

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE**

In re

LUGANO DIAMONDS & JEWELRY INC.,
et al.,

Debtors.

Chapter 11

Case No. 25-12055 (BLS)
Jointly Administered

Hearing Date: December 30, 2025 10:30AM (ET)
Objection Deadline: December 22, 2025 at 4:00PM (ET)

Related Docket No. 13

COMMITTEE’S LIMITED OBJECTION TO AGENCY AGREEMENT

The Official Committee of Unsecured Creditors (“**Committee**”) is disappointed the sale process did not result in a buyer willing to acquire the Debtors’ assets as a going concern, which would have increased creditor recoveries, preserved jobs, and sustained landlord and other business relationships. Nonetheless, the Committee supports the Debtors’ assumption of, and performance under, the Agency Agreement proposed in the Debtors’ *Motion ... To Assume (1) The Agency Agreement ...* [Doc 13] (the “**Motion**”)¹ subject to its objection to two provisions: (1) embedded in the Agency Agreement is a request for the approval of stay bonuses to insiders, which are prohibited under Bankruptcy Code § 503(c) short of an extraordinary evidentiary showing; and (2) the mandate that all sale proceeds be paid directly to CODI rather than to the estates subject to CODI’s alleged liens.

¹ Capitalized terms used but not defined in this objection are used as defined in the Motion.

THE COMMITTEE

The Committee was formed on November 26, comprising nine members, seven of whom are individuals and small businesses. In fact, the vast majority of the more than \$250 million of unsecured claims consist of individuals and small businesses who were the victims of the massive prepetition fraud and the acts and omissions of other parties implicated by that fraud.²

THE AGENCY AGREEMENT

While the Committee does not object to the regrettable liquidation of the Debtors' assets in the manner contemplated by the Agency Agreement, the Committee does object to: (a) the payment of stay bonuses to insiders in violation of Bankruptcy Code § 503(c),³ and (b) payment of sale proceeds directly to CODI.

Stay Bonuses

Section 4.1 of the Agency Agreement permits the Agent to net out its Expenses against the full Cost Value of the Merchandise, up to a cap of 30%. The estates alone bear all Expenses in excess of 30%. Importantly, however, even if the expenses do not exceed 30%, recoveries to the estates will likely be adversely affected because the estates' portion of any Sharing Amounts will decrease. Those Expenses expressly include so-called "Incentive Bonuses" to be paid to "Retained Employees" under § 9.4, which provides:

Subject to approval by the DIP Lender and the Bankruptcy Court, and subject further to the Agent Expense Cap, Agent shall pay, as an Expense, incentive bonuses ("Incentive Bonuses") (which bonuses shall be inclusive of payroll taxes, but as to which no benefits shall be payable), up to a maximum of five percent (5.0%) of gross sales for all Retained Employees, to such Retained Employees who

² The Committee has begun investigating the facts and circumstances surrounding these cases to uncover how such a massive fraud occurred, purportedly leaving the Debtors with over \$900 million of liabilities, at least \$250 million of which are general unsecured claims of defrauded individuals and small businesses. The Committee's investigation will be vigorous and will seek to substantiate claims against all parties responsible for causing or enabling the massive fraud. The Committee is aware of the Special Committee's investigatory efforts and intends to avoid duplicating its work as much as possible.

³ The Committee does not object to paying stay bonuses to store-level employees who are not insiders as defined in Bankruptcy Code § 101(31).

do not voluntarily leave employment and are not terminated “for cause,” as Agent (in consultation with Merchant) may determine in its discretion. Subject to approval by the Bankruptcy Court, the amount of such Incentive Bonuses shall be in an amount to be determined by Agent, in its discretion ...

The Agency Agreement does not identify who is a Retained Employee or whether any of the Retained Employees are insiders, as defined in the Bankruptcy Code. That is a significant oversight because both sentences of § 9.4 begin with the caveat that Court approval is required, and because the Retained Employees need only remain in the Debtors’ employ to qualify for these bonuses. In other words, despite the moniker “Incentive Bonuses,” these are explicitly stay bonuses, directly implicating Bankruptcy Code § 503(c) for any such payments intended for insiders. Neither the Debtors nor the Agent have filed an appropriate motion seeking approval of stay bonuses under, and as required by, Bankruptcy Code § 503(c).

These proposed stay bonuses are significant, likely approximating **\$7 million**.⁴ Thus, it is critical to understand who will receive the stay bonuses, whether some or all of the stay bonuses are intended for insiders, how the \$7 million pool is to be allocated among the Retained Employees, whether Retained Employees are eligible to receive both stay bonuses and sales commissions, and whether one may be a credit against the other. Yet the Agency Agreement discloses none of this information and the Debtors’ financial advisors did not provide this information before the Committee filed this objection.⁵ But given the Committee’s general familiarity with the process, the Committee strongly suspects that the Retained Employees include Joshua Gaynor, the Debtors’ president and CEO, and Christoph Pachler, the Debtors’ chief financial officer. (Both are members of the Debtors’ board). Both Messrs. Gaynor and Pachler are indisputably insiders under the

⁴ Assuming an 85% recovery on \$165 million of Merchandise, gross sales would be \$140,250,000. The 5% stay bonuses would total \$7,112,500.

⁵ Although the Debtors likely attempted to obtain that information from the Agent, they did not provide any of it to the Committee before this objection was filed.

Bankruptcy Code. Both were in management positions with the Debtors during at least part of the time the alleged fraudulent scheme was occurring. Both are the subject of investigations by the Special Committee for any connection or culpability with the fraud that felled these Debtors.

The Agent has broad discretion regarding the stay bonuses. For example, under § 4.1, the Agent decides who the Retained Employees are, how much of a stay bonus each of them would get, and how long to employ them. Despite that the Agent exerts sole control over those bonuses, the estates are on the hook for all stay bonuses, which invariably deplete the estates:

- If the stay bonuses did not exist, the \$7 million would ostensibly flow through to the estates in the form of a higher Guaranteed Amount (that is, more than 40%) or more favorable Sharing Amounts (the net revenue allocated between the Agent and the estates that applies the remaining 30% after the Guaranteed Amount (40%) and the Expenses (30%)—*see* Agency Agreement § 3.2);
- The Agent can maximize the stay bonuses if Expenses come in under the 30% cap to make the total Expenses equal or exceed the cap, obligating the estates to pay the overage dollar-for-dollar—*see* Agency Agreement § 4.1(A)(1).
- The Agent can theoretically manipulate the stay bonuses to bring all Expenses up to the 30% cap (even if they were otherwise going to come in under the cap), reducing the percentage of sales to which the sharing between the Agent and the estates applies. For example, if gross sales total \$100, the Guaranteed Amount for the estates is \$40. If up to \$30 is carved out for Expenses, then the estates and Agent share the other 30%. But if expenses come in at 25%, the Agent would have to share 35% of gross sale receipts, meaning both that (a) stay bonuses always cost the estates money, and (b) the Agent can use the stay bonuses and their discretion over them to reduce the amount of gross sales subject to the sharing.

While stay bonuses to store-level employees may be commonplace in retail liquidations, what makes this case different is that a significant amount of the stay bonuses are being paid to insiders who are being investigated for their role in a massive fraud that left the Debtors in shambles with approximately \$1 billion in debt. And because Bankruptcy Code § 503(c) limits stay bonuses to insiders, the Debtors should not be able to accomplish indirectly what they cannot accomplish directly. Yet the Debtors have not filed a motion to approve them, despite the Agency Agreement's requiring it.

Payment Directly to CODI

Section 3.4(a) of the Agency Agreement requires the Debtors to “direct Agent to make all payments due to [the Debtors] under this Agreement in respect of the Tier 2 Period directly to the DIP Lender ...” The Guaranteed Amount of approximately \$66 million (representing nearly all the value in these estates attributable to the Debtors’ tangible assets) would completely bypass the estates and go directly to CODI on account of their alleged secured claim. Needless to say, neither the Debtors nor CODI have sought or obtained relief from the automatic stay or any other relief that would justify allowing nearly all the estates’ presently-realized value to side-step the estates entirely such that no creditor other than CODI would have any recovery from that value.

OBJECTION TO STAY BONUSES

Bankruptcy Code § 503(c) prohibits the allowance or payment of “a transfer made to ... an insider of the debtor for the purpose of inducing such person to remain with the debtor’s business” unless the court specifically finds after taking evidence that, among other things, “(A) the transfer or obligation is essential to retention of the person because the individual has a bona fide job offer from another business at the same or greater rate of compensation; [and] (B) the services provided by the person are essential to the survival of the business ...”

The Debtors have not moved for approval of the stay bonuses identified in the Agency Agreement under Bankruptcy Code § 503(c) or made any evidentiary showing that would begin to satisfy Bankruptcy Code § 503(c)'s requirements. Because the Retained Employees are the Debtors' employees rather than the Agent's, the Debtors must file such a motion and support it with appropriate, admissible evidence.

This is particularly important if one assumes that Messrs. Gaynor and Pachler—the Debtors' most senior officers and board members—are included in the Retained Employees. Any stay bonus proposed to be paid to either of them (or any other insider) may only be paid under the strictures contained in Bankruptcy Code § 503(c). As noted above, the stay bonuses are manifestly “for the purpose of inducing such person to remain with the debtor's business” because all a Retained Employee need do to receive a stay bonus under § 9.4 of the Agency Agreement is to “not voluntarily leave employment.”⁶ The type of non-incentive-based, pay-to-stay bonus proposed in the Agency Agreement—at least if any insiders are included in the group of Retained Employees who would receive these bonuses—may only be paid if this Court approves them after an evidentiary showing under Bankruptcy Code § 503(c). The Committee objects to these stay bonuses being allowed or paid unless and until the Debtors can make the required showing under Bankruptcy Code § 503(c).

The Committee also questions paying any stay bonuses to Messrs. Gaynor and Pachler because both of those insiders were the Debtors' senior-most officers during at least part of the period when the massive fraud was perpetrated. In due course, the Special Committee or the

⁶ No performance-based criteria or metrics apply. This sole requirement to simply show up to work indicates why the proposed bonuses implicate Bankruptcy Code § 503(c) in the way that incentive bonuses found in KEIPs do not. *See, e.g., In re Global Home Prods., LLC*, 369 B.R. 778, 783–86 (Bankr. D. Del. 2007), in which this Court considered whether the Plans constitute a ... (“KERP”), also known as a “pay to stay” compensation plan, or are intended to create ... a “pay for value” compensation plan. If the bonus plan “walks like a duck (KERP), quacks like a duck (KERP), it's a duck (KERP).” *In re Dana Corp.*, 351 B.R. 96, 102 n.3 (Bankr. S.D.N.Y. 2006).

Committee or both will determine whether, and to what extent, they were culpable for that fraud and its catastrophic consequences. Although the extent of their blameworthiness, if any, for over a quarter billion dollars in creditor losses is presently unknown, it is not appropriate to distribute millions of dollars to either of them now, wholly aside from the impermissibility of doing so under Bankruptcy Code § 503(c). These two individuals should not receive millions from the fire sale they may have had a hand in causing.

OBJECTION TO PAYMENT TO CODI

The Committee and the Special Committee are also investigating CODI's potential culpability in the Debtors' fraud-induced downfall, including the extent of estate claims against CODI. The Committee has also begun its investigation into the validity, perfection, extent, and enforceability of CODI's alleged prepetition debt and security interests, including whether CODI's prepetition conduct justifies recharacterizing its claims as equity or equitably subordinating its claims. Given the sheer size of CODI's alleged prepetition debt, the 23 credit facility amendments over the last couple of years, the nature of the fraud that occurred, and CODI's multi-faceted roles as majority equity owner, sole lender, and board member while the fraud was being perpetrated, this is no perfunctory investigation.

It is difficult to imagine less appropriate circumstances for CODI to receive nearly all the value in these liquidating estates outside of a plan while this investigation continues. And even arm's-length third-party lenders are entitled to no more under the Bankruptcy Code than to have their liens attach to the proceeds of a § 363 sale, rather than have those proceeds irretrievably paid to them outside of a confirmed plan. While it is not unusual for secured lenders to be paid sale proceeds at closing in many Chapter 11 cases, that only occurs in circumstances where the estate will incur the accrual of interest if repayment funds are held back—that is, when lenders are both

oversecured (and therefore entitled to postpetition interest on prepetition debt under § 506(b)) and not facing the specter of multiple investigations of profound and actionable wrongdoing.

Here, CODI would not be entitled to postpetition interest—even if its prepetition debt were found to be fully and properly secured and perfected and not subject to any potential invalidation, subordination, or recharacterization—because CODI is obviously undersecured. There is no good reason to pay over nearly all the value in these estates to CODI now, outside of a confirmed plan, when neither the estates nor CODI can be harmed by escrowing the sale proceeds in a segregated interest-bearing account.

And there *is* a good reason not to pay sale proceeds to CODI in particular: CODI may not be able to repay tens of millions of dollars to the estates if later proceedings require CODI to do so because CODI is experiencing its own financial challenges. CODI has been forced to restate its 2024 and 2025 financials in light of the massive losses associated with Lugano. It is presently in default with its own senior lender consortium. And it received a going concern warning in its last audit. Better that tens of millions of dollars of value be preserved for proper distribution under a confirmed plan than for that money to leave the estates now with the optimistic hope that CODI will be able to return those funds later.

CONCLUSION

For the reasons stated above, the Committee objects to the Debtors' assumption of, and performance under, the Agency Agreement insofar as the Agency Agreement compels the payment of impermissible stay bonuses to insiders and the payment of sale proceeds directly to CODI outside of a confirmed plan.

December 22, 2025

Respectfully submitted,

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