

**IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE EASTERN DISTRICT OF TENNESSEE  
SOUTHERN DIVISION**

In re	§	
	§	
PROPEX INC.,	§	Case No. 08-10249
PROPEX HOLDINGS INC.,	§	
PROPEX CONCRETE SYSTEMS	§	Case No. 08-10250
CORPORATION,	§	
PROPEX FABRICS INTERNATIONAL	§	Case No. 08-10252
HOLDINGS I INC.,	§	
PROPEX FABRICS INTERNATIONAL	§	Case No. 08-10253
HOLDINGS II INC.,	§	
	§	Case No. 08-10254
Debtors.	§	
	§	
	§	Chapter 11
	§	
	§	Jointly Administered Under
	§	Case No. 08-10249

**RESPONSE OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF  
PROPEX INC., ET AL. TO THE OBJECTIONS OF (I) THE DEBTORS AND (II) BNP  
PARIBAS TO THE MOTION OF THE OFFICIAL COMMITTEE OF UNSECURED  
CREDITORS OF PROPEX INC., ET AL. FOR AN ORDER DIRECTING THE  
PRODUCTION OF DOCUMENTS AND AUTHORIZING THE TAKING OF  
DEPOSITION TESTIMONY PURSUANT TO RULE 2004 OF THE FEDERAL  
RULES OF BANKRUPTCY PROCEDURE**

The Official Committee of Unsecured Creditors (the “Committee”) of Propex Inc. (“Propex”) and its affiliated debtors and debtors in possession (collectively with Propex, the “Debtors”), by and through its undersigned counsel, hereby submits this response (the “Response”) to (I) the Debtors’ objection [Docket No. 545] (the “Debtors’ Objection”) and (II) BNP Paribas’ objection [Docket No. 540] (the “Lenders’ Objection”, and together with the Debtors’ Objection, the “Objection”) to the Committee’s Motion for Entry of an Order Directing the Production of Documents and Authorizing the Taking of Deposition Testimony Pursuant to

Rule 2004 of the Federal Rules of Bankruptcy Procedure [Docket No. 494] (the “2004 Motion”).<sup>1</sup> In support of this Response, the Committee respectfully submits the following:

### **PRELIMINARY STATEMENT**

The core argument in the Objection is that discovery is unnecessary because the DIP Documents, on their face, together with discussion at the Interim DIP Hearing, make clear that the DIP Parties always agreed to pledge 100% of the capital stock of the Debtors’ foreign subsidiaries (the “Putative Foreign Stock Pledge”). The documents produced by the DIP Parties, however, contradict this argument. Based on the limited documents that the Committee has had an opportunity to analyze, the Committee has learned, among other things, the following facts:

- The DIP Parties always intended that the foreign stock pledge be contingent on the tax consequences caused by the pledge.
- In a written memorandum sent by Debtors’ counsel to Lenders’ counsel on February 11, 2008 – two days before the Final DIP Hearing – the Debtors concluded that a pledge of 100% of the foreign stock would cause material adverse tax consequences to the company.
- In the same February 11 memorandum, the Debtors concluded that they were not required under the DIP Documents to pledge 100% of the foreign stock.
- On multiple occasions subsequent to the February 11 memorandum, the Debtors repeated their conclusion to the Lenders that a 100% pledge of the foreign stock would cause material adverse tax consequences to the company.

These and other facts learned from the DIP Parties’ documents (which consist only of documents in the possession of the Debtors’ and Lenders’ counsel) raise significant concerns about the DIP Parties’ conduct and lack of candor with both the Court and the Committee. At a minimum, further discovery is necessary to understand why the DIP Parties failed to disclose the conditional nature of the 100% foreign stock pledge, and why, in midstream, the DIP Parties

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<sup>1</sup> Unless otherwise defined, each capitalized term used in this Response shall have the same meaning ascribed to such term the 2004 Motion.

abandoned the condition, to the detriment of unsecured creditors. That the Debtors and Lenders would object to the Committee's request for additional discovery to further understand how unsecured creditors' rights may have been compromised by the DIP Parties' conduct is troublesome to say the least. Equally troubling is the Debtors' opposition to the Committee's motion for a continuance [Docket No. 531], which together with the timing of the Debtors' motion seeking approval of the Amendment [Docket No. 502] (the "Foreign Pledge Motion"), appear designed to avoid shedding light on the Putative Foreign Stock Pledge and to moot the Committee's 2004 Motion.

The Debtors' assertion that parol evidence (including the evidence described above) is inadmissible on the grounds that the DIP Documents are unambiguous is without merit. As a threshold matter, if the DIP Documents were in fact unambiguous, as the Objection alleges, then the DIP Parties would not have had any need for the Amendment. Furthermore, various provisions in the DIP Documents appear to conflict with one another and, therefore, parol evidence is clearly warranted in order to harmonize these provisions. Specifically, in the absence of parol evidence, the provision in the DIP Credit Agreement pursuant to which the Debtors covenant to pledge 100% of their foreign stock conflicts, not only with Schedule 6 of the DIP Security Agreement, but also with the definition of "Pledged Equity" in the DIP Security Agreement, which expressly carves out any security interest in the stock of the Debtors' foreign subsidiaries that could reasonably be expected to result in a material adverse tax consequence to the Debtors. The limited evidence obtained thus far provides some insight into these issues. Further discovery is necessary to fully develop the record on these points. Accordingly, for the foregoing reasons, and as discussed more fully below, the Committee respectfully requests that the Court grant the 2004 Motion in its entirety.

## ADDITIONAL FACTUAL BACKGROUND

1. The Response hereby cross-references and incorporates the facts set forth in the Committee's objection [Docket No. 543] to the Foreign Pledge Motion.

### RESPONSE

2. As described in detail in the 2004 Motion, it is well established that the scope of a Rule 2004 examination is unfettered and broad. Here, the discovery sought by the Committee falls well within this scope, as it pertains only to the pledge of the Debtors' unencumbered foreign stock, which may possibly constitute the most substantial source of recovery for unsecured creditors in these cases.

#### **I. The Document Productions Underscore The Need for Further Discovery**

3. In their Objection, the Debtors and the Lenders rely heavily on the testimony adduced at the Interim DIP Hearing in contending that, from the outset, the Debtors agreed to pledge 100% of the stock of their foreign subsidiaries. But it is now evident from the DIP Parties' documents that the record at the Interim DIP Hearing, as it pertained to the Putative Foreign Stock Pledge, was not fully developed, and the witness testimony on the issue was vague at best. Nor was the record at the Final DIP Hearing fully developed. The document productions received by the Committee have shown that the DIP Parties agreed to a 100% pledge *but only to the extent* that no material adverse tax consequences would result therefrom. The document productions also show that the Debtors concluded, on multiple occasions, that a 100% pledge would indeed cause material adverse tax consequences. The DIP Parties failed to disclose these facts to the Court and the Committee.

4. Thus, at a minimum, the Committee should be entitled to examine why the DIP Parties failed to make these material disclosures, and why the DIP Parties entered into the

Amendment notwithstanding the material adverse tax consequences. Indeed, since the Amendment first came to light, the Committee has been concerned that, among other things, the DIP Parties surreptitiously entered into the Amendment solely to enhance the collateral package held by the Prepetition Lenders. The document productions have only deepened those concerns, and the Committee should be permitted to pursue Rule 2004 discovery to further examine whether the DIP Parties engaged in improper conduct, which may compromise the rights of the Committee's unsecured creditor constituency and the proper administration of these chapter 11 cases.

5. Moreover, additional discovery, including deposition testimony, relating to the Putative Foreign Stock Pledge is warranted because the DIP Parties have not complied with the Committee's document requests. No documents have been received from the Debtors and Lenders themselves or from their respective financial advisors. Moreover, it appears that the Lenders' counsel may have withheld certain responsive documents that were nonetheless produced by the Debtors' counsel. Additional discovery is thus necessary to corroborate, further explore, and understand the Putative Foreign Stock Pledge.

6. The attempt in the Lenders' Objection to (a) dismiss certain emails reflecting the conditional nature of the Putative Foreign Stock Pledge as misunderstandings "amongst junior lawyers" (even though very senior lawyers were copied on these emails) and (b) downplay the 66% pledge referenced in Schedule 6 of the DIP Security Agreement as merely a drafting error only serves to underscore the necessity for additional discovery regarding the negotiating history and meaning of the DIP Documents. See Lenders' Objection at ¶ 6. Similarly, the Lenders' suggestion that the Debtors' analysis of the tax consequences of the Putative Foreign Stock Pledge simply reflected an opportunity for the Debtors to convince the Lenders to forego the

100% pledge highlights the need for discovery regarding what the DIP Parties actually intended would occur if the Putative Foreign Stock Pledge gave rise to a material adverse tax consequence. See id. at n.4.

## **II. The DIP Documents Are Ambiguous and Justify Further Discovery**

7. Citing Tennessee law, the Debtors contend that the Rule 2004 discovery sought by the Committee will be both irrelevant and result in inadmissible parol evidence because the DIP Documents are unambiguous. See Debtors' Objection at ¶ 15; see also Lenders' Objection at ¶¶ 1-4 (asserting that the DIP Documents are unambiguous). This argument is misplaced.

8. As a threshold matter, the Debtors fail to recognize that that the DIP Documents contain choice of law provisions specifying New York law as the applicable law. See DIP Credit Agreement § 10.15; DIP Security Agreement § 27. Accordingly, New York law should apply to this Court's interpretation of the DIP Documents. See, e.g. Wright v. Rains, 106 S.W.3d 678, 681 (Tenn. Ct. App. 2003) ("Tennessee will honor a choice of law clause if the state whose law is chosen bears a reasonable relation to the transaction and absent a violation of the forum state's public policy.") (citations omitted). But in any event, under both New York and Tennessee law, parol evidence is admissible to clarify the meaning of ambiguous contract terms. See Allstate Ins. Co. v. Watson, 195 S.W.3d 609, 611-612 (Tenn. 2006) (holding that because there was ambiguity in the contract, the intent of the parties should be discerned through parol evidence); Birdwell v. Psimer, 151 S.W.3d 916, 920 (Tenn. Ct. App. 2004) (holding that parol evidence was admissible because "the parol evidence rule does not prevent the introduction and consideration of extraneous evidence to explain an ambiguous contractual provision."); Capital Dist. Enterprises, LLC v. Windsor Development of Albany, Inc., --- N.Y.S.2d ----, 2008 WL 2609351 at \*3 (N.Y. App. Div. 2008) ("Where an ambiguity is found, extrinsic evidence may then be

considered and a determination as to the meaning of the contract rendered by the trier of fact.”); CV Holdings, LLC v. Artisan Advisors, LLC, 835 N.Y.S.2d 778, 779 (N.Y. App. Div. 2007) (holding parol evidence concerning the parties’ intent to be admissible because the relevant contract was ambiguous).

9. Furthermore, the Debtors’ – as well as the Lenders’ – assertion that the DIP Documents are clear on their face is disingenuous. If the DIP Documents were so clear, then the Amendment increasing the foreign stock pledge from 66% to 100% would not have been necessary. The plain language of the provisions in the DIP Documents governing the Putative Foreign Stock Pledge are ambiguous. Specifically, in the absence of parol evidence, section 6.11(A) of the DIP Credit Agreement, pursuant to which the Debtors covenant to pledge 100% of their foreign stock, conflicts with both (a) the definition of “Pledged Equity” in the DIP Security Agreement, which carves out any security interest in the Debtors’ foreign subsidiaries that could reasonably be expected to result in material adverse tax consequences to the Debtors, and (b) Schedule 6, which expressly lists only 66% of the foreign stock as being pledged. See DIP Credit Agreement § 6.11(A); DIP Security Agreement § 31(b), Schedule 6. In the absence of parol evidence, the foregoing provisions do not make any sense.

10. The DIP Parties’ attempt to blame the inconsistency in the DIP Documents on a purported drafting error in Schedule 6 also rings hollow. Even if the Court were to accept that argument, the DIP Parties cannot explain the definition of “Pledged Equity” in the DIP Security Agreement, which operates to carve out the remaining 34% of the Debtors’ foreign stock. Perhaps the DIP Parties will argue that this was a “drafting error” as well.

11. Evidence beyond the four corners of the DIP Documents is thus necessary to harmonize the provisions governing the Putative Foreign Stock Pledge. Indeed, the documents

received by the Committee thus far have begun to provide some insight as to how these provisions can and should be harmonized – namely, that the Debtors agreed to the Putative Foreign Stock Pledge, but subject to the determination that no material adverse tax consequences could reasonably be expected to ensue. Accordingly, the Committee should be permitted to take further discovery pursuant to Rule 2004 of the Bankruptcy Code to resolve these ambiguities in the DIP Documents, to safeguard its unsecured creditor constituency’s rights and to ensure the proper administration of these chapter 11 cases.

12. For all the foregoing reasons, the Committee respectfully requests that the Court grant its motion seeking Rule 2004 discovery in its entirety.

Respectfully submitted this 19<sup>th</sup> day of August 2008.

/s/ Abid Qureshi

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