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

LIMITED OBJECTION OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF PROPEX INC., ET AL. TO THE DEBTORS' EMERGENCY MOTION FOR FINAL ORDER (I) AUTHORIZING THE DEBTORS TO OBTAIN POST-PETITION FINANCING, (II) AUTHORIZING THE DEBTORS TO USE CASH COLLATERAL, (III) GRANTING ADEQUATE PROTECTION TO THE PREPETITION LENDERS AND (IV) MODIFYING THE AUTOMATIC STAY

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") submits this limited objection (the "Limited Objection") to the Debtors' Emergency Motion (the "Motion") for Final Order (I) Authorizing the Debtors to Obtain Post-Petition Financing, (II) Authorizing the Debtors to Use Cash Collateral; (III) Granting Adequate Protection to the Prepetition Lenders; and (IV) Modifying the Automatic Stay. In support of its Limited Objection, the Committee respectfully states as follows:

PRELIMINARY STATEMENT

By the Motion, the Debtors seek entry of a final order (the "Final DIP Order") authorizing the proposed terms of the 2009 DIP Facility,[1] which the Court approved on an interim basis at a hearing on January 28, 2009. At the interim hearing, the Committee supported the Debtors in proceeding with the 2009 DIP Facility rather than a competing DIP facility offered by another potential lender, but nonetheless objected to certain provisions contained in the 2009 DIP Facility. The Committee files this Limited Objection in support of its continued opposition to the following proposed terms of the 2009 DIP Facility: (1) the Debtors' pledge of 100% of the Debtors' foreign stock; (2) the waiver of the Debtors' rights under 506(c) of the Bankruptcy Code; and (3) the inclusion in the Carve-Out of fees payable to the Debtors' Chief Restructuring Officer. At the January 28 Hearing, the Court rejected each of the Committee's foregoing objections principally on the basis that unsecured creditors in these cases are "out of the money", thereby rendering these objections irrelevant and only of concern to the Debtors' secured creditors. The Committee respectfully disagrees. As set forth below, irrespective of where the valuation of the Debtors' assets will prove to be following a market test (which there has yet to be), the Committee has a legitimate basis to object to the foreign stock pledge, the 506(c) waiver, and the terms of the Carve-Out.

BACKGROUND

1. On January 18, 2008 (the "Petition Date"), each of the Debtors filed a voluntary petition for relief under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code") in the United States Bankruptcy Court for the Eastern District of Tennessee, Southern Division (the "Court").

[1] Capitalized terms used but not otherwise defined herein shall have the meaning ascribed to such terms in the Committee's Initial Objection (as defined below).

2. On January 16, 2009, the Debtors filed the Motion for entry of interim and final orders authorizing the Debtors to enter into a debtor in possession financing facility (the "2009 DIP Facility") arranged by Wayzata Investment Partners LLC (the "DIP Lender").

3. On January 21, 2009, the Committee filed an objection (the "Initial Objection") to the Motion. The facts set forth in the Initial Objection are hereby referenced and incorporated.

4. On January 28, 2009 (the "January 28 Hearing"), the Court heard testimony and oral argument on the Motion. At the conclusion of oral argument, the Court rendered its decision from the bench and granted the interim relief requested in the Motion. On January 29, 2009, the Court entered an order (the "Interim DIP Order") authorizing the 2009 DIP Facility on an interim basis and scheduled a final hearing on the 2009 DIP Facility for February 9, 2009.

OBJECTION

I. The Pledge of 100% of the Debtors' Foreign Stock Should Not Be Approved.

5. As set forth in the Committee's Foreign Stock Pledge Objection [Docket No. 543], in order to circumvent the negative tax consequences of Section 956 of the Internal Revenue Code, U.S. companies rarely pledge two-thirds or more of the capital stock of their foreign subsidiaries. See Foreign Stock Pledge Objection, ¶¶ 50-51. Notwithstanding these adverse tax consequences, the 2009 DIP Facility requires the Debtors to pledge 100% of their foreign stock, even though such a pledge may cause the Debtors to incur millions of dollars of additional tax liability. See, e.g., Foreign Stock Pledge Objection, ¶ 50. The Debtors have failed to adduce any evidence that, in light of these adverse tax consequences, it remains a reasonable exercise of their business judgment to pledge 100% of the Debtors' foreign stock under the 2009 DIP Facility.

6. At the January 28 Hearing, the Court suggested that the Committee's objection to the foreign stock pledge is irrelevant because, even if only 66% of the Debtors' foreign stock

were pledged, the Debtors' secured creditors would still be entitled to the remaining 34% of the foreign stock prior to unsecured creditors on account of the secured creditors' superpriority administrative expense claim on the Debtors' collateral. See Transcript of January 28 Hearing (hereinafter, "Jan. 28 Hr'g Tr.") 18:1-19:18. The Committee acknowledges that while the Court's analysis may apply to the Debtors' postpetition secured lenders, it does not apply to the Debtors' ***prepetition*** secured lenders who, by contrast, are not entitled to any recovery on their superpriority administrative expense claim unless and until they demonstrate that there has been a diminution in the value of their collateral during the pendency of these chapter 11 cases. See Interim DIP Order, § 14. Until such a showing is made (and the prepetition secured lenders prove that such a claim attaches to the unencumbered foreign stock), the remaining 34% of the Debtors' foreign stock remains unencumbered and available to satisfy the claims of unsecured creditors. Accordingly, the Committee has a very direct and sound legal basis for objecting to the foreign stock pledge, notwithstanding the Debtors' untested assertion that unsecured creditors are "out of the money."

II. The Section 506(c) Waiver is Inappropriate and Prejudices Unsecured Creditors.

7. As argued in the Committee's Initial Objection and incorporated herein by reference, the Debtors should not be forced to waive their rights under section 506(c) of the Bankruptcy Code. See In re Willingham Investments, Inc., 203 B.R. 75, 78 (Bankr. M.D. Tenn. 1996) (holding that the "equities of the case" provision of section 506(c) "dictate[s] that [the lender] be prohibited from obtaining priority over the claims of postpetition creditors for funds expended to improve [lender's] position"); In re Brown Bros., Inc., 136 B.R. 470, 474 (W.D. Mich. 1991) (holding cash collateral order to be unenforceable to the extent its provisions attempted "to immunize [lender] . . . from surcharge payment obligations under 11 U.S.C. § 506(c). Such a provision is not enforceable in light of the congressional mandate that a trustee

have the authority to use a portion of secured collateral for its preservation or proper disposal.").

8. At the January 28 Hearing, the Court stated that Committee does not have a basis to contest the section 506(c) waiver required under the 2009 DIP Facility to the extent that unsecured creditors are out of the money. See Jan. 28 Hr'g Tr. 15:16-16:9. The Committee respectfully disagrees, with the support of prevailing case law.[2] Courts, including those within the Sixth Circuit, have indicated that section 506(c) surcharges are permissible even when a debtor's reorganization efforts were unsuccessful and/or unsecured creditors may have been out of the money. See, e.g., In re U.S. Flow Corp., 332 B.R. 792, 797 n.13 (Bankr. W.D. Mich. 2005) ("Without question, the bankruptcy estate is administratively insolvent . . . . The court recognizes that other creditors, through the efforts of the trustee, might receive the benefit of a surcharge of the Secured Creditors' collateral pursuant to 11 U.S.C. § 506(c). Further, if the trustee is successful in surcharging a secured creditor's collateral, it has long been held in this district that the recovery shall benefit all creditors of the estate and not only the aggrieved creditor which provided goods or services that benefited the secured creditor.") (citations omitted); In re Resource Technology Corp., 356 B.R. 435, 446 (Bankr. N.D. Ill. 2006) (holding that the estate, and not an individual claimant, owns all section 506(c) surcharges because the "plain meaning application of § 506(c) – recovery payable only to the estate – is particularly compelling where, as here, the estate is administratively insolvent and the trustee or the trustee's attorneys contend that they provided services generating the right to a § 506(c) surcharge").[3]

9. The section 506(c) waiver is especially inappropriate here, where the DIP Lender

[2] This argument is also not supported by the facts. Although parties have made bald assertions that unsecured creditors in these chapter 11 cases are out of the money, the fact remains that no party has to date brought conclusive evidence that unsecured creditors are out of the money and, indeed, there cannot be any finding on this issue until, at a minimum, the Debtors' assets have been marketed and sold. Until such time, the Court should reserve judgment on whether unsecured creditors are out of the money.

[3] If the Court is unwilling to strike the section 506(c) waiver, the Committee should be vested with standing in the Final DIP Order to seek a surcharge against collateral if the facts ultimately prove that a section 506(c) surcharge is appropriate.

is seeking to acquire the Debtors' assets by forcing a quick sale – a fact which the DIP Lender conceded at the January 28 Hearing. Thus, because the DIP Lender is utilizing the chapter 11 process solely to maintain and preserve its own collateral for solely its own benefit, it would be highly inequitable to make the Debtors' estates bear the administrative expenses of liquidating the DIP Lenders' collateral, especially under the circumstances here, where there may not be any way to pay such administrative costs absent a section 506(c) surcharge.

III. The Carve-Out Should Not Include Any "Success" Fee Payable to the Debtors' Chief Restructuring Officer.

10. The Carve-Out provided under the 2009 DIP Facility may be used to pay "the allowed fees and expenses of the respective retained professionals of the Debtors and the Creditors' Committee and the Debtors' Chief Restructuring Officer (the "CRO")." Interim DIP Order, § 8(b). As the Court is well aware, the foregoing language includes the $1 million "success" fee (the "CRO Success Fee") that may be payable to the CRO at the conclusion of these chapter 11 cases. The CRO Success Fee, however, should not be included in the Carve-Out for the following reasons: First, the inclusion of the CRO Success Fee increases the risk that administrative claims will not be paid in full at the end of these chapter 11 cases. Indeed, the Debtors have conceded that the Carve-Out, even as it is currently structured, may not be sufficient to ensure that administrative claims are paid in full.[4] Second, the fees of the CRO, including, the CRO Success Fee, are not subject to any holdback or final approval of the Court. Accordingly, it is unfair and inappropriate to lump the CRO Success Fee together with the fees

[4] See Jan. 28 Hr'g Tr. 32:10-32:15. ("***We're not sure the $4.2 million carve-out will cover everything.*** We think there's a good chance that it will, but that number was a heavily negotiated number because ***we did not want to leave unpaid administrative expenses at the time of the sale at the end of the two-month period***. And you see, as you move toward the two-month period, a significant amount of work is going to be done not only by the Debtors' professionals, but by the Creditors' Committee professionals in overseeing what is being done and there are going to be fees incurred to accomplish a transfer of the company on a going concern to whoever the ultimate bidder is and once that sale occurs ***you don't want to leave a bunch of unpaid administrative expenses for either a liquidating trustee or a Chapter 7 trustee to, to be burdened by***.") (emphasis added).

and expenses of other Court-appointed professionals, whose fees and expenses are subject to holdback and final approval of the Court. Third, the CRO Success Fee was not included in the 2008 DIP Facility and, thus, including the CRO Success Fee in 2009 DIP Facility is simply a wrongful grab by the Debtors to enrich their own professionals to the detriment of other creditors.

11. At the January 28 Hearing, the Court indicated that the foregoing arguments are without merit for substantially the same reasons that the Court dismissed the Committee's arguments concerning the section 506(c) waiver – i.e., the Carve-Out should be of no concern to the Committee because unsecured creditors are out of the money. See Jan. 28 Hr'g Tr. 15:16-16:9. Whether or not unsecured creditors prove to be out of the money following a market test of the Debtors' value, however, the Committee has a valid basis to object to inclusion of the CRO Success Fee in the Carve-Out. As the Debtors have acknowledged, it is in the interest of their estates that all administrative expenses, including those incurred by the Committee, are satisfied at the time of the sale of the Debtors' assets. See supra n.4. Inclusion of the CRO Success Fee in the Carve-Out, however, increases the risk to the Debtors' estates that administrative expenses will not paid in full. Moreover, the Debtors have failed to articulate any justification for why their contractual commitment to pay the CRO Success Fee should be protected by the Carve-Out. Indeed, the inclusion of the CRO Success Fee runs contrary to the very logic behind the existence of the Carve-Out in the first place. This provision was surely not a requirement of the DIP Lender, and instead represents an attempt by the Debtors to overreach that should not be approved.

CONCLUSION

For the foregoing reasons, the Committee respectfully requests that the Court: (i) condition the relief requested in the Motion by modifying the Final DIP Order to reflect the changes set forth above and/or (ii) grant such other relief as the Court deems just, proper and equitable.

Respectfully submitted this 5th day of February 2009.

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