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7 Bankruptcy Counsel for eStyle, Inc.,  
Debtor and Debtor in Possession

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

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

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19 Tax Id # 95-4712564

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

Chapter 11

**DEBTOR'S REPLY TO LIMITED  
OBJECTION TO MOTION FOR USE OF  
CASH COLLATERAL AND DEMAND FOR  
ADEQUATE ASSURANCE OF  
PERFORMANCE UNDER EXECUTORY  
CONTRACT AND ADEQUATE  
PROTECTION; DECLARATION OF  
ROBERT KELLEHER**

DATE: April 17, 2008  
TIME: 2:00 p.m.  
PLACE: U.S. Bankruptcy Court  
Courtroom 1575  
255 East Temple Street  
Los Angeles, CA 90012

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22 eStyle, Inc. (the "Debtor"), debtor in possession in this case, hereby replies  
23 to the "Limited Objection to Motion for Use of Cash Collateral and Demand for Adequate  
24 Assurance of Performance Under Executory Contract and Adequate Protection" filed by  
25 New Breed, Inc. ("New Breed"), and in support of its reply, respectfully submits as  
26 follows:  
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I.

**INTRODUCTION**

In its limited objection (the "Limited Objection"), New Breed requests that the Court condition the Debtor's use of cash collateral with the following four provisions: (a) that New Breed be granted a replacement lien equal in value of any goods of the Debtor that New Breed releases or the indubitable equivalent thereof; (b) that the Debtor be required to cure current defaults under the agreement (including pre-petition defaults); (c) that the Debtor be required to pay New Breed all amounts owed under its agreement with the Debtor (the "Agreement") due pending assumption or request of the Agreement; and (d) that New Breed's statutory lien under section 7209 of the California Commercial Code on the goods of the Debtor that remain in New Breed's possession is preserved. New Breed also requests "such other and further relief as the Court deems equitable and just".

In sum the Debtor is agreeable to all of New Breed's requested conditions, except the requirement that it be compelled to pay New Breed for all pre-petition charges under the Agreement. Requiring the Debtor to pay these amounts is inappropriate because (a) the Debtor has not decided yet whether to assume or reject the Agreement, and hence should not be compelled to cure pre-petition defaults; and (b) New Breed is adequately protected by the value of the inventory that is in its possession, and will remain adequately protected during the cash collateral period. See Declaration of Robert Kelleher.

II.

**THE DEBTOR SHOULD BE COMPELLED TO CURE THE PRE-PETITION DEFAULTS ONLY IF AND WHEN IT ELECTS TO ASSUME THE AGREEMENT WITH NEW BREED**

The Bankruptcy Code provides that, subject to court approval, the debtor in possession may assume or reject any executory contract or unexpired lease of the debtor. See 11 U.S.C. § 365(a). An executory agreement continues in effect while the debtor decides whether to assume or reject the contract. Data-Link Systems, Inc. v.

1 Whitcomb & Keller Mortgage Co., Inc. (In re Whitcomb & Keller Mortgage Co., Inc.), 715  
2 F.2d 375, 378 (7<sup>th</sup> Cir. 1983). Under Section 365(d) of the Bankruptcy Code, a debtor in  
3 possession may assume or reject an executory contract at any time before confirmation  
4 of a plan, unless the court specifies a period of time within which the contract must be  
5 assumed or rejected. 11 U.S.C. § 365(d)(2). Furthermore, Section 105(a) of the  
6 Bankruptcy Code authorizes the Court to “issue any order, process, or judgment that is  
7 necessary or appropriate to carry out the provisions of [the Bankruptcy Code].” 11 U.S.C.  
8 § 105(a). Section 105(a) can be used to compel a contracting party to continue  
9 performance pending a debtor’s decision to assume or reject an executory contract. See  
10 Whitcomb, 715 F.2d at 378 n.4. Furthermore, case law is clear and consistent that after  
11 the commencement of a bankruptcy case and prior to the Debtor either assuming or  
12 rejecting an executory contract, the non-debtor party to the contract must continue to  
13 perform. See In re Pacific Gas & Electric Co., 2004 U.S. Dist. LEXIS 22023, \*14-20 (N.D.  
14 Cal. 2004), citing NLRB v. Bildisco & Bildisco, 465 U.S. 513, 531, 104 S. Ct. 1188, 79  
15 L.Ed. 2d 482 (1984); In re Public Service Co. of New Hampshire, 884 F.2d 11, 14 (1<sup>st</sup> Cir.  
16 1989); Whitcomb & Keller Mortgage Co., Inc., 715 F.2d at 378; Chick Smith Ford v. Ford  
17 Motor Credit Co., 46 B.R. 515, 519 (Bankr. M.D. Fla. 1985).

18 Pursuant to the Agreement, New Breed provides warehousing, fulfillment  
19 and distribution services to the Debtor. At this early stage in its bankruptcy case, the  
20 Debtor has not yet decided whether to elect to assume or reject the Agreement, and is  
21 weighing other options it has for warehousing services. Nothing in the Code requires the  
22 Debtor to cure any pre-petition arrearages owed to New Breed prior to making the  
23 election to assume the Agreement.

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1 III.

2 **NEW BREED IS ADEQUATELY PROTECTED BY THE VALUE OF THE DEBTOR'S**  
3 **INVENTORY IN ITS POSSESSION**

4 The Debtor's inventory, at the Debtor's cost, which was in New Breed's  
5 possession as of April 12, 2008, was approximately \$3,000,000, including approximately  
6 \$169,000 of damaged inventory. The inventory in New Breed's possession represents  
7 over 50% of all of the Debtor's inventory at cost. While it is correct the Debtor will use  
8 the inventory as it is released to the Debtor, new shipments of inventory will be received  
9 by New Breed, which will substantially replace the sold inventory. However, the total  
10 amount of the Debtor's inventory will decline during the period covered by the proposed  
11 cash collateral period, primarily because the Debtor will be closing stores and not  
12 replacing inventory for those stores. The total inventory levels will also decline partially  
13 because the Debtor is selling off aged and re-boxed inventory from its distribution center.  
14 Assuming that the inventory level in New Breed's possession remains at over 50% of the  
15 Debtor's total inventory, it is estimated that through the proposed cash collateral period,  
16 the inventory will have a value at cost of approximately \$2.6 million. Providing New  
17 Breed with a replacement lien on that inventory is all of the adequate protection that is  
18 required. Where New Breed's pre-petition claim is only approximately \$330,000 (See  
19 discussion below), it is indisputable that the value of the inventory provides New Breed  
20 with adequate protection in and of itself.

21 Although the term "adequate protection" is not defined in the Bankruptcy  
22 Code, Section 361 provides the following three non-exclusive examples of what may  
23 constitute adequate protection:

- 24 (1) requiring the trustee to make a cash payment or  
25 periodic cash payments to such entity, to the extent that the . .  
26 . use . . . under section 363 of this title . . . results in a  
27 decrease in the value of such entity's interest in such  
28 property.

1 (2) providing to such entity an additional or replacement  
2 lien to the extent that such . . . use . . . results in a decrease in  
the value of such entity's interest in such property; or

3 (3) granting such other relief . . . as will result in the  
4 realization by such entity of the indubitable equivalent of such  
entity's interest in such property.

5 Neither Section 361 nor any other provision of the Code defines the nature  
6 and extent of "interest in property" of which a secured creditor is entitled to adequate  
7 protection under Section 363. However, the statute plainly provides that a qualifying  
8 interest demands protection only to the extent that the use of the creditor's collateral will  
9 result in a decrease in "the value of such entity's interest in such property". United  
10 Savings Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365, 108 S.  
11 Ct. 626, 98 L. Ed. 2d 740 (1988). Timbers teaches that a secured creditor is entitled to  
12 "adequate protection" only against the diminution in value of the collateral securing its  
13 allowed secured claim.

14 Courts have also recognized that the existence of an equity cushion, alone,  
15 if sufficient in size, can constitute adequate protection where the equity cushion is not  
16 likely to erode to the point where no cushion remains. See In re Mellor, 714 F.2d 1396,  
17 1402 (9<sup>th</sup> Cir. 1984) (20% equity cushion sufficient); In re Hawaii Pacific Industries, 17  
18 B.R 670 (Bankr. Hawaii 1982) (15% equity cushion sufficient). In the context of a case  
19 involving real estate collateral the Ninth Circuit has specifically held that a 20% equity  
20 cushion constitutes adequate protection. Mellor, supra, 714 F.2d at 1402. This principle  
21 is equally applicable here, when New Breed's position is secured by collateral that has a  
22 cost value that is almost 10 times that of its claim. Further when viewing the equity  
23 cushion in *conjunction* with the post -petition replacement lien that the Debtor proposes to  
24 provide to New Breed, it is clear that New Breed is more than adequately protected.

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1 IV.

2 **NEW BREED MISSTATES THE AMOUNT OF ITS CURRENT CLAIM AGAINST THE**  
3 **DEBTOR**

4 First, it is important to note that New Breed improperly characterizes the  
5 Debtor as being in default under the Agreement. The truth is that under the Agreement,  
6 the Debtor has 30 days from the date of receipt of an invoice to pay the amounts due.  
7 See Agreement, ¶2.06. According to Exhibit B attached to the Limited Objection, which  
8 lists the invoices that New Breed claims are outstanding only the invoices dated February  
9 25, 2008 (\$3,248)<sup>1</sup> and February 19, 2008 (\$45,567.61) are technically late. All of the  
10 other invoices are within their payment terms (though it is true that the Debtor does not  
11 propose to pay any pre-petition invoices). Further, with respect to the invoice number  
12 6800705 dated March 25, 2008 in the amount of \$65,890.77, which covers both pre and  
13 post-petition dates of services, the Debtor requested that New Breed send it a new  
14 invoice separating the pre and post-petition services, and indicated that it would promptly  
15 pay for the post-petition portion of that invoice. New Breed has not sent a new invoice.  
16 Finally, the only wholly post-petition invoice, invoice number 6800713 in the amount of  
17 \$45,551.63, has already been paid by the Debtor. See Declaration of Robert Kelleher.  
18 Accordingly, under any circumstances, the amount of New Breed's pre-petition claim is  
19 \$334,280.48 less the post-petition portion of invoice number 6800705.<sup>2</sup> Finally, the  
20 Debtor asserts set off claims against New Breed for two chargeback claims, including a  
21 claim for an over-billing in 2007 for \$13,363.58, and a claim for reimbursement of \$4,270  
22 in costs of systems consulting and troubleshooting that was incurred by the Debtor due to  
23 a system change that New Breed installed without proper notification. Both of these  
24 claims have been previously communicated to New Breed.

25  
26 <sup>1</sup> The Debtor disputes this charge, which is for storage space that is not covered  
by the Agreement. The Debtor has advised New Breed that it is disputing these charges.

27 <sup>2</sup> The Debtor is also in the process of reviewing all of invoices which the Debtor  
28 only recently received, and reserves its rights to object to the total amount of the charges.

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V.

**ADDITIONAL PROPOSED ADEQUATE ASSURANCE**

In addition to the replacement liens requested by New Breed, the Debtor agreed to accept electronic invoices from New Breed, and pay them according to the same 30 day terms. This arrangement was designed to significantly speed up the payment process, and provides New Breed with additional adequate protection. Unfortunately, despite agreeing to provide the Debtor with electronic invoices, New Breed has not done so to date.

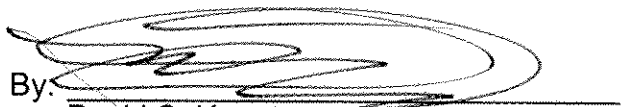
VI.

**CONCLUSION**

Based on the foregoing, the Debtor respectfully requests that the Court overrule the Limited Objection, and find that adequate protection to New Breed, if any is required, is provided by (a) the granting of post-petition replacement liens to New Breed on the existing Pre-Petition Inventory and any new inventory that is received by New Breed; (b) requiring the Debtor to timely pay invoices as they come due for post-petition services; and (c) ) the preservation of New Breed's statutory lien under section 7209 of the California Commercial Code on the goods of the Debtor that remain in New Breed's possession.

DATED: April 15, 2008

**SulmeyerKupetz**  
A Professional Corporation

By: 

David S. Kupetz  
Mark S. Horoupian  
Bankruptcy Counsel for eStyle, Inc.,  
Debtor in Possession



1 the pre and post-petition services, and indicated that it would promptly pay for the post-  
2 petition portion of that invoice. New Breed has not sent a new invoice.

3 5. Invoice number 6800713 in the amount of \$45,551.63, has already been  
4 paid by the Debtor. It was actually paid last week, which was three weeks prior to its  
5 technical due date. With respect to the \$3,248 outstanding amounts shown by New  
6 Breed on invoice 6800692, the Debtor disputes this charge, which is for storage space  
7 that is not covered by the Agreement. The Debtor has advised New Breed that it is  
8 disputing these charges.

9 6. The Debtor asserts set off claims against New Breed for two chargeback  
10 claims, including a claim for an over-billing in 2007 for \$13,363.58, and a claim for  
11 reimbursement of \$4,270 in costs of systems consulting and troubleshooting that was  
12 incurred by the Debtor due to a system change that New Breed installed without proper  
13 notification. Both of these claims have been communicated to New Breed.

14 7. The Debtor to agreed to accept electronic invoices from New Breed, and  
15 pay them according to the same 30 day terms that exist under the Agreement. This  
16 arrangement was designed to significantly speed up the payment process, and provides  
17 New Breed with additional adequate protection. Unfortunately, despite agreeing to  
18 provide the Debtor with electronic invoices, New Breed has not done so to date.

19 I declare under penalty of perjury under the laws of the United States of America  
20 that the foregoing is true and correct.

21 Executed April 15, 2008, at Los Angeles, California.

22  
23 *R. S. Kelleher*

24 Robert S. Kelleher  
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PROOF OF SERVICE

STATE OF CALIFORNIA, COUNTY OF LOS ANGELES

At the time of service, I was over 18 years of age and **not a party to this action**. I am employed in the County of Los Angeles, State of California. My business address is 333 South Hope Street, Thirty-Fifth Floor, Los Angeles, California 90071-1406.

On April 15, 2008, I served the following document(s) described as **DEBTOR'S REPLY TO LIMITED OBJECTION TO MOTION FOR USE OF CASH COLLATERAL AND DEMAND FOR ADEQUATE ASSURANCE OF PERFORMANCE UNDER EXECUTORY CONTRACT AND ADEQUATE PROTECTION; DECLARATION OF ROBERT KELLEHER** on the interested parties in this action as follows:

**SEE ATTACHED SERVICE LIST**

**BY E-MAIL OR ELECTRONIC TRANSMISSION:** Based on a court order or an agreement of the parties to accept service by e-mail or electronic transmission, I caused the document(s) to be sent from e-mail address [mviramontes@sulmeyerlaw.com](mailto:mviramontes@sulmeyerlaw.com) to the persons at the e-mail addresses listed in the Service List. I did not receive, within a reasonable time after the transmission, any electronic message or other indication that the transmission was unsuccessful.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct and that I am employed in the office of a member of the bar of this Court at whose direction the service was made.

Executed on April 15, 2008, at Los Angeles, California.

  
\_\_\_\_\_  
Maria R. Viramontes

SERVICE LIST

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