee or official committee of unsecured creditors has  
13 been appointed in this case.

14 The Debtor owns and operates 23 retail stores specializing in maternity, baby and kids  
15 apparel, toys, gear and related products. Wachovia is the Debtor's senior secured lender, and as  
16 of the Petition Date is owed approximately \$2,500,000 (the "Pre Petition Obligations"). On or  
17 about December 21, 2006, the Debtor entered into a Loan and Security Agreement (the "Credit  
18 Agreement") with Wachovia for a secured revolving credit facility of up to \$5,000,000 (the  
19 "Wachovia Facility") to be used for ongoing working capital needs.

20 As collateral to secure the Debtor's obligations under the Credit Agreement, the Debtor  
21 granted to Wachovia a blanket security interest in the Debtor's right, title and interest in and to  
22 all of the Debtor's assets, including, without limitation, all of the following: (i) Accounts<sup>2</sup>;  
23 (ii) general intangibles, including, without limitation, all Intellectual Property; (iii) goods,  
24 including, without limitation, Inventory and Equipment; (iv) Real Property and fixtures;  
25 (v) instruments (including all promissory notes); (vi) deposit accounts; (vii) to the extent not  
26 otherwise described above, all Receivables; (viii) all products and proceeds of the foregoing, in

27 <sup>2</sup> Capitalized terms not defined herein shall have the meaning ascribed to them in the  
28 Credit Agreement and supporting loan documents.

1 any form, including insurance proceeds and all claims against third parties for loss or damage to  
2 or destruction of or other involuntary conversion of any kind or nature of any or all of the other  
3 Collateral (collectively, the “Prepetition Collateral”). The security interest in the Prepetition  
4 Collateral was properly perfected through: (i) filing UCC financing statements in the applicable  
5 jurisdictions, (ii) deposit account control agreements, and (iii) a Trademark assignment  
6 agreement.

7 **III. DEBTOR DOES NOT DEMONSTRATE ADEQUATE PROTECTION OF**  
8 **WACHOVIA’S INTEREST IN CASH COLLATERAL**

9 Under 11 U.S.C. § 363(c)(2), a debtor may not use cash collateral unless “(a) each entity  
10 that has an interest in such cash collateral consents; or (b) the court, after notice and hearing,  
11 authorizes such use, sale, or lease in accordance with the provisions of this section.” Those  
12 provisions require the court to prohibit or condition the use of cash and other collateral as is  
13 necessary to provide “adequate protection” of a creditor’s interest in such collateral. 11 U.S.C.  
14 § 363(e). The term “cash collateral” is defined in section 363(a) of Bankruptcy Code as “cash  
15 . . . or cash equivalents . . . whenever acquired in which the estate and an entity other than the  
16 estate have an interest and includes the proceeds . . . of property subject to a security interest as  
17 provided in section 552(b) . . . .” 11 U.S.C. § 363(a). Based upon its loans and security  
18 agreements, all cash or cash equivalents currently in the Debtor’s possession, including all post-  
19 Petition Date proceeds of the Collateral, constitute cash collateral in which Wachovia has a valid,  
20 perfected security interest (the “Cash Collateral”).

21 **A. Debtor Bears The Burden of Proof On The Issue Of Adequate Protection**

22 It is the debtor’s burden to establish that the creditor will receive adequate protection for  
23 the value of its interest in collateral which the debtor seeks to use, sell or lease. 11 U.S.C.  
24 § 363(o) (“In a hearing under this section – (1) the trustee has the burden of proof on the issue of  
25 adequate protection . . . .”); *In re Certified Corp.*, 51 B.R. 768, 771 (Bankr. D. Hawaii 1985)  
26 (debtor-in-possession has burden of proof on issue of adequate protection when seeking court  
27 order authorizing use of cash collateral).

1           Moreover, when the debtor seeks authority to use cash collateral, its burden of proof is  
2 particularly high. *In re Polzin*, 49 B.R. 370, 371-372 (Bankr. Minn. 1985) (“[D]ue to the fact  
3 that the collateral is consumed or used in a § 363 context and the creditor’s use is not merely  
4 delayed as in a § 362 context, the adequate protection standard is a strict one”). The debtor must  
5 establish by *clear and convincing evidence* that the value of the creditor’s interest in the  
6 collateral would remain adequately protected were its application granted. *Northern Trust Co. v.*  
7 *Leavell (In re Leavell)*, 56 B.R. 11, 13 (Bankr. S.D. Ill. 1985) (“When requesting Court  
8 authorization for expenditure of cash collateral, a debtor must prove by clear and convincing  
9 evidence that the secured creditor will realize the value of its bargain in light of all the facts and  
10 circumstances of the case”); *In re Sheehan*, 38 B.R. 859, 868 (Bankr. D.S.D. 1984) (“A party  
11 proposing to use cash collateral must prove by clear and convincing evidence that an entity  
12 claiming an interest in cash collateral will realize the value of its bargain in light of all the facts  
13 and circumstances of the case”).

14           **B. Adequate Protection Must Preserve The Value Of The Creditor’s Original**  
15           **Bargain With The Debtor**

16           A court may insure that a creditor receives adequate protection of its interest in collateral  
17 by requiring the debtor to make “periodic cash payments” or to provide “additional or  
18 replacement liens,” or by “granting such other relief . . . as will result in the realization by such  
19 entity of the indubitable equivalent of such entity’s interest in such property.” 11 U.S.C. § 361.  
20 Although the concept of adequate protection was designed to be flexible to permit courts to  
21 “adapt to varying circumstances and changing modes of financing” (Sen. Rep. No. 95-989, 95<sup>th</sup>  
22 Cong., 2d Sess. 83 (1978); accord H.R. No. 950595, 95<sup>th</sup> Cong., 1<sup>st</sup> Sess. 339 (1978)), any means  
23 a court adopts for providing such protection must insure that the “secured creditor receives the  
24 value for which he bargained.” Sen. Rep. No. 95-989, 95<sup>th</sup> Cong., 2d Sess. 83 (1978).

25           The concept of adequate protection is derived from the Fifth Amendment protection of  
26 property interests as enunciated by the United States Supreme Court in such cases as *Wright v.*  
27 *Union Central Life Ins. Co.*, 311 U.S. 273, 61 S.Ct. 196, 85 L.Ed. 184, *reh’g denied*, 312 U.S.C.

1 711, 61 S.Ct. 445, 85 L.Ed. 1142 (1940) and *Louisville Joint Stock Land Bank v. Radford*, 295  
2 U.S. 555, 55 S.Ct. 854, 79 L.Ed. 1593 (1935). Sen. Rep. No. 95-989, 95<sup>th</sup> Cong., 2d Sess. 83  
3 (1978). However, adequate protection has been held to require an even higher level of protection  
4 against the uncompensated taking of creditor rights than does the Fifth Amendment. *In re*  
5 *Sheehan*, 38 B.R. 859, 865 (Bankr. D.S.D. 1984) (“Whatever adequate protection is or must be,  
6 this Court is convinced that it compels a stricter standard than that imposed by the Fifth  
7 Amendment”).

8 **C. Debtor Has Not Sufficiently Demonstrated Adequate Protection of**  
9 **Wachovia’s Security Interest in the Cash Collateral**

10 As the Debtor provided Wachovia with no advance notice of its decision to commence  
11 this case, Wachovia has not had adequate time to assess the appropriateness of the Debtor’s use  
12 of the Cash Collateral. However, in the relatively short amount of time that Wachovia has had to  
13 review Debtor’s first day motions and supporting papers, Wachovia has identified numerous  
14 significant deficiencies in the Debtor’s Cash Collateral Motion and Cash Collateral Model  
15 attached thereto as Exhibit 1 (the “Cash Collateral Budget”):

16 A number of facts admitted by the Debtors make it clear that their future is far from  
17 certain. The Omnibus Declaration of Robert S. Kelleher In Support of Debtor’s “First-Day”  
18 Motions (Docket No. 11) (the “Kelleher Declaration”) provides that “[f]or the year ended  
19 January 26, 2008, eStyle incurred a net loss of approximately \$10.4 million and negative cash  
20 flows from operations of \$11.4 million. For the year ended January 27, 2007, eStyle incurred a  
21 net loss of approximately \$9.8 million and negative cash flows from operations of \$6.7 million”.  
22 Kelleher Declaration, Part III.B. The Cash Collateral Budget for the month of April 2008,  
23 presents a far rosier projection of a positive cash flow of approximately \$89,000. Neither the  
24 Cash Collateral Motion, the Cash Collateral Budget nor the Kelleher Declaration explain how  
25 eStyle, which was averaging a \$950,000 per month cash burn rate in January 2008 attains a cash  
26 surplus of \$89,000 for the month of April 2008. Even when factoring in the yearly savings of  
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1 \$1.5 million from eliminating 13 corporate employees, that would only increase cash flow by  
2 \$125,000, not the \$1,039,000 that Debtor fails to explain between January and April 2008.

3 With respect to Debtor's inventory the existence of any equity cushion for Wachovia is  
4 wholly dependent on the Debtor's ability to obtain orderly liquidation values. Debtor, which is a  
5 retail business, has its existing Debtor-estimated value only to the extent it can be maintained as  
6 a going concern. The existence of any equity cushion is wholly dependent on the Debtor's  
7 ability to obtain orderly liquidation values for its inventory.

8 But the Debtor's estimates of orderly liquidation value, which is assumed to be 35% of  
9 retail value (which is itself a multiple of cost value), are belied by close scrutiny of its  
10 projections concerning its own scheduled partial liquidation. The Debtor intends to liquidate six  
11 out of its 23 stores, in other words, a quarter of its bricks and mortar retail business, but projects  
12 receiving only \$765,636 of proceeds from this "orderly liquidation." From these meager  
13 proceeds one must deduct the \$150,000 of store closing costs noted in the footnote "\*\*\*\*\*" of  
14 the April projection, yielding net liquidation proceeds of the stores, before assigning any  
15 overhead, of only \$515,000. The Debtor's budget assumptions state that each store has  
16 inventory with a landed cost basis of approximately \$125,000 to \$150,000, or taking the mean,  
17 \$900,000 of landed cost value inventory in these six stores. The orderly liquidation of the six  
18 stores is producing only 57% ( $\$515,000/\$900,000$ ) of the cost value of inventory, without even  
19 accounting for the general and administrative expenses of the Debtor, or the possible dilution of  
20 this skimpy recovery by the Debtor's continuance of its returns and gift card policies.

21 Projecting these results on the inventory collateral remaining at the end of the Debtor's  
22 budget, or \$5,750,173, would lead to an orderly liquidation value of the remaining inventory of  
23 approximately \$3,277,000 ( $57\% \times \$5,750,173$ ), against a Wachovia secured claim which will, by  
24 then, have increased with the accrual of interest and fees. Moreover, the A/R equity value may  
25 be subject to dilution by charge backs arising after product returns and the equipment value is  
26 hypothetical.

1 To make matters worse, the Budget not only grossly overstates orderly liquidation value,  
2 but it also omits expense categories. The Debtor's proposed Cash Collateral Budget (i) omits to  
3 pay or accrue post-petition interest and fees owing to Wachovia as an over-secured creditor;  
4 (ii) omits to provide for payment of utility expenses, even though the utility deposit motion states  
5 that utility payments of approximately \$35,000 per month; (iii) fails to include any reserve or  
6 other item for redemption of outstanding gift cards and gift certificates in the amount of  
7 \$190,000, even though the Debtor seeks concurrently seeks the Court's approval to honor such  
8 gift cards on a dollar for dollar basis; (iv) amazingly, includes no provision professional fees or  
9 expenses; and (v) fails to provide expense items for most of the proposed \$700,000 critical  
10 vendor payment set forth in the Debtor's Critical Vendor Motion. *See Part IV, infra.*

11 And the Debtor is not merely seeking approval of the Cash Collateral Budget, but a 10%  
12 variance as well. If the Debtor exceeds each month by the 10% variance, the cumulative effect  
13 will be approximately \$450,000 for April, \$368,000 in May, and \$337,000 in June, or an  
14 aggregate of \$1,136,000. If the Budget were exceeded by the permissible ten percent variance,  
15 and the Debtor actually paid all of the critical vendors and sold goods for all of the outstanding  
16 gift cards, Wachovia's orderly liquidation value would afford virtually no cushion at all. The  
17 Budget simply does not provide adequate protection to Wachovia.

18 Liquidation of the direct to consumer goods through internet and catalog sales is likely to  
19 be anything but orderly, so the rosy prospects offered by the Debtor's expert Mr. Alston (whose  
20 experience, although substantial, appears to be devoid of relevant retail experience) appear  
21 unfounded. All of the Debtor's numbers assume that the Debtor will be able to get 59.6%  
22 markups, even in stores in liquidation, and assumption which is suspect given the rapidly  
23 deteriorating retail climate.

24 The Debtor proposes, in essence, to consume all of the liquidation proceeds of the six  
25 stores to fund its still unprofitable operations. The Debtor fails to provide for any adequate  
26 protection payments to Wachovia to offset the impairment of its collateral. This Budget will  
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1 leave the Debtor teetering on the brink of administrative insolvency and will destroy Wachovia's  
2 bargained for equity cushion.

3 **D. Any Cash Collateral Order Should Provided The Following Procedural**  
4 **Protections**

5 The Debtor brought the Cash Collateral Motion as an emergency motion and accordingly  
6 the hearing of March 21, 2008 is a preliminary hearing. No final hearing on cash collateral may  
7 be noticed until at least fifteen (15) days after service of the motion, which was served on  
8 March 19, 2008. Thus, the earliest that a final hearing could be heard is April 3, 2008. Under  
9 Bankruptcy Rule 4001(b), the Debtor may obtain interim use of cash collateral at a preliminary  
10 hearing, but "only that amount of cash collateral as is necessary to avoid immediate and  
11 irreparable harm." That amount, as set forth in the Debtor own budget, is no more than \$319,000  
12 (the \$794,520 of cash in week one, minus \$475,000 in week three.) From these the Court should  
13 also exclude all amounts related to necessity payments, as these cannot be approved for twenty  
14 days pursuant to Bankruptcy Rule 6003(b).

15 As such any order authorizing the Debtor to use the Cash Collateral on an emergency  
16 basis, at a minimum, should only authorize use of the Cash Collateral for a limited period of time  
17 (no more than fifteen (15) days, with an automatic one week extension if the Debtor provides  
18 designated financial information and are otherwise in compliance with the other provisions of the  
19 Cash Collateral Order). This limited time period will allow the Debtor to continue operations  
20 while allowing Wachovia sufficient time to properly assess the implications of the Debtor's use  
21 of the Cash Collateral before any order covering a more extended period of time is entered.

22 Furthermore, the Interim Cash Collateral Order should: (i) prohibit the Debtor from  
23 using the cash or proceeds deposited in the Blocked Account at Wachovia pursuant to the Credit  
24 Agreement and related Deposit Account Control Agreements, (iii) prohibit the payment of any  
25 prepetition attorneys' fees and expenses from Cash Collateral, (iv) require the Debtor to make  
26 current payments of interests and fees as required by the Wachovia Credit Facility;<sup>3</sup> (v) require

27 <sup>3</sup> Based on the Debtor's statements that Wachovia presently are oversecured, this is  
28 appropriate as section 506(a) of the Bankruptcy Code entitles Wachovia to the payment of

(cont'd)

1 the Debtor to provide Wachovia with general financial information and access to its financial  
2 consultants as well as a reconciliation of actual expenditures and any cash collateral budget; and  
3 (vi) contain such other provisions that make it clear that Wachovia is not waiving any of their  
4 rights, including, without limitation, their rights under the Bankruptcy Code.

5 To enable Wachovia to monitor the Debtor's compliance with the Cash Collateral Budget  
6 and any order authorizing the use of the Cash Collateral, and to assess any diminution in their  
7 collateral position, the Debtor should be required to provide regular reporting to Wachovia  
8 including:

- 9 (a) a weekly report delivered on each Tuesday for the immediately prior week  
10 (ending on Friday) reflecting actual figures against those set forth in the Budget  
11 for such weekly period;
- 12 (b) uncertified financial statements and other reports required to be delivered by the  
13 Debtor pursuant to the provisions of the Wachovia Credit Facility; the Debtors  
14 should be required to provide the financial statements and other reports for the  
15 period ended February 29, 2008 by March 31, 2008;
- 16 (c) a current accounts receivable aging report as soon as practicable, but in no event  
17 later than October 6, 2006 and thereafter a deliver and updated current receivable  
18 aging report delivered on each Tuesday current through the immediately prior  
19 week (ending on Friday);
- 20 (d) a written update regarding the operations of the Debtor, including, without  
21 limitation, information regarding:
  - 22 (i) relationships with key customers, suppliers and vendors since the Petition  
23 Date;
  - 24 (ii) status of inventory liquidation and store closings since the Petition Date;
  - 25 and
  - 26 (iii) any issues identified regarding receivables issues identified regarding the

27 \_\_\_\_\_  
28 interest and fees. The Order could provide explicitly that any such payment is provisional only.

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likelihood of collections or timing of payment; and

- (e) a written update of the Debtor’s refinancing efforts including, without limitation, potential lenders, the status of any negotiations and the and terms contemplated, and the likely time frame.

The Debtor should be required to cooperate fully with Wachovia and Wachovia’s financial consultant(s), as applicable, and as required by the Credit Agreement, in order to enable Wachovia to assess the degree to which adequate protection may be lacking. Among other things, any order authorizing the Debtor to use the Cash Collateral should require that the Debtor grant Wachovia’s financial consultants and their representatives full access to the books, records, personnel, premises and consultants of the Debtor during normal business hours and require that the Debtor and their consultants cooperate with Wachovia and its financial consultants and their representatives with respect to any reasonable request for information, documentation and/or inspection relating to the operations of the Debtor and the collateral securing the Debtor’s obligations to Wachovia.

Any order authorizing the Debtor to use the Cash Collateral should address the procedural safeguards to which Wachovia is entitled with respect to any effort to seek future, longer term, use of cash collateral, including:

- (a) any future requests to use the Cash Collateral shall be tied to a budget for the period for which such use is required, and any such budget, along with the proposed terms of any such order, shall be served on Wachovia, at least seven (7) business days prior to any future hearing on the Motion; and
- (b) any witness that the Debtor will rely upon in support of the Cash Collateral Motion or subsequent Cash Collateral Motions shall be required to be made available for discussion of the budget for the next period no sooner than two (2) business days after delivery to Wachovia of any extended budget and projections, and no later than two (2) business days prior to any hearing on extended use of Cash Collateral.

1 **IV. FRBP 6003(b) AND APPLICABLE BANKRUPTCY LAW DO NOT AUTHORIZE**  
2 **DEBTOR TO PAY PREPETITION CLAIMS UNDER THESE**  
3 **CIRCUMSTANCES**

4 The Debtor in its Critical Vendor Motion proposes to pay prepetition unsecured debts  
5 totaling approximately \$702,000 to shippers, freight handlers, warehousemen and customs  
6 brokers from Wachovia's Cash Collateral. Yet Debtor advances no justification as to why these  
7 payments are necessary other than a general statement that it is "essential that shippers, freight  
8 handlers and warehousemen do not stop the flow of Debtor's product or hold it in transit." Critical  
9 Vendor Motion, p. 4 at 7-8. In fact, Federal Rule of Bankruptcy Procedure ("FRBP") Rule  
10 6003(b) provides that "[e]xcept to the extent that relief is necessary to avoid immediate and  
11 irreparable harm, the court shall not, within 20 days after the filing of the petition, grant relief  
12 regarding the following . . . a motion to use, sell, lease, or otherwise incur an obligation  
13 regarding property of the estate, including a motion to pay all or part of a claim that arose before  
14 the filing of the petition, but not a motion under Rule 4001." Fed. R. Bankr. Proc. 6003(b) . The  
15 prohibition in Rule 6003(b) covers motions to pay prepetition claims of vendors. The rationale  
16 for this is straightforward. "It should be the very rare case that a vendor needs payment so  
17 critically and so immediately that it could not wait 20 days for that payment." 10 Collier on  
18 Bankruptcy ¶ 6003.02[2][c][ii] (15th ed. rev. 2007).

19 While Rule 6003(b) permits such payment in order to prevent "immediate and irreparable  
20 harm," the burden is on the Debtor to demonstrate such harm. The seminal case on critical  
21 vendor motions is *In re Kmart Corp.*, 359 F.3d 866 (7th Cir. 2004). In that case the Court stated  
22 that "the debtor must prove, and not just allege, two things: that, but for immediate full payment,  
23 vendors would cease dealing; and that the business will gain enough from continued transactions  
24 with the favored vendors to provide some residual benefit to the remaining, disfavored creditors,  
25 or at least leave them no worse off." *Id.* at 868 (emphasis added). Here, the Debtor has not  
26 demonstrated with competent evidence that it will face immediate and irreparable harm if the  
27 prepetition claims of its critical vendors are not paid.

1           The Ninth Circuit also has significantly limited the application of the court’s equitable  
2 powers in connection with the payment of prepetition claims in a longstanding precedent which  
3 Debtor inexplicably, and inexcusably failed to cite. In *B&W Enterprises, Inc. v. Goodman Oil*  
4 *Co. (In re B&W Enterprises, Inc.)*, 713 F.2d 534, 537 (9th Cir. 1983), the Court rejected the  
5 notion that a bankruptcy court’s equitable powers support the payment of critical vendors’  
6 prebankruptcy claims. The Court wrote that it is “unwise to tamper with the statutory priority  
7 scheme devised by Congress.” *Id.* at 537. After the debtor, a trucking company, paid prepetition  
8 claims of certain trade creditors without obtaining court approval, the Chapter 7 trustee sought to  
9 avoid such payments under sections 549 and 550 of the Bankruptcy Code. *Id.* at 535-36. The  
10 bankruptcy court held that the transfer can be avoided and the district court and Ninth Circuit  
11 affirmed. *Id.* at 535-36, 538. The Ninth Circuit reasoned that “there is no indication that  
12 Congress intended the courts to fashion their own rules of super-priorities within any given  
13 priority class” and that the court’s equitable powers cannot be used to justify such prepetition  
14 claims payments. *Id.* at 537.

15           In *In re Timberhouse Post and Beam, Ltd.*, 196 B.R. 547 (Bankr. D. Mont. 1996), the  
16 debtor filed a motion to pay certain prepetition claims of unsecured creditors in order to continue  
17 a supply of materials to the debtor for its on-going business operation. *Id.* at 548. The debtor did  
18 not present any evidence that any of these suppliers would stop future, post petition orders, even  
19 on a COD basis, or that any of these creditors would terminate such supply if the prepetition debt  
20 was not paid. *Id.* The court adopted the bright line rule in *B&W Enterprises* and held that a  
21 prepetition unsecured claim could not be elevated to an administrative expense and paid out of  
22 the property of the estate. *Id.* at 550-51.

23           Here, the Debtor has not provided any evidence that these proposed critical vendors  
24 would terminate their relationship with the Debtor absent immediate payment of their prepetition  
25 claims. Indeed, most of the proposed critical vendors provide a service that can be substituted  
26 with minimal disruption. For example, FedEx or DHL is a suitable substitute for UPS. Based on  
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1 the foregoing, the Debtor's Critical Vendor Motion should be denied under FRBP Rule 6003(b)  
2 and under the Ninth Circuit's decision in *B&W Enterprises*.

3 **V. WACHOVIA DID NOT VIOLATE THE AUTOMATIC STAY AS THE FUNDS IN**  
4 **THE BLOCKED ACCOUNT WERE NOT PROPERTY OF THE ESTATE**

5 Debtor alleges, and intends to file, a notice that Wachovia has violated section 362(a) of  
6 the Bankruptcy Code by automatically sweeping funds held in the Blocked Account to pay down  
7 the Wachovia Credit Facility. The Debtor's allegation is without merit. The Credit Agreement  
8 provides that "Borrower agrees that all payments made to such Blocked Accounts or other funds  
9 received and collected by Lender, whether in respect of the Receivables, as proceeds of  
10 Inventory or other Collateral or otherwise shall be treated as payments to Lender in respect of the  
11 Obligations and therefore shall constitute the property of Lender to the extent of the then  
12 outstanding Obligations." Credit Agreement ¶ 6.3; *see also* Credit Agreement, ¶ 1.20 ("all items  
13 received or deposited in the Blocked Account are property of Lender"). Payments into the  
14 Blocked Account are property of Wachovia, and therefore cannot be considered property of the  
15 Debtor's bankruptcy estate.

16 These payments to the Blocked Account held by Wachovia are analogous, and indeed,  
17 are even less susceptible to the Debtor's claims than assets held in a third party escrow, which  
18 are not considered property of the estate. Here, the Loan Agreement makes absolutely clear that  
19 funds in the Blocked Account are held as Wachovia's property, to which the Debtor's estate has  
20 no claim under section 541(a) of the Bankruptcy Code. The Debtor agreed that Wachovia holds  
21 funds in the blocked account as Wachovia's property. Neither turnover nor the automatic stay  
22 applies to assets owned by third parties, such as Wachovia.

23 In determining whether a valid escrow exists for purposes of excluding property from the  
24 estate, courts look as to whether (i) there was an agreement in place governing the assets, (ii) the  
25 funds were delivered to a third party with transfer to the beneficiary upon the performance of  
26 some act or the occurrence of some event, and (iii) the stipulated conditions were met prior to the  
27 distribution of the funds from escrow. *See, e.g., In re Kemp*, 52 F.3d 546, 551 (5th Cir. 1995); *In*  
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1 *re Royal Business School, Inc.*, 157 B.R. 932, 938 (Bankr. E.D.N.Y. 1993). Here, the Credit  
2 Agreement governs the treatment of the Blocked Account. The Loan Agreement provides, at  
3 Section 6.3(a), that remittances to a Blocked Account “shall be treated as payments to the Lender  
4 in respect of the obligations and therefore shall constitute property of the Lender to the extent of  
5 the then outstanding obligations.”

6         Once the existence of an agreement determining the ownership of an asset has been  
7 established, the estate’s property is confined to the rights conferred upon the debtor by the  
8 agreement, and not the property rights in the assets escrowed. *See In re Scanlon*, 239 F.3d 1195  
9 (11th Cir. 2001) (finding that funds that debtor forwarded to escrow account were never owned  
10 or controlled by the debtor and thus were not part of the bankruptcy estate); *see also In re*  
11 *Newcomb*, 744 F.2d 621, 626-27 (8th Cir. 1984) (finding that once the escrow was created, the  
12 only interest in the escrowed funds remaining in the debtor was a contingent right). The funds in  
13 the Blocked Account that were swept and applied to the Wachovia Credit Facility constitute  
14 funds to which the Debtor’s estate has no claim or right under the Credit Agreement.

15         Here, the Debtor has presented a series of exhibits that fail to show the time of the  
16 transfer from the Concentration Account, where the funds were property of the Estate, to the  
17 Blocked Account, where they are not. Exhibit 5 shows a transfer, but the time stamp on that  
18 document is dated from March 20, 2008, which is the run date of the report, whereas any transfer  
19 took place on March 19. Exhibit 6 merely shows the condition of the loan on March 19 and  
20 March 20. The loan amount would have remained constant until the monies in the Blocked  
21 Account, which were already Wachovia’s property, were credited to the loan. There is no  
22 evidence that the transfer from the Concentration Account to the Blocked Account took place  
23 after Wachovia received actual notice of the chapter 11 filing. It would be premature for the  
24 Court to issue any relief on this paltry record.

25 **VI. CONCLUSION**

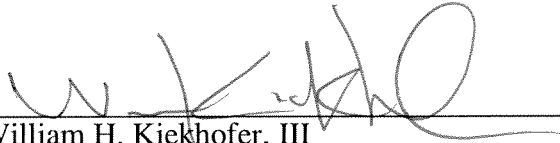
26         For the reasons set forth in this Objection, Wachovia respectfully requests that this Court:  
27 (i) deny or significantly limit the relief sought by the Debtor in the Cash Collateral Motion,

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1 (ii) deny the relief sought by the Debtor in the Critical Vendor Motion, (iii) find that Wachovia  
2 did not violate the terms of the automatic stay by sweeping the Blocked Account, and (iv) grant  
3 such other and further relief as may be deemed just or proper under the circumstances.  
4

5 DATED: March 20, 2008

MAYER BROWN LLP  
WILLIAM H. KIEKHOFFER, III  
ANTHONY J. NAPOLITANO

7  
8 By:   
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11 WACHOVIA CAPITAL FINANCE COMPANY  
12 (WESTERN)  
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1 **PROOF OF SERVICE BY EMAIL AND MAIL**

2 I am employed in Los Angeles County, California. I am over the age of eighteen years  
3 and not a party to the within-entitled action. My business address is 350 South Grand Avenue,  
4 25th Floor, Los Angeles, California 90071-1503. I am readily familiar with this firm's practice  
5 for collection and processing of correspondence for mailing with the United States Postal  
6 Service. On March 20, 2008, I placed with this firm at the above address for deposit with the  
7 United States Postal Service true and correct copies of the within document:

8 WACHOVIA CAPITAL FINANCE CORPORATION'S OBJECTION TO DEBTOR'S  
9 (I) EMERGENCY MOTION PURSUANT TO SECTION 363(C) OF THE  
10 BANKRUPTCY CODE AND RULE 4001(B) OF THE FEDERAL RULES OF  
11 BANKRUPTCY PROCEDURE FOR INTERIM AND FINAL ORDERS AUTHORIZING  
12 USE OF CASH COLLATERAL; (II) EMERGENCY MOTION FOR ORDER  
13 AUTHORIZING PAYMENT OF CUSTOMS DUTIES AND CERTAIN PREPETITION  
14 CLAIMS OF SHIPPERS, FREIGHT HANDLERS, WAREHOUSERS AND CUSTOM  
15 BROKERS; AND (III) NOTIFICATION OF VIOLATION OF THE AUTOMATIC  
16 STAY

13 in sealed envelopes, postage fully paid, addressed as set forth on the attached service list. I also  
14 transmitted true and correct copies of the foregoing document to the parties listed on the attached  
15 service list at the email addresses set forth on the attached service list.

16 Following ordinary business practices, the envelopes were sealed and placed for  
17 collection and mailing on this date, and would, in the ordinary course of business, be deposited  
18 with the United States Postal Service on this date.

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

21 I declare under penalty of perjury under the laws of the United States of America that the  
22 above is true and correct.

23 Executed on March 20, 2008, at Los Angeles, California.

24 

25 \_\_\_\_\_  
Holly Wells

1 *In re eStyle, Inc.*  
U.S.B.C., Central District of California, Los Angeles Division  
2 Chapter 11 Case No. 2:08-bk-13518-SB

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