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WACHOVIA CAPITAL FINANCE CORPORATION (WESTERN)
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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
14 babystyle, Cadeau, and Cadeau Designs,
15 Debtor.

Case No. 2:08-bk-13518-SB
Chapter 11

WACHOVIA CAPITAL FINANCE CORPORATION'S OBJECTIONS TO DEBTOR'S 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

[Declaration of Robin Van Meter filed concurrently herewith]

Date: April 17, 2008
Time: 2:00 p.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 submits its further objections¹ to Debtor’s (i) Emergency Motion Pursuant to Section
6 363(c) of the Bankruptcy Code and Rule 4001(b) of the Federal Rules of Bankruptcy Procedure
7 for Interim and Final Orders Authorizing Use of Cash Collateral (Docket No. 13) (the “Cash
8 Collateral Motion”), as follows:

9 **I. BACKGROUND**

10 Wachovia is the Debtor’s senior secured lender and as of the Petition Date is owed
11 approximately \$2,070,000² (the “Pre Petition Obligations”). As collateral to secure the Debtor’s
12 Pre-Petition Obligations, the Debtor granted to Wachovia a blanket security interest in the
13 Debtor’s right, title and interest in and to all of the Debtor’s assets (the “Prepetition Collateral”).
14 The security interest in the Prepetition Collateral was properly perfected through: (i) filing UCC
15 financing statements in the applicable jurisdictions, (ii) deposit account control agreements, and
16 (iii) a Trademark assignment agreement.

17 On March 19, 2008 (the “Petition Date”), the Debtor filed its voluntary petition for relief
18 under Chapter 11 of title 11 of the United States Code (the “Bankruptcy Code”). The Debtor is
19 currently operating its business as a debtor-in-possession pursuant to sections 1107 and 1108 of
20 the Bankruptcy Code. Also, on March 19, 2008, the Debtor filed its Cash Collateral Motion and
21 set it for hearing on March 21, 2008 at 10:00 a.m., along with Debtor’s other first-day motions,
22 Wachovia filed its initial Objection to Debtor’s Cash Collateral Motion, and certain other first-
23 day motions, on March 20, 2008.

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25 ¹ The Debtor advised Wachovia that the Debtor will provide a new cash collateral model
26 showing the effect of the closing of an additional five stores and the liquidation of the inventory
27 of the additional five stores. Wachovia did not receive the anticipated new model in time to
28 consider it in this pleading. Wachovia anticipates that discussions with the Debtor will continue
through the Final Cash Collateral Hearing.

² This amount assumes application of the \$303,000 as discussed in Section III, *infra*.

1 The Court continued the hearing on the Cash Collateral Motion to March 25, 2008, so
2 that Wachovia and Debtor could come up with a suitable interim cash collateral order. Debtor
3 and Wachovia were unable to reach agreement on the form of the proposed interim order. On
4 March 25, 2008, this Court entered its Order Granting Debtor's Emergency Motion For Order
5 Approving Use Of Cash Collateral And Granting Of Replacement Liens On An Interim Basis, as
6 supplemented by certain reporting provisions that were read into the record. (the "Interim Cash
7 Collateral Order"). This Court set the final hearing on the Cash Collateral Motion for April 17,
8 2008 at 2:00 p.m. The Court also permitted Wachovia and Debtor to lodge an Amended Interim
9 Cash Collateral Order to supplement the Interim Cash Collateral Order.

10 **II. WACHOVIA'S OBJECTIONS TO DEBTOR'S POST-PETITION CASH**
11 **COLLATERAL REPORTS AND PRE-PETITION INVENTORY REPORTS**

12 **A. The Debtor Proposes to Deplete Collateral Without Concomitant Reductions**
13 **in Wachovia's Secured Claim**

14 Following entry of the Interim Cash Collateral Order, the Debtor and Wachovia have had
15 extensive communications to attempt to arrive at a mutually acceptable Budget for the period
16 from April 17 through June 30, 2008, and the Debtor provided Wachovia financial reports and
17 forecasts, including several cash collateral models. Until Friday, April 11, 2008, all of these
18 discussions and cash collateral models assumed that the Debtor would provide adequate
19 protection by paying down Wachovia's loan by \$.50 for every \$1.00 reduction in cost value of
20 Wachovia's inventory, a ratio that corresponds to Wachovia's advance rate on its loans to the
21 Debtor. The cash collateral model presented by the Debtor on Friday, April 11, 2008, a copy of
22 which is attached to the Declaration of Robin Van Meter (the "Van Meter Decl.") as Exhibit "1"
23 ("the April 11 Budget"),³ departed from this approach to adequate protection. The Debtor's
24 losses projected by the April 11 Budget were too great to permit a reduction in Wachovia's loan
25 proportionate to the depletion of its inventory collateral. Wachovia has concluded after careful

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27 ³ The Debtor extended the time for the filing of this Opposition to Monday, April 14 at
28 5:00 p.m. to afford Wachovia an opportunity to give consideration to the April 11 Budget.

1 review and consideration of the April 11 Budget that the loss making operations of the Debtor
2 under the April 11 Budget would impair Wachovia's Collateral and deny it adequate protection.

3 **B. The Debtor Projects Steep and Relentless Depletion of Cash and Inventory**

4 The April 11 Budget projects a downward spiral of cash and inventory that defies the
5 confident predictions offered at the March 25, 2008 hearing. The April 11 Budget shows that
6 actual cash at the end of the week of the March 25, cash collateral hearing was \$1,133,895 (Exh.
7 1, p. 1, D102), and actual inventory, valued by the Debtor at Orderly Liquidation Value ("OLV")
8 was \$5,810,530 (Exh. 1, p. 1, D106), a total of \$6,944,425. The other components of
9 Wachovia's collateral, Other (including Equipment and FFE) and Accounts Receivable are
10 essentially unchanged, but their values remain highly speculative due to the difficulties of
11 liquidating far flung fixtures and the dilutive effect of charge backs and chargeback reserves on
12 credit card receivables.

13 By the final week of the June Budget, cash is projected to decrease to \$445,652 (Exh. 1,
14 p.3, J95), a decrease of \$688,243. Inventory is projected to decrease to \$4,950,403 (Exh. 1, p.3,
15 J100), a decline of \$860,127. The total decrease of collateral in the cash and inventory
16 categories from the end of the week of March 29 to the end of the week of June 21 is \$1,305,779.
17 The April 11 budget projects that Wachovia's loan amount will decrease by a much lesser
18 amount, only \$174,845, from \$2,069,161 on March 29, 2008 (Exh. 1, p. 1, D96) to \$1,894,316
19 (Exh. 1, p.3, J89) on June 21, 2008. The April 11 Budget projects that collateral value will
20 decline at a rate almost seven and a half times faster than the rate of decrease in the loan.

21 **C. The Debtor Still Has No Exit Plan**

22 At the end of the April 11 Budget, the Debtor will continue to lose money, projecting a
23 net cash flow in June of (\$308,614) (Exh. 1, p.3, N79), while inventory remains roughly flat,
24 increasing slightly (\$88,548) from \$5,456,573 to \$5,545,121 (Exh. 1, p. 3, D98, J98). The
25 Debtor has no prospect other than continuing losses and diminution of collateral, as it consumes
26 Wachovia's collateral to cover the unstaunched losses.

1 The Debtor has failed to demonstrate adequate protection through its failure to estimate a
2 cost of a complete liquidation of the Debtor, whose remaining stores are scattered across the
3 United States. Counsel for Wachovia questioned the Debtor's financial consultant, Richard
4 Alston, on the additional categories of expense that would be deducted from the OLV that the
5 Debtor used in the Original Budget and the April 11 Budget, and Alston conceded that the OLV
6 the Debtor used did not capture all of the expenses that would be incurred in a complete
7 company liquidation, omitting such items as marketing expenses, see Transcript of Proceedings,
8 March 25, 2008 lodged concurrently herewith ("TR"), p. 44, ln. 2-13, wages, TR, p. 44, ln 18-24,
9 freight, TR, p. 44, ln. 25 to p. 45, ln. 4, rents, TR p. 45, ln. 5-6, all of which will reduce
10 Wachovia's recovery from the OLV, or the Net OLV, TR, p. 45, ln. 10-19.

11 Mr. Alston had not at the time of the hearing computed a Net OLV, TR, p. 45, ln. 21 to
12 p. 46, ln. 6, and the Debtor still has not done so. The April 11 budget does not show an exit
13 strategy for the creditors if the Debtor manages to survive until June 21, 2008. Rather, the April
14 11 Budget shows inventory depleted to \$4.9 million. Certainly, there is no realistic prospect of
15 reorganizing on a stand alone basis if the Debtor continues to rack up monthly operating losses
16 for which the only funding source is the further depletion of Wachovia's collateral.

17 **D. The Debtor Has Not Estimated Liquidation Expenses**

18 Wachovia believes that if the Debtor's inventory is reduced to \$4.9 million and the
19 Debtor then liquidates that Wachovia will have a shortfall after all of the liquidation expenses are
20 paid. Mr. Alston testified that he believed that the Inventory Net OLV could be as much as
21 \$500,000 less than OLV recorded at the end of June, 2008 in the Original Budget \$4,966,168
22 (\$4,950,400 in the April 11 Budget), or perhaps as little as \$4.45 million. TR, p. 50, ln. 5-23.
23 But liquidation is a costly and risky undertaking, as the liquidating entity bears many of its costs
24 of operations. The Original Budget had monthly operating expenses of \$3,337,065 for June,
25 2008, of which \$1,053,922 were inventory purchases, which would be drastically curtailed in a
26 liquidation. But other costs, such as rent, salaries, taxes, and shipping, will be unchanged, and if
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1 the inventory purchases were eliminated, the Original Budget still projects June, 2008 operating
2 expenses of \$2,283,143.

3 In a six week liquidation, and assuming that the Court would allow the Debtor to pay
4 prorated rents for partial months if the Debtor completed its liquidation mid-month, it is
5 reasonable to project that the Debtor would incur approximately 150% of its monthly operating
6 expenses, or \$3,424,714, plus additional store closing costs resulting from liquidation, which the
7 Debtor in its original projection posited to be \$25,000 per store, or \$425,000 (17 remaining stores
8 times \$25,000). Presumably, there would be additional costs associated with liquidating the
9 Debtor's warehoused goods. The administrative expense costs of a self liquidation Debtor
10 through its liquidation would be \$3,849,971.

11 Alston testified, at TR, p. 67, ln. 24, through p. 68, ln. 13, that the Debtor absorbed these
12 costs "above the line" and estimates that the Net OLV would be 32% of retail value of inventory
13 (compared to OLV at 35% of the retail value of the inventory). Alston did not explain how the
14 Debtor's cost structure of administration, which produces such copious losses while the Debtor
15 operates in the ordinary course of business, will be transformed into a lean, efficient liquidation
16 machine. The losses which are depleting the collateral today will, for the most part, continue or
17 even grow.

18 Although Alston agreed that a liquidation advisor would be necessary to a well managed
19 liquidation, TR, p. 48, ln. 7-12, he did not obtain any estimates of the liquidation agency fees and
20 costs for managing a liquidation of the Debtor's far flung retail chain, TR, p. 48, ln. 21, to p. 49,
21 ln. 4. The Debtor chose to measure adequate protection by OLV, but has failed to provide a
22 model of the expenses of a liquidation.

23 Wachovia believes that the expenses of the liquidation, that is, the difference between
24 OLV and Net OLV, will be much higher than Alston allowed for in his 3% difference between
25 OLV and Net OLV. TR, p. 68, ln. 1-13. Wachovia believes that if the Court lets the Debtor
26 operate under the April 11 Budget, and the cost value of inventory is depleted in June, 2008 to
27 \$4.9 million, that the expenses of the liquidation will be so great as to cause a shortfall of
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1 proceeds to pay Wachovia loan in full. Adequate protection will have failed, and all other
2 classes of creditors will be completely wiped out by Wachovia's resulting Section 507(b) claim.

3 **E. The Debtor Is Missing Its Revenue Projections**

4 A comparison of the Actual Receipts from the April 11 Budget with the original Cash
5 Collateral Model attached to the Emergency Cash Collateral Motion, a copy of which is attached
6 for the Court's convenience to the Van Meter Decl. as Exhibit "2" (the "Original Budget"),
7 shows that the Debtor is already missing its revenue targets by substantial margins. For the week
8 ending March 29, the Debtor projected in the Original Budget total receipts of \$835,501 (Exh. 2,
9 p.1, Week 1 (3/23-3/29), Net Cash Receipts Total DTC & Stores), but the April 11 Budget shows
10 actual receipts for that week of only \$809,412 (Exh. 1, p.1, D54). For the week ending April 5,
11 the Debtor in the Original Budget projected receipts of \$941,380 (Exh. 2, p.1, Week 1 (3/30-
12 4/05), Net Cash Receipts Total DTC & Stores), but the April 11 Budget recorded actual receipts
13 of only \$850,679 (Exh. 1, p.1, F54). In the first two weeks, measured by its own reporting, the
14 Debtor has already "missed" on revenues by \$116,790. While the Debtor has also recorded
15 fewer expenses, this reflects that Court's denial of the Critical Vendor Motion, which forced the
16 Debtor to defer paying the supposedly critical prepetition expenses.

17 **F. The Debtor Has Provided Inconsistent and Inaccurate Inventory Reporting**

18 Wachovia also notes that the April 11 Budget states \$6,508,579 as Wachovia's week of
19 March 29, 2008 ending cost basis inventory (Exh. 1, p.1, D106), whereas the Original Budget
20 had stated that Wachovia's week of March 29, 2008 ending cost basis inventory was \$6,971,651
21 (Exh. 2, p.1, Week 1 (3/23-3/29) Ending Inventory (Net of Reserves). The unexplained
22 downward adjustment of \$463,072 occurred even though sales, as noted in the previous
23 paragraph, were less than projected. This unexplained downward adjustment of nearly seven
24 percent (7%) in a single week is disturbing, and marks a continuation of a trend of inaccurate and
25 inflated inventory reporting that had begun prepetition.

26 The Debtor had recorded cost basis of inventory of more than \$8 million as set forth in
27 the Debtor's Flash Inventory report for the week ending March 8, 2008, a true and correct copy
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1 of which is attached to the Van Meter Decl. as Exhibit "3", which it reduced by more than \$1
2 million by the time it reported the Debtor's Flash Inventory report for the week ending
3 March 22, 2008, a true and correct copy of which is attached to the Van Meter Decl. as
4 Exhibit "4".⁴ The disappearance of \$1.4 million of inventory between March 8, 2008 and the
5 present constitutes another impairment of Wachovia's adequate protection.

6 **III. WACHOVIA AND DEBTOR DEFERRED LITIGATION CONCERNING THE**
7 **\$303,000 AND THE COURT SHOULD DEFER CONSIDERATION OF RELIEF**
8 **IN RESPECT TO THE \$303,000**

9 During the interval between the Interim and Final Cash Collateral hearings, Wachovia
10 and the Debtor were in continuous and ongoing discussions on adequate protection for the use of
11 cash collateral. While conducting these discussions, Wachovia and the Debtor held discovery
12 and litigation concerning the \$303,000 that was the subject of the Debtor's initial Motion to
13 Enforce the Automatic Stay in abeyance.⁵ It would have made no sense for the Debtor or
14 Wachovia to have expended attorneys' fees investigating or litigating over the \$303,000 if it was
15 to be paid as an adequate protection payment. Indeed, the April 11 Budget, and all of the other
16 cash collateral models furnished by the Debtor to Wachovia, assumed that the \$303,000 would
17 be applied by Wachovia against its loan as partial adequate protection. Wachovia has focused its
18 attention on trying to reach a consensual cash collateral arrangement rather than on litigating
19 cash collateral or the legal status of the \$303,000. It would be premature for the Court to enter
20 relief in respect to the \$303,000 prior to full and fair litigation of the legal and factual issues
21 related thereto.

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24 ⁴ Debtor's March 8, 2008 Flash Inventory Report provides an inventory value of
25 \$7,991,000, \$8,074,000, and \$8,018,000 for Weeks 4, 5 and 6 of Fiscal Year 2008, respectively.
26 Exh. 3, p. 1, AA61-63. Debtor's March 22, 2008 Flash Inventory Report revises these amounts
27 downward to \$7,117,000, \$7,200,000, and \$7,145,000 for the very same weeks. Exh. 4, p.1,
28 AA61-63.

⁵ All sums other than the \$303,000 which were "swept" to Wachovia in the first several
days after the case was filed have been wired to the Debtor, and no further sweeps have
occurred.

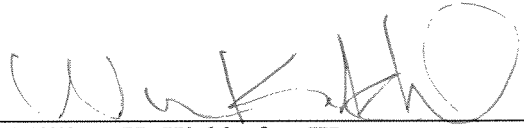
1 **IV. CONCLUSION**

2 Wachovia reserves its rights to submit supplemental comments and/or objections to
3 Debtor's Cash Collateral Motion based on the Debtor's reporting for the week ending April 12,
4 2008, and to supplement this Objection based on further financial reporting from the Debtor and
5 ongoing evaluation of Debtor's financial performance during the pendency of Debtor's
6 bankruptcy case.

7 Wachovia respectfully submits that the Debtor has failed to provide adequate protection
8 of Wachovia's interests, that it terminate the Debtor's use of cash collateral for any purpose other
9 than to fund a liquidation of the Debtor's assets, and grant such other and further relief as may be
10 deemed just or proper under the circumstances.

11 DATED: April 14, 2008

MAYER BROWN LLP
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13
14 By: 
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