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

Cooley GODWARD KRONISH LLP

BANKRUPTCY AND RESTRUCTURING GROUP

RARE RETAIL REORGANIZATION

Crabtree & Evelyn Successfully Reorganizes With Cooley's Assistance

On January 14, 2009, the Bankruptcy Court for the Southern District of New York confirmed the plan of reorganization of Crabtree & Evelyn, Ltd. Since the recent economic downturn, numerous U.S. retailers have filed for bankruptcy protection and only a small number of these companies have successfully reorganized. Crabtree & Evelyn is now one of those select few. "It is almost unique since 2005 for a retailer to reorganize," said Lawrence C. Gottlieb, chair of Cooley's bankruptcy and restructuring practice group, "but Crabtree & Evelyn was able to successfully use the bankruptcy process to right-size its retail platform and begin to implement its new business plan."

In conjunction with its plan of reorganization, Crabtree & Evelyn has closed on a $26.3 million exit loan from its parent company, Kuala Lumpur Kepong Berhad. This facility will provide sufficient cash to make all payments under the plan of reorganization and pay amounts necessary to consummate Crabtree & Evelyn's new strategic business plan. The company has already realized many of benefits from its new business plan, including right-sizing its retail footprint by exiting 35 of its retail locations and focusing on its remaining 91 retail locations. It has also launched a new e-commerce platform, at www.crabtree-evelyn.com, introduced new product lines, and re-launched its accessories program.

"We are extremely excited about confirmation of the plan and the fresh start

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Third Circuit To Consider "Credit Bidding" Rights In Asset Sales Conducted Pursuant to Chapter 11 Plan

In a decision that will certainly have a major impact on the manner in which assets are disposed of in chapter 11 cases, the District Court for the Eastern District of Pennsylvania recently ruled that a debtor may preclude its secured creditor from "credit bidding" in asset sales conducted pursuant to a chapter 11 plan. In *In re Philadelphia Newspapers*, LLC, 2009 U.S. Dist. LEXIS 104706 (E.D. Pa. Nov. 10, 2009), the district court affirmed the bankruptcy court's ruling that the debtors were authorized to bar their secured creditors from credit bidding in an asset sale conducted pursuant to a chapter 11 plan (in contrast to an asset sale conducted pursuant to section 363 of the Bankruptcy Code) so long as the plan provides the secured creditors with the "indubitable equivalent" of their claims.

In recent years, debtors have utilized the chapter 11 process to dispose of their assets pursuant to section 363 of the Bankruptcy Code with increasing regularity. Section 363(b) provides that, after notice and a hearing, a debtor may sell or dispose of its assets outside of the ordinary course of business "free and clear" of all liens, claims, interests and encumbrances. Section 363(k) protects the debtor's secured creditors by empowering them to "credit bid" the amount of their claim against the collateral

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from the editor

JEFFREY L. COHEN

As Congress continues to debate the merits of bolstering the Bankruptcy Code to include a "too big to fail" bankruptcy fix, bankruptcy professionals continue to demonstrate the dexterity necessary to facilitate the emergence of distressed companies from chapter 11 in these harsh economic times. While the traditional chapter 11 "reorganization" remains a rare occurrence these days, the Cooley bankruptcy group was recently successful in accomplishing that very feat for venerable retailer Crabtree & Evelyn, which emerged from chapter 11 in January 2010. More common, however, has been the implementation of warp-speed, "prepackaged" or "prearranged" bankruptcy cases for companies of all shapes and sizes, including the CIT Group, which emerged from bankruptcy protection in a mere 38 days.

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

This issue continues the discussion from prior issues relative to strategies employed in "prepackaged" cases, including the credit bidding dispute climbing its way to the Third Circuit in the *Philadelphia Newspapers* cases and highlights recent developments in bankruptcy law, including defining the eligibility requirements for 503(b)(9) status, administrative priority of "stub rent" claims and remedies available to creditors harmed by fraudulent or preferential transfers.

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

Second Circuit Says Unsecured Creditors Can Recover Postpetition Attorneys' Fees

Hot on the heels of the Ninth Circuit's parallel holding in the *In re SNTL Corp.* case, the Second Circuit recently issued a decision holding that postpetition attorneys' fees are categorically allowable as part of a creditor's unsecured claim, provided that such fees are recoverable under the terms of an otherwise enforceable prepetition agreement. This issue was not addressed by the United States Supreme Court in its renowned 2007 decision in *Travelers Casualty & Surety Co. of America v. Pacific Gas & Electric Co.*, 549 U.S. 443, in which the Supreme Court reversed a Ninth Circuit ruling that disallowed an unsecured claim for postpetition attorneys' fees incurred in connection with the litigation of bankruptcy law issues. The Supreme Court's holding in *Travelers* was limited to the far narrower issue of whether attorneys' fees incurred while litigating bankruptcy law issues may be recouped as part of an unsecured creditor's allowed claim.

In *Ogle v. Fidelity & Deposit Company of Maryland*, No. 09-0691-bk, 2009 WL 3645651 (2d Cir. Nov. 5, 2009) ("*Ogle*"),the Second Circuit held that the Bankruptcy Code does not prohibit unsecured creditors from seeking allowance and payment of postpetition attorneys' fees for which the debtor is required to pay pursuant to the terms of an enforceable prepetition agreement—regardless of whether such fees are incurred in connection with the litigation of bankruptcy law issues.

In *Ogle*, the Second Circuit construed the Supreme Court's *Travelers* decision as setting forth the broad rule that a claim *must* be allowed under the Bankruptcy Code unless the claim is (a) unenforceable under state law or (b) subject to one of the express disallowance provisions of section 502(b) of the Bankruptcy Code. Finding that the underlying prepetition agreement obligated

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Second Circuit: Section 502(d) Does Not Bar Allowance of Administrative Expense Claims

The Second Circuit Court of Appeals recently held that while the plain language of section 502(d) of the Bankruptcy Code bars allowance of "any claim" held by alleged recipients of preferential transfers, section 502(d) does not bar allowance of requests for payment of an administrative expense made by those same recipients. The Second Circuit's ruling hinged on its finding that the phrase "any claim" as used in section 502(d) does not include requests for payment of administrative expenses.

In *ASM Capital, LP v. Ames Department Stores, Inc.* (*In re Ames Department Stores, Inc.*), 2009 U.S. App. LEXIS 20764 (2d Cir. Sept. 18, 2009), the appellant, ASM Capital, LP, an investor in distressed debt, acquired claims against the estate from various creditors, including a reclamation claim from G&A Sales, Inc., one of Ames' vendors, along with its request for payment of an administrative expense. In 2002, approximately one year after its chapter 11 filing, Ames suspended payment of its administrative expense obligations when it decided to abandon its reorganization efforts. In the course of its liquidation, Ames commenced adversary proceedings against numerous vendors, including G&A, to avoid and recover allegedly preferential transfers.

In 2005, ASM moved the bankruptcy court for an order allowing its administrative expense request and compelling Ames to pay them on an immediate basis. Ames opposed the motion and argued that section 502(d) of the Bankruptcy Code barred allowance and payment of ASM's administrative expense requests until any and all preferential transfers received by G&A were returned to the estate. Both the bankruptcy court and the district court ruled in favor of Ames, holding that ASM's administrative expense requests were "claims" within the meaning of section 502(d) of the Bankruptcy Court and therefore must be disallowed until such time as the preference action against G&A was resolved. From ASM's perspective, this "temporary" disallowance was effectively a "final" disallowance because, during the pendency of the adversary proceeding, G&A filed its own chapter 11 case that effectively precluded any recovery by the Ames' estate of the allegedly preferential transfers.

On appeal, the Second Circuit reversed the lower court rulings based on its interpretation of the plain language of section 502(d) and consideration of the statute's underlying Congressional intent. The Second Circuit began its analysis by drawing a distinction between "claims" and "requests for payments of administrative expenses," noting that the structure and context of the statute suggest that Congress intended section 502(d) to differentiate between claims and administrative expense requests. The Second Circuit observed that section 502, when read in conjunction with section 501, provides a mechanism for the allowance of claims that is fundamentally distinct from that providing for the allowance of administrative expense requests under section 503.

The Second Circuit also explained that the language of section 502 suggests that its application is limited to the prepetition context, and not the postpetition context which includes administrative expense requests under section 503. Specifically, section 502(e)(2), (f), (g), (h), and (i) explicitly bring some, but not all, postpetition claims within the scope of the statute by providing, in each case, that the claims "shall be allowed under subsection (a), (b), or (c) of this section, or disallowed under subsection (d)…the same as if such claim had become fixed before the date of the filing of the petition." The Second Circuit reasoned that these explicit references to subsection (d) of section 502 suggest that, but for a

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In the News

Current Cooley Representations

In re Crabtree & Evelyn, Ltd., Case No. 09-14267 (Bankr. S.D.N.Y. 2009) Crabtree & Evelyn evolved from a small, entrepreneurial business, to a company with worldwide manufacturing and distribution capabilities and 91 retail locations in the United States, making it well-known and respected for its English-style elegance. At the end of January 2010, Crabtree emerged from bankruptcy as one of the handful of retailers to have successfully reorganized since the 2005 amendments to the Bankruptcy Code. As counsel to the debtors, Cooley assisted Crabtree in the closure of 35 unprofitable retail locations. In addition, Cooley formulated the debtor's plan of reorganization, which reorganizes the debtor around a smaller retail platform and was ultimately confirmed by Judge Lifland in the Bankruptcy Court for Southern District of New York.

In re 7677 East Berry Avenue Assocs., L.P., Case No. 09-28000 (Bankr. D. Colo. 2009) The debtor is a luxury lifestyle community in the suburbs of Denver, Colorado known as the Landmark, consisting of two condominium towers with 276 luxury units and an adjacent retail center. Cooley represented Hypo Real Estate Capital Corporation, the first lien lender owed approximately $98 million as of the petition date. The Debtor filed for bankruptcy without conferring with Hypo and simultaneously sought non-consensual use of Hypo's cash collateral and approval of a priming DIP facility with an alternative lender. In an extremely compressed time frame, through contentious litigation, Cooley successfully defeated the non-consensual use of Hypo's cash collateral, successfully defeated the debtor's attempt to prime Hypo's lien, and

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obtained approval of an alternative DIP facility to be provided by Hypo on terms acceptable to Hypo.

In re Eddie Bauer Holdings, Inc., et al., Case No. 09-12099 (Bankr. D. Del. 2009) Cooley represents the official committee of unsecured creditors of Eddie Bauer, an internationally recognized retailer that operated approximately 370 retail and outlet stores throughout the United States and Canada prior to its bankruptcy filing. Approximately six weeks after it filed for chapter 11 protection on June 17, 2009, Eddie Bauer was sold as a going concern to Golden Gate Capital, a San Francisco private equity firm, for $286 million plus the assumption of hundreds of millions of dollars in liabilities. The sale, which was approved by the Delaware bankruptcy court following an auction that lasted more than 15 hours, will keep open at least 336 of Eddie Bauer's 370 stores. In addition to continuing its operations on a going concern basis, Eddie Bauer recently filed a chapter 11 plan of liquidation and disclosure statement, which provides that preferences will not be pursued and estimates a meaningful distribution to general unsecured creditors. The plan is supported by the creditors' committee and the confirmation hearing is scheduled for March 2010.

In re Uno Restaurant Holdings Corporation, et al., Case No. 10-10209 (Bankr. S.D.N.Y. 2010) Uno owns and operates 99 Uno Chicago Grill full-service casual dining restaurants (formerly known as Pizzeria Uno) as of the petition date, is a party to agreements with franchisees who operate 76 Uno Chicago Grill and 2 take-out restaurants, and produces a variety of Uno Chicago Grill branded products, such as refrigerated and frozen

Delaware Bankruptcy Court Abandons *Per Se* Rule For "Stub Rent" Claims

One of the benefits a debtor enjoys under the Bankruptcy Code is the ability to reject burdensome nonresidential leases. Prior to their rejection, however, section 365(d)(3) of the Bankruptcy Code obligates the debtor to timely perform those lease "obligations" arising after the bankruptcy filing and until such time as the lease is rejected. The term "obligation" is not defined by the Bankruptcy Code and, as a result, courts have struggled in determining whether a debtor's obligation to pay "stub rent" gives rise to a mere prepetition unsecured claim or one entitled to timely payment under section 365(d)(3) of the Bankruptcy Code. A debtor's "stub rent" is generally defined as the rent owed its landlords for the period beginning on the day the bankruptcy is filed and continuing through the end of that month. In most cases, a debtor's obligation to pay rent will most often come due on the first of the month. Accordingly, when a bankruptcy is filed after the first day of the month, the debtor often argues that because its obligation to pay rent for the "stub" period arose prior to its bankruptcy filing, section 365(d)(3) does not apply and the debtor's failure to pay such rent will leave its landlords with no better than a prepetition unsecured claim.

Treatment of stub rent claims has varied among bankruptcy courts in recent years. In the Spring 2009 edition of Absolute Priority, we reported on the stub rent decision issued by the Bankruptcy Court for the Southern District of New York in the Steve & Barry's case in which Cooley represented the committee. In that case, the SDNY bankruptcy court held that stub rent is an obligation of the debtor that accrues or arises daily, thereby entitling a landlord's claim for stub rent to timely postpetition payment under section 365(d)(3) of the Bankruptcy Code. 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. Dec. 17 2008). In so holding, the SDNY bankruptcy court applied the so-called "proration" approach in which courts have equitably reasoned that even if the lease requires the full payment of monthly rent in advance, payment of that rent should be prorated between the prepetition and stub periods, the latter being entitled to timely payment under section 365(d)(3) the Bankruptcy Code.

As a result of the Third Circuit's precedential interpretation of section 365(d)(3) in the *In re Montgomery Ward Holding Corp.* case, the Delaware bankruptcy courts have interpreted the statute in a manner far less equitable to landlords. Under the Third Circuit's ruling in the *Montgomery Ward* case, a landlord does not have the right to timely payment of those obligations of the debtor which, according to the terms of the lease, arise prior to the bankruptcy filing. See *In re Montgomery Ward Holding Corp.*, 38 BCD 135 (3d Cir. 2001). This so called "billing date" interpretation of the statute has foreclosed any argument that a landlord's stub rent claim falls within the rubric of section 365(d)(3) in the Third Circuit.

However, in a 2008 decision hailed by many as a groundbreaking compromise to the Third Circuit's harsh "billing date" approach to stub rent claims under section 365(d)(3) of the Bankruptcy Code, Judge Sontchi of the Delaware bankruptcy court reasoned that "the mere fact that the Debtors are occupying the [l]andlord's premises is sufficient, *in and of itself*, to establish that payment for that use and occupancy is an actual, necessary expense of preserving [a debtor's estate] under section 503(b)(1)." *In re Goody's Family Clothing, Inc.*, 392 B.R. 604, 614 (Bankr. D. Del. 2008) (emphasis added). Section 503(b) provides for the allowance

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Section 503(b)(9) Developments: Circuit City and Pilgrim's Pride Courts Weigh In

Added to the Bankruptcy Code as part of the 2005 BAPCPA amendments, section 503(b)(9) provides an administrative priority claim for the value of goods received by the debtor in the ordinary course of business within the 20 days prior to the commencement of a bankruptcy case. Prior to BAPCPA, a debtor's failure to pay for goods received within the 20 days preceding the bankruptcy gave rise to an unsecured prepetition claim, subject to very limited reclamation rights. These prepetition claims would ordinarily be paid by a debtor on the same *pro rata* basis as other unsecured claims under a confirmed plan, often at a severe discount. Early court decisions concerning section 503(b)(9) claims focused on when such claims must be paid by the debtor and invariably concluded that, in the absence of truly unique circumstances, nothing in the Bankruptcy Code requires payment of such claims prior to confirmation of a plan. *See e.g., In re Bookbinders' Restaurant*, 2006 WL 3858020, No. 06-12302 (Bankr. E.D. Pa. Dec. 28, 2006) (creditor not entitled to immediate payment of 20-day claim as a matter of law); *In re Global Home Products, LLC*, No. 06-10340 (Bankr. D. Del. Dec. 21, 2006) (denying immediate payment where it would cause "substantial harm" to estate outweighing the "little prejudice or hardship" to be suffered by the creditor in having payment deferred until confirmation).

More recently, section 503(b)(9) decisions have addressed the issue of what constitutes "goods" within the meaning of the statute. The first court to weigh in on this issue was the Bankruptcy Court for the Eastern District of Michigan in the *Plastech* bankruptcy case. *In re Plastech Engineered Products, Inc., et al.*, 394 B.R. 147 (Bankr. E.D. Mich. 2008). Although the nature of the section 503(b)(9) claims at issue in *Plastech* varied, each included the provision of a service in connection with the transfer of raw materials. For example, one claimant provided snow removal services and charged the debtors for the de-icing and salt materials used in the removal process. With respect to that claim, the debtors argued that if a mixture of goods and services was provided, the court should apply the "predominant purpose" test which looks to the overall purpose of the transaction to determine whether more goods than services were provided or vice versa. In other words, the debtors argued that the court should apply an "all or nothing" approach—i.e., if the predominant purpose of the transaction was the provision of services, rather than the supply of goods, then the claim should not be awarded section 503(b)(9) priority. The *Plastech* court rejected the debtors' "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?"

Less than two months after the *Plastech* decision was issued, the Bankruptcy Court for the District of Delaware presiding over the *Goody's Family Clothing* case further examined the definition of "goods" as it pertains to section 503(b)(9) of the Bankruptcy Code. *In re Goody's Family Clothing, Inc., et al.* (Bankr. D. Del. Feb. 6, 2009). In that case, the section 503(b)(9) claim at issue concerned one of the debtors' vendors who provided services, including inspecting, ticketing and repackaging apparel purchased from other vendors. The court began its analysis by joining the *Plastech* court's analysis that pursuant to UCC § 2-105(1) "goods'" cannot include

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deep-dish and other pizzas and pizza-related products for sale to supermarkets and other retail venues. Since being selected as counsel for the creditors' committee, Cooley focused its efforts on achieving a recovery greater than the zero percent contemplated by the debtors and their noteholders in the pre-arranged chapter 11 filings negotiated with all parties other than unsecured creditors prior to the January 20, 2010 petition date. The efforts of Cooley and the creditors' committee have resulted in a global settlement with the debtors and a majority of their noteholders which provides for a successful reorganization of Uno's as a going concern, a return to unsecured creditors and an agreement amongst the parties that preference actions will not be pursued.

In re Ritz Camera Centers, Inc., Case No. 09-10617 (Bankr. D. Del. 2009) As counsel to the official committee of unsecured creditors in the Ritz Camera Centers, Inc. bankruptcy, Cooley actively negotiated a sale of substantially all of Ritz's assets to RCI Acquisition, LLC. Prior to the sale and partial liquidation, Ritz Camera was considered America's largest camera store chain with more than 1,000 store locations spread across 45 states. As a result of the sale, RCI will continue operating approximately 400 stores across the United States. The Committee is assisting the debtor in liquidating the remaining property of the estate, which includes 6 owned real estate properties, and drafting and negotiating a joint plan of liquidation.

In re Filene's Basement, Inc., et al., Case No. 09-11525 (Bankr. D. Del. 2009) After the purchaser of substantially all of Filene's assets operated the company for nearly 10 years after its

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1999 bankruptcy, Filene's again filed for bankruptcy protection on May 4, 2009. Cooley represents the official committee of unsecured creditors. Filene's is the oldest off-price retailer in America with 26 operating retail locations and approximately $422 million in annual sales. The debtors determined that a sale of their operations was the best option for the debtors to maximize the value of their business. Cooley was instrumental in utilizing the auction process to maximize recoveries for unsecured creditors. At the end of a three-day auction, a joint venture of Syms Corp. and Vornado Realty acquired substantially all of the assets of Filene's for approximately $63 million—a figure almost 300% higher than the $22 million stalking horse bid. Under the sale, the Syms/Vornado joint venture acquired leases for 23 retail stores and a distribution center, along with inventory, fixed assets and equipment at all locations, as well as certain Filene's contracts, intellectual property, trade names and related assets. The sale assured that Filene's would continue to operate throughout the Northeast and Midwest. As a result of the sale, pursuant to a confirmed plan, preferences will not be pursued and creditors are expected to receive over 75% return on their claims.

In re BT Tires Group Holding, LLC, et al., Case No. 09-11173 (Bankr. D. Del. 2009) Cooley represents the official committee of unsecured creditors of Big 10 Tire Stores, one of the largest independent tire dealers in the Southeastern United States. For 54 years, Big 10 Tire has specialized in offering its recurring customer base a broad selection of tire products and competitive pricing. On April 2, 2009, Big 10 Tire filed for a chapter 11 petition. On June 26, 2009, the Delaware bankruptcy court approved the sale of

Tousa Creditors Score Big With Fraudulent Transfer Victory

In what can only be described as a "home run" for creditors, the Bankruptcy Court for the Southern District of Florida recently issued a 182-page decision finding that Tousa, Inc. had fraudulently or preferentially transferred liens, a tax refund and hundreds of millions of dollars in cash to certain of its lenders in the months preceding the bankruptcy filing. Tousa, the Florida-based homebuilder that was ravaged by the housing downturn, filed its chapter 11 cases in January 2008. Prior to its bankruptcy filing, Tousa agreed to settle a litigation commenced by certain of its lenders (the Senior Transeastern Lenders) for a cash payment of approximately $420 million. In order to finance the settlement, Tousa borrowed $500 million from their First and Second Lien Lenders and granted liens on substantially all of its assets—and the assets of certain subsidiaries who were not defendants in the litigation (the Conveying Subsidiaries)—to secure the borrowings.

Less than six months after these transactions were consummated, Tousa and the Conveying Subsidiaries filed chapter 11 cases in the Southern District of Florida and the creditors' committee commenced an adversary proceeding seeking to avoid and recover the approximately $500 million in liens that were granted to the First and Second Lien Lenders, the approximately $420 million cash litigation settlement payment made to the Senior Transeastern Lenders and a security interest in a $207 million tax refund that was granted to the First and Second Lien Lenders as further borrowing security and which was perfected less than 90 days before the bankruptcy filings.

Granting judgment in favor of the creditors' committee on the $500 million liens and $420 million settlement payment, the *Tousa* court relied on numerous reports and emails prepared by Tousa's top management personnel indicating that Tousa had knowledge of the severe downturn in the Florida housing market and its homebuilding business prior to entering into the transactions. Similarly, substantial evidence led the court to conclude that the First and Second Lien Lenders had significant doubts about Tousa's solvency. The court also found that while the Conveying Subsidiaries were insolvent both before and after the transaction, the First and Second Lien Lenders, motivated by the prospect of substantial fees, and Tousa's management, motivated by "outsized personal incentives," were determined to consummate a deal that provided, at most, minimal indirect benefits to the Conveying Subsidiaries. Moreover, the Court found that the First and Second Lien Lenders and the Senior Transeastern Lenders did not act in good faith and were grossly negligent in failing to investigate Tousa's finances and knew or should have known that the liens granted on the Conveying Subsidiaries' assets would be used to repay a debt for which the Conveying Subsidiaries were not themselves liable. The *Tousa* court also found in favor of the committee with respect to the transfer of the security interest in the $207 million tax refund to the First and Second Lien Lenders. The court deemed this security interest avoidable because, *inter alia*, the interest was perfected during the 90-day prepetition period of presumed insolvency, a presumption that the First and Second Lien Lenders could not rebut.

The *Tousa* court granted a variety of remedies to the debtors' estates in furtherance of its ruling. Significantly, the court compelled the Senior Transeastern Lenders' disgorgement of $403 million, plus prejudgment interest, which represented the value of the Conveying Subsidiaries' assets that were subject to the liens granted to the

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Delaware Bankruptcy Court Says Subsequent New Value Need Not Remain Unpaid

In a recent decision in the *Pillowtex* case, a Delaware bankruptcy court considered a frequently debated aspect of the so-called "subsequent new value" defense to preference actions as codified in section 547(c)(4) of the Bankruptcy Code. *In re Pillowtex Corp., et al.*, 416 B.R. 123 (Bankr. D. Del. 2009). Specifically, the court addressed whether a creditor is entitled to assert as a defense to a preference any new value that it subsequently supplied to the debtor and for which the debtor paid the creditor in full. In other words, may the creditor offset against the preference claim any subsequent unsecured credit that it extended to the debtor—even if this subsequent extension of credit was actually paid for by the debtor?

The *Pillowtex* debtors argued that this question must be answered in the negative, because otherwise the creditor would effectively be entitled to "double count" subsequent credit extensions—first, in the form of a payment actually received by the creditor and second, in the form of a defense to the recovery of an earlier payment made by the debtor. This "remains unpaid" approach is said to be adopted by the Third, Seventh and Eleventh Circuits. On the other end of the spectrum are the Fourth, Fifth and Ninth Circuits, which have refused to read the "remains unpaid" requirement into section 547(c)(4) of the Bankruptcy Code. These courts have focused on the plain language of section 547(c)(4) and have refused to write such a requirement into the statute.

Looking to the plain language of section 547(c)(4), the *Pillowtex* court reasoned that the statute does not demand that subsequent new value remain unpaid—only that such new value not be paid on account of an otherwise avoidable transfer. Put simply, the creditor may offset against the preference claim subsequent extensions of credit that were paid for by the debtor, but may not do so if the payments made on account of those subsequent extensions of credit were indefensible preferences themselves.

The *Pillowtex* decision is remarkable for its divergence from what many believed was settled precedent in the Third Circuit—that new value must remain unpaid. Judge Carey was careful to recognize his obligation to follow established precedent, but ultimately determined that no such precedent exists with respect to this discreet issue. Judge Carey reasoned in the absence of such precedent, and taking into account the subsequent development of decisional law and other scholarship, the plain language of section 547(c)(4) does not require that new value must remain unpaid, only that it not be paid for by an otherwise avoidable transfer. •

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First and Second Lien Lenders. The court also voided the Conveying Subsidiaries' obligations to the First and Second Lien Lenders and disallowed all claims held on account thereof.

Although this strongly-worded decision and outcome will surely prove to be a lesson for borrowers and lenders alike, it is important to bear in mind that the transfers at issue in *Tousa* were consummated less than six months before the bankruptcy filing. This factor was no doubt critical to the creditors' committee's ability to prove insolvency—the linchpin to any successful fraudulent conveyance action. •

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Big 10 Tire as a going concern to an affiliate of Sun Capital Partners, Inc., a private investment firm. Cooley successfully negotiated a return for creditors with the buyer and is now focused on assisting with the confirmation of a liquidation plan and wind-down of the bankruptcy case.

In re Gottschalk's, Inc., Case No. 09-10157 (Bankr. D. Del. 2009) Founded in 1904, Gottschalk's, Inc. operated 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 post-petition financing to ensure that the company possessed sufficient liquidity to fully market its assets as a going concern. After the debtor was unable to attract a going concern buyer, we were instrumental in maximizing the value of the estate for the benefit of unsecured creditors through the debtor's liquidation by negotiating (i) a stalking horse asset purchase agreement for the sale of the debtor's inventory that set the stage for a robust auction and the commencement of going out of business sales that netted over $90 million for creditors; (ii) agreements for the sale of Gottschalk's lease portfolio and owned real property that have added more than $20 million of value to the estate; and (iii) the terms of a plan of liquidation that will ensure a meaningful distribution to unsecured creditors. The debtor's plan of liquidation was filed in early December 2009, and is likely to go effective in mid-March 2010.

In re St. Vincent Catholic Medical Centers of New York, Case No. 05-14945 (Bankr. S.D.N.Y. 2005) Cooley was counsel to the official tort claimants' committee in the St. Vincent's chapter 11 case, representing over 750 medical

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malpractice claimants asserting hundreds of millions of dollars of claims against the various debtors operating 10 hospitals and related medical facilities in the five boroughs of New York City. Cooley helped facilitate relief from the automatic stay for hundreds of medical malpractice creditors seeking to liquidate their claims in state court and ultimately played a pivotal role in the confirmation of a chapter 11 plan providing for St. Vincent's emergence from chapter 11 and the funding of trusts from which medical malpractice creditors could seek recovery on their claims in the absence of available insurance coverage. Cooley currently represents the Medical Malpractice Trust Monitor in connection with its oversight and enforcement duties under the chapter 11 plan.

In re Bernie's Audio Video TV Appliance Co., Inc., Case No. 10-20087 (Bankr. D. Conn. 2010) Bernie's Audio Video TV Appliance Co., Inc., a brand-name electronics retailer, operates a chain of approximately 15 stores in Connecticut, Massachusetts, and Rhode Island. Cooley was retained to represent the creditors' committee after Bernie's filed for protection under chapter 11 of the Bankruptcy Code on January 14, 2010. Prior to the commencement of the bankruptcy, Bernie's began going-out-of-business sales at all of its stores. The continuance of the full-chain liquidation, which was approved by the bankruptcy court on the first day of the case, is expected to conclude by the end of February 2010. The going-out-of-business sales are not expected to generate sufficient funds to satisfy the debts owed to Bernie's prepetition secured lender. Nevertheless, through Cooley's efforts on behalf of unsecured creditors, the debtor's lender agreed not to seek a lien on preference

"Prepackaged" Bankruptcy Filings Surge As Debtors And Creditors Work Together To Avoid Costs And Uncertainties Of Chapter 11

2009 was marked by a dramatic rise in number of so-called prepackaged bankruptcy filings. A prepackaged bankruptcy is essentially a pre-negotiated plan of reorganization. If a debtor enters chapter 11 with enough support for a plan, then the case can be streamlined, administrative expenses minimized and the plan can be expeditiously approved by the bankruptcy court. Prepackaged bankruptcy cases, to the extent successful, provide the debtor with a quick and efficient exit from chapter 11.

Of the 164 companies with public equity and debt that filed for bankruptcy in 2009, 30 were prepackaged filings—representing over 18% of all filings. Moreover, these 30 prepack filings, which included such significant cases as *CIT Group Inc, Charter Communications Inc, Lear Corp and Six Flags Inc.*, represent a considerable uptick from the 10 prepackaged filings observed in 2008. While the economic outlook for 2010 is one of recovery, some of the factors spurring the growth of prepackaged bankruptcies are still in effect and will most likely continue.

In addition to the well-documented deterioration of the credit and housing markets, the surge in prepack filings can unquestionably be attributed to certain amendments and additions to the Bankruptcy Code made by Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). For example, prior to BAPCPA, the debtor had the exclusive right to file a plan during the first 120 days of its case and 180 days to have that plan accepted by creditors. Importantly, bankruptcy courts were given wide latitude to extend these exclusive periods and routinely granted such extensions—often for multiple years in larger chapter 11 cases. Now, however, bankruptcy courts are powerless to extend the debtor's 120-day exclusive period to file a plan beyond 18 months, nor can the debtor's exclusive solicitation period be extended beyond 20 months. The compression of the debtor's exclusivity period under BAPCPA has undoubtedly motivated debtors to work with creditors in advance of the bankruptcy filing to formulate a consensual emergence strategy.

The ability to confirm prepackaged chapter 11 plans has also helped debtors secure necessary exit financing. Lear Corp, an auto parts manufacture, filed a prepackaged chapter 11 case that included a $500-million debtor-in-possession financing facility that could be converted into an exit financing facility, although Lear ultimately secured a more beneficial exit facility from a third party than the convertible facility offered by its postpetition lender. The debtor-in-possession facility in the *Readers Digest* prepack case was also convertible to an exit facility. Prepackaged bankruptcies also give the debtor added leverage, or at least an alternative plan, in the context of debt exchanges. CIT Group attempted a massive debt exchange while simultaneously soliciting consent for a prepackaged bankruptcy plan. Negotiating a prepackaged bankruptcy can pressure bondholders and lenders to consent to a debt exchange.

Prepackaged bankruptcy filings are not without risk of course. In March 2009 Charter Communications Inc., the nation's fourth largest cable television company, filed what the bankruptcy court called "perhaps the largest and most complex prearranged bankruptcies ever attempted." Pursuant to a prearranged plan of reorganization, Charter sought to remove more than eight billion dollars from its highly leveraged capital structure to secure the

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investment of approximately $1.6 billion in new capital through a rights offering. The proposed rights offering was back-stopped by a group of bondholders who would have the right to reconstitute Charter's board and reinstate certain prepetition credit facilities with the objective of preserving favorable existing credit terms and saving hundreds of millions of dollars in incremental annual interest expense that would otherwise be payable. The prepack plan also provided Paul Allen, co-founder of Microsoft and controlling shareholder of Charter, with $375 million, which included consideration paid under a settlement that would allow Charter to dilute Allen's control interests, preserve net operating losses and shelter future income.

Charter's senior secured lenders, led by JPMorgan, argued that Charter had defaulted on its debt and, therefore, the senior secured credit facility could not be reinstated. JPMorgan also asserted that the plan shifted most of Allen's 91 percent stake in the company to four noteholders: Apollo Management LP, Crestview LLC, Oaktree Capital Group Holdings GP and Franklin Resources Inc. Because the four funds had acted as a group, and because they could own more than 35 percent of Charter's stock, JP Morgan argued that a technical change in control would occur under the plan.

After what has been called one of the most hotly contested confirmation battles ever conducted, the bankruptcy judge approved the plan which shed $8 billion in debt and gave Charter $1.6 billion through a rights offering. In doing so, the court held that the senior secured credit facility could be reinstated as no default had occurred and the plan would not constitute a change in control since "Allen will retain sufficient voting power and the bondholders have not acted as a group."

The Charter confirmation battle confirms that prepackaged chapter 11 cases are not without their pitfalls. While Charter's decision to forge ahead with a prepackaged case was clearly predicated on its belief that doing so would provide more certainty in outcome, less interruption to the business and a swift exit out of bankruptcy, a recalcitrant creditor can disrupt even the best laid plans. Here, had the bankruptcy court sustained JPMorgan's objections, Charter would have been forced back to the drawing board, subject to all of the usual uncertainties surrounding a debtor in bankruptcy and having already spent significant estate resources. •

CRABTREE & EVELYN REORGANIZES

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we have received from our short stay in bankruptcy. The bankruptcy process has allowed us to focus on a smaller footprint of retail stores, making each one of them a distinctive experience for our customers," said Stephen W. Bestwick, Acting President, who has been with the company for over 20 years. "Crabtree & Evelyn's successful reorganization is a testament to our outstanding partnerships with our customers, employees, vendors and landlords, and we appreciate their hard work and dedication to the company throughout this process." In the coming months, Crabtree & Evelyn looks forward to executing its long-term strategic business plan, including enhancing its product assortment, expanding its wholesale business division and further refining the consumer shopping experience.

Crabtree & Evelyn was represented by Cooley Godward Kronish LLP partners Lawrence C. Gottlieb and Jeffrey L. Cohen and associate Richelle Kalnit. Clear Thinking Group LLC served as Crabtree & Evelyn's financial advisors and KPMG Corporate Finance LLC served as real estate advisors.•

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actions and established a fund to finance the orderly wind-down of the estate.

In re G.I. Joe's Holding Corp., et al., Case No. 09-10713 (Bankr. D. Del. 2009) Cooley represents the official committee of unsecured creditors of G.I. Joe's Inc., a sporting goods retailer which operated 31 stores in Washington, Oregon and Idaho prior to its chapter 11 filing in March 2009 and subsequent liquidation. G.I. Joe's filed its chapter 11 case with substantial first and second lien secured debt that will not be paid in full from the proceeds of the company's store closing and intellectual property sales. Nevertheless, the committee was successful in achieving a significant "carve out" from the secured lenders' collateral, which proceeds shall be distributed exclusively to unsecured creditors at the conclusion of the case.

In re Against All Odds, Inc., Case No. 09-10117 (Bankr. D.N.J. 2009) In May 2009, Against All Odds, USA, Inc., sold its assets and 30 of its leases to New Deal, LLC, which will continue to run the debtor's business as a going concern. Cooley was counsel to the official committee of unsecured creditors in the case and led the negotiations with New Deal. Against All Odds, an urban-style clothing retailer, filed for bankruptcy protection in early January 2009. As a result of the sale to New Deal, unsecured creditors received a guaranteed return on their debt that far exceeded liquidation value.

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

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key role in the sale of substantially all of the Lenox assets to Clarion Capital after a three-day sale hearing. The sale of substantially all of the Lenox assets has enabled the Lenox business to continue as a going concern and ensuring the continued employment of more than 1,500 employees. In December 2009, Lenox confirmed a plan of liquidation, which, among other things, ensures that creditors will not be the target of preference actions.

In re Samsonite Company Stores, Case No. 09-13102 (Bankr. D. Del. 2009) Samsonite is one of the world's leading travel brands. Its parent company produces popular luggage lines, as well as casual and outdoor bags, business and computer cases, leather goods and travel accessories. It sells these products principally under the labels of Samsonite, American Tourister and Samsonite Black Label. As part of its parent's global restructuring, the debtor filed for bankruptcy in October 2009 primarily to refocus the debtor's U.S. retail store business on profitable "outlet" stores. On behalf of the creditors' committee, the Firm was instrumental in ensuring that unsecured creditors would obtain a return of 100% on their claims.

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 and subsequently liquidated its assets. Cooley represents the official committee of unsecured creditors in its pursuit of a complex $1.2 billion litigation related to the 2004 acquisition of Mervyn's by various private equity firms,

"CREDIT BIDDING" RIGHTS continued from page 1

being sold by the debtor. In other words, if the secured creditor wants to purchase the asset being sold, it is entitled to offset the amount of its claim against the purchase price. This is a significant protection for secured creditors and many courts have held that the creditor is entitled to credit bid the "face amount" of the secured claim, even if the secured creditor is undersecured —i.e., where the value of the underlying collateral is less than the amount of the claim.

The Bankruptcy Code also permits the debtor to sell assets pursuant to a chapter 11 plan. Section 1123(a)(5) of the Bankruptcy Code provides that a plan may be implemented through the transfer of all or a part of the property of a debtor's estate. Additionally, section 1123(b)(4) provides that a plan may provide for the sale of all or substantially all assets of the estate. If a chapter 11 plan providing for the sale of all or substantially all of a debtor's assets is rejected by a class of secured creditors, then the plan may only be confirmed through the so-called "cramdown" provisions of section 1129(b)(2). This process imposes additional requirements on the debtor that would not otherwise be required. Specifically, section 1129(b)(2)(A) mandates that the proposed plan be "fair and equitable" to such secured creditors. The debtor may satisfy the fair and equitable standard by meeting *one* of three requirements:

- the plan provides that the secured creditor (i) retains the lien securing its claim, regardless of whether the collateral is retained by the debtor or transferred to another entity; and (ii) receives deferred cash payments totaling at least the allowed amount of its secured claim;
- the plan provides for the sale of the secured creditor's collateral free and clear of its lien, with such lien attaching to the proceeds of the sale, and with the secured creditor retaining the right to credit bid in any such sale; or
- the plan provides for the sale of the secured creditor's collateral, with the secured creditor receiving other value that is the "*indubitable equivalent*" of its claim.

Importantly, the third requirement of the fair and equitable standard is silent as to whether the secured creditor retains the right to credit bid its claim against the purchase price of the collateral.

In the *Philadelphia Newspapers* case, the debtors owned and operated a number of media publications in the Philadelphia region, most notably the *Philadelphia Inquirer* and the *Philadelphia Daily News*. In June 2006, an investor group purchased the debtors and financed the acquisition through an approximately $295 million loan secured by a first priority lien on substantially all of the debtors' assets. In February 2009, the debtors filed their chapter 11 cases and, several months later, proposed a plan of reorganization contemplating the sale of substantially all of their assets to a stalking horse bidder with the consummation of such sale subject to any higher or better bids received by the debtors at auction. The stalking horse bid contemplated the purchase of the debtors' assets for $30 million in cash and the assumption of $41 million in liabilities – a total purchase price that was far less than the aggregate amount of secured claims held against the debtors.

In connection with the proposed sale of the company under the plan, the debtors sought the bankruptcy court's approval of certain procedures governing the conduct of the auction. The procedures proposed by the debtors barred the secured creditors from credit bidding at the auction, which the debtors argued was appropriate because the assets were being sold under a plan rather than section 363 of the Bankruptcy Code. The secured creditors

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objected to this bar, arguing that because they intended to reject the plan, the debtors could only confirm the plan under the "cramdown" provisions of section 1129(b)—which specifically preserves the secured creditors' rights to credit bid their claims against the purchase price. The debtors argued that section 1129(b) requires only that they meet one of the three fair and equitable requirements, that the proposed plan satisfied the "indubitable equivalent" requirement and that this requirement does not preserve the secured creditors' rights to credit bid their claims.

The bankruptcy court agreed with the secured creditors. Finding that section 1129(b) was ambiguous on its face, the bankruptcy court reviewed the legislative history and concluded that Congress's intent was that the secured creditor be permitted to credit bid its claim in full at *any* sale of its collateral in bankruptcy. On appeal, the district court reversed, finding that section 1129(b) was clear and unambiguous on its face, and that the bankruptcy court's consideration of the legislative history was therefore unwarranted. In so holding, the district court adhered to the plain meaning of section 1129(b), and noted that because the various requirements of the "fair and equitable" test set forth above are phrased in the disjunctive, a debtor needs only to satisfy one of them to the exclusion of the others. Of the two requirements relevant to the case, the district court concluded that a plan may fairly and equitably provide for the disposition of a secured creditor's collateral if the plan (i) empowers the secured creditor to credit bid at the sale or (ii) provides the secured creditor with the indubitable equivalent of its claim. Notably, the district court did not opine as to whether the proposed treatment of the secured creditors under the plan satisfied the indubitable equivalent requirement of section 1129(b).

The secured lenders appealed the decision. On November 17, 2009, the Court of Appeals for the Third Circuit issued an order staying the auction of the debtors' assets pending its ruling on appeal. The Third Circuit heard argument on December 15, 2009 and a decision has not yet been rendered. Certainly, the district court's decision leaves many questions unanswered, including what constitutes the "indubitable equivalent" of a secured claim.

The Third Circuit's ruling will have a profound impact on the dynamic between debtors and their secured creditors, particularly in those cases where the decision to sell the debtor's business and/or assets is made prior to or shortly following the bankruptcy filing. Secured creditors with large undersecured claims have traditionally held significant leverage in all aspects of the bankruptcy sale process by virtue of their ability to credit bid claims at auction—a power that often chills the bidding process by creating a disincentive for third parties to compete. If the debtor is, in fact, empowered to strip the secured creditor of its credit bidding rights under a chapter 11 plan that provides the secured creditor with the indubitable equivalent of its claim, then secured creditors will assuredly be less able to impact the chapter 11 process. Of course, such a "victory" for debtors cuts both ways, particularly with respect to those secured creditors' whose cash collateral is needed by the debtors to fund the chapter 11 process or, to an even greater extent, those secured creditors who provide debtor-in-possession financing to fund the debtor's chapter 11 process. It is highly unlikely that such creditors would permit the debtor's use of cash collateral or extend additional financing without conditioning such use or extension on the debtor's agreement to take no action that might preclude the creditor's right to credit bid in any sale of its collateral. We will certainly keep you posted on the Third Circuit's ruling.•

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which stripped Mervyn's retail operations from its valuable real estate pursuant to an "opco/propco" structure. The defendants include affiliates of Cerberus, Lubert-Adler, Sun Capital, Goldman Sachs, Bank of America, Citigroup and Target, among others. The creditors' committee is also pursuing causes of action valued at over $30 million against the debtors' second lien lender (affiliates of Sun Capital) relating to the validity of its liens.

In re KB Toys, Inc., et al., Case No. 08-13269 (Bankr. D. Del. 2008) After emerging from bankruptcy in 2004 pursuant to a plan of reorganization under which Prentice Capital Management acquired a majority ownership of the debtors, KB Toys filed a second bankruptcy on December 11, 2008 in which Cooley represents the official committee of unsecured creditors. KB was the nation's leading mall-based specialty toy retailer with approximately 277 retail locations and approximately $480 million in annual sales. Although the debtors examined various alternatives to address their projected liquidity shortfall, none of these alternatives proved viable and the debtors determined that a liquidation of their retail-based operations through expedited and orderly going-out-of-business sales within chapter 11 would maximize the value of their assets. As a result of its investigation and prosecution of a fraudulent conveyance action against Prentice and its affiliates, the creditors' committee was able to procure a settlement providing for substantial distributions to KB's section 503(b)(9) and "stub rent" creditors and the structured dismissal of KB's chapter 11 cases in lieu of conversion.

In re The Ski Market, Ltd., Inc., Case No. 09-22502 (Bankr. D. Mass. 2010) Prior to filing for bankruptcy protection,

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The Ski Market operated seven retail locations in the Northeast which featured a wide selection of skis, snowboards, bicycles, and skateboards, as well as related accessories and apparel. Upon filing for bankruptcy, the company sought to sell substantially all of its assets. Cooley, as counsel to the creditors' committee, took a substantial role in the sale process. After it became apparent that the value of the company's assets was insufficient to provide a full return to the company's secured creditors, Cooley negotiated a carve-out agreement establishing a trust for the benefit of unsecured creditors. Absent the agreement, unsecured creditors would have received nothing.

In re Long Rap, Inc., Case No. 09-00913 (Bankr. D. D.C. 2009) Long Rap, Inc. is a chain of approximately 20 retail fashion apparel stores located primarily in Washington, D.C., Virginia, Maryland and California. Cooley was retained to represent the official committee of unsecured creditors shortly after the company filed for chapter 11 protection on October 14, 2009. Despite substantial prepetition secured debt and a challenging retail environment, Long Rap is attempting to reorganize and emerge from chapter 11 as a going concern. While the case remains in its preliminary stages, the Committee is actively working with the debtors and other stakeholders in the case to achieve a favorable outcome for unsecured creditors.

In re 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

UNSECURED CREDITORS CAN RECOVER FEES continued from page 2

the debtor to pay the subject attorneys' fees and that the contract was valid and enforceable as a matter of applicable state law, the Second Circuit turned to the debtor's argument that fees could not be recouped by the creditor pursuant to section 502(b)(1) of the Bankruptcy Code because the debtor's obligation to pay such fees was contingent as of the bankruptcy filing and the amount of such fees was unknown at that time. The Second Circuit reasoned that an unsecured claim for postpetition attorneys' fees that a debtor is otherwise obligated to pay under a valid prepetition contract is *deemed to have arisen prepetition*. Moreover, the Second Circuit reasoned that had the fees at issue in *Travelers* been deemed unrecoverable under section 502(b) merely because the amount of the claim was unknown as of the bankruptcy filing, the Supreme Court surely would have decided that case differently.

The Second Circuit also rejected the argument that section 506(b) of the Bankruptcy Code, which provides the basis for allowance of an *oversecured* creditor's contractual recovery of attorneys' fees, provides the negative inference that attorneys' fees incurred by *unsecured* creditors must be disallowed. Reiterating its broad reading of the Supreme Court's interpretation of section 502(d) and noting its previous observation from *United Merchants & Mfrs., Inc. v. Equitable Life Assurance Soc'y of the U.S.*, 674 F.2d 134 (2d Cir. 1982), that neither the language nor the legislative history of section 506(b) address unsecured creditors, the Second Circuit reasoned that because the Bankruptcy Code does not expressly forbid the recovery of contractual attorneys' fees as part of an unsecured claim, unsecured creditors should be permitted to realize the bargained-for terms of their contracts, whether or not the resulting claims affect the distribution scheme among similarly situated creditors.

The Second Circuit's *Ogle* decision parallels the Ninth Circuit's June 2009 decision in *In re SNTL Corp.*, 571 F.3d 829 (9th Cir. 2009), allowing postpetition attorneys' fees as part of an unsecured creditor's claim where the debtor was obligated to pay such fees under an enforceable prepetition agreement. These decisions signal a notable expansion of the *Travelers* decision to include attorneys' fees incurred in connection with matters wholly unrelated to the debtor's bankruptcy case, and will likely result in a proliferation of such claims in the future. Moreover, these decisions may influence creditors and bankruptcy courts to reconsider the substantial body of case law that has rejected claims concerning various prepetition contract provisions, including prepayment penalty clauses and liquidated damage provisions.•

"STUB RENT" CLAIMS continued from page 4

of administrative expenses for "the actual, necessary costs and expenses of preserving the estate." See 11 U.S.C. § 503(b)(1)(A). Unlike section 365(d)(3) of the Bankruptcy Code, which has been interpreted to provide the landlord's right to receive timely payment of rent, claims allowed under section 503(b) of the Bankruptcy Code do not trigger an immediate right to payment, but rather an administrative expense entitlement and elevated distribution priority above priority and general unsecured claims. Thus, section 503(b) offers a middle ground for the treatment of landlord claims for payment of stub rent—although not required to pay such claims on an immediate basis, the debtor generally must pay such claims in full in order to confirm a plan of reorganization.

Although the Third Circuit had previously held that rent is an actual and necessary expense of preserving the estate, Judge Sontchi concluded that a debtor's use and occupancy of the premises during the stub rent period represents a *per se* benefit to the estate in the amount of the fair market occupancy value of the premises. Taking this analysis one step further, Judge Sontchi reasoned that the fair market value of the debtor's occupancy of the premises is *presumed* to be the contract rate established under the lease agreement. Accordingly, under Judge Sontchi's *Goody's* decision, a debtor cannot argue successfully that no benefit to the estate derived from its use and occupancy of leased premises and bears the burden of proof to the extent it argues that the contractual rate of rent does not represent fair market value.

Admittedly backpedaling on his *Goody's* ruling, Judge Sontchi recently renounced his *per se* rule that a debtor's use and occupancy of leased premises during the stub rent period confers a benefit to the estate in the amount of the fair market occupancy value of the premises. In his recent decision issued in the *In re Sportsman's Warehouse, Inc.* case, Judge Sontchi concluded that courts must analyze the evidence submitted by the parties and determine, on a case by case basis, whether and to what extent a benefit has been conferred upon the estate through the debtor's use and occupancy. See *In re Sportsman's Warehouse, Inc., et al.*, 2009 WL 2382625 (Bankr. D. Del. Aug. 3, 2009). As a result of this rejection of the *per se* benefit rule, a debtor may introduce evidence that its use and occupancy of the leased premises did not confer a benefit to the estate in an amount equal to, not only the contractual rate of rent, but also the fair market occupancy value of the premises. Indeed, in response to the *Sportsman's Warehouse* debtors' argument that their use and occupancy of the subject premises conferred no benefit to the estate whatsoever, Judge Sontchi concluded that a decision on the landlords' stub rent claims was not ripe for decision and required a further evidentiary hearing to address the debtors' "no benefit" argument.

Judge Sontchi's renunciation of the *per se* benefit rule is a critical reversal of fortune for landlords asserting stub rent claims in Delaware bankruptcy cases. Whereas it previously appeared that a debtor's use and occupancy of leased premises during the stub rent period constituted an automatic benefit to the estate, a debtor is now free to contest this threshold issue and subject landlords to the considerable expense of evidentiary hearings to determine whether any benefit to the estate was actually received by virtue of the debtor's use and occupancy. •

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served as counsel to an *ad hoc* committee of unsecured trade vendors and secured a payment on behalf of the unsecured trade creditor body in connection with the prepetition going-concern sale of approximately 30 store locations. 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 an additional 14 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. Subsequently, Cooley negotiated favorable settlements reducing the claims of senior secured creditors and priority tax claims by several million dollars, thus paving the way for a plan to be filed. On February 2, 2010, the Court confirmed the joint plan of liquidation proposed by the Committee and BTWW Retail providing for an anticipated distribution to unsecured creditors.

In re Landmark Luggage & Gifts, LLC, Case No. 09-00444 (Bankr. S.D. Iowa 2009) Landmark Luggage & Gifts is a regional leather luggage and accessories retailer which operates six stores located in five states in the Upper Midwest. Cooley was retained to advise the official committee of unsecured creditors after the filing of Landmark Luggage's bankruptcy petition on February 12, 2009. On August 11, 2009, the debtors filed a plan of reorganization that provided for a sale of substantially all of the company's assets to an entity that is operating the business as a going concern through four of the established locations. Cooley analyzed the proposed sale and negotiated a revision of its terms with the company to ensure that the sale provided a recovery to unsecured creditors.

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In re 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 D.C. 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 worked closely with the debtor in formulating a consensual plan of reorganization, which was filed in January 2010 and that will allow the company to continue as a going concern while providing a return to unsecured creditors. •

CIRCUIT CITY AND PILGRIM'S PRIDE continued from page 5

"services." The *Goody's* court found that the vendor did not provide any goods to the debtors, reasoning that "[i]t is the *goods* and not the *value* received by the debtor [which] trigger[s] § 503(b)(9)." As such, the court was not required to reach the issue of whether the predominant purpose test is the appropriate standard for mixed transactions of goods and services.

Emboldened by the *Plastech* and *Goody's* courts' narrow interpretations of the term "goods," debtors have continued mounting aggressive challenges to section 503(b)(9) claims in chapter 11 cases throughout the country. Recently, In *In re Circuit City Stores, Inc., et al.*, 416 B.R. 531 (Bankr. E.D. Va. 2009), the debtors sought a ruling that (i) the term "goods," as used in section 503(b)(9), should carry the same definition as set forth in the UCC and (ii) in transactions involving both the sale of goods and the provision of services, the predominant purpose test should be employed to determine whether section 503(b)(9) priority applies. By so arguing, the debtors hoped to dramatically reduce the aggregate number and amount of administrative claims that they would be obligated to pay.

The first issue before the *Circuit City* court was the definition of "goods" within the meaning of section 503(b)(9). The court noted that the term goods is neither defined in the Bankruptcy Code nor subject to precedential interpretation by the Fourth Circuit. The court next turned to state law for guidance, but noted that such practice would be impractical in large bankruptcy cases concerning transaction governed by various state laws. Accordingly, the court turned to Uniform Commercial Code §2-105(1), which defines goods as "all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid…" The court also noted that the UCC's definition of goods is consistent with *Black's Law Dictionary* and the term's ordinary and common usage.

The *Circuit City* court also found support for its application of the UCC definition of goods from section 503(b)(9), which is part of a section of BAPCPA titled "Reclamation." Reclamation, the court explained, allows sellers to take back goods delivered to buyers under certain circumstances. Reclamation rights arise under §2-702 of the UCC and are both protected and limited by section 546 of the Bankruptcy Code. The court reasoned that "[g]iven that the remedy of reclamation arises from the UCC and given that Congress did not choose to lay out a different definition of "goods" in the Bankruptcy Code, it seems more likely than not that Congress intended for the UCC definition of "goods" to apply to section 546(c) of the Bankruptcy Code…. [and] the word "goods" in section 503(b)(9) should be defined in the same way as "goods" is defined in section 546(c)."

As to the applicable standard governing "mixed" transactions of goods and services, the *Circuit City* court rejected the flexible Plastech standard in favor of the predominate purpose test for determining whether a claim is entitled to administrative priority under section 503(b)(9). In so holding, the court looked favorably upon the Fourth Circuit's prior articulation of the test: "[T]he test for inclusion or exclusion is not whether they are mixed but, granting that they are mixed, whether their predominant factor, their thrust, their purpose, reasonably stated, is the rendition of service, with goods incidentally involved." *Princess Cruises, Inc. v. General Electric Co.*, 143 F.3d 828, 833 (4th Cir. 1998).

The United States Bankruptcy Court for the Northern District of Texas also recently addressed the issue of what constitutes goods for purposes of section 503(b)(9) of the Bankruptcy Code. In the *Pilgrim's Pride* case, numerous creditors filed 503(b)(9) claims that were subsequently challenged,

CIRCUIT CITY AND PILGRIM'S PRIDE continued from page 14

including trucking companies that provided shipping services to the debtors, a municipality that provided water, sewage and garbage removal services to the debtors, an electricity provider and natural gas utility companies. *In re Pilgrim's Pride Corp., et al.*, 2009 Bankr. LEXIS 2763 (Bankr. N.D. Tex. Sep. 16, 2009).

Applying the UCC definition of "goods," the *Pilgrim's Pride* court concluded that the shipping and garbage removal claims involved pure services and therefore did not fall within the purview of section 503(b)(9). The court reasoned that section 503(b)(9) should be construed narrowly to cover only products that can be packaged and handled and that occupy tangible space. Finding these characteristics also lacking with respect to the claims of the electricity provider, the court likewise concluded that section 503(b)(9) was inapplicable as to them.

The *Pilgrim's Pride* court did find that the natural gas utility claims, as well as those claims of the municipality involving the provision of water and sewage services, fell within the ambit of section 503(b)(9). The court concluded that water and gas are more tangible and motile than electricity, and noted that the UCC explicitly provides that contracts for the sale of minerals, oil and gas are contracts for the sale of "goods." However, because section 503(b)(9) limits a creditor's priority claim to the *value* of such goods, the court ruled that the water and gas providers would not be entitled to an allowed section 503(b)(9) claim unless and until they had adequately demonstrated the value of the goods provided to the debtors during the 20 days prior to the commencement of the bankruptcy cases.

Although it remains unclear whether the majority of bankruptcy courts will ultimately adopt the *Circuit City* court's debtor-friendly predominant purpose test or the *Plastech* court's bifurcation approach, it appears that courts will narrowly construe the threshold question of what constitutes "goods" and thereby limit the types of claims that may be asserted against a debtor under section 503(b)(9) of the Bankruptcy Code. This is certainly a new and important area of the law, as the extent of a debtor's section 503(b)(9) obligations will more often than not have a significant impact on its ability to emerge from chapter 11. •

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few delineated exceptions, the statute does not apply generally to postpetition claims, including administrative expense requests under section 503.

From a policy perspective, the Second Circuit explained that the Bankruptcy Code establishes a "clear division" between an entity in its prepetition and postpetition capacities and grants an elevated priority to administrative expenses to encourage third parties to supply goods and services on credit for the benefit of the estate and creditors generally. The Second Circuit opined that this goal would be undermined by allowing a debtor to forestall payment of an administrative expense simply by alleging that the creditor was the recipient of a transfer potentially subject to avoidance under chapter 5 of the Bankruptcy Code.

The Second Circuit's ruling is an important one from the perspective of both debtors and creditors. The decision should clearly instill confidence among trade vendors doing business with debtors-in-possession, as the Second Circuit's ruling makes clear that section 502(d) does not require the automatic disallowance of administrative expense requests during the pendency of avoidance actions commenced against the vendor. Moreover, the decision certainly limits the ability of debtors to invoke section 502(d) as a negotiating tool in the context of a claims reconciliation process.•

Bankruptcy & Restructuring Event Calendar
Winter/Spring 2010 Speaking Appearances

Event	Date/Location	Cooley Godward Kronish Participant/Topic
New York Law School Alumni Reception	February 18, 2010 New York, NY	Cathy R. Hershcopf / Host Reception Honoring Judger Bernice Siegal
Turnaround Management Association—Connecticut Chapter	March 1, 2010 New Haven, CT	Jeffrey Cohen / Speaker "What's Next for the Retail Industry?"
Turnaround Management Association	April 13, 2010 Webinar	Jeffrey Cohen / Speaker "Retention of Estate Professionals in Successors Cases"
Turnaround Management Association's Spring Conference	Apr. 21, 2010 New York, NY	Lawrence C. Gottlieb / Panelist "Challenges of Out-of-Court Restructuring"
Turnaround Management Association's Spring Conference	Apr. 21–23, 2010 New York, NY	Ronald R. Sussman / Board Member
American Bankruptcy Institute	April 30, 2010 National Harbor, Maryland	Lawrence Gottlieb / Debater Great Debates: "The 2005 Bankruptcy Reform Amendments"