

**IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF DELAWARE**

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|----------------|---|-------------------------|
| In re:         | : | Chapter 11              |
|                | : |                         |
| NovaSom, Inc., | : | Case No. 19-11734 (BLS) |
|                | : |                         |
| Debtor.        | : |                         |
|                | : |                         |

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**MOTION OF DEBTOR NOVASOM, INC. FOR INTERIM AND FINAL ORDERS (A)  
AUTHORIZING THE DEBTOR TO USE CASH COLLATERAL  
OF PRIMARY LENDERS AND GRANTING ADEQUATE  
PROTECTION FOR ITS USE AND (B) PRESCRIBING FORM AND MANNER  
OF NOTICE AND SETTING THE TIME FOR THE FINAL HEARING**

NovaSom, Inc., the above-captioned debtor and debtor-in-possession (“Novasom” or the “Debtor”), by its undersigned proposed counsel, hereby moves this Court (the “Motion”), for the entry of an interim order substantially in the form attached hereto as **Exhibit A** (the “Interim Order”) and a final order (the “Final Order,” and with the Interim Order, the “Cash Collateral Orders”), pursuant to 11 U.S.C. §§ 105, 361, and 363 and Fed. R. Bankr. P. 4001 and 9014, (a) authorizing the Debtor to use the cash collateral of the Primary Lenders (as defined herein) and granting adequate protection to the Primary Lenders for the use of cash collateral and (b) prescribing the form and manner of notice and setting the time for the final hearing on the Motion (the “Final Hearing”). In further support of this Motion, the Debtor respectfully represents as follows:

**Bankruptcy Rule 4001 and Local Rule 4001-2 Concise Statement**

1. The disclosures required by Bankruptcy Rule 4001(b)(1)(B)(i)-(iv) are as follows:
  - a. *Name of Each Entity with Interest in Cash Collateral.*
    1. East West Bank (“East West”)

2. The following subordinated noteholders (The “Subordinated Noteholders”):

Safeguard Delaware, Inc.  
TPG Biotechnology Partners II, L.P.  
Quaker Bio Ventures II, L.P.  
Gregory A. Hartzler  
Francis H. Koch and John F. Koch, Trustees  
John T. Spitznagel  
Reid A. Williams  
Gary Corbett

Collectively, East West and the Subordinated Noteholders are referred to herein as the “Primary Lenders”.

b. *Purposes of Use of Cash Collateral.*

To fund the operations of the Debtor’s business and the administrative expenses of this bankruptcy case, as set forth in the Budget and such further Budgets that may be submitted by the Debtor.

c. *Duration of Use of Cash Collateral.*

The Debtor is requesting authority to use cash collateral from the date of entry of the Interim Order until the earlier of: (a) the entry of a subsequent interim cash collateral order, or (b) the entry of a Final Order.

d. *Liens, Cash Payments or Other Adequate Protection to Be Provided to Each Entity with Interest in Cash Collateral.*

The Replacement Liens (as defined in this Motion) and the preservation of the going concern value of the Debtor’s business by continued operations until an orderly sale can be consummated.

2. Pursuant to Local Bankruptcy Rule 4001-2(a)(i), the Debtor states that none of the provisions identified in Local Rule 4001-2(a)(i) are included in the proposed order.

3. A concise statement of the relief sought herein is that the Debtor seeks to use cash collateral to continue operating the Debtor’s business as a going concern, pending a sale either under 11 U.S.C. § 363 or through a confirmed plan. As adequate protection for the use of such cash collateral, the Debtor intends to provide replacement liens and to protect the value of such

collateral by continuing to operate the Debtor's business as a going concern while it pursues a sale of substantially all of the Debtor's assets to a third party purchaser.

### **JURISDICTION**

4. The Court has jurisdiction to consider this matter pursuant to 28 U.S.C. §§ 1334. This matter is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2).

5. The Debtor consents to the entry of final orders or judgments of the Court if it is determined that the Court, absent consent of the parties, cannot enter final orders or judgments consistent with Article III of the United States Constitution.

6. Venue is proper in this district pursuant to 28 U.S.C. §§ 1408 and 1409.

7. The bases for the relief requested herein are sections 105, 361 and 363 of title 11 of the United States Code, 11 U.S.C. §§ 101 – 1532 (the "Bankruptcy Code"), Rules 2002, 4001 and 9014 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"), and Rule 4001-2 of the Local Rules (the "Local Rules") of the United States Bankruptcy Court for the District of Delaware (the "Court").

### **BACKGROUND**

8. On August 2, 2019 ("Petition Date"), the Debtor filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code. The Debtor is operating its business and managing its properties as a debtor-in-possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code. No request for the appointment of a trustee or examiner has been made in this Chapter 11 case.

9. A detailed description of the Debtor's business, capital structure, and the reasons for commencing the Chapter 11 Case is set forth in the Declaration of Gregory Stokes in support of the Debtor's First Day Pleadings (the "Stokes Declaration").

10. NovaSom is a home sleep testing (“HST”) company having its principal place of business in Glen Burnie, Maryland. Its business model is to send a medical device (FDA approved sleep recorder) to a patient’s home in order for the patient to be tested for obstructive sleep apnea (“OSA”) in his or her own home, rather than in a sleep lab, when a physician prescribes the HST based on symptoms and the patient’s condition. The device records and auto-scores the number of apnea events, then sends the data back to NovaSom’s servers via a cell phone chip in the device. Sleep physicians are then able to overscore the data and give an opinion to the ordering physician as to the patient’s likelihood of having OSA.

11. From 2010 to 2012, NovaSom developed a new device (“AccuSom”), which enabled sleep data to be sent wirelessly, rather than requiring the return of the device to a lab in order to download the data. When that device launched, sales were not as robust as planned, and the management team was replaced in 2013 by a commercially oriented team. Between 2013 and 2017, orders for the AccuSom HSTs grew 500%. However, the average sales price dropped by nearly 30% over that period of time due to market conditions and the general availability of HST providers. Additionally, the cost of growing the sales was significant and included hiring more sales representatives, as well as support and customer service personnel to manage the orders. As a result, NovaSom never reached profitability.

12. Novasom tried to attract a buyer for the company, and, when that did not work, to find possible private equity groups to provide the resources for continued growth, to find a structured debt provider which was to provide significant growth capital for the company, and then again to find a potential buyer. When this last effort failed, in June, 2019, NovaSom retained Sherwood Partners, a financial advisory firm, at the request of the senior secured lender to help identify potential asset purchasers and determine the best path moving forward to protect

its shareholders, creditors and employees. During July, 2019, in consultation with its senior secured lender, NovaSom solicited and received an offer to acquire substantially all of its assets from VirtuOx, Inc. (the “Stalking Horse Purchaser”). That offer was conditioned, among other things, on the immediate filing of a voluntary Chapter 11 petition and an expeditious sale process in which the acquired assets would be sold to the Stalking Horse Purchaser, free and clear of liens, claims, encumbrances and interests pursuant to section 363(b) and (f) of the Bankruptcy Code, with the assumption and assignment of certain executory contracts, subject to higher and better bids, all as more as fully set forth in the Asset Purchase Agreement, by and between the Stalking Horse Purchaser and the Debtor.

13. NovaSom evaluated the offer of the Stalking Horse Purchaser in conjunction with the Lender and determined that proceeding with this Chapter 11 case (the “Chapter 11 Case”), and a sale to the Stalking Horse Purchaser of substantially all of its assets, subject to a process for obtaining potentially higher, better or competing offers, was in the best interest of NovaSom, its creditors, customers and employees in that, among other reasons, it would stem the Debtor’s operating losses while preserving the continuity of the Debtor’s customer services.

#### **THE DEBT TO THE PRIMARY LENDERS**

14. The only parties believed to assert an interest in the Debtor’s cash collateral are the Primary Lenders. These parties’ interests arise from the following loans extended to the Debtor:

- (a) East West extended (a) a term loan in the original principal amount of \$8.5 million and (b) a revolving line of credit to the Debtor pursuant to that certain Loan and Security Agreement dated on or about January 25, 2018, as such agreement has been amended (the “East West Loan”);
- (b) The Subordinated Noteholders made various loans to the Debtor in the period from May 22, 2014 to the present (the “Subordinated Noteholder Loans”), which loans were memorialized by, inter alia, promissory notes issued by the Debtor. The original principal amount of the loans made by the Subordinated Noteholders totals \$15,554,500. The Subordinated Noteholders originally asserted a first priority lien in certain collateral,

including but not limited to accounts. The Subordinated Noteholders later executed a subordination agreement by which their liens on the Debtor's property were subordinated to East West Bank.

15. East West asserts that the East West Loan is secured by first priority liens on and security interests in and to all personal property of the Debtor, wherever located, including but not limited to all accounts, chattel paper, deposit accounts, certain intellectual property, and proceeds thereof. The Subordinated Noteholders assert that the Subordinated Noteholder Loans are secured by all of the Debtor's assets of every kind, including but not limited to accounts, chattel paper, equipment, inventory, and the proceeds thereof (the collateral securing the East West Loan and the collateral securing the Subordinated Noteholder Loans is collectively referred to herein as the "Collateral").

16. East West asserts that as of the Petition Date, the aggregate outstanding principal balance of the East West Loan exceeds \$10 million. The Subordinated Noteholders assert that as of the Petition Date, the aggregate outstanding principal balance of the Subordinated Noteholder Loans exceeds \$ 18.5 million.

17. The Debtor believes that the indebtedness to East West Bank likely greatly exceeds the value of the Collateral, so that as a practical matter the debt of the Subordinated Noteholders is unsecured.

18. The Debtor intends to use cash collateral to operate its business while it pursues a sale of its business.

**RELIEF REQUESTED**

19. By this Motion, pursuant to sections 105, 361 and 363 of the Bankruptcy Code and Bankruptcy Rules 4001 and 9014, the Debtor requests that the Court grant the following relief as provided for in the Interim Order and the Final Order:

- a. authorize the Debtor on an interim basis pursuant to section 363(c) of the Bankruptcy Code, to use proceeds of assets on which the Primary Lenders assert first priority liens and security interests (the “Cash Collateral”)<sup>1</sup> in accordance with the budget (as amended from time to time, the “Budget”) attached to the Interim Order as Exhibit 1;
- b. authorize the Debtor on an interim basis, pursuant to sections 361 and 363 of the Bankruptcy Code, to provide the adequate protection described herein to the Primary Lenders with respect to any diminution in value of the Primary Lenders’ interests in the Collateral whether from the use of the Cash Collateral or the use, sale, lease, depreciation, decline in market price, or otherwise of the Collateral;
- c. schedule the Final Hearing, pursuant to Bankruptcy Rule 4001, no later than twenty-five (25) days after the entry of the Interim Order, to consider entry of a Final Order authorizing the use of the Cash Collateral and approving the notice procedures in respect of the Final Hearing;
- d. authorize the Debtor on a final basis pursuant to section 363(c) of the Bankruptcy Code, to use the Cash Collateral in accordance with the Budget and any supplemental budgets as approved by the Court after further notice and hearing; and
- e. authorize the Debtor on a final basis, pursuant to sections 361 and 363 of the Bankruptcy Code, to provide the adequate protection described herein to the Primary Lenders with respect to any diminution in value of the Primary Lenders’ interests in the Collateral whether from the use of the Cash Collateral or the use, sale, lease, depreciation, decline in market price, or otherwise of the Collateral.

### **BASIS FOR RELIEF**

#### **A. The Debtor Has an Immediate Need for Use of the Cash Collateral.**

20. The Debtor has an urgent need for the immediate use of the Cash Collateral pending the Final Hearing on this Motion. Accordingly, the Debtor seeks to use Cash Collateral existing on or after the Petition Date that may be subject to the Primary Lenders’ liens. As of the Petition Date, the Debtor does not have sufficient unencumbered cash to fund its business operations and pay present operating expenses.

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<sup>1</sup> The Debtor does not hereby make any admission or consent with respect to the validity, priority, extent or enforceability of the liens asserted by the Lenders, and hereby reserve all rights with respect thereto.

21. It is the Debtor's understanding that East West consents to the use of cash collateral in accordance with the Budget.

22. Absent the ability to use Cash Collateral, the Debtor will not be able to pay insurance, wages, rent, utility charges, and other critical operating expenses. Consequently, without access to Cash Collateral, the Debtor will not be able to maintain its business operations and, and would likely be forced to cease operations immediately and commence a fire sale of its assets. This would result in a loss of going concern value that would cause the Debtor's estate to be immediately and irreparably harmed.

23. If the Debtor is unable to obtain sufficient operating liquidity to meet its postpetition obligations on a timely basis, a permanent and irreplaceable loss of business will occur, causing a loss of value to the detriment of the Debtor and its creditors. This potential loss of revenue and going concern value would be extremely harmful to the Debtor, its estate and its creditors at this critical juncture. See In re Global Safety Textiles Holdings LLC, 2009 WL 7834657, at \*4 (Bankr. D. Del. July 30, 2009), aff'd as modified by 2009 WL 7834658 (Bankr. D. Del. Sept. 21, 2009) (finding good cause for the use of cash collateral based on the Debtor's immediate need to use cash collateral to continue operation of their businesses and maintain business relationships with vendors).

24. The Debtor's management has formulated the initial 13 week Budget for the use of Cash Collateral after the Petition Date. The Debtor believes that the Budget includes all reasonable, necessary and foreseeable expenses to be incurred in the ordinary course in connection with the operation of its business and its restructuring efforts for the period set forth in the Budget. The Debtor also believes that the use of Cash Collateral in accordance with the Budget will provide the Debtor with adequate liquidity to pay administrative expenses as they

become due and payable during the period covered by the Budget.

25. The Debtor's right to use Cash Collateral under the Interim Order shall commence on the date of the entry of the Interim Order and expire on the earlier of (a) the entry of a subsequent interim order, or (b) the entry of the Final Order.

**B. The Interests of the Primary Lenders Are Adequately Protected.**

26. Pursuant to section 363(c)(2) of the Bankruptcy Code, a debtor in possession may only use "cash collateral" with the consent of the secured party with an interest therein or court approval. *See* 11 U.S.C. § 363(c)(2). *See In re Pursuit Athletic Footwear, Inc.*, 193 B.R. 713, 721 (Bankr. D. Del. 1996) (holding that secured creditors were adequately protected and allowing debtor to use cash collateral). Section 363(e) of the Bankruptcy Code provides that, upon request of an entity that has an interest in cash collateral sought to be used by a debtor, the Court shall prohibit or condition such use of cash collateral as is necessary to provide adequate protection of such entity's interest. *See* 11 U.S.C. § 363(e).

27. Appropriate adequate protection is decided on a case-by-case basis. *See, e.g., Resolution Trust Corp. v. Swedeland Dev. Group*, 16 F.3d 552, 564 (3d Cir. 1994); *In re Columbia Gas Sys., Inc.*, 1992 WL 79323, at \*2 (Bankr. D. Del. Feb. 18, 1992). Although adequate protection is not defined in the Bankruptcy Code, section 361 of the Bankruptcy Code provides the following three (3) nonexclusive examples of what may constitute adequate protection:

- (1) requiring the [debtor] to make a cash payment or periodic cash payments to such entity, to the extent that the . . . use . . . under section 363 . . . results in a decrease in the value of such entity's interest in such property;
- (2) providing to such entity an additional or replacement lien to the extent that such . . . use . . . results in a decrease in the value of such

entity's interest in such property; or

(3) granting such other relief . . . as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

11 U.S.C. § 361. Essentially, with the provision of adequate protection, the Bankruptcy Code seeks to shield a secured creditor from diminution in the value of its interest in the particular collateral during the period of use. See In re Continental Airlines, Inc., 154 B.R. 176, 180-81 (Bankr. D. Del. 1993).

28. The Debtor asserts that the Primary Lenders are adequately protected by the granting of replacement liens (only to the extent their prepetition security interests are perfected and enforceable) and the continuation of the Debtor's business.

29. Although it appears that the amounts asserted to be due by East West greatly exceed the value of the Collateral, the protections described herein for the Subordinated Noteholders will protect those parties in the event, and to the extent, that the Subordinated Noteholders in fact have a security interest in cash collateral.

Replacement Liens

30. As adequate protection for any diminution in value of the Primary Lenders' interests, the Debtor requests that the Court grant the Primary Lenders' security interests (the "Replacement Liens") equivalent to a lien granted under section 364(c)(2) and (3) of the Bankruptcy Code, as applicable, in and upon the Debtor's personal property, including Cash Collateral, whether such property was acquired before or after the Petition Date, to the extent: (i) that the type of personal property is currently part of the Primary Lenders' Collateral as of the Petition Date; (ii) that the Primary Lenders' prepetition security interests in the Collateral are valid and properly perfected, and (iii) of the amount of any diminution in value of the Collateral.

If granted, the Replacement Liens will adequately protect the Primary Lenders' interests from any potential depreciation and deterioration.

Continued Operation of the Debtor's Business

31. In addition to the proposed Replacement Liens, the Primary Lenders are also adequately protected as a result of the continuation of the Debtor's business operations. Without the use of the Cash Collateral, the Debtor would likely be required to cease operations, resulting in a permanent diminution in value of the Debtor's business. Indeed, absent use of the Cash Collateral, the Debtor likely will be unable to pay ordinary business expenses, including employee wages. In that event, all operations will cease—employees will be terminated, the company will no longer operate, and all assets on which the Primary Lenders assert a lien will be worth substantially less than they would be as part of a sale of a going concern. The use of the Cash Collateral to operate the business and maintain going concern value provides adequate protection to the Primary Lenders. As going concern value exceeds liquidation value, adequate protection is being provided.

32. The continuation of the Debtor's operations to facilitate a sale presents the best opportunity for the Primary Lenders to receive the greatest recovery on account of their claims. Moreover, the Stalking Horse Contract requires as a condition to closing that the Debtor maintain its operations in the ordinary course through the date of closing of any sale of the Debtor's assets. Accordingly, the Debtor submits that use of the Cash Collateral will allow the Debtor to continue operations pending a sale and, thereby, protect the Primary Lenders' interests. Courts have recognized that the preservation of the going concern value of secured lender's collateral constitutes adequate protection of such creditor's interest in the collateral. See, e.g., Pursuit Athletic Footwear, Inc., 193 B.R. at 716 (holding that if there is no actual diminution of

value of collateral and the debtor can operate profitably post-petition, then the secured creditor is adequately protected); In re 499 W. Warren Street Assocs., Ltd. P'ship, 142 B.R. 53, 56 (Bankr. N.D.N.Y. 1992) (court found a secured creditor's interest in collateral adequately protected when cash collateral was applied to normal operating and maintenance expenditures on the collateral property); In re Willowood E. Apts. of Indianapolis II, Ltd., 114 B.R. 138, 143 (Bankr. S.D. Ohio 1990) (same); In re Stein, 19 B.R. 458, 460 (Bankr. E.D. Pa. 1982) (creditor's secured position would be enhanced by the continued operation of the debtor's business); In re Aqua Assocs., 124 B.R. 192, 196 (Bankr. E.D. Pa. 1991) ("The important question, in determining whether the protection to a creditor's secured interest is adequate, is whether that interest, whatever it is, is being unjustifiably jeopardized.") (citation omitted).

33. In summary, the Debtor submits that the Primary Lenders are adequately protected by the proposed Replacement Liens in the Collateral and by the continued operation of the Debtor as a going concern, thereby preventing any diminution in the value of the Collateral.

**C. Interim Approval Should Be Granted.**

34. The Debtor respectfully requests that the Court conduct an expedited preliminary hearing on this Motion and authorize the Debtor (from and after the entry of the Interim Order and pending the final hearing) to obtain use of the Cash Collateral in accordance with the Budget for, among other things, working capital purposes and the payment of certain obligations in accordance with the relief authorized by the Court. Interim access to the Cash Collateral will ensure that the Debtor maintains ongoing operations and avoid immediate and irreparable harm and prejudice to its estate and all parties in interest pending the Final Hearing.

35. The Debtor submits that, for the reasons set forth herein, immediate access to the use of Cash Collateral (first, on an interim basis as requested in this Motion), on the terms set forth in the Budget, is necessary to preserve the value of the Debtor's estate for the benefit of all

parties in interest.

**D. Request for Final Hearing**

36. Pursuant to Bankruptcy Rule 4001(b)(2), the Debtor requests that the Court set a date for the Final Hearing that is as soon as practicable, but no earlier than fourteen (14) days following the service of the Motion, and fix the time and date prior to the Final Hearing for parties to file objections to this Motion.

**Notice**

37. The Debtor has provided notice of this Motion to: (a) the Office of the United States Trustee for the District of Delaware; (b) the Primary Lenders; (c) the United States Attorney for the District of Delaware; (d) the entities listed on the List of Creditors Holding the 20 Largest Unsecured Claims filed pursuant to Bankruptcy Rule 1007(d); (e) the Internal Revenue Service; and (f) David Weitman, K&L Gates LLP, 1717 Main Street, Suite 2800, Dallas, Texas 75201, counsel to the Stalking Horse Purchaser; and (g) all parties entitled to notice pursuant to Local Rule 9013-1(m) via electronic or overnight mail, as appropriate. In light of the nature of the relief requested, the Debtor respectfully submits that no further notice is necessary.

WHEREFORE, the Debtor respectfully requests that the Court enter an order, substantially in the form attached hereto as **Exhibit A**; and grant such other and further relief as is just and proper.

Dated: August 2, 2019

/s/ Peter C. Hughes

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