IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	:	Chapter 11
VALERITAS HOLDINGS, INC., *et al.*,[1]	:	Case No. 20-10290 (LSS)
Debtors.	:	(Jointly Administered)
	:	**Re: D.I. 16, 17, 66, 120**

REPLY OF THE DEBTORS TO THE OBJECTION OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS TO POSTPETITION FINANCING AND RELATED RELIEF

Valeritas Holdings, Inc. and its affiliated debtors and debtors in possession (collectively, the "Debtors"), by and through their proposed undersigned counsel, DLA Piper LLP (US), hereby submit this reply (the "Reply") in support of the postpetition financing motion (the "Motion")[2] and in response to the objection (the "Objection")[3] filed by the Official Committee of Unsecured

[1] The debtors in these chapter 11 cases, along with the last four digits of each debtor's federal tax identification number, are: Valeritas Holdings, Inc. (8907); Valeritas, Inc. (1056); Valeritas Security Corporation (9654); Valeritas US, LLC (0007). The corporate headquarters and the mailing address for the debtors is 750 Route 202 South, Suite 600, Bridgewater, New Jersey 08807.

[2] *Motion of Debtors for Entry of Interim and Final Orders (I) Authorizing the Debtors to Obtain Senior Secured Superpriority Postpetition Financing; (II) Granting (A) Liens and Superpriority Administrative Expense Claims and (B) Adequate Protection to Certain Prepetition Lenders; (III) Authorizing the Use of Cash Collateral; (IV) Modifying the Automatic Stay; (V) Scheduling a Final Hearing; and (VI) Granting Related Relief* [D.I. 16]. Capitalized terms used but not otherwise defined in this Reply shall have the meaning ascribed to them in the Motion. In support of the Motion, the Debtors relied upon the First Day Declaration and also submitted the *Declaration of Brendan J. Murphy in Support of Debtors' Motion to Obtain Senior Secured Superpriority Financing and Related Relief* [D.I. 17] (the "Murphy Declaration") and proffered the testimony of Peter Gnatowski of Lincoln International at the first day hearing on February 12, 2020 (the "Gnatowski Testimony," and together with the First Day Declaration and the Murphy Declaration, which comprise the existing evidentiary record, the "Evidentiary Record").

[3] *Objection of the Official Committee of Unsecured Creditors to Motion of Debtors for Entry of Interim and Final Orders (I) Authorizing the Debtors to Obtain Senior Secured Superpriority Postpetition Financing; (II) Granting (A) Liens and Superpriority Administrative Expense Claims and (B) Adequate Protection to Certain Prepetition Lenders; (III) Authorizing the Use of Cash Collateral; (IV) Modifying the Automatic Stay; (V) Scheduling a Final Hearing; and (VI) Granting Related Relief* [D.I. 120].

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Creditors (the "Committee"). In further support of the Motion and this Reply, the Debtors respectfully state as follows:

PRELIMINARY STATEMENT

In the Objection, the Committee does not contend that the DIP Facility is unnecessary but rather asserts, without evidence, let alone an offer in hand, that "other financiers may be more willing to support the Debtors' restructuring" on "considerably better" terms. Objection, ¶ 8. The Objection then complains of several of the DIP Facility's provisions.[4] Some of these complaints are throwaway objections to routine postpetition financing provisions that ignore the particular circumstances of the DIP Facility—that the DIP Lender is providing new money to Debtors that own limited hard assets and have a fully levered capital structure, and therefore required certain waivers from the Debtors as a necessary precondition to extending postpetition credit. Other objections completely ignore the Debtors' dire prepetition financial condition, the robust prepetition marketing and negotiation process that culminated in the DIP Facility, the Debtors' alternatives for postpetition financing as of the Petition Date (which have been provided to the Committee),[5] and the fact that the Debtors have not received any proposals following the Petition Date from any party offering to provide alternative debtor-in-possession financing. In short, the Committee is seeking to deprive the Debtors of critical postpetition financing based on some hypothetical alternative lender who has yet to materialize. The Court should not entertain an

[4] Several of the Committee's objections, including those that relate to adequate protection to the Prepetition Secured Parties, have already been resolved by agreements among parties in interest. These agreements are not addressed in this Reply but will be the subject of a forthcoming amended settlement motion under rule 9019 of the Federal Rules of Bankruptcy Procedure.

[5] The Debtors have put forth evidence that their alternatives for DIP financing as of the Petition Date did not provide the full amount of financing required and thereby would have forced the Debtors back into the market to find supplemental DIP financing, which would entail further priming discussions with the Prepetition Secured Lenders and/or exorbitant fees and costs.

objection based solely on the Committee's hopes that, if granted, would devastate the Debtors' restructuring.

As discussed in the Motion and established by the Evidentiary Record, Lincoln International ("Lincoln"), the Debtors' proposed investment banker, first sought to obtain debtor-in-possession financing from the Debtors' existing lenders and the Stalking Horse Bidder, but those parties were unwilling to extend postpetition credit on any basis. Lincoln then aggressively canvassed the market and approached 50 potential outside lenders to provide a new-money debtor-in-possession financing facility to a company with a fully levered capital structure and very few hard assets. Extensive diligence and negotiations with several potential lenders followed, and these efforts culminated in the DIP Facility. The terms of the DIP Facility reflect the challenging circumstances and limited timeframe in which the Debtors sought to obtain postpetition financing and are the most favorable financing terms that the Debtors were able to obtain under the circumstances. The Debtors believe that the terms of the DIP Facility are fair and reasonable under the circumstances and, accordingly, the Objection should be overruled in its entirety and the Motion granted on a final basis.

REPLY

A. The DIP Facility Is the Best Source of Funding Available Under the Circumstances and Its Terms Are the Product of Extensive, Arm's-Length Negotiations.

1. The Committee argues, without any support, that the DIP Facility may not be the best source of financing available. The Committee simply speculates—again, without any evidence—that better financing may be available now that the Debtors' lot release testing data has demonstrated that the manufacturing yield issue has been ameliorated. The Committee's vague

and unsubstantiated statements are not grounded in reality and provide no basis for denying the Motion.

2. The Committee also raises various objections regarding the DIP Facility's terms, including its interest rates and fees. These objections fail to account for the fact that the DIP Facility arose out of dire liquidity needs under challenging circumstances and was the product of extensive marketing, diligence, and negotiations with a multitude of potential financing sources, as well as good faith, arm's-length negotiations with the DIP Lender.

3. As noted in the Motion, the Debtors recognized that it would be difficult to secure postpetition financing due to the limited timeframe available, the quantum and location of collateral, funding needs, certain conditions under the stalking horse asset purchase agreement, and because substantially all of the Debtors' assets are encumbered by existing liens under their prepetition debt. In addition, the prepetition lenders were unwilling to consent to a "priming" DIP facility by a third party absent the terms of the CRG Settlement, and the Debtors were concerned that a priming fight with their prepetition lenders likely would have derailed their efforts to sell their business as a going concern.

4. Against that backdrop, Lincoln ran an aggressive prepetition marketing process that involved initial outreach to 50 potential outside lenders, which resulted in the execution of 20 nondisclosure agreements and five subsequent financing proposals. Of these five proposals, Lincoln recommended further discussions with two potential lenders.[6] Following further diligence and negotiations, the Debtors and DIP Lender reached the terms reflected in the DIP Facility. As the Court aptly noted at the first day hearing, "I will say it's not cheap financing, but it's been

[6] Nor must the Committee take the Debtors' word for it—the Debtors have provided the Committee with these alternative financing proposals.

market tested and this is what's available." *See* Feb. 12, 2020 Hr'g Tr., 61:1-2. The Debtors respectfully submit that nothing in the Objection should cause the Court to deviate from its prior conclusion, and the Motion should be approved on a final basis.

B. The Debtors Appropriately Pledged Avoidance Actions as DIP Collateral.

5. The Committee further objects to the pledge of avoidance actions as DIP Collateral under the DIP Facility and argues, incorrectly, that avoidance actions "cannot be pledged to the DIP Lender." Objection, ¶ 19.

6. Contrary to the Committee's Objection, a debtor may pledge its unencumbered assets, including avoidance actions and any related proceeds, to secure postpetition financing. *See, e.g.*, 11 U.S.C. § 364(c)(2) (authorizing a debtor to obtain credit "secured by a lien on property of the estate that it not otherwise subject to a lien" when unsecured credit is unavailable). The Debtors accepted the best financing terms available under the circumstances (as the Committee can see for itself, having been provided with the alternative proposals) and the provision of specific forms of DIP Collateral was negotiated and ultimately required by the DIP Lender as a condition of extending credit. This pledge of avoidance actions as collateral is particularly appropriate in the Chapter 11 Cases, where the Debtors have few hard assets, and the value of their assets lies in the going concern value of the Debtors' business.

7. Courts in this District routinely grant liens over unencumbered property, including proceeds of avoidance actions, when entering financing orders. *See, e.g., In re Destination Maternity Corp.*, Case No. 19-12256 (BLS) (Bankr. D. Del. Nov. 22, 2019), ECF No. 306; *In re Bayou Steel BD Holdings, L.L.C.*, Case No. 19-12153 (KBO) (Bankr. D. Del. Nov. 13, 2019), ECF No. 241; *In re Avenue Stores, LLC, et al.*, Case No. 19-11882 (LSS) (Bankr. D. Del. Sept. 13, 2019), ECF No. 223; *In re Blackhawk Mining LLC, et al.*, Case No. 19-11595 (LSS) (Bankr. D.

Del. Aug. 13, 2019), ECF No. 185; *In re Fuse, LLC*, Case No. 19-10872 (KG) (Bankr. D. Del. June 18, 2019), ECF No. 250; *In re Triangle Petroleum Corp.*, Case No. 19-11025 (MFW) (Bankr. D. Del. June 10, 2019), ECF No. 61.

C. The Waivers of Rights Under Sections 506(c) and 552(b) and the Marshaling Doctrine Are Appropriate.

8. The Committee also raises several objections to the waivers of (i) the right to surcharge for the costs and expenses associated with the preservation and disposition of collateral under section 506(c); (ii) the power of the Court to prevent prepetition liens from extending to postpetition proceeds of collateral under section 552(b); and (iii) the marshaling doctrine. These waivers are customary and appropriate in postpetition financing arrangements and are especially appropriate here, where the Debtors have few hard assets and a third-party DIP lender is providing new money with these waivers as a necessary precondition to extending postpetition credit. Accordingly, none of these arguments provides any basis for denying the relief sought in the Motion.

a. The 506(c) Waiver Is Appropriate.

9. Section 506(c) of the Bankruptcy Code allows a debtor to "recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property." Such claims are an asset of the debtor and are not available to any creditor or other party in interest. *See Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000 ("[T]he trustee is the only party empowered to invoke [section 506(c)]."). The decision to grant a section 506(c) waiver thus belongs to the debtor. Accordingly, it was entirely appropriate for the Debtors to grant a section 506(c) waiver in exchange for valuable

consideration as was done here, in exchange for access to the new-money DIP Facility in the full amount needed to get to closing of a sale.

10. Furthermore, the primary rationale for section 506(c) is to allow for a surcharge of secured creditors' collateral to the extent that unencumbered assets are used during the cases for the secured creditors' benefit. *See, e.g., C.S. Assocs. v. Miller*, 29 F.3d 903, 907 (3d Cir. 1994) ("Courts have narrowly construed § 506(c) to encompass only those expenses that are specifically incurred for the express purpose of ensuring that the property is preserved and disposed of in a manner that provides the secured creditor with a maximum return on the debt and also apportions those costs to the secured creditor who, realistically, is assuming the asset.") (citation omitted). This rationale is not applicable here, where the Debtors are using the proceeds of the DIP Facility to operate their business and fund the Chapter 11 Cases through to a sale that will generate value for all parties in interest.

11. These types of waivers are common in financings between sophisticated parties, particularly where a third-party DIP lender is providing new money, and courts in this District have frequently approved section 506(c) waivers in final DIP financing orders. *See, e.g., In re BL Rests. Holding LLC, et al.*, Case No. 20-10156 (MFW) (Bankr. D. Del. March 2, 2020), ECF No. 233; *In re Grabit, Inc.*, Case No. 19-12703 (LSS) (Bankr. D. Del. Jan. 21, 2020), ECF No. 78; *In re Vector Launch Inc., et al.*, Case No. 19-12670 (JTD) (Bankr. D. Del. Jan. 15, 2020), ECF No. 84; *In re Arsenal Res. Dev. LLC, et al.*, Case No. 19-12347 (BLS) (Bankr. D. Del. Dec. 3, 2019), ECF No. 162; *In re GCX Ltd., et al.*, Case No. 19-12031 (CSS) (Bankr. D. Del. Oct. 15, 2019), ECF No. 107; *In re Blackhawk Mining LLC, et al.*, Case No. 19-11595 (LSS) (Bankr. D. Del. Aug. 13, 2019), ECF No. 185.

b. The 552(b) Waiver Is Appropriate.

12. The Committee further objects to the waiver of the "equities of the case" exception under section 552(b) of the Bankruptcy Code. Section 552(b) provides that if the debtor entered into a prepetition security agreement and the security agreement extends to property acquired prepetition and to proceeds of such property, the security agreement also extends to postpetition proceeds of such property as provided under nonbankruptcy law unless the court orders otherwise "based on the equities of the case." Section 552(b) is not relevant to DIP Lenders, as it relates to prepetition security agreements.

13. Like the section 506(c) waiver, the section 552(b) waiver was negotiated in good faith and at arm's length by the Debtors and the DIP Lender and is common in postpetition financing arrangements, particularly where a third-party DIP lender is providing new money. Courts in this District frequently have approved waivers of rights under section 552(b). *See, e.g.*, *In re BL Rests. Holding LLC, et al.*, Case No. 20-10156 (MFW) (Bankr. D. Del. March 2, 2020), ECF No. 233; *In re Grabit, Inc.*, Case No. 19-12703 (LSS) (Bankr. D. Del. Jan. 21, 2020), ECF No. 78; *In re Vector Launch Inc., et al.*, Case No. 19-12670 (JTD) (Bankr. D. Del. Jan. 15, 2020), ECF No. 84; *In re Arsenal Res. Dev. LLC, et al.*, Case No. 19-12347 (BLS) (Bankr. D. Del. Dec. 3, 2019), ECF No. 162; *In re GCX Ltd., et al.*, Case No. 19-12031 (CSS) (Bankr. D. Del. Oct. 15, 2019), ECF No. 107; *In re Blackhawk Mining LLC, et al.*, Case No. 19-11595 (LSS) (Bankr. D. Del. Aug. 13, 2019), ECF No. 185.

c. Waiver of the Marshaling Doctrine Is Appropriate.

14. The Committee states that "the DIP Lender and Debtors have provided no basis for curtailing the Court's power to marshal assets." Objection, ¶ 35. However, "unsecured creditors cannot invoke the equitable doctrine of marshalling," which is a remedy available to

secured creditors. *In re Advanced Mktg. Servs., Inc*., 360 B.R. 421, 429 n.8 (Bankr. D. Del. 2007) (holding that unsecured creditors could not direct secured lenders to satisfy their claim using different collateral).

15. The marshaling waiver was a negotiated aspect of the DIP Facility, and such waivers are customary in debtor in possession financing arrangements. Courts in this District often have approved similar waivers. *See e.g*., *In re BL Rests. Holding LLC, et al.*, Case No. 20-10156 (MFW) (Bankr. D. Del. March 2, 2020), ECF No. 233; *In re Grabit, Inc.*, Case No. 19-12703 (LSS) (Bankr. D. Del. Jan. 21, 2020), ECF No. 78; *In re Vector Launch Inc., et al.*, Case No. 19-12670 (JTD) (Bankr. D. Del. Jan. 15, 2020), ECF No. 84; *In re Arsenal Res. Dev. LLC, et al.*, Case No. 19-12347 (BLS) (Bankr. D. Del. Dec. 3, 2019), ECF No. 162; *In re GCX Ltd., et al.*, Case No. 19-12031 (CSS) (Bankr. D. Del. Oct. 15, 2019), ECF No. 107; *In re Blackhawk Mining LLC, et al.*, Case No. 19-11595 (LSS) (Bankr. D. Del. Aug. 13, 2019), ECF No. 185.

D. The Committee's Remaining Objections

16. The Committee also objects to various other provisions of the DIP Facility, which is summarized below, along with the Debtors' responses:

a. The Committee should receive simultaneous copies of financial forecasts delivered to the DIP Lender, including copies of Budgets and Variance Reports.

- The Debtors are amenable to providing this information (but, where the Debtors deem necessary, on an advisors'-eyes-only basis in order to protect confidential and sensitive business information).

b. The Committee should receive reports or other pertinent documents provided to the DIP Lender or CRG relating to the chapter 11 process.

- Same response as above.

c. The Final Order should provide for the use of Cash Collateral during the Remedies Notice Period.

- The DIP Lender is not willing to permit the Debtors to use Cash Collateral following the purported termination of the DIP Facility, particularly since if the DIP Facility were terminated, the DIP Lender would only pay the items essential to the liquidation of the DIP Collateral to satisfy the DIP Obligations.

d. The Final Order should not contain limitations on the use of DIP Proceeds or any Carve-Out restrictions on funding challenges to the DIP Obligations.

- The DIP Lender, like all DIP lenders, is unwilling to fund litigation against itself. It is unreasonable to expect that any DIP Lender would agree to this provision.

e. The Final Order should confer automatic standing on the Committee to bring any timely filed Challenges or, alternatively, provide that if a Challenge would require that the Court grant the Committee derivative standing, such Challenge or adversary proceeding will be deemed timely filed and relate back to a derivative standing motion that is filed before the expiration of the Challenge Period.

- The Debtors object to granting any party the automatic standing to bring claims owned by the Debtors, particularly claims for which the facts are unknown or unsubstantiated.

RESERVATION OF RIGHTS

17. The Debtors reserve the right to supplement this Reply at any time prior to, or orally at, the hearing and to raise new or additional arguments with respect to the Objection.

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WHEREFORE, for the foregoing reasons, the Debtors respectfully request that the Court (i) overrule the Committee's Objection, (ii) grant the Motion and enter the Final Order, and (iii) grant such further relief as the Court deems just and proper.

Dated: March 9, 2020
Wilmington, Delaware

Respectfully submitted,

DLA PIPER LLP (US)

/s/ Maris. J. Kandestin

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