absolute PRIORITY
Current Developments in Bankruptcies and Workouts to Keep You Ahead of the Curve

Cooley GODWARD KRONISH LLP

BANKRUPTCY AND RESTRUCTURING GROUP

Madoff Bankruptcy Alert:

SDNY Leaves Open Whether Investors Can File Post-Bar Date Proofs of Claims On Account Of Avoidance Action Repayments In SIPA Cases

An interesting issue has surfaced in the Madoff case involving investors who redeemed their accounts before the bankruptcy was filed. Trustees often sue investors in alleged Ponzi scheme cases, asserting fraudulent transfer and other avoidance actions under chapter 5 of the Bankruptcy Code. In defense of these claims, investors often argue that the redemption of their accounts were made in good faith and without any knowledge of the alleged fraud.

Generally speaking, the resolution of these litigations often occurs long after the claims bar date expires in the underlying bankruptcy case and therefore raises the question: if the trustee is ultimately successful in the litigation, or if a settlement is reached with the investor, should the investor be entitled to file a post-bar date proof of claim on account of their repayment? Before turning to that question in the specific context of Securities Investor Protection Act ("SIPA") bankruptcy cases, such as the Madoff case, it is helpful to understand how avoidance action repayment claims are treated in chapter 11 cases.

Under section 502(h) the Bankruptcy Code, an entity against whom an avoidance action is commenced may assert a claim

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BAPCPA's Expanded Definition of Swap Agreements: Congress Rewards Marketplace Creativity

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") enlarged the protections afforded to financial derivatives participants and transactions by expanding the definitions of "swap participants," "swap agreements" and "commodity forward agreements." Although these expanded definitions clearly broaden the scope of transactions eligible for the safe harbor exemption from the automatic stay and the trustees' avoidance powers, the Bankruptcy Code provides little guidance on the specific transactions that are eligible for the exemption. As such, courts have been, and will continue to be, tasked with determining whether major commercial contracts can be distinguished from the Bankruptcy Code's newly defined swap agreements. Most recently, the U.S. Court of Appeals, Fourth Circuit issued an opinion reversing an earlier bankruptcy court decision addressing the issue of whether a natural gas supply contract may qualify as a swap agreement or forward contract under the Bankruptcy Code.

In *Hutson v. E.I. du Pont de Nemours and Co. (In re Nat'l Gas Distribs., LLC)*, 2009 U.S. App. LEXIS 2830 (4th Cir. February 11, 2009), the Fourth Circuit provided some clarity to participants in the commodities markets. The debtor, National Gas Distributors LLC, filed for bankruptcy in January 2006 and the Court appointed a chapter 11 trustee shortly thereafter.

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from the editor

JEFFREY L. COHEN

Corporate casualties of the frozen credit market and economic recession continue to mount, while the debate continues over whether further changes to the Bankruptcy Code, or perhaps a roll-back of the 2005 amendments, are necessary to help stem the downward trend of the U.S. economy. Parties embroiled in chapter 11 proceedings around the country have been forced to draw upon their collective creativity and ingenuity to adapt to the drastically different economic reality facing distressed companies. This survival mentality has forced debtors and creditors alike to behave in a protect and preserve manner, as lenders undergo "stress tests" and Capitol Hill weighs the pros and cons of further "bailouts" and revisions to the Bankruptcy Code to restore liquidity to the credit market and kick start corporate reorganization in chapter 11.

So, in other words, it's a great time for the Spring edition of *Absolute Priority*.

This issue discusses the recovery efforts of jilted investors of the Bernard Madoff debacle and highlights recent developments in bankruptcy law, including the impact of the revised definition of "swap agreements" and what constitutes "goods" for purposes of section 503(b)(9) of the Bankruptcy Code.

The Cooley bankruptcy group has been very busy representing creditors' committees in most of today's prominent retail bankruptcy cases and representing strategic and financial buyers of distressed assets. Nevertheless, we are never too busy to keep you up to date on the latest developments in the bankruptcy world. You are, after all, our *Absolute Priority*.

Enjoy this latest issue and we look forward to hearing from you.•

Third Circuit: Who's An "Insider" in a Preference Action?

In a recent decision that expands the scope of the Bankruptcy Code's preference provisions, the U.S. Court of Appeals, Third Circuit addressed for the first time whether a creditor can be considered a non-statutory insider for the purposes of extending the time for recovery of preferential payments under section 547 of the Bankruptcy Code. In *Schubert v. Lucent Technologies (In re Winstar Communications, Inc.)* (3d Cir. 2009), the Court deemed Lucent a "non-statutory insider" of Winstar, thereby extending the time frame for recovery of $188 million in payments made to Lucent four months prior to Winstar's 2001 bankruptcy filing. The Court relied upon evidence that Lucent had dominated Winstar's affairs and coerced it into consummating transactions that were not in its best interest.

Ordinarily, a trustee may recover transfers made by a debtor within 90 days of the bankruptcy. However, the Bankruptcy Code authorizes a trustee to recover any transfers made within a year of the bankruptcy if the creditor was an "insider." The Bankruptcy Code defines an "insider" of a corporation to include directors and officers of a debtor, persons in control of the debtor, a general partner of the debtor, a partnership in which the debtor is a general partner, or a relative of a general partner, director, officer, or person in control of the debtor. Additionally, courts have identified a category of creditors, sometimes called "non-statutory insiders," who fall within the definition of an insider but outside of any of the enumerated categories. The issue in Winstar was whether the relationship between Lucent and Winstar fell within this definition.

Prior to its bankruptcy, Winstar provided local and long distance telecommunications services and was engaged in the construction of a global broadband network. In October 1998, Winstar entered into what the parties described as a "strategic part-

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Delaware Bankruptcy Court Prohibits Parties from Contracting Around Mutuality Requirement of Bankruptcy Code's Setoff Provision

In a recent decision that may disrupt the customary business practices of many companies in the energy industry and elsewhere, a Delaware bankruptcy court ruled that contracting for cross-affiliate netting does not create the mutuality required for setoff under section 553 of the Bankruptcy Code. In *In re SemCrude LP* (Bankr. D. Del. 2008), the court held that, as a matter of law, triangular setoffs were impermissible regardless of whether a prepetition agreement provides for such setoff.

Section 553 provides that a debtor's bankruptcy filing "does not affect any right of a creditor to offset a mutual debt by such creditor to the debtor that arose before the commencement of the case against a claim of such creditor against the debtor that arose before the commencement of the case." Thus, section 553 preserves for the benefit of a creditor its setoff right that it possessed under applicable non-bankruptcy law, and imposes a restriction that must be met in order to impose a setoff against a debtor in bankruptcy—the obligations at issue must be mutual prepetition debts. Such a requirement prohibits so-called "triangular setoffs" where party A seeks to setoff a debt it owes to party B against a debt that party C owes to party A.

In *SemCrude*, Chevron USA, Inc. entered into prepetition contracts with three debtor entities, SemCrude, SemFuel and SemStream, for the purchase of crude oil and other energy products. Each of the agreements cross-referenced the other and contained provisions that stated, in the event either party fails to make a timely payment, the other party may offset any deliveries or payments due under this agreement "or any other agreement between the parties and their affiliates." As of the commencement of the SemCrude bankruptcy cases, Chevron owed SemCrude $1.4 million and was owed a total of $13.5 million by SemFuel and SemStream.

Accordingly, Chevron made a motion seeking the authority to set off the amounts it owed SemCrude against the amounts it was owed by SemFuel, and SemStream. The debtors, the creditors committee and several individual creditors objected, arguing that the parties to the agreements at issue could not contract around the mutuality requirement of section 553. In sustaining the objections, the court noted that while nearly a dozen cases had recognized a "contract exception" to section 553's mutuality requirement, in each such case setoff was not permitted.

The Court then found that past decisions allowing setoff had unanimously required mutuality of debts and had strictly construed mutuality against the party seeking set off. Based on a narrow reading of the agreements at issue, the Court determined that mutuality could not be established by multiple agreements contemplating triangular setoff because an agreement to setoff funds does not create indebtedness from one party to another. Indeed, under the contracts at issue, Chevron did not have the right to collect anything from SemCrude, and did not have any independent obligations to SemFuel and SemStream.

The *SemCrude* decision may be viewed as announcing a rule that triangular setoffs are impermissible despite the existence of an express right to do so in a prepetition contract. It remains to be seen whether this decision will be reconsidered or appealed. If the decision stands, it is a significant statement that a bankruptcy court may eliminate what had become a widely utilized method of contractually circumventing the mutuality requirement of section 553. •

In the News

Current Cooley Representations

In re Gottschalk's, Inc., Case No. 09-10157 (Bankr. D. Del. 2009)

Founded in 1904, Gottschalk's, Inc. operates 50 full-line department stores and three specialty stores in six western states. Cooley, on behalf of the creditors' committee, played a key role in revising the terms of the debtor's postpetition financing to ensure that the company possessed sufficient liquidity to fully market their assets. In addition, Cooley was instrumental in the negotiation of a stalking horse asset purchase agreement in furtherance of the sale process. On April 1, 2009, the court approved the debtor's liquidation of substantially all of its inventory through GOB sales managed by Great American Group. An auction of the debtors lease portfolio is currently scheduled for May 13, 2009.

In re Lenox Sales, Inc., et al., Case No. 08-14679 (Bankr. S.D.N.Y. 2008)

Lenox is a leading designer, distributor, wholesaler, manufacturer and retailer of fine quality tableware, collectible and other giftware products marketed under the Lenox, Department 56, Dansk and Gorham brand names. Cooley, on behalf of the creditors' committee, played a key role in the sale of substantially all of the Lenox assets to Clarion Capital. Since the filing date of November 23, 2008, the Lenox assets were poised for a sale to a third-party purchaser or to a group of their term loan lenders, led by Clarion Capital. After an auction, which was re-opened following a three-day sale hearing, the debtors, in consultation with the creditors' committee, concluded that the bid of Clarion Capital was the highest or otherwise best offer. The sale of substantially all of the Lenox assets to Clarion Capital has now closed, enabling the Lenox busi-

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ness to continue as a going concern and ensuring the continued employment of more than 1,500 employees.

In re Goody's, LLC, et al., Case No. 09-10124 (Bankr. D. Del. 2009) Shortly after emerging from bankruptcy in October 2008, as an unfortunate consequence of a suffering retail economy, Goody's filed for bankruptcy again on January 13, 2009. Cooley represented the creditors' committee in both the Goody's I and Goody's II cases and was instrumental in fashioning a global solution to resolve outstanding issues from the Goody's I case, in concert with approval of an asset disposition strategy for the Goody's II case. Immediately upon the filing of Goody's II, Cooley filed a motion to dismiss the cases arguing, in part, that Goody's obligations under the plan of reorganization confirmed in the first case needed to be fulfilled if the second case was going to move forward. The motion to dismiss forced a settlement, whereby funds from the liquidation of the debtors' assets will be used to increase reserves for administrative creditors under the plan of reorganization in the Goody's I case, provide for the administrative solvency of Goody's II, enhance recovery for general unsecured creditors in Goody's I and set aside a fund for unsecured creditors in Goody's II.

In re KB Toys, Inc., et al., Case No. 08-13269 (Bankr. D. Del. 2008) After having emerged from bankruptcy in 2005 pursuant to a plan of reorganization under which Prentice Capital Management acquired a majority ownership of the debtors, KB Toys again filed for bankruptcy on December 11, 2008. Cooley represents the official committee of unsecured creditors. KB was the nation's leading mall-based specialty toy retailer

SDNY Weighs In On "Stub Rent"

One of the benefits a debtor enjoys under the Bankruptcy Code is the ability to reject burdensome leases. During the postpetition, pre-rejection period, §365(d)(3) of the Bankruptcy Code obligates the debtor to timely perform its obligations under such leases:

The trustee shall timely perform all the obligations of the debtor…arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of [the Bankruptcy Code].

On its face, § 365(d)(3) only applies to obligations under a nonresidential lease that arise postpetition and pre-rejection. However, the term "arising" is not defined by the Bankruptcy Code. This has led to inconsistent holdings by Courts about whether "stub rent"—the portion of monthly rent attributable to the period from the date of the bankruptcy petition (the "Petition Date") through the end of the petition month—is (i) an obligation that arose prior to the Petition Date, therefore making any claim for stub rent a prepetition claim or (ii) an obligation that accrued daily, therefore making any claim for stub rent a claim entitled to timely payment under § 365(d)(3).

On December 18, 2008, in connection with the bankruptcy of the Steve & Barry's retail chain, the United States Bankruptcy Court for the Southern District of New York held that under § 365(d)(3) of the Bankruptcy Code, stub rent was an obligation that accrued daily, therefore making the landlords' claim for stub rent a claim entitled to timely payment under § 365(d)(3). See *In re Stone Barn Manhattan LLC (f/k/a Steve & Barry's Manhattan LLC), et al.*, 2008 Bankr. Lexis 3260 (Bankr. S.D.N.Y. 2008). Cooley represents the committee in the Stone Barn bankruptcy proceedings.

Differing Approaches to the Treatment of Stub Rent

Currently, the law in the Second Circuit (the circuit in which the Stone Barn cases are pending) is unclear on how stub rent should be treated. Some courts have held that the obligations under unexpired leases become obligations according to the terms of the lease (the due date or the billing date), regardless of when those charges accrued (the "*Billing Date Approach*"). Other courts have held that the Bankruptcy Code calls for the debtor's obligations under a lease to be prorated based upon postpetition days prior to rejection, regardless of billing date (the "*Pro-Ration Approach*").

The Billing Date Approach—Argued by the Stone Barn Debtors

According to the Billing Date Approach, a debtor's obligations to pay rent, maintenance, taxes, and other lease obligations only arise as the debtor becomes legally obligated to perform (which under almost all leases is on the first of the month). Courts applying the Billing Date Approach, focus on the date on which a debtor is required to pay under a lease, and not the date or dates on which the premises are used by the debtor.

If the Stone Barn debtors were required to follow the Billing Date Approach with respect to stub rent, the Stone Barn debtors would not have to pay landlords stub rent under § 365(d)(3) of the Bankruptcy Code. The Stone Barn debtors' obligation to pay rent under almost all of the leases for July 2008 arose on July 1, 2008, i.e., prior to the Petition Date. Thus, the Stone Barn debtors would not be required to pay stub rent under § 365(d)(3) (possible under § 503(b)) upon confirmation.

The Pro-Ration Approach—Argued by the Landlords

According to the Pro-Ration Approach, a debtor's obligation to pay rent, taxes, maintenance, and other payments required under a lease accrues each day a debtor occupies the leased property postpetition. Courts

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SDNY Tackles Stamp Tax Exemption In The Wake Of Piccadilly

In June 2008, the U.S. Supreme Court issued an opinion in *Florida Department of Revenue v. Piccadilly Cafeterias, Inc.*, holding that the exemption from the state stamp taxes under section 1146(a) of the Bankruptcy Code does not apply to asset sales under section 363 of the Bankruptcy Code that are closed prior to the confirmation of a chapter 11 plan. Cooley highlighted this decision in the Fall 2008 edition of *Absolute Priority*. *Piccadilly*, however, did not address whether the exemption applies to a pre-confirmation sale that closes after confirmation and is necessary to the consummation of a plan. In a recent decision from the Bankruptcy Court, Southern District of New York in *In re New 118th, Inc., et al.*, the Court held that the exemption does, in fact, apply to a post-confirmation transfer that follows a pre-confirmation sale if the transfer facilitates the implementation of the plan.

In this case, the debtors owned 21 apartment buildings which they sought to sell pursuant to section 363 of the Bankruptcy Code. According to the Court, the sale was "the linchpin" of the liquidating plan that the chapter 11 trustee intended to file. The New York City Department of Finance (the City) objected both to the sale and plan confirmation arguing, among other things, that *Piccadilly* (which was decided the day before the sale hearing) "established a bright-line test under which the exemption did not apply to a § 363 pre-confirmation sale, even if the sale closed post-confirmation." The City also argued that the exemption applied only to "reorganization" plans and not to liquidating plans. The Court rejected both arguments.

The Court found that *Piccadilly* does not prohibit application of section 1146(a) to

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applying the Pro-Ration Approach focus on the time period during which a debtor uses the property and not the date on which an obligation arises under the lease.

If the Stone Barn debtors were required to follow the Pro-Ration Approach with respect to stub rent, they would pay stub rent at the rate set forth in the leases except that rents would be prorated so that landlords would not get paid for any prepetition July rent—the period of July 1 through July 8, 2008. Notwithstanding that rent under the leases is due July 1, 2008, the Stone Barn debtors' obligation to pay stub rent would begin to accrue on the Petition Date, on a daily basis.

The Stone Barn Decision

The Bankruptcy Court adopted the Pro-Ration Approach, rejecting the argument that stub rent was an unsecured prepetition obligation. Rather, the Bankruptcy Court held that even if the lease requires the full payment of monthly rent in advance, that payment should be prorated between the prepetition and postpetition periods under the Bankruptcy Code.

If the holding in *In re Stone Barn* becomes binding precedent in the Second Circuit, debtor-tenants should consider filing later in the month since the debtor will be obligated to pay prorated rent for the postpetition days in that month. However, if the Bankruptcy Court's adoption of the Pro-Ration Approach is overruled, debtor-tenants will continue to enjoy flexibility in the decision making process, given that the entire month's rent will be deemed an unsecured prepetition obligation. •

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with approximately 277 retail locations and approximately $480 million in annual sales. The debtors filed chapter 11 having already commenced liquidation sales at all store locations during the peak holiday season. In addition to assisting in maximizing value in the liquidation, the creditors' committee is pursuing an investigation of the purportedly secured debt of Prentice, with a focus on achieving administrative solvency of the estates, including payment of "stub rent" and claims under section 503(b)(9) of the Bankruptcy Code.

In re Mervyn's Holdings, LLC, et al., Case No. 08-11586 (Bankr. D. Del. 2008) Mervyn's, a chain of approximately 175 family-friendly, promotional department stores predominantly located in California and the southwestern United States, filed for chapter 11 protection on July 29, 2008. Cooley represents the official committee of unsecured creditors. The company implemented a number of strategic operational initiatives, including the immediate liquidation of 26 underperforming stores and cost-cutting measures. Unfortunately, against the backdrop of the global economic crisis, Mervyn's determined, after consultation with the creditors' committee and other constituents, that the best course of action to maximize value for creditors was to close all of their remaining stores and liquidate all of the estates' assets, including the debtors' intellectual property assets. The debtors conducted store closing sales during the holiday season and have completed such sales and the sale of their intellectual property. The creditors' committee is pursuing causes of action related to the 2004 acquisition of Mervyn's by an entity formed by affiliates of various private equity firms, including avoidance of certain transac-

IN THE NEWS continued

tions and recovery of certain transfers consummated in connection with such acquisition. The creditors' committee is also currently evaluating additional causes of action which may be brought on behalf of the debtors' estates.

In re Boscov's, Inc. et al., Case No. 08-11637 (Bankr. D. Del. 2008). Boscov's Inc., through its operating subsidiary Boscov's Department Store, LLC and other debtor subsidiaries, owns and operates the nation's largest family-owned department store chain, with 39 locations across five states in the Mid-Atlantic region generating approximately $1 billion in sales on an annual basis as the date of its bankruptcy filing on August 12, 2008. Cooley, as counsel for the official committee of unsecured creditors, has been actively involved in all aspects of these cases. Cooley has been intimately involved in every aspect of the sale process which resulted in the assets of Boscov's being sold to members of the founding families of Boscov's as a going concern. In addition, Cooley's investigation of the leveraged recapitalization of Boscov's resulted in a court-approved settlement, which enhanced the purchase price paid by the founding families, for the benefit of the unsecured creditors. Lastly, Cooley has assumed a lead role in litigation with a disgruntled bidder for the assets of Boscov's in its quest to be paid a $4 million break-up fee.

In re Sports Collectibles Acquisition Corp., Case No. 08-12170 (Bankr. D. Del. 2008) Sports Collectibles d/b/a BC Sports was organized for the purpose of acquiring the BC Sports Collectibles retail chain from Electronics Boutique Holding Corporation in 2002. Prior to the filing of the case, BC Sports leased over 50 retail locations and offered four primary

What Constitutes "Goods" For Purposes of an Administrative Claim Under Section 503(b)(9)?

In a recent decision by the Bankruptcy Court, Eastern District of Michigan, in *In re Plastech Engineered Products, Inc., et al.* (Bankr. E.D. Mich. Dec. 10, 2008), the Court addressed an issue of first impression with respect to administrative claims asserted under section 503(b)(9) of the Bankruptcy Code. Specifically, the Court addressed, among other things, whether certain claimants provided goods to Plastech, as opposed to services, as required in order to assert an administrative claim under section 503(b)(9).

Although the nature of the claims varied, each included the provision of a service in connection with the transfer of the raw materials. For example, one claimant provided snow removal services and in connection with such services, charged the debtors for the de-icing and salt materials used in the snow removal process. Another claimant sold the debtors certain pellets, which Plastech used to make automotive parts. Each such claimant filed claims under section 503(b)(9) for the services provided and/or the raw materials used in the provision of such service.

Plastech argued that the claims under section 503(b)(9) should be disallowed based on various theories. First, Plastech argued that none of the claimants delivered "goods." Second, Plastech argued that if a mixture of goods and services was provided, the Court should apply the "predominant purpose" test, adopted by courts in non-bankruptcy contexts whereby courts look to the predominant purpose of the transaction to determine whether goods or services were provided. In other words, Plastech argued that the Court should apply an "all or nothing" approach to the extent it found that a mixture of goods and services was provided.

In its analysis, the Court first determined that it would apply the definition of "goods" from the Uniform Commercial Code (UCC) to determine whether the claimants provided "goods" under section 503(b)(9). Using such definition, the Court found that each of the creditors provided "goods" to Plastech. The Court next rejected the "winner take all" approach and found that the predominant purpose test is "unnecessary," noting that "[i]f a particular transaction provides for both a sale of goods and a sale of services, and the value of each of them can be ascertained, why shouldn't the value of the goods be entitled to the section 503(b)(9) administrative expense priority and the value of the services be relegated to an unsecured non-priority claim?"

The Plastech decision, to the extent it survives appeal, represents a victory for creditors who provide a mixture of goods and services. However, creditors should be cautioned that the decision may be limited to the situation where claimants separately list on their invoices the value of the goods and services provided.

Less than two months after the Plastech decision, the Bankruptcy Court, District of Delaware issued an opinion in *In re Goody's Family Clothing, Inc., et al.* (Bankr. D. Del. Feb. 6, 2009) further examining the definition of "goods" as it pertains to section 503(b)(9) of the Bankruptcy Code, relying, in part, on the *Plastech* decision.

In this case, one of Goody's vendors provided certain services, including inspecting, ticketing and repackaging of apparel purchased from other vendors. Goody's objected to the administrative claim asserted by the vendor under section 503(b)(9) of the Bankruptcy Code.

The Court found, as did the *Plastech* Court, that "the term 'goods' in section 503(b)(9) conforms with the meaning given in UCC § 2-105(1)" and that "'goods' cannot include services." Because the Court found

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"Use" of Intellectual Property For Administrative Claim Purposes

For trademarks, should the relevant analysis for administrative priority focus on the debtor-in-possession's continued "use" of the intellectual property and whether such "use" benefited the debtor's estate, rather than whether the debtor induced the creditor to provide the trademark on a postpetition basis?

A recent decision by Judge Barbara J. Houser indicates as much. In *Meredith Corp. v. Home Interiors & Gifts, Inc. (In re Home Interiors & Gifts, Inc.)* (Bankr. N.D. Tex. 2008), Judge Houser found that "[the] focus on postpetition 'inducement' is misplaced in the trademark use context." Here are the details.

Home Interiors & Gifts, Inc. engages in the manufacture and distribution of home decorative accessories. The company primarily sells its products through a direct selling channel of independent sales representatives who purchase HIG's products at a discount and then resell them to the consumer at retail price through, primarily, in-home sales parties. As part of the marketing process HIG publishes and circulates several print brochures. These include a quarterly catalog, a monthly catalog and a monthly news publication.

HIG entered into a prepetition licensing agreement with Meredith Corporation that allowed HIG to use Meredith's "Better Homes and Gardens" trademark in connection with their products. Under the licensing agreement, HIG was allowed to use the trademark on over 900 of its products while Meredith maintained exclusive control regarding the quality and the type of goods containing the mark.

HIG later filed a voluntary petition for relief under Chapter 11. In response to a motion to compel assumption or rejection of the licensing agreement filed by Meredith, HIG decided to reject the agreement and Meredith responded by filing both an unsecured rejection damages claim and an administrative expense claim for HIG's postpetition use of the "Better Homes and Gardens" trademarks. While the debtor and Meredith were able to agree on an appropriate settlement amount for the rejection damages claim, the administrative expense claim was left for the Court to decide.

The debtor argued that Meredith was not entitled to any administrative expense claim because all postpetition transactions involving products containing the "Better Homes & Gardens" trademarks involved goods manufactured and purchased by the debtor prepetition. In contrast, Meredith asserted because one million catalogs containing products bearing the trademarks were received by the HIG sales force just as the case was being filed and used postpetition to sell the debtors products,

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that the vendor did not provide goods, the Court also found that any costs required to make the goods saleable were not entitled to administrative status. Citing *Plastech*, the Court found that "[i]t is the goods and not the value received by the debtor [which] trigger[s] § 503(b)(9)."

Unlike *Plastech*, the *Goody's* Court did not have to reach the issue of whether the "predominant purpose test" applied. Goody's made the argument that the only "goods" that the vendor could have sold to it were the tags and tickets affixed to the garments and that the Court should apply the "predominant purpose test" to determine whether the contract was for goods or services. The *Goody's* Court held that it did not decide the issue because the vendor did not raise the argument, nor was any evidence presented regarding the value of the tickets and tags.•

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categories of merchandise for sale in such locations and online: (i) autograph memorabilia; (ii) licensed sports apparel; (iii) trading cards; and (iv) licensed sports gifts and novelty items. Since the petition date, the debtors have closed certain underperforming stores. The creditors' committee, represented by Cooley, has engaged in substantial negotiations with BC Sports concerning a plan of reorganization, which is contingent upon obtaining exit financing. If BC Sports obtains exit financing and a plan of reorganization is confirmed, it will be one of a select few retailers to successfully emerge from chapter 11 as a going concern since the BAPCPA amendments in 2005.

BTWW Retail, L.P., et al., Case No. 08-35725 (Bankr. N.D. Tex. 2008)
BTWW Retail, L.P. and its wholly-owned affiliates are operators of western apparel and boot stores as well as a nationally known mail-order catalog that sells western wear. Prior to the filing of the bankruptcy cases in November 2008, Cooley served as counsel to an ad hoc committee of unsecured trade vendors and secured a payment on behalf of the unsecured trade creditor body. Cooley was then retained as counsel to the official committee of unsecured creditors and facilitated the sale of substantially all of BTWW's inventory and intellectual property, including the sale of 14 of its stores as a going concern to Boot Barn, Inc. and the liquidation of the inventory at its remaining stores to a joint venture led by Hudson Capital Partners.

Innovation Luggage, Inc., Case No. 09-10564 (Bankr. D. N.J. 2009)
Innovation Luggage is a regional luggage and travel specialty retailer that operates a website and 10 stores located in New York, New Jersey, Connecticut and Washington,

IN THE NEWS continued

DC. After the filing of Innovation's bankruptcy petition on February 10, 2009, Cooley was retained to represent the official committee of unsecured creditors. The creditors' committee is currently analyzing the company's go-forward business plan and investigating the October 2008 transaction pursuant to which the debtor's assets were transferred to an insider of the debtor's secured lender.

In re Marty's Shoes, Inc., et al., Case No. 08-12129 (Bankr. D. Del. 2008)
Marty's, a footwear retailer, operated 47 retail locations prior to its chapter 11 filing on September 12, 2008. During the chapter 11 cases, Marty's received approval to assume an agreement it had entered into prior to the petition date with Great American to liquidate the inventory in Marty's stores. Store closing sales have now been completed. In connection with negotiating issues related to DIP financing, Cooley, as counsel to the creditors' committee, negotiated for a fund to be distributed to general unsecured creditors. It is anticipated that the estates will be administratively solvent, and that a motion for approval of distributions to general unsecured creditors will be filed in the near term. •

Bankruptcy Court Says Store Credit Not A Deposit Under Section 507(a)(7)

In *In re Utility Craft, Inc.*, 51 BCD 26 (Bankr. M.D.N.C. 2008), a Middle District of North Carolina bankruptcy court refused to afford priority status to a creditor holding a claim on account of an unused store credit issued prior to the bankruptcy filing.

Section 507 of the Bankruptcy Code sets forth ten categories of prepetition claims that are entitled to priority over general unsecured claims. Section 507(a)(7) confers priority status upon the allowed unsecured claims of individuals, to the extent of $2,425, arising from the prepetition deposit of money in connection with the purchase of property for personal, family or household use, that was not delivered.

Arguing that a gift certificate is the same as a store credit, the creditor relied on a decision issued by a Delaware bankruptcy court in the *Woodworkers Warehouse* case, *In re Woodworkers Warehouse, Inc.*, 43 B.R. 149 (Bankr. D. Del. 2004). In that case, the Court declined to treat the prepetition purchase of a gift certificate as a final and complete transaction and held that it was a deposit entitled to priority pursuant to section 507(a)(7). The *Woodworkers* court held that to relegate the gift certificate holders to the status of general unsecured creditors would perpetuate the very problem the statute was designed to remedy.

The trustee opposed the creditor's request for priority status, arguing that the "was not delivered" language of section 507(a)(7) imparts a critical distinction between claims arising from an unused store credit and claims arising from an unused gift certificate. According to the trustee, while an unused gift certificate may qualify as a deposit because, arguably, no delivery of property has been made to the holder, an unused store credit cannot qualify as a deposit under the statute because delivery of the property has been made, notwithstanding its subsequent return.

The Court adopted the trustee's reasoning and sustained the objection in a decision that appears to support the *Woodworkers* court's decision to grant priority status to gift certificate claims with less than full consideration of some other important elements of the statute—including whether priority would extend where (a) an entity, and not an individual, is the holder of the certificate, (b) an individual holds a certificate that was purchased by an entity, and not an individual, (c) the holder is not a family member of the individual who purchased the certificate.

As recent cases like *Sharper Image* and *Bombay* have illustrated, the question of whether gift certificates, gift cards, store credits and merchandise credits are entitled to priority treatment will continue to be a hotly contested issue in retail chapter 11 cases, particularly in those cases where unsecured creditor distributions are jeopardized by what could be a massive pool of gift certificate and store credit claims. •

Circuit City Court Addresses Adequate Assurance Issues for Utilities

The Bankruptcy Court, Eastern District of Virginia recently issued an opinion in the Circuit City bankruptcy case addressing issues of importance to utility companies and debtors alike. As is often the case in retail chapter 11 cases, part of Circuit City's request for "first day" relief was a request to, among other things, provide its utility companies with adequate assurance of payment. Following opposition by a group of the utility companies, the Court issued a written opinion on the issue.

In the motion, Circuit City sought approval to create a segregated account with $5 million, representing two weeks of utility service from all of its utility companies. The account could be drawn down by a utility company in a manner similar to a letter of credit. In addition, Circuit City requested that the Court find that all utility companies entitled to assurance of payment under section 366 of the Bankruptcy Code be deemed to have received adequate assurance of payment. Circuit City proposed to establish certain procedures to the extent a particular utility company took issue with the adequacy or form of the proposed payment assurance.

After Circuit City consensually resolved objections to the motion, the Court entered an order approving Circuit City's request. Subsequently, however, certain utility companies who did not object to the motion in the first instance, filed opposition papers. The Court affirmed its order and rejected the utilities' arguments.

The Court surmised that the opposition was primarily premised on the argument that a bankruptcy court may not determine the appropriate amount of adequate assurance until the debtor has first paid whatever amount the utility company has demanded. The Court rejected this argument as being "simply unworkable," noting that "a utility may simply fail to respond to a debtor's offer of adequate assurance, or it may choose to respond on the thirtieth day. In either event, the result would be calamitous for a debtor in the throes of bankruptcy." The Court found that it is authorized to modify the assurance of payment after notice and a hearing, and that a debtor is not first required to pay a demand that is unilaterally satisfactory to the utility company. •

INTELLECTUAL PROPERTY CLAIM

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postpetition revenue was created for the debtor. In other words, the debtor "used" the trademarks postpetition to generate proceeds. Thus, Meredith argued they were entitled to an administrative expense claim for that usage.

Section 503 of the Bankruptcy Code provides for the allowance of administrative expenses for the actual, necessary costs and expenses of preserving the estate. Generally, in order to qualify as an "actual and necessary cost" under 503(b)(1)(a), a claim against the estate must have arisen postpetition transaction with the debtor that benefited the estate.

Here, the Court found that HIG continued to market, sell, and distribute products bearing the trademarks after the Petition Date and concluded that the continued postpetition "use" of the trademarks each constituted a transaction which benefited the estate. While it is true that Meredith approved the use of the trademarks and all of the publications in question prior to the bankruptcy filing, these two facts did not preclude Meredith's administrative expense claim. As Judge Houser asserted, "the true value of a trademark comes from its public use," and "the actual date of product approval or physical production of marketing material is not the relevant inquiry in the context of the postpetition use of a trademark." •

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The trustee commenced fraudulent conveyance actions against a number of customers, alleging that National Gas sold gas at below market prices, either as part of a fraudulent scheme or in a constructively fraudulent manner. Among the defendants in these actions were several end-users of gas, including Smithfield Packing Company and E.I. du Pont de Nemours and Company (collectively, the "End Users").

The End Users were each parties to contracts with Natural Gas derived from a form agreement created by the North American Energy Standards Board. Among the contract provisions was a mutual acknowledgment that the agreement would constitute a "forward contract" for purposes of the Bankruptcy Code.

In their answers and motions to dismiss the fraudulent conveyance complaints, the End Users asserted that the parties' acknowledgments as to the "forward" nature of the contracts were determinative on the issue, therefore invoking the Bankruptcy Code's safe harbor exemption. The bankruptcy court disagreed, reasoning that the defenses were unavailable to the End Users because the contracts—physical supply agreements—were not traded on an exchange and therefore excluded from the class of commodity forward agreements that Congress intended to protect.

On appeal, the Fourth Circuit considered whether the bankruptcy court erred in ruling that the contracts did not qualify as commodity forward agreements. The Fourth Circuit concluded that the bankruptcy court's interpretation of the statutory term "commodity forward agreement" was too narrow in its requirement that the contract be traded on a commodity exchange, as opposed to one that simply involves the physical delivery of a commodity. The Fourth Circuit based its reasoning on, among other things, the absence of any

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against the estate on account of any repayment ultimately made to the estate through settlement or judgment. To the extent such claim is ultimately allowed, section 502(h) dictates that the claim will be deemed to have arisen before the date of the filing of the petition. This provision is directed not only at the priority of the claim (i.e., a prepetition claim), but also the timing of its filing. The language of section 502(h) recognizes that avoidance action resolutions will often trail the claims bar date set in the underlying chapter 11 case, and allows these claims to be filed months or even years after the applicable claims bar date.

SIPA cases generally involve two claims bar dates. The first bar date established is for brokerage customers seeking to recover the securities in their accounts or, as in the Madoff case, the securities that were supposed to have been in their accounts. The Securities Investor Protection Corporation ("SIPC") insurance of up to $500,000 applies to these customer claims. A second bar date, usually established a few months later, is for general creditors, including those holding claims in excess of the $500,000 SIPC protection or those holding more traditional creditor claims.

Recently in the Madoff case, several investors filed a motion seeking to have the bar date order clarified with respect to any repayment claims they might hold in the event avoidance actions were commenced against them by the trustee. These investors had previously redeemed some or all of their investments, and were seeking clarification that any repayment claims ultimately held could be filed within thirty days after settlement or judgment—a provision commonly included in chapter 11 bar date orders by virtue of section 502(h).

The investors sought this clarification for two reasons. First, the investors wanted to ensure that repayment claims filed after the bar date would be deemed timely filed. Second, the investors were concerned that, to the extent they did not receive such assurance and were therefore required to file protective claims before the bar date, they would be involuntarily submitting themselves to the court's jurisdiction—potentially waiving their right to a jury trial in any avoidance action brought against them.

The Madoff trustee opposed the investors motion, arguing, among other things, that these investors lacked standing to make the request because they had not yet been sued and therefore were not creditors. The trustee also argued that section 502(h) of the Bankruptcy Code is inapplicable in SIPA cases because it conflicts with SIPA's absolute bar date requirements (SIPA provides that Bankruptcy Code provisions are generally applicable in SIPA cases to the extent consistent with SIPA provisions).

In a five-page decision issued on February 24, 2009, Judge Lifland of the SDNY Bankruptcy Court denied the investors motion, holding that the Court lacked the discretion to extend the applicable bar dates and that any determination concerning the applicability of section 502(h) prior to the actual commencement of avoidance actions would amount to an improper advisory opinion.

In denying the investors motion for lack of actual controversy, the Court left open the issue of whether section 502(h) would apply in SIPA cases to permit creditors holding avoidance action repayment claims to file post-bar date proofs of claim. Unless and until this issue is addressed, investors will be forced to choose between filing protective claims (and potentially submitting themselves to the jurisdiction of the bankruptcy court) or running the risk that any repayment claims ultimately held would be deemed untimely filed. •

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nership" with Lucent in order to further the construction of its broadband network. In connection therewith, Lucent and Winstar entered into a secured credit agreement through which Lucent, in exchange for a lien on virtually all of Winstar's assets, provided Winstar with a $2 billion line of credit to be used for the purchase of certain products and services. Simultaneously, Lucent and Winstar entered into a supply agreement under which Lucent would take primary responsibility for the construction of Winstar's network.

In May 2000, Winstar obtained a $1.15 billion revolving credit and term loan from a consortium of bank lenders, which was secured by its assets, and used the proceeds of this facility and from other sources to pay off the outstanding balance on its loan facility with Lucent. Lucent then released its lien on Winstar's assets. At the same time, Lucent and Winstar entered into a second credit agreement, pursuant to which Lucent was granted a senior security interest in some, but not all, of the assets of Winstar. The second credit agreement also contained new financial covenants limiting the amount of Winstar's capital expenditures, and requiring Winstar to use borrowings under its new bank facility to repay Lucent.

In November 2000, Siemens, a competitor of Lucent, agreed to join the bank facility and lend an additional $200 million to Winstar. Although the Siemens loan was to be used for "general corporate purposes," the second loan agreement between Lucent and Winstar obligated Winstar to use these funds to pay Lucent. The failure to do so would cause defaults under both the bank facility and Winstar's loan agreement with Lucent. Nonetheless, Winstar sought permission to keep all, or alternatively, half, of the new loan proceeds. Lucent refused and required Winstar to return all

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of the proceeds by threatening to cut off further draws under its credit agreement. Accordingly, on December 7, 2000, Winstar closed on the Siemens facility and paid Lucent approximately $188 million from the proceeds thereof to reduce Winstar's outstanding loan with Lucent. Winstar filed for bankruptcy four months later and the case was converted to chapter 7 in 2002.

The chapter 7 trustee commenced an adversary proceeding in the bankruptcy court seeking to recover the $188 million paid to Lucent as a preference payment. Lucent contended that the payment was outside of the scope of the preference statute because it was made more than 90 days prior to the commencement of the bankruptcy. The bankruptcy court disagreed, finding that the trustee could recover the amounts paid to Lucent in December 2007 as a preference. The Court ruled that Lucent was an insider of Winstar, both under the "person in control" language of the Bankruptcy Code and as a non-statutory insider. The bankruptcy court based its ruling on evidence presented at trial that Winstar and Lucent had not conducted business at arm's length prepetition. In particular, the bankruptcy court found that:

- Lucent used Winstar as a mere instrumentality to inflate its own revenues;
- Lucent used its position as Winstar's lender to ensure Winstar's cooperation by repeated threats to stop the funding of Winstar's draw requests; and
- Lucent controlled many of Winstar's decisions relating to the build out of its network by (i) forcing it to purchase goods well before the goods were needed; and (ii) treating Winstar as a captive buyer for Lucent's goods.

Lucent appealed this ruling to the District Court and later to the Third Circuit. The Third Circuit overturned the bankruptcy court's ruling that Lucent was an insider as a "person in control" of Winstar under the Bankruptcy Code because the evidence presented at trial failed to show that Lucent maintained actual control over Winstar during the period when the payment at issue was made. The Third Circuit also affirmed the bankruptcy court's holding that Lucent should be deemed a non-statutory insider of Winstar in light of the (i) closeness of the parties' relationship and (ii) fact that the transfer at issue was not made at arm's length. In so ruling, the Third Circuit noted that the record was replete with instances in which Lucent was able to coerce Winstar into consummating transactions that were not in its best interest, and concluded that Lucent had come to dominate Winstar. The Third Circuit then upheld the bankruptcy court's finding that Lucent had failed to meet its burden in establishing any defenses to the trustee's preference claim, and affirmed the Court's ruling that the trustee may recover the $188 million paid to Lucent.

This decision is noteworthy because it expands the scope of the Bankruptcy Code's definition of an "insider" to include all entities that do not bargain with the debtor at arm's length or exercise dominion or control over the debtor, and in so doing, significantly expands the reach of the Code's preference provision. •

Retail Bankruptcy Round-Up

The following cases are retail chapter 11 bankruptcies that were filed within the last several months. Cooley Godward Kronish represents the Creditors' Committee in many of these cases (please see sidebar for summaries of current representations).

Case Name	Petition Date	Case Number	Bankruptcy Court
Boot Town	November 3, 2008	08-35725	N.D. Tex. (Dallas)
Tweeter	November 5, 2008	08-12646	D. Del. (Wilmington)
Circuit City Stores, Inc.	November 10, 2008	08-35653	E.D. Va. (Richmond)
National Wholesale Liquidators	November 10, 2008	08-12847	D. Del. (Wilmington)
Lenox Sales, Inc.	November 23, 2008	08-14679	S.D.N.Y. (Manhattan)
KB Toys, Inc.	December 11, 2008	08-13269	D. Del. (Wilmington)
eToys, Inc.	December 28, 2008	08-13416	D. Del. (Wilmington)
Against All Odds, Inc.	January 5, 2009	09-10117	D.N.J. (Newark)
Goody's, LLC	January 13, 2009	09-10124	D. Del. (Wilmington)
Gottschalks Inc.	January 14, 2009	09-10157	D. Del. (Wilmington)
Hartmarx Corporation	January 23, 2009	09-02046	N.D. Ill. (Chicago)
Fortunoff Holdings	February 5, 2009	09-10714	S.D.N.Y. (Manhattan)
S&K Famous Brands, Inc.	February 9, 2009	09-30805	E.D. Va. (Richmond)
Innovation Luggage	February 10, 2009	09-10564	S.D.N.Y. (Manhattan)
Ritz Camera	February 23, 2009	09-10617	D. Del. (Wilmington)
Everything But Water	February 25, 2009	09-10649	D. Del. (Wilmington)
GI Joes, Inc.	March 4, 2009	09-10714	D. Del. (Wilmington)
Sportsman's Warehouse	March 21, 2009	09-10990	D. Del. (Wilmington)

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pre-confirmation sales under section 363, and that "nothing in § 1146(a) requires the 'sale' to occur post-confirmation. In fact, the word 'sale' does not even appear in § 1146(a)." The Court rejected the bright-line test proposed by the City, finding instead that the transfers of the apartment buildings qualified for the exemption under section 1146 because they followed a pre-confirmation sale and the transfer facilitated the implementation of the plan (*i.e.*, was necessary to the consummation of the plan). The Court also found that section 1146(a) applies both to reorganization and liquidation plans, finding that a liquidating plan under chapter 11 is a permissible form of reorganization.

The *New 118th* decision takes a practical look at section 363 sales in light of *Piccadilly*. While some particularly taxing authorities may consider it to be an end-run around the strict constructionist view of the *Piccadilly* Court, it surely will be lauded by debtors. •

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Bankruptcy Code requirement that a commodity forward agreement be traded on an exchange in order to gain the protections of the safe harbor exemption.

Despite these conclusions, however, the Fourth Circuit did not hold that the contracts in the case were commodity forward agreements, but rather remanded such determination to the bankruptcy court. Circuit Judge Paul V. Niemeyer acknowledged that the bankruptcy court would have little guidance in making its decision on remand and remarked: "[t]he marketplace is creative, designing instruments to fit the needs of the moment, and Congress sought to anticipate this in BAPCPA. In doing so, Congress forwent describing the elements of transactions it sought to exempt from the effects of bankruptcy…its repetitive generalized comments about protecting financial markets from the instability that bankruptcy proceedings might cause and the potpourri of agreements included in the term 'swap agreement' barely distinguish any major commercial contract from a swap agreement."

Although the Fourth Circuit's reasoning provides some guidance regarding Congress' expansion of the safe harbor exemption for swap and commodity forward agreements, there remains significant ambiguity over the types of transactions that qualify as swap agreements. We will certainly monitor the bankruptcy court's decision on remand and other decisions concerning the scope of the safe harbor exemption. •

Bankruptcy & Restructuring Event Calendar
Spring/Summer 2009 Cooley Godward Kronish Speaking Appearances

Event	Date/Location	Cooley Godward Kronish Participant/Topic
American Bankruptcy Institute 27th Annual Spring Meeting	April 2, 2009 National Harbor, MD	Cathy Hershcopf / Speaker "Critical Legal Issues for Vendors in Recent Retail Bankruptcies"
American Bar Association Business Section Spring Meeting	April 16-18, 2009 Vancouver, BC	Robert Eisenbach / Speaker "Comparative Treatment of Intellectual Property in Bankruptcy: Does Any Country Have It Right?"
Turnaround Management Association Spring Conference	April 27-30, 2009 Chicago, IL	Ronald Sussman / Speaker
New York State Bar Association CLE Program	June 2, 2009 New York, NY	Jim Beldner / Chair "Practical Skills Bankruptcy, Collections and the Enforcement of Money Judgments"
Turnaround Management Association 7th Annual Mid-Atlantic Regional Symposium	June 3-5, 2009 Atlantic City, NJ	Richard Kanowitz / Speaker Education Session: "Boscovs: A Case Study of a Successful Outcome in a Retail Chapter 11"
American Conference Institute Debtor-Creditor Boot Camp	July 16-17, 2009 New York, NY	Larry Gottlieb / Speaker
American Bankruptcy Institute 9th Annual Complex Financial Restructuring Program	September 10-11, 2009 Lake Tahoe, NV	Robert Eisenbach / Speaker
National Association of Credit Managers 2009 Credit Professionals Conference	September 17, 2009 Kansas City, MO	Larry Gottlieb / Speaker "Preferences, Fraudulent Conveyances and Other Annoying Notices From The Bankruptcy Court"

For more information on these appearances, please contact the Marketing Department at 212-479-6163.