UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MARYLAND
(Greenbelt Division)

In re:	)	
	)	Chapter 11
CREATIVE HAIRDRESSERS, INC., *et al*.,	)	
	)	Case Nos. 20-14583, 20-14584-TJC
Debtors.	)	(Jointly Administered)
	)	

SUPPLEMENTAL OBJECTION TO DEBTORS' MOTION TO COMPEL HC SALON HOLDINGS INC. TO COMPLY WITH THE TRANSITION SERVICES AGREEMENT

HC Salon Holdings, Inc. ("**HC Salon**"), through its undersigned counsel, DLA Piper LLP (US), submits this Supplemental Objection to the *Debtors' Motion to Compel HC Salon Holdings Inc. to Comply with the Transition Services Agreement* [ECF No. 785] (the "**Motion to Compel**") filed by Creative Hairdressers Inc. and Ratner Companies, L.C. (collectively, the "**Debtors**"). This Supplemental Objection supplements the original Objection to the Motion to Compel filed by HC Salon on December 28, 2020 [ECF No. 798]. Unless otherwise defined herein, all capitalized terms used in this Supplemental Objection have the meanings set forth in the original Objection.

In support of its Supplemental Objection, HC Salon respectfully states as follows:

I. INTRODUCTION

1. Faced with a vastly overleveraged balance sheet, a hopelessly overweight cost structure and the impending COVID-19 shutdown, the Debtors were on the verge of liquidation. After acquiring the pre-petition secured debt, HC Salon worked quickly with the Debtors to salvage the Debtors' business, and with it save thousands of jobs and hundreds of leases.

2. The parties closed on the sale of substantially all of the Debtors' assets on June 4, 2020, ***nearly eight months ago***. In addition to assuming substantial liabilities, HC Salon credit bid more than $32 million of the secured debt. In order to support the Debtors through the entirety

of the sale process, HC Salon provided more than $6 million in new money debtor in possession financing. Also, in order to facilitate an orderly transition of administrative services, HC Salon paid more than $3.6 million for reimbursable transition services under the parties' Transition Services Agreement. Finally, to assist the Debtors in the wind down of their estates, HC Salon agreed to pay $100,000 to fund the Debtors' wind down costs. This was a specific and bargained-for deal term that is plainly stated in the Court-approved Asset Purchase Agreement.

3. Now, with the sale having been completed in June 2020, and with the TSA having expired by its own terms in September 2020, the Debtors incredibly contend that HC Salon is obligated to fund the entirety of the costs of winding down their Chapter 11 cases, which the Debtors believe will last at least until the middle of 2021 – ***a full year after the closing of the sale of the Debtors' assets***. The Debtors make this virtually unprecedented argument through a selective parsing of a single provision of the TSA. In doing so, the Debtors ignore the clear and unambiguous language of the parties' integrated agreements, as well as the Debtors' own contrary positions.

4. When the parties' agreements are viewed in their entirety and in context, there is no question that HC Salon never agreed to pay unlimited wind down costs. Accordingly, the Motion to Compel should be denied.

II. FACTUAL BACKGROUND[1]

The Bankruptcy Filing and the Sale Transaction

5. In the first quarter of 2020, even before the onset of the COVID-19 pandemic, the Debtors were experiencing severe financial distress. The Debtors had defaulted on their

[1] The facts in this Supplemental Objection are set forth in the Declaration of Seth Gittlitz dated January 31, 2021 (the "**Gittlitz Declaration**") and the Declaration of Christopher Conover dated February 1, 2021 (the "**Conover Declaration**") submitted herewith.

$40 million senior secured credit facility; they had virtually no liquidity; their protracted efforts to identify a new investor or asset purchaser had failed; and they faced an urgent and immediate threat of liquidation, which would result in the termination of thousands of jobs and the permanent loss of enterprise value. In short, the Debtors were out of money and out of options.

6. In the weeks leading up to the bankruptcy filing, the Debtors and HC Salon engaged in extensive negotiations regarding a sale transaction. As a result of these negotiations, HC Salon agreed to acquire the Debtors' senior secured debt and agreed to act as the stalking horse purchaser in an expedited Section 363 sale process. HC Salon also agreed to provide funding, both prior to and after the bankruptcy filing, which the Debtors desperately needed to maintain their operations and preserve thousands of jobs.

7. Against this backdrop, the Debtors filed their bankruptcy cases and commenced the sale process.

Key Terms of the APA

8. The APA clearly and unambiguously identifies the assets that HC Salon agreed to purchase, the liabilities it agreed to assume, and the consideration it agreed to pay. Certain of the terms of the APA relevant to the issues raised by the Motion to Compel are discussed below.

9. The consideration that HC Salon agreed to pay, including the specific amount that HC Salon agreed to pay to fund costs of the "Wind Down" (as such term is defined Section 1.1 of the APA), is set forth in Section 2.3 of the APA, which provides as follows:

> Section 2.3 Consideration; Deposit. The consideration for the Acquired Assets (the "Total Consideration") shall be (i) the Assumed Liabilities, (ii) the credit bid in an amount equal to 90% of the Obligations (as defined in the DIP Financing Agreement) (the "Credit Bid") (as an offset against, and reduction in the amount of Sellers' debt in respect of such Obligations under the DIP Financing Agreement, pursuant to Section 363(k) of the Bankruptcy Code), and (iii) ***$100,000 paid in cash, to fund the Wind Down*** (such amounts, together with the amount of the Senior DIP

> NM Term Loan Obligations and the Credit Bid, the "***Purchase Price***"); provided, however, that Purchaser reserves the right to increase the Purchase Price, subject to the Bidding Procedures Order and applicable Law. Notwithstanding the foregoing, the Buyer further agrees to waive any unsecured claims in the Bankruptcy Cases.

APA at § 2.3 (emphasis added).

10. Seeking to divert the Court's attention from the specific provision of the APA that addresses wind down costs, the Debtors broadly assert that HC Salon's wind down cost obligations are not capped or otherwise limited by the APA. *See* Motion to Compel at ¶ 35. Yet, Section 2.3 of the APA expressly provides that HC Salon would pay $100,000 "to fund the Wind Down[.]" The $100,000 figure was the result of extensive negotiations among the Debtors, HC Salon and the Creditors Committee. HC Salon did not agree to pay any amount beyond $100,000 to fund the Debtors' wind down costs, and the APA does not any impose any obligation beyond $100,000.

11. The definition of "Assumed Liabilities" in Section 1.1 of the APA is also critical, as this is where one would find an obligation on the part of HC Salon to fund the Debtors' wind down costs. As set forth in the introductory language to the definition of "Assumed Liabilities," however, ***HC Salon agreed to assume "only the following Liabilities" that are specifically listed***; and as set forth in the closing language to the definition, "***notwithstanding anything to the contrary set forth in this definition, the Assumed Liabilities shall not include any Excluded Liabilities***." *See* APA at § 1.1 (Definition of "Assumed Liabilities") (emphasis added).

12. As set forth in subparagraphs (f) through (i) of the definition of "Assumed Liabilities," HC Salon expressly agreed to assume certain administrative expenses of the bankruptcy estates (in particular, certain court-approved real estate consulting fees, cure costs for contracts and leases being assumed and assigned, up to $50,000 of liabilities arising under sections 503(b)(9) and 507(a) of the Bankruptcy Code, and up to $500,000 of liabilities relating to "stub rent" administrative claims for rejected leases). Significantly, however, the definition of

"Assumed Liabilities" does not say one word about HC Salon agreeing to assume any wind down costs of the Debtors.

13. The definition of "Excluded Liabilities" in Section 1.1 of the APA reinforces the fact that HC Salon agreed to assume only the specific liabilities identified in the definition of "Assumed Liabilities." It provides in relevant part as follows:

> "Excluded Liabilities" means ***any Liabilities of Sellers***, whether existing on the Closing Date or arising thereafter as a result of any act, omission or circumstances taking place prior to the Closing, ***other than the Assumed Liabilities***. Without limiting the foregoing, Buyers shall not be obligated to assume, and do not assume, and hereby disclaims all the Excluded Liabilities, including the following Liabilities (which shall also be considered Excluded Liabilities) of any of Sellers or of any predecessor of any of Sellers, whether incurred or accrued before or after the Closing:
>
> (a) any Liability not relating to or arising out of the Business or the Acquired Assets, including any Liability exclusively relating to or primarily arising out of the Excluded Assets;
>
> * * *
>
> (e) any Liabilities in respect of any Contracts or Leases that are not Designated Contracts or Assumed Leases, respectively;
>
> (f) all Liabilities for fees, costs and expenses that have been incurred or that are incurred or owed by Sellers in connection with this Agreement or the administration of the Bankruptcy Cases (including all fees and expenses of professionals engaged by Sellers) and administrative expenses and priority claims accrued through the Closing Date and specified post-closing administrative wind-down expenses of the bankrupt estates pursuant to the Bankruptcy Code (which such amounts shall be paid by Sellers from the proceeds collected in connection with the Excluded Assets) and all costs and expenses incurred in connection with (i) the negotiation, execution and consummation of the transactions contemplated under this Agreement and each of the other documents delivered in connection herewith, (ii) the negotiation, execution and consummation of the DIP Financing Agreement, and (iii) the consummation of the transactions contemplated by this Agreement, including any retention bonuses, "success" fees, change of control payments and any other payment obligations of Sellers payable as a result of the consummation of the transactions contemplated by this Agreement and the documents delivered in connection herewith;

> (g) all Liabilities (i) related to WARN Act, to the extent applicable, with respect to the termination of Sellers' employees, (ii) for any action resulting from Sellers' employees' separation of employment (the "Company Severance Payments"), and (iii) for vacation, sick leave, parental leave, and other paid time accrued by Sellers' employees who are not Transferred Employees (the "Company PTO Payments");
>
> * * *
>
> (j) all Company Benefit Plans (including all assets, trusts, insurance policies and administration service contracts related thereto);
>
> * * *
>
> (q) Liabilities to any employees arising prior to the Closing, except for vacation, sick leave, parental leave and other paid time accrued by Sellers' employees who are Transferred Employees; and
>
> (r) all Liabilities of Sellers or its predecessors arising out of any contract, agreement, Permit, franchise or claim that is not transferred to a Buyer as part of the Acquired Assets or is not transferred to a Buyer because of any failure to obtain any third-party or governmental consent required for such transfer.

APA at § 1.1 (Definition of "Excluded Liabilities") (emphasis added).

14. As is clear from the definitions of "Assumed Liabilities" and "Excluded Liabilities," the parties took great care to identify in the APA the specific liabilities that HC Salon agreed to assume. They also took great care to express in the APA that, except to the extent a liability was expressly assumed, it was excluded.

15. The Sale Order confirms that HC Salon was assuming only the specific liabilities identified in the definition of "Assumed Liabilities." *See* Sale Order at p. 10, ¶ VIII(D) ("The Buyers shall have no obligations with respect to any liabilities of the Debtors other than the Assumed Liabilities and such obligations specifically set forth in and solely to the extent provided pursuant to the Final APA.").

16. The APA is also remarkable for what it does not say. At no point does it provide for, or in any way reference, any obligation on the part of HC Salon to pay unlimited wind down

costs of the Debtors. To the contrary, as set forth in Section 2.3, the APA provides for a specific dollar amount (*i.e.*, $100,000) that was earmarked to fund the Debtors' wind down costs.[2]

17. At all times relevant to the APA, HC Salon understood that it had agreed to pay only $100,000 toward wind down costs. HC Salon never agreed to pay, nor did it intend to agree to pay, any amount beyond the $100,000 figure set forth in Section 2.3 of the APA.

Key Terms of the TSA

18. Under Section 2.5(b) of the APA, the TSA was identified as a closing deliverable. Consistent with the requirements of the APA, the parties entered into the TSA on June 4, 2020, contemporaneous with the closing of the sale transaction.

19. As is evident from its recitals, the TSA (like all transition services agreements that are commonly entered into at closing in Section 363 sales) was intended as a short-term agreement under which the Debtors agreed to provide specified services to HC Salon for a limited time to assist in the transitioning of the acquired business. *See* TSA Second Recital (stating that, "pursuant to the APA and in connection with the consummation of the transactions contemplated thereby, the Parties desire to enter into an agreement, pursuant to which each Party will provide certain services to the Purchaser on a transitional basis").

20. The TSA includes an enormously detailed schedule of the transition services that the Debtors agreed to provide, and for which HC Salon agreed to pay. The schedule, which grouped the transition services under six headings (marketing, total rewards, information systems, finance, operations support and miscellaneous third party management) was designed to set forth

[2] The Debtors now contend that the $100,000 figure provided for under Section 2.3 the APA was intended solely to pay the costs of the Official Committee of Unsecured Creditors. The APA, however, does not include any such limitation on the use of the $100,000.

the specific services covered under the TSA. Each of the services covered under the TSA was intended to provide benefit to HC Salon by assisting its efforts to transition the acquired business.

21. The compensation to be paid to the Debtors by HC Salon is governed by Article 5 of the TSA. Under Section 5.1, HC Salon agreed to pay a fee of $25,000 per month for the term of the TSA.

22. Under Section 5.2, HC Salon agreed to pay or reimburse the Debtors' out-of-pocket costs and expenses reasonably incurred in connection with the performance of services under the TSA, including wind down costs ***incurred in connection with the performance of services under the TSA***, subject to a review and approval process. Section 5.2 provides as follows:

> Section 5.2. Reimbursable Expenses. The Purchaser agrees to reimburse the Seller for any and all of its ***actual, documented, out-of-pocket costs and other expenses reasonably incurred in connection with the performance of the services hereunder or any wind down costs of seller***, including the allowed fees of Sellers' professionals employed under one or more orders of the Bankruptcy Court *provided* that the ***Seller shall, where possible, inform the Purchaser of the actual or reasonably estimated amount of such expenses before they are incurred and shall not incur any such expenses without the Purchaser's prior written consent.*** All costs incurred must be presented with supporting documentation, such as receipts.

TSA at § 5.2 (emphasis added).

23. The Debtors adopt a tortured interpretation of Section 5.2 in support of their position that HC Salon agreed to pay unlimited wind down costs unrelated to services performed under the TSA. The Debtors' interpretation, however, is contrary to specific provisions of the APA, including Section 2.3 of the APA under which the parties agreed that HC Salon would pay a specific amount (*i.e.*, $100,000) to fund wind down costs.

24. The Debtors' interpretation is also contrary to the stated purpose of the TSA (*i.e.*, for the Debtors to provide specified services to HC Salon for a limited time to assist in the transitioning of the acquired business). Consistent with this purpose, HC Salon agreed to pay the

Debtors' out-of-pocket costs and expenses, including related wind down costs, so long as they were reasonably incurred in connection with the performance of services under the TSA, subject to a review and approval process.

25. At all times relevant to the TSA, HC Salon understood that it had agreed to pay only wind down costs that were reasonably incurred by the Debtors in connection with the performance of services under the TSA, subject to a review and approval process. HC Salon never agreed to pay, nor did it intend to agree to pay, any wind down costs that were not reasonably incurred by the Debtors in connection with the performance of services under the TSA.

The TSA Approval Motion

26. The Debtors' new-found interpretation of the TSA ignores the fact that, when the Debtors applied to the Court for approval of the TSA, they described HC Salon's obligations under the TSA in a manner that is fundamentally consistent with the plain meaning of the TSA described above.

27. On June 5, 2020, the Debtors filed their motion seeking authorization and approval of the TSA (the "**TSA Approval Motion**") [ECF No. 484]. The Debtors described the purpose of the TSA as follows:

> 9. In connection with the sale, and as contemplated by the Final APA, HC Salon is preparing to begin reopening salons and rehiring Salon Professional[s] to staff those salons. As it will take time for HC Salon to fully integrate the Debtors' former processes and systems into HC Salon's platform, the Debtors and HC Salon addressed the need for the provision of transition services in conjunction with the Debtors' transfer of its businesses to HC Salon. As a result of that identified need, the Debtors and HC Salon entered into a Transition Services Agreement ("TSA"), a copy of which is attached hereto as Exhibit A.

TSA Motion at ¶ 9.

28. Critical for purposes here, the Debtors described in detail HC Salon's payment obligations under the TSA. In doing so, ***the Debtors precisely followed the clear language of the***

TSA, and they never once indicated to the Court that HC Salon had agreed to pay unlimited wind down costs:

> 14. The TSA provides, among other things, that the Debtors will, at HC Salon's sole cost, provide facilities, personnel, and other resources required to provide certain services as more fully set forth on the Schedule of Services appended to the TSA. ***Accordingly, HC Salon will reimburse the Debtors for all of their actual, documented, out-of-pocket costs and other expenses reasonably incurred in connection with the performance of services under the TSA, including related wind down costs and allowed fees of the Debtors' professionals.***

TSA Approval Motion at ¶ 14 (emphasis added).

29. Had the Debtors extracted an agreement that obligated HC Salon to pay unlimited wind down costs, they surely would have trumpeted it to the Court and all constituencies in these cases. At no point in the TSA Motion, however, do the Debtors state that HC Salon agreed to pay unlimited wind down costs. Instead, the Debtors state that HC Salon agreed to pay wind down costs that are related to the performance of services under the TSA, a statement which is consistent with HC Salon's understanding and interpretation of the plain meaning of the TSA and directly contrary to the interpretation that the Debtors are now claiming before the Court.

The Process for Review and Approval of TSA-Related Costs and Expenses

30. In an effort to sidestep the requirement under Section 5.2 of the TSA that all reimbursable expenses be approved in advance by HC Salon, and to justify their failure to claim that HC Salon had agreed to pay unlimited wind down costs until after the TSA had terminated, the Debtors now assert that HC Salon did not require prior written consent and that the parties conducted the process for review and approval of TSA-related costs and expenses in an informal manner. Nothing could be further from the truth.

31. Following the closing of the sale transaction, the Debtors and HC Salon engaged in a formal process whereby the Debtors requested payment of, and HC Salon reviewed and approved, all TSA-related costs and expenses.

32. Consistent with the requirements of the TSA, the Debtors were required to provide supporting documentation for all requested costs and expenses, and all requests were submitted to senior management of HC Salon for approval. Properly supported costs and expenses were promptly approved and paid by HC Salon. Costs that were not supported and/or not related to the services provided under the TSA were denied.

33. At no time during the frequent communications and interactions between the Debtors and HC Salon during the three-month period when the TSA was in effect, did the Debtors assert that HC Salon was obligated to pay unlimited wind down costs unrelated to the services provided by Debtors under the TSA. At all relevant times, the parties acted as if HC Salon's sole obligation was to pay out-of-pocket costs and expenses incurred by the Debtors in connection with the performance of services under the TSA, subject to a review and approval process. This coincides with HC Salon's efforts to end the services being provided to it by the Debtors as promptly as possible to limit its financial exposure under the TSA. Indeed, HC Salon offered certain TSA employees incentivized bonuses to move the new company away from the Debtors' transition services well in advance of the September 4, 2020, TSA expiration. Had HC Salon agreed to pay unlimited wind down costs to the Debtors, in both time and money, it would never have offered to incentivize Debtors' employees to wind down and terminate the TSA so quickly.

34. HC Salon's Chief Financial Officer, Christopher Conover, managed the day-to-day communications and interactions with the Debtors relating to costs and expenses. Mr. Conover regularly reviewed forecasted costs and expenses submitted by the Debtors, and he regularly

prepared detailed requisitions that itemized all requested costs and expenses. During the term of the TSA, he prepared four detailed requisitions that compiled multiple payment requests received from the Debtors, as well as several additional *ad hoc* payment requests received from the Debtors.

35. At the commencement of the TSA, Mr. Conover met with Phil Horvath, then-President and Chief Operations Officer of the Debtors, and Christa Hart, a managing director of FTI, to review a ramp up summary (the "**Ramp Up Summary**") financial model depicting the costs related to re-opening the salons. The Ramp Up Summary depicted a 16-week projection of costs, including both TSA-related costs and expenses as well as costs and expenses of HC Salon outside of the TSA. The Ramp Up Summary was used to set up the initial requisition for funding under the TSA.

36. Further requisitions for funding under the TSA were compiled based on information provided by the Debtors' various department heads. These requisitions generally included costs and expenses related to the Debtors' expected expenditures forecasted for the following two-week period. The costs and expenses were inputted into each requisition, which were then submitted to Mr. Horvath for review and approval.

37. Upon the approval of Mr. Horvath, Mr. Conover submitted each requisition to HC Salon's management committee for review and approval. Mr. Conover would then communicate with the management committee to address any questions and requests made by the management committee for additional information. If any expenditures were rejected by the management committee, Mr. Conover would prepare and circulate a revised requisition to the management committee.

38. If a signature was required for reimbursement of expenses under the TSA, the request was sent to Seth Gittlitz, Chief Executive Officer of HC Salon, for signature. At one point

during the transition period, an employee of the Debtors signed a contract for TSA-related expenditures of behalf of HC Salon, which was inconsistent with the parties' process. In response, Mr. Conover promptly sent an email to the Debtors to remind them of the appropriate process for execution of contracts under the TSA.

39. Upon approval of the requisition for funding under the TSA, which signified approval of the proposed expenditures, HC Salon funded the requisition via wire transfer into the Debtors' operating account maintained at M&T Bank (the "**Operating Account**"). The only authorized signatories of the Operating Account were Mr. Horvath and Lester Mardiks, both employees of the Debtors.

40. Generally, as expenses were ready for payment, the Debtors' department heads would contact Mr. Conover by email to confirm that funds had been approved through the requisition process.

Termination of the TSA

41. Consistent with the clear and unambiguous purpose and terms of the TSA and HC Salon's corporate goals, HC Salon successfully transitioned substantially all TSA-related services to its own platforms in the weeks following the closing of the sale transaction. As a result, and in accordance with the requirements of Section 9.2 of the TSA, HC Salon provided written notice to the Debtors on July 14, 2020 that it was terminating substantially all TSA-related services effective July 17, 2020.

42. By its terms, the TSA terminated after three months, unless terminated earlier. *See* TSA at § 9.1 (providing that the TSA shall "continue until the earliest of . . . three (3) months from the Effective Date"). The TSA thus terminated on September 4, 2020 (*i.e.*, three months following

the June 4, 2020 Effective Date). At no time did the Debtors or HC Salon request to extend the term of the TSA beyond September 4, 2020.

43. In late August 2020, in the days preceding termination of the TSA, Mr. Conover, along with other representatives of HC Salon, communicated with representatives of the Debtors regarding the upcoming termination of the TSA. During these communications, they informed the Debtors that HC Salon no longer required services under the TSA , but that that HC Salon wanted to ensure that the Debtors had the data and information they needed to wind down the estates as HC Salon would no longer be funding any of the software platforms, email systems or staff needed to do so.

44. By September 4, 2020, HC Salon no longer used any services or employees provided by the Debtors under the TSA. Currently, HC Salon is not using any services, vendors or employees provided by the Debtors under the TSA.[3]

Reconciliation of TSA-Related Costs and Expenses

45. The Debtors have provided a reconciliation of the amount they claim is owed under the TSA as of September 2020 (the "**Reconciliation**"). Based on the Reconciliation, the Debtors assert that $422,435.51 is owed by HC Salon to the Debtors under the TSA.

[3] The Debtors contend that, after termination of the TSA, HC Salon has continued to use a bank account for payment of employee benefit claims. In actuality, the bank account at issue is maintained solely by the Debtors (and not by HC Salon) for payment of benefit claims relating to the Debtors' own employees. HC Salon has never had access to the bank account, and it derives no benefit from the bank account. The Debtors also contend that HC Salon has continued to use the services of a vendor, Iron Mountain, for document storage. The Debtors, however, never informed HC Salon that Iron Mountain was being used as a vendor, nor did they identify the materials that are being stored at Iron Mountain. Further, the Debtors never requested reimbursement for any expenses incurred with Iron Mountain in accordance with the review and approval requirements of the TSA. HC Salon first learned that the Debtors were using Iron Mountain as a vendor after the filing of the Motion to Compel.

46. The Debtors' Reconciliation does not accurately reflect the status of TSA-related costs and expenses. In actuality, HC Salon has fully paid all costs and expenses that were related to and reimbursable under the TSA and presented to HC Salon for approval and payment.

47. Certain of the amounts listed on the Debtors' Reconciliation have already been paid by HC Salon. The Debtors assert that $100,000.00 in monthly fees is owed under the TSA. HC Salon, however, only agreed to pay $25,000.00 per month for the three-month term of the TSA. *See* TSA at § 5.1. Accordingly, the $100,000 figure for monthly fees reflected in the Debtors' Reconciliation is overstated by $25,000. Further, HC Salon has paid all monthly fees owed under the TSA.

48. The Debtors also assert that $30,000 is owed under the TSA to Stanton, a public relations firm that assisted in preparing press releases in connection with the bankruptcy proceedings. As reflected in the TSA funding requisitions that were prepared by Mr. Conover, HC Salon advanced $35,000 to the Debtors for payment of Stanton.

49. Certain of the amounts listed on the Debtors' Reconciliation were rejected by HC Salon through the reimbursement review and approval process. For example, HC Salon rejected the Debtors' request to engage Rodger Jacobson as a financial consultant because the Debtors already employed a controller. Notwithstanding HC Salon's rejection of this expense, the Debtors proceeded to engage Mr. Jacobson. Because this expense was rejected, HC Salon is not obligated to reimburse the Debtors for the cost of engaging and compensating Mr. Jacobson.

50. Other amounts listed on the Debtors' Reconciliation were never submitted to HC Salon for approval and payment. For example, the Debtors assert that $118,674 in quarterly fees owed to the U.S. Trustee – $47,016.00 for the third quarter of 2020 and $71,658.00 for the second quarter of 2020 – are owed under the TSA. HC Salon agrees that it is obligated to pay fees

payable to the U.S. Trustee that were reasonably incurred by the Debtors "as a direct result of the [Debtors] providing services under [the TSA]." TSA at § 5.3. The Debtors, however, never submitted to HC Salon invoices for payment of these fees.

51. In addition, the Debtors assert that $58,348.56 is owed for "unpaid legal fees through August 31, 2020, net of retainer" (which HC Salon understands to be the legal fees of Shapiro Sher Guinot & Sandler); $67,298.75 for the Debtors' employment counsel (Littler Mendelson); $98,871.96 for the Debtors' claims and noticing agent (Epiq); and $57,651.20 for the Debtors' financial advisor (Carl Marks Advisors). The Debtors, however, never submitted to HC Salon invoices or other requests for payment of these fees, and it is unclear how these fees relate to services provided by the Debtors under the TSA. Further, HC Salon informed the Debtors that HC Salon had already engaged employment counsel and, as a result, it derived no benefit from the engagement of the Littler firm. Notwithstanding HC Salon's rejection of this expense, the Debtors proceeded to engage the Littler firm.

52. Subject to the foregoing, once the Debtors' Reconciliation is adjusted to include all payments made by HC Salon and to remove the costs and expenses claimed by the Debtors that are not reimbursable under the TSA, HC Salon has overpaid the Debtors in the amount of $147,877.25, as reflected on a January 7, 2021 summary of all amounts paid to the Debtors under the TSA that was prepared by Mr. Conover. The overpayment to the Debtors largely resulted from advances that HC Salon made to the Debtors to fund cash drawers for the reopening of the salons. If the overpayment is not returned, HC Salon reserves the right to file an application seeking allowance of an administrative expense claim for the overpayment.

The Debtors' Wind Down Budget

53. Lost within the meandering argument of the Debtors is that they are asking the Court to require HC Salon to pay wind down costs that have largely arisen ***since the termination of the TSA and which were first presented to HC Salon only shortly before the Debtors filed their Motion to Compel***. In particular, the Motion to Compel includes a proposed budget of the wind down costs and expenses projected through March 2021. In recent days, the Debtors have amended the Wind Down Budget to include additional wind down costs through June 2021 (as amended, the "**Wind Down Budget**").

54. At no time during the period when the TSA was in effect, or in the months thereafter, did the Debtors request that HC Salon pay their wind down costs.

55. The costs and expenses identified do not relate to services provided under the TSA and do not benefit HC Salon in any way. The Debtors are no longer providing services to HC Salon, and none of the items reflected in the Wind Down Budget are related to services provided under the TSA. The Wind Down Budget includes $820,900 for a wind down staff, which includes full-time salaries for six employees and independent contractors of the Debtors, notwithstanding that the Debtors have no further operations and are no longer providing services to HC Salon under the TSA. The Wind Down Budget also includes fees for the Debtors' professionals from September 2020 through June 2021. The services provided by these professionals (including the legal fees incurred by the Debtors in connection with their prosecution of the Motion to Compel and fees related to noticing and claims agent services) are not related to services provided under the TSA and do not benefit HC Salon.

56. Also included in the Wind Down Budget are expenses relating to the Debtors' operations and systems, even though the Debtors no longer provide any services to HC Salon. The

budgeted expenses include information technology systems (email/domain/file server, Oracle dBase license, and IT consulting), data storage (Lawson/Velocity, secure data destruction, and Iron Mountain), bank fees, and fees related to final employee payroll and taxes (W2 filing fees, 1099 filing fees, 1095 notices, payroll processing fees, ADP tax reporting, and FSA claims) – all systems and costs that HC Salon expressly discussed with the Debtors' representatives in late August 2020, when HC Salon informed the Debtors that HC Salon would not be paying for these services and that Debtors would be required to engage these services and complete these wind down tasks at their own cost. Because these expenses are not related to services provided under the TSA, they are not reimbursable under the TSA.

57. Given the circumstances of the Debtors' bankruptcy proceedings, the costs and expenses identified in the Wind Down Budget are not reasonable. The Sale Transaction closed on June 4, 2020, and the Debtors have provided no transition services to HC Salon since early September 2020. The expenses included in the Wind Down Budget are duplicative and unnecessary for providing transition services to HC Salon and the wind down of the Debtors' estates, and HC Salon has properly rejected many of these expenses. Accordingly, the expenses included in the Wind Down Budget are not reimbursable under the TSA.

III. LEGAL ANALYSIS AND ARGUMENT

A. The APA and the TSA Should be Viewed as Integrated Agreements

58. Although the APA and the TSA are governed by the law of different states (New York and Virginia), the law of each state recognizes that agreements arising out of the same business transaction should be interpreted together. *See In re Residential Capital, LLC*, 533 B.R. 379, 396-98 (Bankr. S.D.N.Y. 2015) (holding that, under New York law, asset purchase agreement and ancillary documents, including transition services agreement, should be interpreted as

integrated agreements); *Foothill Capital Corp. v. East Coast Bldg. Supply*, 259 B.R. 840, 844 (E.D. Va. 2001) (holding that, under Virginia law, "it is the duty of the court, where a business transaction is based upon more than one document executed contemporaneously by the parties . . . to construe the documents together when determining the parties' contractual intent") (internal quotation marks omitted).

59. Here, the APA and the TSA arise out of the sale transaction that was approved by the Court. Further, the agreements are interdependent and contain numerous references to each other. *See* APA at § 2.5(b); TSA at §§ 1, 2.2, 10.2, 10.8, Recitals, and Schedule of Services. Accordingly, the APA and the TSA should be interpreted together as integrated agreements.

B. Based on the Unambiguous Terms of the APA and the TSA, HC Salon Did Not Agree to Pay Unlimited Wind Down Costs

60. Slicing and dicing discrete provisions of the TSA, the Debtors craft a fantastical argument that HC Salon somehow agreed to fund the entirety of the Debtors' administrative costs for a case that has virtually no end in sight. This argument ignores the clear and unambiguous language of the parties' agreements, under which HC Salon never agreed to pay unlimited wind down costs.

61. Under New York law, "[a] contract must be read as a whole to determine its purpose and intent, and single clauses cannot be construed by taking them out of their context and giving them an interpretation apart from the contract of which they are a part." *Analisa Salon, Ltd. v. Elide Properties, LLC*, 30 A.D.3d 448, 448-49, 818 N.Y.S.2d 130, 131 (2d Dep't 2006) (internal quotation marks and ellipses omitted). *See also Zodiac Enterprises, Inc. v. American Broadcasting Cos., Inc.*, 81 A.D.2d 337, 339, 440 N.Y.S.2d 240, 242 (1st Dep't 1981), *aff'd*, 56 N.Y.2d 738 (1982) ("Words considered in isolation may have many and diverse meanings. In a written document the word obtains its meaning from the sentence, the sentence from the paragraph, and

the latter from the whole document, all based upon the situation and circumstances existing at its creation.") (internal citations omitted). Virginia law also recognizes these principles of contract interpretation. *See TM Delmarva Power, LLC v. NCP of Virginia, LLC*, 263 Va. 116, 119, 557 S.E.2d 199, 200 (2002) ("contracts must be considered as a whole without giving emphasis to isolated terms") (internal citation omitted).

62. Consistent with the rule that contracts should be viewed as a whole, New York and Virginia courts presume that the parties to a contract intend that each word and provision of the contract has meaning and purpose. Therefore, a court should not adopt a "construction which would render a contractual provision meaningless or without force or effect." *Valle v. Rosen*, 138 A.D.3d 1107, 1109, 30 N.Y.S.3d 285, 287 (2016) (internal quotation marks omitted). *See also City of Chesapeake v. States Self–Insurers Risk Retention Group, Inc.*, 271 Va. 574, 628 S.E.2d 539, 541 (2006) ("[n]o word or clause in the contract will be treated as meaningless if a reasonable meaning can be given to it, and there is a presumption that the parties have not used words needlessly").

63. New York and Virginia courts also follow the universally accepted rule of contract interpretation that "specific terms in a contract will override the general, including when the specific and general provisions appear to conflict." *In re Residential Capital, LLC*, 533 B.R. at 399 (internal quotation marks omitted) (collecting cases). *See also Donnelly v. Donatelli & Klein, Inc.*, 258 Va. 171, 180, 519 S.E.2d 133, 138 (1999) ("a general provision in a contract must give way to a special one covering the same ground").

64. The Debtors' interpretation of the parties' agreements does not give effect to and harmonize all of their provisions. Instead, the Debtors' position is based on an isolated reading of

one clause within Section 5.2 of the TSA that fails to view the parties' agreements as a whole and renders key provisions meaningless.

65. The Debtors all but ignore the unambiguous terms of the APA, including the critical language in Section 2.3 of the APA that HC Salon agreed to pay only $100,000 to fund wind down costs and the definitions in Section 1.1 of the APA that clearly limit the liabilities that HC Salon agreed to assume. Because these provisions are specific and detailed, they should be interpreted to override any inconsistent general provision.

66. The Debtors also ignore the fact that, under the TSA, the parties negotiated a detailed schedule that specifies the services to be provided. If HC Salon had a blanket obligation to fund all costs and expenses, then what was the purpose of preparing such a detailed schedule of the specific services for which HC Salon was agreeing to pay?

67. The Debtors' self-serving interpretation also fails to consider the context of the TSA. This was a distressed sale of assets to an undersecured creditor that had the right to credit bid the full amount of its debt. There were no competing bidders, and the Debtors had no funds to sustain their operations during a pandemic that had forced businesses to shutter. Under such circumstances, the purchaser has no reason to pay any amount greater than the cost to fund the bankruptcy through the conclusion of the sale and the transitioning of the assets. And this is exactly what HC Salon agreed to fund here. Throughout the sale process – first, in connection with the DIP, and, later, in connection with the TSA – HC Salon required detailed itemization of every single item that was funded, and every single item was carefully reviewed by HC Salon before it was approved for funding.

68. The Court should avoid any interpretation of the parties' agreements that would produce an outcome that is absurd, commercially unreasonable or contrary to the reasonable

expectations of the parties. *See, e.g.*, *Matter of Lipper Holdings, LLC v. Trident Holdings, LLC*, 1 A.D.3d 170, 171, 766 N.Y.S.2d 561, 562 (1st Dep't 2003) ("A contract should not be interpreted to produce a result that is absurd, commercially unreasonable, or contrary to the reasonable expectations of the parties.") (internal citations omitted). See also *Goldkress Corp. v. Orthopaedic & Spine Ctr.*, 2016 WL 7209848, at *16 (Va. Ct. App. Dec. 13, 2016) ("our focus when interpreting a contract centers on the intent of the parties, and we will not interpret a contract in a manner that leads to absurd results") citing to *Transit Cas. Co. v. Hartman's, Inc.*, 218 Va. 703, 708, 239 S.E.2d 894, 896 (1978) (the construction of a contract "should be reasonable, and absurd results are to be avoided").

69. The effect of the Debtors' interpretation would be to grant the Debtors a blank check to pay wind down costs. This type of outcome was never bargained for by the parties, and it certainly was never agreed to by HC Salon, which at all times understood that it was required to pay wind down costs of the Debtors only to the extent that such costs relate to the performance of services under the TSA. The Debtors' interpretation would thus result in an absurd outcome that would be both commercially unreasonable and contrary to the reasonable expectations of the parties.

C. The Debtors' Current Position is Directly Contrary to the Description of the TSA that was Presented in the TSA Approval Motion

70. If HC Salon had truly agreed to pay unlimited wind down costs, as the Debtors now contend, the Debtors most assuredly would have proclaimed this to the Court and creditors as a marvelous victory for the bankruptcy estates. They did not. Instead, they described HC Salon's obligations in the TSA Approval Motion in the following manner: "HC Salon will reimburse the Debtors for all of their actual, documented, out-of-pocket costs and other expenses reasonably incurred in connection with the performance of services under the TSA, ***including related wind***

down costs and allowed fees of the Debtors' professionals." TSA Approval Motion at ¶ 14 (emphasis added).

71. Based on the Debtors' description of HC Salon's obligations in the TSA Motion, it is perfectly clear that "related wind down costs" are a subset of "expenses reasonably incurred in connection with the performance of services under the TSA" rather than an additional category of expenses. Of course, HC Salon relied on this description in June 2020 when the Debtors presented the TSA Approval Motion to the Court. Had the Debtors taken the position in June 2020 that they are taking now, HC Salon would have promptly addressed the issue.

72. The Debtors cannot disown statements made in their Court filings. Because the Debtors' statement in the TSA Motion that HC Salon will reimburse the Debtors only for "related wind down costs" (rather than unlimited wind down costs) is directly contrary to the position they are now taking before the Court, this statement constitutes a judicial admission that is binding on the Debtors. *See In re Jackson*, 2012 WL 3071218, at *25 (Bankr. S.D. Tex. July 27, 2012) ("Any 'deliberate, clear and unequivocal' statement, either written or oral, made in the course of judicial proceedings qualifies as a judicial admission.") (citing *In re Jones*, 197 B.R. 949, 956 (Bankr. M.D. Ga. 1996)). *See also Flexi-Van Leasing, Inc. v. Travelers Indem. Co.*, 2020 WL 6866643, at *3 (4th Cir. Nov. 23, 2020) ("A judicial admission is usually treated as absolutely binding" although a court "has the right to relieve a party of his judicial admission if it appears that the admitted fact is clearly untrue and that the party was laboring under a mistake when he made the admission") (quoting *New Amsterdam Casualty Co. v. Waller*, 323 F.2d 20, 24 (4th Cir. 1963)).

D. The Debtors' Position is At Odds with Well-Established Notions of Bankruptcy Practice

73. The Debtors' bankruptcy cases, like so many other Chapter 11 cases, involved a front-loaded Section 363 sale that was approved by the Court on an expedited basis to address

urgent financial distress. Now, eight months after the closing of the sale and four months after the end of the exclusivity period, the Debtors have made no discernable effort to conclude their bankruptcy cases through dismissal, conversion or a liquidating plan.

74. The hallmark of a Section 363 sale process is that, once the assets are sold, the Chapter 11 cases are quickly resolved to maximize the return to creditors and minimize the administrative burn. The below table – which summarizes retail bankruptcy filings from 2020 that were filed ***after*** the Debtors' cases, many of which involving Section 363 sales – illustrates the realities of bankruptcy practice in this environment:

Debtor/Case No./Court	Petition Date	Sale Status	Plan Status
J. Crew Case No. 20-32181 (KLP) (E.D. Va.)	5/4/2020	Store Closures/ No Sale	Plan Confirmed 8/25/2020
Neiman Marcus Case No. 20-32519 (DRJ) (S.D. Tex.)	5/7/2020	Store Closures/ No Sale	Plan Confirmed 9/4/2020
Stage Stores Case No. 20-32564 (DRJ) (S.D. Tex.)	5/10/2020	Store Closures/ No Sale	Plan Confirmed 8/14/2020
JC Penney Case No. 20-20182 (DRJ) (S.D. Tex.)	5/15/2020	Sale Approved 11/9/2020	Plan Confirmed 12/16/2020
Tuesday Morning Case No. 20-31476 (HDH) (N.D. Tex.)	5/15/2020	Store Closures/ No Sale	Plan Confirmed 12/23/2020
GNC Case No. 20-11662 (KBO) (D. Del.)	6/23/2020	Sale Approved 9/18/2020	Plan Confirmed 10/14/2020
Lucky Brand Case No. 20-11768 (CSS) (D. Del.)	7/3/2020	Sale Approved 8/12/2020	Plan Confirmed 11/17/2020
Sur La Table Case No. 20-18368 (MBK) (D.N.J.)	7/8/2020	Sale Approved 8/13/2020	Plan Confirmed 10/22/2020
Brooks Brothers Case No. 20-11785 (CSS) (D. Del.)	7/8/2020	Sale Approved 8/14/2020	Plan Pending D/S Approved
RTW Retail (New York & Co.) Case No. 20-18445 (JKS) (D.N.J)	7/13/2020	Sale Approved 9/4/2020	Plan Confirmed 12/10/2020

Ascena Retail (Ann Taylor/Loft) 20-20-33113 (KRH) (E.D. Va.)	7/23/2020	Store Closures/ No Sale	Plan Pending D/S Approved
Tailored Brands (Jos. A. Bank) 20-33900 (MI) (S.D. Tex.)	8/2/2020	Store Closures/ No Sale	Plan Confirmed 11/13/2020
Lord & Taylor 20-33332 (KLP) (E.D. Va.)	8/2/2020	Store Closures/ No Sale	Plan Pending D/S Pending
Stein Mart 20-2387 (JAF) (M.D. Fla.)	8/12/2020	Sale Approved 11/24/2020	Plan Pending D/S Approved

75. Every single one of the above recently-filed retail cases, some of which were far more complex than the Debtors' cases, have resulted in confirmed plans or have plans that are currently pending confirmation. Here, the Debtors have hewn a far different path; a course not dictated by the complexity of these cases (as there are no extraordinary issues delaying resolution), nor by the Debtors' liquidity (as the Debtors currently have more than $2 million in the bank, most of which has been provided by HC Salon, either through the payment of funds to the Debtors or by the release of its liens). Rather, the Debtors have decided to roll the dice on a gamble that the Court will parse the language of two clear and unambiguous agreements to forge a result never seen in Chapter 11.

E. The Debtors' Wind Down Expenses are Excessive and Unreasonable

76. As discussed above, there should be nothing extraordinary about winding down the Debtors' bankruptcy cases. For reasons not known, however, the Debtors' cases have taken far longer and have been far more expensive than other cases involving a front-loaded sale process.

77. Based on the Debtors' Wind Down Budget, the Debtors are now projecting that the wind down of the bankruptcy estates will not be concluded until June 2021 at a staggering cost of nearly $1.9 million (which figure includes more than $800,000 for a "wind down staff" of highly paid employees and more than $600,000 in legal fees). By any standard, the projected timetable

and costs of the wind down – which should have been concluded months ago – is excessive and unreasonable.

F. The Extrinsic Evidence Confirms that HC Salon Did Not Agree to Pay Unlimited Wind Down Costs

78. Finally, should the Court find that the APA and the TSA are in any way ambiguous, the extrinsic evidence confirms that HC Salon did not agree to pay unlimited wind down costs.

79. From the outset, HC Salon's objective was to acquire the Debtor's business on fair and reasonable terms. There were no competing bidders, and there was no reason whatsoever for HC Salon to assume the extraordinary liability of paying unlimited wind down costs of the Debtors' bankruptcy estates.

80. At all times relevant to the APA, HC Salon understood that it had agreed to pay only $100,000 toward wind down costs, as provided for in Section 2.3 of the APA. HC Salon never agreed to pay, nor did it intend to agree to pay, any amount beyond the $100,000 figure set forth in Section 2.3 of the APA. At all times relevant to the TSA, HC Salon understood that it had agreed to pay only wind down costs that were reasonably incurred by the Debtors in connection with the performance of services under the TSA, subject to a review and approval process. HC Salon never agreed to pay, nor did it intend to agree to pay, any wind down costs that were not reasonably incurred by the Debtors in connection with the performance of services under the TSA.

81. Moreover, at no time during the negotiation of the APA and the TSA did the Debtors even request that HC Salon pay unlimited wind down costs. Had such a request been made, it would have been summarily denied as overreaching.

82. There is no credible evidence that the Debtors understood that HC Salon had agreed to pay unlimited wind down costs. There is compelling evidence, however, that the Debtors fully understood that HC Salon agreed to pay only wind down costs related to the performance of

services under the TSA, as demonstrated by the Debtors' own description of HC Salon's obligations in the TSA Approval Motion.

83. Further, the conduct of the parties during the period when the TSA was in effect confirms the Debtors' understanding that HC Salon never agreed to pay unlimited wind down costs. "The parties' interpretation of the contract in practice, prior to litigation, is compelling evidence of the parties' intent." *Ocean Transp. Line, Inc. v. Am. Phil. Fiber Indus., Inc.*, 743 F.2d 85, 90-91 (2d Cir. 1984); *see also GE Funding Capital Mkt. Servs., Inc. v. Neb. Inv. Fin. Auth.*, 2017 WL 2880555, at *4 (S.D.N.Y. July 6, 2017) (noting that courts may consider the parties' course of conduct throughout the life of the contract, in determining contract meaning). While the court should generally refrain from using extrinsic evidence to interpret the clear intent of the parties, it may review the parties' course of performance to reconcile any terms it considers to be ambiguous. *Video Zone, Inc. v. KF&F Properties, L.C.*, 267 Va. 621, 627 (2004) (noting that "uncertain rights of parties may be determined and fixed by their practical dealings with each other"); *see also Robinson-Huntley v. George Washington Carver Mut. Homes Ass'n, Inc.*, 287 Va. 425, 431 (2014) ("the acts of the parties in relation to a contract establish a practical construction of it").

84. Here, the parties engaged in extensive communication regarding disbursement issues during the three-month period when the TSA was in effect. During this period, the Debtors worked with HC Salon to submit expense requests as contemplated by Section 5.2 of the TSA, but they never once asserted that HC Salon was obligated under the TSA to pay unlimited wind down costs. Indeed, the Debtors did not raise the issue of unlimited wind down costs until after the TSA had terminated. Given these circumstances, the Debtors have no valid basis for seeking to compel HC Salon to pay wind down costs.

IV. CONCLUSION

85. For the reasons set forth in its Objection and this Supplemental Objection, and for such other reasons that may be presented at any hearing on this matter, HC Salon respectfully requests that this Court deny the Debtors' Motion to Compel.

Dated: February 1, 2021

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that, on this 1st day of February, 2021, I reviewed the Court's CM/ECF system, and it reports that an electronic copy of the foregoing *Supplemental Objection to Debtors' Motion to Compel HC Salon Holdings Inc. to Comply with the Transition Services Agreement* will be served electronically by the Court's CM/ECF system on the following:

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