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11 **UNITED STATES BANKRUPTCY COURT**
12 **FOR THE CENTRAL DISTRICT OF CALIFORNIA**
13 **SAN FERNANDO VALLEY DIVISION**

14 In re:

15 ESCOM, LLC,

16 Debtor.

Bk. No. 1:10-bk-13001-GM

Chapter 11

**OPPOSITION TO MOTION FOR
ORDER (I) AUTHORIZING DEBTOR
TO SELL ASSETS FREE AND CLEAR
OF LIENS, CLAIMS, AND
18 ENCUMBRANCES, (II) APPROVING
19 ASSET PURCHASE AGREEMENT
WITH SUCCESSFUL BIDDER
20 CLOVER HOLDINGS LIMITED, (III)
AUTHORIZING PAYMENT OF SALE
21 COMMISSIONS FROM SALE
PROCEEDS, AND (IV) GRANTING
22 RELATED RELIEF**

Scheduled Hearing:

Date: October 27, 2010

Time: 10:00 a.m.

Place: Courtroom 303

21041 Burbank Blvd

Woodland Hills, CA 91367

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1 **TO THE HONORABLE GERALDINE MUND, UNITED STATES BANKRUPTCY**
2 **JUDGE, AND TO ALL PARTIES IN INTEREST:**

3 **PLEASE TAKE NOTICE** that creditor Nuthin' But Net ("NBN") hereby opposes and
4 objects to that portion of the *Motion for Order (I) Authorizing Debtor to Sell Assets Free and*
5 *Clear of Liens, Claims, and Encumbrances, (II) Approving Asset Purchase Agreement with*
6 *Successful Bidder Clover Holdings Limited, (III) Authorizing Payment of Sale Commissions from*
7 *Sale Proceeds, and (IV) Granting Related Relief* [Dkt. No. 115] (the "Sale Procedures Motion")
8 that seeks to provide the Debtor authorization to "distribute the net sale proceeds upon the closing
9 to the Secured Lenders."

10 NBN objects to the purported amounts claimed by the purported Secured Lenders and
11 asserts that purported creditor iEntertainment's claim should be disallowed.

12 **PLEASE TAKE FURTHER NOTICE** that NBN therefore requests, that if the Court
13 otherwise approves the relief requested in the Sale Procedures Motion, that the disputed portion
14 of the net sale proceeds be placed in a segregated, interest bearing escrow account pending
15 determination by this Court of the allowance, amount, and priority of the claims that are in
16 dispute.

17 This Objection is based on the accompanying Memorandum of Points and Authorities, the
18 Declaration of Gabriel Fried, the Declaration of Harold Baldauf, all pleadings, papers and records
19 on file with the Court, and such other evidence, oral or documentary, as may be presented to the
20 Court prior to or at the time of hearing of this Objection.

21 Dated: October 26, 2010

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By /s/ _____

Attorneys for Nuthin' But Net, LLC

1 MEMORANDUM OF POINTS AND AUTHORITIES

2 INTRODUCTION

3 1. Nuthin But Net (“NBN”) objects to the *Motion for Order (I) Authorizing Debtor to*
4 *Sell Assets Free and Clear of Liens, Claims, and Encumbrances, (II) Approving Asset Purchase*
5 *Agreement with Successful Bidder Clover Holdings Limited, (III) Authorizing Payment of Sale*
6 *Commissions from Sale Proceeds, and (IV) Granting Related Relief* [Dkt. No. 115] (the “Sale
7 Procedures Motion”) solely as it relates to the distribution of proceeds from the sale to the
8 putative Secured Lenders, as defined in the Sale Procedures Motion. NBN does not object to the
9 sale *per se*. As set forth more fully below, the insiders who control the Debtor are also the
10 Secured Lenders who will be paid from the sale proceeds. In effect, the controlling insiders will
11 be paying themselves unlawfully, to the detriment of all other creditors. Under the equities of this
12 case, they should not be permitted to do so.

13 2. Rather than risk the loss of this sale, NBN asks that all sale proceeds, after
14 payment of the costs of the sale and any undisputed portion of the Secured Lenders’ claims, be
15 deposited into an interest bearing escrow account, with any further distribution to be made only
16 upon further order of this court.

17 3. As the Court is already aware at this point (*see* Motion to Dismiss Involuntary
18 Bankruptcy Petition by Dom Partners LLC, Dkt. No. 3), the relevant purported secured creditors
19 who filed this involuntary bankruptcy petition – iEntertainment, Inc. (“iEntertainment”) and
20 Washington Technology Associates, LLC (“WTA”)¹ – are insiders of the Debtor, both controlled
21 by Michael Mann (“Mann”). What has not been disclosed to the Court, however, is that Mann,
22 through a series of self-dealing transactions, essentially gave away Escom’s most valuable rights
23 to iEntertainment (i.e., to himself) and then had Escom “buy back” those rights from his wholly
24 owned and controlled subsidiary, iEntertainment, in exchange for a \$2.5 million secured note (the
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¹ In addition, AccountingMatters.com, LLC, a nominal unsecured creditor that joined in the involuntary petition, is also controlled by Mann.

1 “iEntertainment Note”). The ultimate, and clearly intended result of this shell game, was to allow
2 Mann to reap a disproportional recovery upon Escom’s sale of its assets, primarily at the expense
3 of NBN, which the Debtor presently owes approximately \$2,337,562.39, but which NBN will not
4 recover if Mann’s self-dealing is sanctioned.

5 4. Thus, NBN contends the iEntertainment Note was wrongfully obtained, and that
6 iEntertainment’s purported secured claim must therefore be disallowed. Upon filing of the Sale
7 Procedures Motion, NBN has sought discovery in order to adduce additional facts to support its
8 objection to the iEntertainment claim. Incredibly, even though Mann signed the involuntary
9 bankruptcy petition initiating these proceedings, he now seeks to personally avoid service of a
10 deposition notice and any discovery concerning the relationship between iEntertainment and
11 Escom or the circumstances of the iEntertainment transactions. Moreover, iEntertainment and
12 WTA have both refused to cooperate with NBN’s requests for discovery or comply with
13 subpoenas seeking a deposition of the person most knowledgeable regarding each entities’
14 dealings with Escom and with each other.
15 Because this discovery is necessary to provide the Court a complete picture of the impermissible
16 self-dealing which lead to the iEntertainment Note, if the Sale Procedures Motion is otherwise
17 approved by the Court, the proceeds of the sale purportedly due iEntertainment should be held in
18 escrow pending resolution of this contested matter.²

19 5. Further, that portion of the sale proceeds purportedly due WTA and DOM arising
20 from default interest rates, late payment penalties, and collection costs should be held in escrow
21 to determine the actual amount properly recoverable. While their secured claims may be
22 allowable, the amounts claimed by the Secured Lenders are presently overstated, as the secured
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25 ² While NBN immediately engaged the Debtor and its insiders (and then served discovery) following the filing of the
26 Sale Procedure Motion in order to obtain necessary discovery, the short time frame provided as a result of the
Debtor’s Motion to Shorten Time for Notice of Hearing has presented additional hurdles to NBN’s ability to obtain
all relevant facts. Notably, the Debtor has rushed the Sale Procedure Motion to a hearing with just a week’s notice
even though it waited approximately 10 days after entering into the Asset Purchase Agreement before filing this
motion.

1 claimants are not entitled to the penalties or default interest rates included in their presently stated
2 claims, nor have they proven the “necessary” collection costs they are entitled to under their
3 respective Notes. The Sales Procedure Motion reflects collection costs of approximately
4 \$491,000 for DOM, \$90,000 for WTA and \$48,000 for iEntertainment. An unrelated debtor
5 would require proof as to the fact and necessity of these alleged expenses. Indicative of the
6 Secured Lenders’ control of the Debtor, at his deposition on October 25, 2010, Del Anthony
7 Polikretis, the Debtor’s CEO/President (“Polikretis”), testified that he had not even seen evidence
8 of detailed costs asserted to be recoverable by the Secured Lenders and the amounts of claims
9 owed the Secured Lenders had only been calculated by the Secured Lenders, not by the Debtor.

10 6. This case presents the highly unique circumstance under which the controlling
11 insiders have announced that they intend to sell the assets, pay themselves all of the proceeds, and
12 dismiss the case³ before other creditors can be paid. Under normal circumstances, the Debtor
13 would have a fiduciary duty to maximize recovery for all creditors. Here, that might include
14 confirming a plan of liquidation under which secured claims might be reinstated and paid at non-
15 default rates, and where inequitable conduct by creditors might cause a debtor to seek equitable
16 subordination or disallowance of claims. But this is not the normal case. This debtor intends to
17 pay its controlling equity holders and leave all other creditors in the dust. That would be wrong,
18 and would be contrary to the principles of the Bankruptcy Code.

19 **RELEVANT FACTS**

20 7. NBN is a creditor of the Debtor with a claim in the amount of \$2,143,791.74,
21 based on a Convertible Promissory Note dated May 12, 2006, as amended by an Extension
22 Agreement dated September 11, 2006, and Interest Payment Extension Agreement, dated
23 December 31, 2006, and the Amendment to the Interest Payment Extension Agreement, dated
24 August 1, 2007, and Amendment # 2 to the Interest Payment Extension Agreement, dated January
25 9, 2008 (the “NBN Note”). NBN’s claim is detailed in its Proof of Claim separately filed with
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³ See Chapter 11 Status Report, Dkt No. 107, at 3, ll. 23-26.

1 the Court.

2 8. NBN is also a “Member” of Escom, LLC (“Escom” or “the Debtor”), as set forth
3 in the Fourth Amended and Restated Limited Liability Agreement of Escom, LLC (the “Escom
4 Operating Agreement”).

5 9. As set forth in the Operating Agreement, Dom Partners, LLC (“Dom”) and WTA
6 are Founders, Managers and Members of Escom.

7 10. Although NBN’s consent to the sale of the Debtor’s assets was required under the
8 Escom Operating Agreement, it was neither requested nor obtained. Nevertheless, NBN does not
9 oppose an order (a) authorizing the Debtor to sell assets free and clear of liens, claims, and
10 encumbrances, or (b) approving the asset purchase agreement with successful bidder Clover
11 Holdings Limited, or (c) authorizing the payment of sale commissions from sale proceeds (d) or
12 permitting distribution of the undisputed portion of WTA’s and Dom’s secured claims.

13 11. NBN does object to the Debtor’s request that the Court authorize the full
14 distribution of “the net sale proceeds upon the closing to the Secured Lenders.” NBN has no
15 objection to distribution of the sale proceeds to reimburse undisputed amounts due under the Dom
16 Note or the WTA Note, but does dispute the distribution of amounts sought under the Dom Note
17 or the WTA Note beyond the principal and non-default interest. Further, NBN contends the
18 iEntertainment Note should be disallowed and no sale proceeds should be distributed to
19 iEntertainment.

20 12. Pursuant to the NBN Note, the Debtor promised to pay NBN \$1.5 million that
21 NBN had loaned to the Debtor, at an interest rate of 15%. The NBN Note is a non-recourse
22 obligation of the Debtor, secured solely by Membership Units in Escom. While the NBN Note
23 permitted, in the event of default, NBN to foreclose on its collateral by converting the Note to
24 Membership Units in Escom, NBN did not foreclose on its collateral prior to the commencement
25 of the Debtor’s Chapter 11 case. Pursuant to Bankruptcy Code § 506(a), NBN’s claim will be
26 deemed a general unsecured claim to the extent that the claim exceeds the value of the collateral.

1 13. In addition to, and as a consequence of its loan to the Debtor, on or about the time
2 such loan was agreed to, NBN became a member of Escom. As the Escom Operating Agreement
3 (Schedule A) reflects, NBN holds one Class A Membership Unit in Escom. See accompanying
4 Declaration of Harold Baldauf, Exhibit C.

5 14. In addition to the NBN Note, as detailed in the Escom Operating Agreement (§
6 3.03), the Debtor's purported currently outstanding debt includes three notes held by insiders of
7 the Debtor: a \$5 million Secured Promissory Note payable to WTA (the "WTA Note"); a
8 \$3,000,000 Secured Promissory Note payable to Dom Partners LLC (the "Dom Note"), and the
9 \$2.5 million iEntertainment Note. See Baldauf Declaration Exhibits A, D, E, and F, respectively.

10 **A. The Purported Claims of the "Secured Lenders"**

11 15. The WTA Note, the Dom Note, and the iEntertainment Note all include an 8%
12 interest rate, a default interest rate of 12%, late payment penalties, and a right to recovery of all
13 "necessary" collection costs.

14 16. The WTA Note, the Dom Note and the iEntertainment Note are all secured by
15 collateral consisting of the sex.com domain name and all tangible and intangible property of
16 Escom, as set forth in the applicable security agreements

17 17. WTA, iEntertainment and Dom entered into a Stipulation dated May 20, 2010
18 resolving the parties' dispute among themselves regarding the proper procedure for the sale of
19 Escom's assets, and agreeing that the Debtor be permitted to operate as a debtor in possession
20 subject to the terms of the attached Settlement Agreement, also dated May 2010. (See Dkt. No.
21 52). Pursuant to the Settlement Agreement, Section 4, WTA, DOM and iEntertainment
22 "acknowledge and agree," among themselves, to the purported "true and accurate amounts owed
23 under" their respective Notes, as of April 30, 2010.

24 18. Significantly, NBN promptly opposed the stipulating parties' request for an order
25 approving the stipulation as written. (See Dkt. No. 53). NBN's opposition was resolved by an
26 order on the stipulation including language proffered by NBN. Specifically, the language in

1 paragraph 1 of the June 9, 2010 Order ultimately approving the Stipulation states: “This
2 stipulation is approved, provided, however, that the Stipulation shall not waive the rights of any
3 creditor or other party in interest to object to the allowance, amount, status or priority of claims
4 evidenced by the Notes set forth in section 4 of the Stipulation, or to assert any claims against the
5 Debtor, and all such rights are expressly reserved.”

6 19. In Section 4 of the Settlement Agreement, the parties to that agreement
7 “acknowledge and agree” that as of April 30, 2010, (a) WTA’s secured claim is \$6,799,281.79, of
8 which \$1,709,293.53 is purported “unpaid interest and late fees,” and \$89,988.26 is purported
9 “costs, expenses, attorneys fees and disbursements;” (b) that DOM’s secured claim is
10 \$4,500,427.11, of which \$1,009,622.73 is purported “unpaid interest and late fees,” and
11 \$490,804.38 is purported “costs, expenses, attorneys fees and disbursements;” and (c) that
12 iEntertainment’s secured claim is \$3,577,264.61, of which \$1,029,919.64 is purported “unpaid
13 interest and late fees,” and \$47,344.97 is purported “costs, expenses, attorneys fees and
14 disbursements.”

15 20. Upon information and belief, based on the data made available to NBN as an
16 Escom Member, including the payments made, and absent the default interest rates, late fees and
17 presently unsupported collection costs relating to each of the purported Secured Lenders’ Notes,
18 the unpaid balance and non-default interest due on each of the three Notes, respectively, as of
19 April 30, 2010, is approximately: (a) \$5,744,626.84 on the WTA Note; (b) \$3,461,691.57 on the
20 Dom Note; and (c) \$3,121,896.68 on the iEntertainment Note.

21 21. Notably, the difference between the amounts claimed by the purported Secured
22 Lenders and the amounts due absent default interest and late fees is \$1,920,620.70 and the
23 collections costs sought total \$628,137.61. Thus, the interest rate, late fee and collection cost
24 dispute has an aggregate value of \$2,548,758.31. The aggregate difference for just the WTA and
25 DOM Notes is \$2,093,389.

26 22. While NBN disputes the iEntertainment Note in its entirety, as well as WTA’s and

1 Dom's entitlement to default interest, late fees and collection costs, NBN does not dispute the
2 distribution to WTA and Dom of their secured claims at non-default interest, for a total of
3 \$9,206,317.

4 **B. The iEntertainment Transactions**

5 23. The iEntertainment Note was the ultimate result of a series of transactions between
6 Escom and iEntertainment. On February 3, 2006, Escom entered into an agreement with
7 iEntertainment granting iEntertainment exclusive and broad based linking and marketing rights
8 with respect to sex.com (the "Web Linking Agreement"). Under the Web Linking Agreement,
9 which had a four year term, Escom was entitled to only 10% of the sales revenue generated by
10 iEntertainment. See Baldauf Declaration, Ex. G.

11 24. On September 18, 2006, iEntertainment and Escom entered into an Agreement to
12 Suspend Linking Rights, pursuant to which iEntertainment agreed to suspend its exclusive rights
13 for 6 months in order to license use and control of sex.com to Playboy.com for that six month
14 period. In exchange for agreeing to suspend its linking rights, iEntertainment was to receive 25%
15 of all revenue Escom received from Playboy.com pursuant to the six month license agreement to
16 Playboy. See Baldauf Declaration, Ex. H.

17 25. Notably, under the Playboy License Agreement, Baldauf Declaration, Ex. I, Escom
18 was entitled to 70% of the monthly "Net Revenue," as defined therein, that Playboy.com
19 generated from its use of and linking with sex.com.

20 26. Playboy.com did not extend its license beyond the initial six months, and
21 iEntertainment's rights under the Web Linking Agreement resumed in April 2007.

22 27. On August 1, 2007, purportedly wishing to regain full control of sex.com, Escom
23 entered into an Agreement to Waive Linking Rights, pursuant to which iEntertainment agreed to
24 waive its linking rights for the remainder of the term in exchange for a \$2.5 million "buy out".
25 As set forth in the Agreement to Waive Linking Rights, because Escom did not then have
26 sufficient capital to pay iEntertainment the Buyout Fee, iEntertainment agreed to accept payment

1 in the form of a secured promissory note. See Baldauf Declaration Ex. J.

2 28. WTA is one of the three managers of Escom. As indicated on the Involuntary
3 Bankruptcy Petition, Michael Mann (“Mann”) is the Chairman of WTA.

4 29. As set forth in Dom’s Motion to Dismiss Involuntary Bankruptcy Petition, “WTA
5 manages Escom. Escom’s only employee and Chief Executive Officer, Del Anthony
6 (“Anthony”)(*sic*), reports to and received instructions from WTA’s Chairman, Mann.” (Dkt. No.
7 3, p. 4).

8 30. Mann also controls iEntertainment. Mann signed the Involuntary Bankruptcy
9 Petition as Chairman of iEntertainment as well. iEntertainment’s corporate filings with the
10 Nevada Department of State identify Mann as President, Secretary, Treasurer and Director of
11 iEntertainment. See Baldauf Declaration, at 5.

12 31. The Escom Operating Agreement, Baldauf Exhibit C, to which NBN is a
13 signatory, acknowledges in Section 5.05 that iEntertainment is an “affiliate” of WTA. Section
14 5.05 also includes a specific acknowledgement by the Members of Escom that Escom entered into
15 the Web Linking Agreement and Agreement to Waive Linking Rights with iEntertainment.
16 Notably, Section 5.05, which is titled “Contracts with Affiliated Persons,” also makes explicit that
17 Escom, with the approval of the Managers, could enter into agreements with “any Member,
18 Manager or Affiliated Person,” “provided in each case the amounts payable thereunder are
19 reasonably comparable to those which would be payable to unaffiliated Persons. . .”

20 32. As set forth in the accompanying Declaration of Gabriel Fried, the amounts
21 payable to iEntertainment under the Web Linking Agreement and Agreement to Waive Linking
22 Rights were not “reasonably comparable” to what an unaffiliated person could expect to receive
23 under similar agreements.⁴ Specifically, (a) Escom could have achieved a higher commission
24 payment, most likely a minimum of 20-25% from any number of providers of similar services in
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⁴ The opinions of Gabriel Fried are being offered at this point to apprise the Court of what NBN intends to establish, once adequate discovery has been obtained, with respect to the iEntertainment transactions.

1 the business; (b) Escom did not have to provide exclusivity to iEntertainment in exchange either
2 for its services or for its commission structure; (c) iEntertainment was under no obligation to
3 perform as part the exclusivity it was able to secure; (d) iEntertainment therefore acquired an
4 asset of value without any consideration; and (e) there is no audit provision in the agreement,
5 permitting Escom to audit its licensee. See accompanying Declaration of Gabriel Fried, filed
6 contemporaneously herewith

7 **III. ARGUMENT**

8
9 **A. The Secured Lenders Are Not Entitled to the Sale Proceeds Unless and Until Their
Claims are Proven to be Recoverable**

10 33. NBN objects to the amount of the WTA and DOM secured claims, and objects not
11 only to the amount of iEntertainment's purported secured claim, but intends to demonstrate that
12 iEntertainment's claim should not be allowed.

13 34. NBN's objection, as a creditor and party in interest, precludes WTA, DOM and
14 iEntertainment from simply agreeing amongst themselves as to the amount and allowability of
15 their respective claims. Pursuant to 11 U.S.C. § 502(a), once an objecting party submits
16 sufficient evidence to place the claimant's entitlement at issue, the burden of going forward with
17 the evidence to sustain the claim shifts to the claimant. *In re Harrison*, 987 F.2d 677 (10th Cir.
18 1993). The objecting party is not required to disprove the claim. *In re Kahn*, 114 B.R. 40 (Bankr.
19 S.D. N.Y. 1990). It is the claimant that must establish by a preponderance of the evidence that its
20 claim should be allowed. *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 97 B.R. 420,
21 424 (Bankr. N.D. Ill. 1989) (claimant bears burden of persuasion by preponderance of evidence);
22 *In re Ousley*, 92 B.R. 278 (S.D. Ohio 1988); *In re Twinton Properties Partnership*, 44 B.R. 420
23 (Bankr. Tenn. 1984).

24 35. Here, in addition to seeking recovery of default interest and late fees which this
25 court should not allow, *see infra*, the purported Secured Lenders assert "necessary" collection
26 costs which collectively *exceed over \$620,000*. No evidence supporting these purported costs or

1 their purported necessity has been disclosed.

2 36. These collection costs are not recoverable unless and until they are proven to have
3 been necessary. *See In re Dalessio*, 74 B.R. 721, 723-4 (9th Cir. B.A.P. 1987) (A creditor should
4 not “be given a blank check to incur fees and costs which will automatically be reimbursed out of
5 its collateral.”); *see also In re Miracle Enterprises, Inc.*, 57 B.R. 133, 136 (Bankr. D.R.I. 1986) (It
6 is “inherently unreasonable to ask a debtor to reimburse attorneys’ fees incurred by a creditor that
7 are not cost justified ... or necessary to preservation of the creditor’s interest.”); *cf. SNTL Corp.*
8 *v. Centre Ins. Co.*, 571 F. 3d 826, 845-46 (9th Cir. 2009) (Court to determine entitlement to
9 attorneys fees and costs under relevant contracts or state law).

10 37. Particularly where, as here, the purported Secured Lenders are also Managers of
11 the Debtor from who collection is sought, the necessity of significant collection costs – as
12 opposed to unrecoverable costs incurred as a result of in-fighting amongst Managers of the
13 Debtor – is arguably, on its fact, inherently unreasonable. Indeed, the lion’s share of the
14 collection costs currently sought (\$490,804.38), were purportedly accrued by Dom, but as Dom’s
15 own Motion to Dismiss Involuntary Bankruptcy Petition (Dkt. No. 3) acknowledges, these costs
16 were accrued primarily due to Dom’s battle with WTA over the proper means of selling Escom’s
17 assets, which is a dispute between the managers of Escom for control over the liquidation process,
18 and not costs incurred by DOM enforcing rights in a dispute with the Debtor.

19 38. Of course, until those costs are documented, it is impossible to identify what
20 portion, if any, should be part of the allowed claims.

21
22 **B. Default Interest Rates and Late Fees Should Not be Allowed For Secured Lenders
That Control the Debtor**

23 39. Collectively, the default interest rates and late payments on the WTA Note, the
24 Dom Note, and the iEntertainment Note amount to approximately \$1.9 million in additional fees
25 claimed by the purported Secured Lenders.

26 40. In *General Electric Capital Corp. v. Future Media Productions, Inc.*, 547 F.3d 956

1 (9th Cir. 2008), the Ninth Circuit held that unlike the “per se” rule against payment of default
2 interest rates to oversecured creditors as part of a Chapter 11 plan, there was nothing in the
3 Bankruptcy Code to prevent an oversecured creditor from collecting interest at a default rate
4 where the debtor was paying creditor's claims out of the proceeds of a Section 363 sale of assets.
5 However, the Ninth Circuit, adopting the rule followed by the majority of federal courts, held a
6 contracted rate of default creates a presumption of allowability, but that presumption can be
7 rebutted. *Id.* at 961.

8 41. Thus, the Ninth Circuit in *General Electric* made clear a Bankruptcy Court can be
9 guided by equitable considerations, and when necessary, rebut the presumption of a creditor’s
10 entitlement to default interest. *Id.* (citing with approval *In re Laymon*, 958 F.2d 72, 75 (5th
11 Cir.1992) (holding “that when an oversecured creditor's claim arises from a contract, the contract
12 provides the rate of post-petition interest,” subject to examination of “the equities involved in
13 [the] bankruptcy proceeding”), cert. den., 506 U.S. 917, 113 S.Ct. 328, 121 L.Ed.2d 247 (1992);
14 *In re Terry Ltd. P'ship*, 27 F.3d 241, 243 (7th Cir.1994) (noting the general rule that there is a
15 “presumption in favor of the contract rate subject to rebuttal based on equitable considerations”).

16 42. Here, the purported Secured Lenders status as controlling insiders of the Debtor
17 rebuts the presumption of entitlement to default interest. Where the very individuals responsible
18 for deciding whether the Notes defaulted would benefit from that default, the equities strongly
19 weigh against recovery of default interest. Generally, a Debtor owes a fiduciary duty to
20 maximize recovery for all creditors. Here, the Debtor and its insiders are doing just the opposite
21 – maximizing their own recovery to the detriment of non-controlling creditors. Of course, the
22 Debtor could maximize returns if it confirmed a liquidating plan, cured defaults, reinstated the
23 notes, and paid notes at contract rates. That would push value down to other creditors. Instead,
24 hoping to avoid an outcome that may reduce their take away by even a penny, the insiders seek to
25 sidestep their duties to the Debtor’s creditors through their purported “Settlement Agreement”
26 and this Sale Procedures Motion. Thus, in this instance, “the equities involved the bankruptcy

1 proceeding,” *In re Laymon*, 958 F.2d at 75, start with understanding that controlling insiders are
2 paying themselves and then intend to dismiss the case so that no one else gets paid anything.

3 43. A debtor truly concerned with the recovery for the estate would in fact propose a
4 plan under which the notes are reinstated, cured, and paid in full at the non-default rate. *See e.g.*,
5 *In re Sylmar Plaza, L.P.*, 314 F. 3d 1070, 1075 (9th Cir. 2002), *cert denied* 2003 U. S. Lexis 3748
6 (U.S., May 19, 2003), and cases cited therein. Just as the better recovery for an estate selling real
7 property is pursuant to a plan, under which payment of state transfer taxes can be avoided, *see*
8 *Florida Dept. of Rev. v. Picadilly*, 128 S. Ct. 2326 (2008), a better recovery for the estate here is
9 one where the Debtor avoids payment of default fees and late penalties.

10 44. The approximate \$1.9 million in default penalties and late fees⁵ is padding the
11 pockets of the very individuals who placed the Debtor into bankruptcy at the expense of
12 unsecured creditors. The equitable considerations Bankruptcy Court’s have found relevant in
13 deciding whether to award default interest at the contract rate include situations where
14 “application of the statutory interest rate would cause direct harm to the unsecured creditors.”
15 *See Urban Communicators PCS Ltd. Partnership v. Gabriel Capital, L.P.*, 394 B.R. 325, 338
16 (S.D.N.Y. 2008). Here, based on the sale price and the amount claimed by the purported Secured
17 Lenders, and depending on whether the iEntertainment claim is allowed, the \$1.9 (or \$1.5
18 excluding iEntertainment) million in default penalties may well determine whether the unsecured
19 creditors recover anything.

20 **C. The iEntertainment Claim Should Be Disallowed**

21 45. Escom entered into a transaction with iEntertainment which provided
22 iEntertainment with essentially 90% of the value of sex.com. Incredibly, in exchange for these
23 valuable rights, iEntertainment paid nothing, and was not obligated under the Web Linking
24 Agreement to do anything. In the event that iEntertainment received revenue, it was required to

25 _____
26 ⁵ The \$ 1.9 million includes iEntertainment’s default interest and late fees. If you exclude the iEntertainment Note, which NBN contends should be disallowed, the default interest and late fees from the WTA Note and Dom Note alone is about \$1.5 million.

1 pay 10% of its revenue to Escom. But the Linking Agreement did not require iEntertainment to
2 generate revenue, had no penalty or termination clause for failure to generate any minimum
3 income, and had no audit rights to confirm either its operations or its revenue upon which
4 payments to Escom were to be calculated. In fact, iEntertainment did not generate *any revenue*
5 for Escom during the period that it operated under the Web Linking Agreement after the end of
6 the Playboy license. Notwithstanding its failure to generate any revenue in and after April 2007,
7 in August 2007 Escom paid iEntertainment \$2.5 million (in the form of a secured promissory
8 note) to “buy back” its rights under the Web Linking Agreement. In short, it was the ultimate
9 sweetheart deal providing all benefits to one party, controlled by Mann, to the detriment of the
10 Debtor. Contrary to the representations made to NBN, the Web Linking Agreement was overly
11 advantageous to iEntertainment and did not reflect commercially reasonable, arm’s length market
12 terms. See Baldauf Declaration, at 5, Fried Declaration, Ex. A.

13 46. There is no commercially reasonable explanation for why Escom, controlled by
14 Mann, even needed to license these rights to another entity, also controlled by Mann. The only
15 plausible explanation for this self-dealing is that it was a means of transferring a significant
16 portion of the value of Escom to Mann himself. Escom, controlled by Mann, then agreed to pay
17 iEntertainment, also controlled by Mann, \$2.5 million to give these rights back.

18 47. A debtor actually concerned with protecting the interests of the estate would have
19 every reason, and multiple grounds, to challenge iEntertainment’s rights to recovery on these
20 transactions. But as the Debtor is presently controlled by the very insiders who benefit from this
21 self-dealing, it is left to NBN do so.

22 48. Although purportedly approved and authorized, these transactions were not
23 permissible under the Operating Agreement, which only sanctioned contracts with affiliates that
24 are “reasonably comparable” to contracts with non-affiliated entities.

25 49. Further, the iEntertainment transactions are a clear example of corporate waste and
26 are therefore void. *In re Infousa, Inc.*, 2007 WL 3325921, 28 (Del.Ch. 2007) (holding a

1 transaction to constitute waste where “no reasonable person could deem the received
2 consideration adequate,” and finding a valid waste claim with respect to related-party
3 transactions, where board of directors allowed director to extract value from the company by
4 selling his own assets to the corporation at inequitable prices). Instead of permitting Escom to
5 generate these revenues for itself, Mann usurped them for his other enterprise.

6 50. While NBN acknowledged the iEntertainment transactions in the Operating
7 Agreement, NBN in fact understood the managers of Escom to be representing that these
8 affiliated transactions were nonetheless fair market transactions. NBN has come to understand,
9 after acknowledging the deal, that these were not fair market transactions, and that the default on
10 the iEntertainment Note resulting from these transactions ultimately facilitated the involuntary
11 petition, through which Mann’s entities – IEntertainment and WTA - ultimately profit. See
12 Baldauf Declaration, at 5.

13 51. Again, in consummating the iEntertainment transactions, WTA, as a Manager of
14 the Debtor, owed a fiduciary duty to NBN as a Member, which duties were breached in approving
15 these self-dealing transactions that were harmful to Escom. *Cf. eBay Domestic Holdings, Inc. v.*
16 *Newmark*, 2010 WL 3516473, at * 29 (Del.Ch. 2010) (holding that even if interested directors of
17 Craigslist, Jim and Craig, engaged in conduct that “did not violate a technical provision of the
18 Shareholders' Agreement,” they owed fiduciary duties to eBay as a minority shareholder, and as
19 fiduciaries, “Jim and Craig were bound not to approve an interested transaction unless that
20 transaction was entirely fair to craigslist and to eBay.”).

21 52. For all these reasons, iEntertainment’s claim which is based entirely on these
22 improper transactions, must be disallowed.

23 **D. Alternatively, the iEntertainment Claim Should be Equitably Subordinated**

24 53. In order to exercise the power of equitable subordination, the bankruptcy court
25 must find that: (1) the creditor engaged in some type of inequitable conduct or fraud, (2) such
26 conduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair

1 advantage on the creditor, and (3) equitable subordination of the claim must not be inconsistent
2 with the provisions of the Bankruptcy Code. *U.S. v. Noland*, 517 U.S. 535, 538-39, 116 S.Ct.
3 1524, 134 L.Ed.2d 748 (1996); *Merrimac Paper Co., Inc. v. Harrison (In re Merrimac Paper Co.,*
4 *Inc.)*, 420 F.3d 53, 59 (1st Cir.2005). Here, the requirements are clearly met.

5 54. Notably, “Claims arising from dealings between a debtor and an insider are
6 rigorously scrutinized by the courts.” *604 Columbus Ave.*, 968 F.2d at 1360 (*quoting In re*
7 *Fabricators, Inc.*, 926 F.2d 1458, 1465 (5th Cir.1991)). While “fraud or misrepresentation are the
8 most frequent justifications for equitable subordination of the noninsider” something less than
9 actual fraud is sufficient when looking at the claims of an insider. *Id.* Substantial misconduct
10 involving moral turpitude or a breach or misrepresentation where other creditors were deceived to
11 their damage or gross misconduct amounting to overreaching is sufficient. *Id.*

12 55. Where, as here, a creditor and an insider of the Debtor manipulated the Debtor for
13 its own ends, the claims of that creditor – iEntertainment – are properly subordinated. *See Matter*
14 *of Century Glove, Inc.*, 151 B.R. 327 (Bankr. D.Del. 1993) (debtor in possession stated claim for
15 equitable subordination against one of its former officers and a creditor, alleging that creditor and
16 officer conspired to control debtor for their own benefit to detriment of debtor's unsecured
17 creditors).

18 56. Accordingly, for the reasons set forth above, NBN respectfully requests that the
19 Court order that all sale proceeds, after payment of the costs of the sale and any undisputed
20 portion of the Secured Lenders’ claims, be deposited into an interest bearing escrow account, with
21 any further distribution to be made only upon further order of this Court, and that the Court
22 schedule a further hearing on this motion in order to provide an opportunity for all parties to
23 conduct necessary discovery and fully brief the issues respecting the disputed portion of the
24 Secured Lenders’ claims.

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Dated: October 26, 2010

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By /s/ _____

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In re: <p style="text-align: center;">ESCOM, LLC</p> <p style="text-align: right;">Debtor(s).</p>	CHAPTER 11 CASE NUMBER 1:10-bk-13001-GM
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PROOF OF SERVICE OF DOCUMENT

I am over the age of 18 and not a party to this bankruptcy case or adversary proceeding. My business address is:
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A true and correct copy of the foregoing document described
OPPOSITION TO MOTION FOR ORDER (I) AUTHORIZING DEBTOR TO SELL ASSETS FREE AND CLEAR OF LIENS, CLAIMS, AND ENCUMBRANCES, (II) APPROVING ASSET PURCHASE AGREEMENT WITH SUCCESSFUL BIDDER CLOVER HOLDINGS LIMITED, (III) AUTHORIZING PAYMENT OF SALE COMMISSIONS FROM SALE PROCEEDS, AND (IV) GRANTING RELATED RELIEF

will be served or was served (a) on the judge in chambers in the form and manner required by LBR 5005-2(d); and (b) in the manner indicated below:

I. TO BE SERVED BY THE COURT VIA NOTICE OF ELECTRONIC FILING ("NEF") – Pursuant to controlling General Order(s) and Local Bankruptcy Rule(s) ("LBR"), the foregoing document will be served by the court via NEF and hyperlink to the document. On 10/26/2010, I checked the CM/ECF docket for this bankruptcy case or adversary proceeding and determined that the following person(s) are on the Electronic Mail Notice List to receive NEF transmission at the email address(es) indicated below:

Service information continued on attached page

II. SERVED BY U.S. MAIL OR OVERNIGHT MAIL(indicate method for each person or entity served):

On 10/26/2010, I served the following person(s) and/or entity(ies) at the last known address(es) in this bankruptcy case or adversary proceeding by placing a true and correct copy thereof in a sealed envelope in the United States Mail, first class, postage prepaid, and/or with an overnight mail service addressed as follows. Listing the judge here constitutes a declaration that mailing to the judge will be completed no later than 24 hours after the document is filed.

By U.S. MAIL

Honorable Geraldine Mund
Courtroom 303
21041 Burbank Blvd.
Woodland Hills, CA 91367

Service information continued on attached page

III. SERVED BY PERSONAL DELIVERY, FACSIMILE TRANSMISSION OR EMAIL (indicate method for each person or entity served): Pursuant to F.R.Civ.P. 5 and/or controlling LBR, on _____, I served the following person(s) and/or entity(ies) by personal delivery, or (for those who consented in writing to such service method), by facsimile transmission and/or email as follows. Listing the judge here constitutes a declaration that personal delivery on the judge will be completed no later than 24 hours after the document is filed.

Service information continued on attached page

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

<u>10/26/2010</u> Date	<u>Christopher R. Scott</u> Type Name	 Signature
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In re: ESCOM, LLC Debtor(s).	CHAPTER 11 CASE NUMBER 1:10-bk-13001-GM
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In re: ESCUM, LLC Debtor(s).	CHAPTER 11 CASE NUMBER 1:10-bk-13001-GM
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In re: ESCOM, LLC Debtor(s).	CHAPTER 11 CASE NUMBER 1:10-bk-13001-GM
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In re: ESCOM, LLC Debtor(s).	CHAPTER 11 CASE NUMBER 1:10-bk-13001-GM
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