Docket #0889 Date Filed: 09/10/2020

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	:	Chapter 11
	:	
EMERGE ENERGY SERVICES LP, *et al.*,[1]	:	Case No. 19-11563 (KBO)
	:	
	:	(Jointly Administered)
Debtors.	:	
----------		**Obj. Deadline: September 10, 2020 @ 4:00 p.m.**

RESPONSE OF MIDWEST FRAC AND SANDS LLC TO REORGANIZED DEBTORS' FIRST (SUBSTANTIVE) OMNIBUS OBJECTION TO, OR MOTION TO RECLASSIFY, PURPORTED SECURED CLAIMS

Pursuant to 11 U.S.C. §§ 502(b) and 506(a) and Fed. R. Bankr. P. 3007 and Local Bankruptcy Rule 3007-1, Midwest Frac and Sands, LLC ("Midwest Frac"), a creditor in this case, through its undersigned counsel, file this response (the "Response") to the *Reorganized Debtors' First (Substantive) Omnibus Objection to, or Motion to Reclassify, Purported Secured Claims* (the "Omnibus Objection") [Doc. No. 876]. In support of its Response, Midwest Frac asserts as follows:

PRELIMINARY STATEMENT

The Debtors engage in the mining of silica sand. They have facilities in Wisconsin, Texas, and Oklahoma. Midwest Frac holds repurchase rights under an agreement relating to one of the Debtors' facilities in Wisconsin. Throughout this case, Midwest Frac has asserted that its interests are superior to those of the Debtors'. Midwest Frac previously filed an adversary proceeding in which it requested a determination under 11 U.S.C. § 506(a) as to the extent and priority of its liens. Those issues have routinely been reserved for later determination. In their Omnibus

[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are: Emerge Energy Services LP (2937), Emerge Energy Services GP LLC (4683), Emerge Energy Services Operating LLC (2511), Superior Silica Sands LLC (9889), and Emerge Energy Services Finance Corporation (9875). The Debtors' address is: 5600 Clearfork Main Street, Suite 400, Fort Worth, Texas 76109.

Objection, the Debtors now argue that Midwest Frac does not hold a valid interest in real property and its claim should be classified as an unsecured claim.

BACKGROUND

1. The above-captioned debtors (collectively, the "Debtors"), including Superior Silica Sands, LLC ("Superior"), each filed for relief under Chapter 11 of Title 11 of the United States Code, 11 U.S.C. §§ 101-1532 (the "Bankruptcy Code") on July 15, 2019 (the "Petition Date").

2. The Debtors, through the operations of Superior, engage in the mining, processing, and distribution of silica sand for use in hydraulic fracturing (or "fracking") of oil and gas wells. Superior has silica mining facilities in Wisconsin, Texas, and Oklahoma.

3. In 2014, Midwest Frac sold a facility located in Barron County, Wisconsin, to Superior. Under the terms of that purchase agreement, Superior is entitled to repurchase the property from Superior in the event of certain defaults. Those defaults occurred and prior to the Petition Date Midwest Frac sued Superior to enforce the purchase agreement.

4. Midwest Frac filed a timely proof of claim in this case. As reflected in its claim, Midwest Frac is owed $5,346,220.88 by Superior as a result of Superior's breach of its obligations under the purchase contract. Due to Superior's breach, Midwest Frac is entitled to purchase the real estate which was the subject of that contract for the sum of $1,000.00 per acre.

PROCEDURAL HISTORY OF THE CASE

5. On the Petition Date, the Debtors filed a variety of so-called "First-Day Motions," including a *Motion (I) Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, and 364 Authorizing the Debtors to (A) Obtain Senior Secured Priming Superpriority Postpetition Financing, (B) Grant Liens and Superpriority Administrative Expense Status, (C) Use Cash Collateral of Prepetition*

Secured Parties, and (D) Grant Adequate Protection to Prepetition Secured Parties; (II) Scheduling a Final Hearing Pursuant to Bankruptcy Rules 4001(b) and 4001(c); and (III) Granting Related Relief [Doc. No. 20] (the "Financing Motion").

6. In the Financing Motion, Superior and the other Debtors asserted that they were parties to certain first and second lien obligations with HPS Investment Partners LLC as administrative and collateral agent on behalf of the "First Lien Prepetition Lenders" and the "Second Lien Prepetition Noteholders." Financing Motion, ¶ 5.

7. In the Financing Motion, Superior and the other Debtors (except for Emerge Energy Services GP LLC and Emerge Energy Services Finance Corporation) asserted they owed the First Lien Prepetition Lenders "not less than $66,710,000, plus accrued and unpaid interest and fees with respect thereto." *Id.*

8. In the Financing Motion, Superior and the other Debtors (except for Emerge Energy Services GP LLC and Emerge Energy Services Finance Corporation) asserted they owed the Second Lien Prepetition Noteholders "not less than $215,755,307, plus accrued and unpaid interest and fees with respect thereto." *Id.*

9. In the Financing Motion, Superior and the other Debtors asserted that the First Lien Prepetition Lenders and the Second Lien Prepetition Noteholders (collectively, the "Pre-petition Lenders") were secured creditors holding liens on the "Pre-petition Collateral" identified in the respective loan documents. Financing Motion, ¶ 6.

10. In the Financing Motion, the Debtors asserted that the Pre-petition Collateral "comprises **substantially all** of the Debtors' assets." Financing Motion, ¶ 7. [Emphasis added].

11. In the Financing Motion, the Debtors sought approval of debtor-in-possession financing from the Pre-petition Lenders who would, as to the post-petition loans, be identified as the DIP Lenders.

12. The final order granting the Financing Motion and approving the DIP financing agreement (Doc. No. 209, the "Final DIP Order") provided that HPS, on behalf of the DIP Lenders, would receive junior liens on any collateral that was subject to "valid, perfected and unavoidable liens senior to the Prepetition Liens in existence immediately prior to the Petition Date." Final DIP Order, ¶ 13(a)(iii).

13. The "DIP Financing Agreement," as approved, recognizes the possible existence of "Prior Permitted Liens" which would include certain valid, perfected, and unavoidable liens in favor of third parties. See § 7.2 of the DIP Financing Agreement attached to the Final DIP Order; and definitions of "Permitted Encumbrances" and "Prior Permitted Liens" contained therein at Section 1.2, pp. 23 and 26.

14. Under the Final DIP Order, the Debtors' stipulations as to the validity and priority of the liens of the Pre-petition Lenders were not binding upon other parties for a period of 75 days after entry of the order approving DIP financing (the "Challenge Period") so as to permit certain so called "Challenges" to be lodged. These Challenges were to include objections to the stipulated valuation of assets as well as issues of lien priority. Final DIP Order, ¶ 26.

15. Under the Final DIP Order, the Debtors' stipulations as to the validity and priority of Pre-petition Liens in the Pre-petition Collateral were subject to Challenge if brought within the Challenge Period; otherwise, the stipulations became binding on third parties.

16. The Final DIP Order was entered on August 14, 2019. The Challenge Period therefore expired on October 28, 2019.

17. On October 28, 2019, prior to the expiration of the Challenge Period, Midwest Frac filed an adversary complaint (the "Midwest Frac Complaint") in the adversary proceeding styled *Midwest Frac and Sand LLC, v. Superior Silica Sands LLC and HPS Investment Partners LLC*, Adv. No. 19-50728. In the Midwest Frac Complaint, Midwest Frac sought a determination of the extent and priority of its interest in the Barron County facility. A copy of the Midwest Frac Complaint is docketed at Adv. Pro. No. 19-50728 [D.I. 1] and all allegations of that complaint are expressly re-alleged and incorporated into this Response.[2]

18. The Debtors' Second Amended Joint Plan of Reorganization [Doc. No. 682, the "Confirmed Plan"] defines a "Secured Claim" as a claim that is "secured by a Lien on property in which any of the Debtors' Estates have an interest or that is subject to setoff under section 553 of the Bankruptcy Code, *to the extent of the value of the Claim holder's interest in such Estate's interest in such property* or to the extent of the amount subject to setoff, as applicable, *as determined pursuant to section 506(a) of the Bankruptcy Code* or, in the case of setoff, pursuant to section 553 of the Bankruptcy Code." (Emphasis added). *See* Second Amended Joint Plan of Reorganization, Doc. No. 682, at 17.

19. The Confirmed Plan defines "Other Secured Claim" as "*any* Secured Claim other than an Administrative Claim, DIP Credit Agreement Claim, Secured Tax Claim, or Prepetition Debt Claim." *Id*. at 13.

20. In the Confirmed Plan, Other Secured Claims were classified as "Class 2." *Id*., at Art. III.B.2.

21. The Confirmed Plan provides that each holder of an allowed Class 2 Claim shall receive, at the "election" of the Debtors or Reorganized Debtors:

[2] The parties had agreed to postpone the adversary proceedings pending their efforts at mediation. Mediation ultimately occurred on July 22, 2020 and was unsuccessful.

> (A) *Cash equal to the amount of such Allowed Class 2 Claim*; (B) such other less favorable treatment as to which the Debtors or Reorganized Debtors, as applicable, and the Holder of such Allowed Class 2 Claim shall have agreed in writing; (C) *the Collateral securing such Allowed Class 2 Claim*; or (D) such other treatment such that it will not be impaired pursuant to section 1124 of the Bankruptcy Code. . . . For the avoidance of doubt, any Lien that secures a Class 2 Claim shall be retained against the applicable Collateral until such Class 2 Claim is paid or reserved in full in Cash or *Disallowed* by order of the Bankruptcy Court.

Id. (emphasis added).

22. Midwest Frac holds an interest in the Barron County facility as provided in the purchase agreement with Superior – i.e., the right (or option) to repurchase the property on set terms in the event of a default in payment.

BASIS FOR RESPONSE

23. In their Omnibus Objection, the Debtors argue that there is no authority (or that they have been unable to locate any such authority) to suggest this repurchase right constitutes an interest in real property at all. However, Wisconsin courts have recognized that an option to purchase real estate is an "interest in lands" within the meaning of statutory provisions governing real estate conveyances (most specifically, the statute of frauds). *Clear View Estates, Inc. v. Veitch*, 67 Wis.2d 372, 227 N.W.2d 84, 90 (Wis. 1975). Indeed, the statute cited in *Veitch* remains valid and unaltered: under Wis. Stat. § 706.01, in the context of a conveyance of real estate the term "grantor" means the person from whom an interest in lands passes by conveyance, including, without limitation, "optionors." Under the purchase agreement, Superior provided Midwest Frac with a repurchase option; this is an interest in lands under Wisconsin law.

24. The Debtors then assert that even if this option right is an interest in real property, Midwest Frac's failure to record something of record means that there is no constructive notice to third parties and the interest is therefore not secured. However, under Wisconsin law a third party

purchaser has constructive notice of liabilities the purchaser would have had knowledge of by reference to "avenues and information available." *Bump v. Dahl*, 26 Wis.2d 607, 133 N.W. 2d 295, 299 (Wis. 1965). A purchaser of land has three sources of information to consult to learn about the rights to land: the records of the office of the register of deeds; other public records; and the land itself. *Id*. at 300.

25. Under Wisconsin law, the failure to record the interest does not, alone, render Midwest Frac's interest unsecured. Instead, third parties could have consulted other public records – including, as asserted in the Midwest Frac Complaint, the Debtors' filings with the Securities and Exchange Commission – to reveal this transaction and gain knowledge about the interest. Under *Bump v. Dahl*, a prospective purchaser is obligated to exercise reasonable diligence in reviewing potential records that might provide notice of a claimed interest in property. Given the frequency with which mining-related land transactions contain repurchase rights or options, Midwest Frac submits that review of the SEC filings regarding transactions, and further inquiry as to the terms of those transactions, would be warranted.

RESERVATION OF RIGHTS

26. Midwest Frac reserve all rights, claims, defenses, and remedies, including the ability to supplement or amend this Response to the extent permitted by rule, to request any needed discovery, and to raise additional responsive objections should the evidence as presented warrant such objections, including Debtors' compliance with LR 3007-1(f)(iii). Midwest Frac also joins in any other responses to the Omnibus Objection to the extent such objections are not inconsistent with this Response.

CONCLUSION

For the foregoing reasons, Midwest Frac requests that the Court enter an Order: (i) sustaining the Response, (ii) denying the Omnibus Objection; (iii) scheduling a hearing under § 506(a) to determine the extent and priority of Midwest Frac's Allowed Secured Claims; and (iv) granting such other and further relief as the Court deems just and proper.

Date: September 10, 2020
Wilmington, DE

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CERTIFICATE OF SERVICE

I, Elihu E. Allinson, III, do hereby certify I am not less than 18 years of age and that on this 10th day of September, 2020, I caused copies of the within *Response of Midwest Frac and Sands, LLC to Reorganized Debtors' First (Substantive) Omnibus Objection to, or Motion to Reclassify, Purported Secured Claims* to be served upon the parties listed below via Electronic Mail. All other parties who have signed up for electronic filing in this case will receive electronic notice via CM/ECF.

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September 10, 2020
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