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Cooley LLP

BANKRUPTCY AND RESTRUCTURING GROUP

PHILLY NEWS UPDATE:

Third Circuit Bars Secured Creditors From Credit Bidding In Asset Sale Under Chapter 11 Plan

In a highly anticipated decision that will undoubtedly have a major impact on the manner in which assets are disposed of in future chapter 11 cases, the Third Circuit recently ruled that a debtor may preclude a secured creditor from "credit bidding" in asset sales conducted pursuant to a chapter 11 plan. In *In re Philadelphia Newspapers, LLC*, 599 F.3d 298 (3d Cir. March 22, 2010), the Third Circuit recently affirmed a district court ruling that we reported on in our Winter 2010 edition of *Absolute Priority*, which authorized the debtors to bar their secured creditors from credit bidding in an asset sale conducted pursuant to a chapter 11 plan—provided that the plan provides the secured creditors with the "indubitable equivalent" of their claims.

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

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The Death of *Frenville*: Third Circuit Redefines When a Claim Arises

On June 2, 2010, the Third Circuit Court of Appeals finally abandoned the so-called "accrual test" for determining when a claim arises under the Bankruptcy Code, which test originates from its decision in *Avellino & Bienes v. M. Frenville Co. (Matter of M. Frenville Co.)*, 744 F.2d 332 (3d Cir. 1984) ("*Frenville*"). The Third Circuit's *Frenville* decision had long been recognized by courts as "one of the most criticized and least followed precedents decided under the current Bankruptcy Code." See *e.g., Firearms Imp. & Exp. Corp. v. United Capital Ins. Co. (In re Firearms Imp. & Exp. Corp.)*, 131 B.R. 1009, 1015 (Bankr. S.D. Fla. 1991).

In *Jeld-Wen, Inc. (f/k/a Grossman's Inc.) v. Van Brunt (In re Grossman's, Inc.)*, Case No. 09-1563 (3d Cir. June 2, 2010) ("*Jeld-Wen*"), the Third Circuit aligned itself with other circuit courts by overruling *Frenville* and holding that a "claim" under section 101(5) of the Bankruptcy Code "arises when an individual is exposed pre-petition to a product or other conduct giving rise to an injury, which underlies a 'right to payment' under the Bankruptcy Code." This decision significantly impacts claims analysis in the Third Circuit given that the time when a claim arises impacts whether the automatic stay applies to the claim, whether the claim will be discharged upon

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in this issue

from the editor

JEFFREY L. COHEN

As the bankruptcy community waits with baited breath to see whether BP will navigate the waters of chapter 11 in response to the billions of dollars in tort claims that have been asserted against it over the past few months, the courts—particularly the Third Circuit—have been busy issuing landmark decisions that will undoubtedly alter the chapter 11 landscape and impact the always important debtor/creditor dynamic. In just the few months that followed our last publication in March, the Third Circuit has redefined its test for when a "claim" arises in bankruptcy, empowered landlords to seek payment of their "stub rent" claims as expenses of the administration of the bankruptcy case, raised the bar for debtors seeking to terminate retiree benefits in chapter 11 and authored a cautionary tale for prospective "stalking horse" bidders in section 363 asset sales.

So, in other words, it's a great time for the Fall 2010 edition of *Absolute Priority*…

This issue also discusses the Third Circuit's critical ruling in the *Philadelphia Newspapers* cases, in which the Court confirmed that a debtor may preclude its secured creditors from "credit bidding" in asset sales conducted pursuant to a chapter 11 plan. This decision will undoubtedly impact the growing trend in which debtors—often at the behest of secured creditors who have little incentive to finance the reorganization process amidst these troubling economic times—have utilized the chapter 11 process to dispose of their assets pursuant to section 363 of the Bankruptcy Code. In addition, this issue reports on a recent bankruptcy court decision allowing creditors to offset section 503(b)(9) claims

Third Circuit Upholds Ruling That Landlords May Seek Administrative Expense Claims for Stub Rent

"Stub rent" is the rent owed by a debtor to its landlords for the period beginning on the day the bankruptcy petition is filed through the end of that month. A number of jurisdictions have adopted the so-called "proration" approach to stub rent, under which the obligation to pay rent is treated as arising each day the lease is in force, rather than on the particular day of the month when rent is due. In these jurisdictions, courts have awarded landlords administrative expense claims for stub rent under section 365(d)(3) of the Bankruptcy Code. Claims awarded under this section, only available to landlords of nonresidential leased premises, must be paid "timely" by the debtor. This means that the landlords would not have to wait until the end of the bankruptcy case when other administrative priority expenses are often paid to receive payment on account of their stub rent claims.

In contrast to the proration approach, courts in the Third Circuit have followed the "billing date" approach to section 365(d)(3) of the Bankruptcy Code ever since the Third Circuit's seminal decision in the *Montgomery Ward* case. In that case, in which Cooley represented the creditors' committee, the Third Circuit concluded that 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 B.R. 135 (3d Cir. 2001). Thus, under the billing date approach, if the terms of the lease indicate that the obligation to pay rent arose prior to the petition date, the landlord will not have a claim for timely payment of rent for the postpetition portion of that first month's rent under section 365(d)(3) of the Bankruptcy Code.

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Bankruptcy Court Rules That Creditors Can Assert 503(b)(9) Claims as New Value Defense To Preference Recovery

In *In re Commissary Operations, Inc.*, 421 B.R. 873 (Bankr. M.D. Tenn. 2010), the Bankruptcy Court for the Middle District of Tennessee became the first bankruptcy court to conclude that creditors are entitled to assert their section 503(b)(9) priority claims as subsequent new value for preference defense purposes. In that case, the debtor, a wholesale food distributor, filed for bankruptcy protection in 2008. Shortly thereafter, over 200 creditors filed priority claims under section 503(b)(9) of the Bankruptcy Code for the value of goods received by the debtor during the 20-day period immediately preceding the bankruptcy filing date. After determining that a reorganization would not be possible under the circumstances, the debtor commenced adversary proceedings against several creditors in an effort to enlarge its estate by recovering allegedly preferential transfers. A number of the preference defendants holding 503(b)(9) claims sought to reduce their preference liability by defensively asserting the "subsequent new value" they provided to the debtor during the 20-day prepetition period. The "subsequent new value" defense, embodied in section 547(c)(4) of the Bankruptcy Code, serves to reduce a creditor's preference liability to the extent that the creditor provided the debtor with additional value following the creditor's receipt of the preferential payment.

Importantly, the creditors not only sought to decrease their preference liability by offsetting the value of their 503(b)(9) claims against the alleged preference exposure, but they also sought affirmative payment of such value through the 503(b)(9) claims filed against the debtor. The debtor argued that if creditors were allowed to use the value of goods supplied within the 20-day period to reduce their preference exposure and to receive a priority claim under section 503(b)(9) for those same goods, they would effectively be paid twice.

The *Commissary* Court disagreed with the debtor and adopted the preference defendants' rationale. The defendants maintained that the value of goods covered by their section 503(b)(9) claims could be included as "new value" for three reasons. First, they argued that under section 547(c)(4) of the Bankruptcy Code, the new value defense is determined as of the filing date. At that time, the section 503(b)(9) claims could not have arisen as against the debtor because such claims do not arise under the Bankruptcy Code until *after* a debtor has filed for bankruptcy protection. The possibility that a creditor might be paid postpetition, pursuant to section 503(b)(9), does not negate the value realized by the debtor on account of its receipt of those goods. Second, the Congressional policy to encourage creditors to continue doing business with struggling debtors, manifest in sections 547(c)(4) and 503(b)(9) of the Bankruptcy Code, is furthered by allowing creditors to include the value of their 503(b)(9) claims as subsequent new value for preference purposes. Third, a reading of the plain language of sections 547(c)(4) and 503(b)(9) does not compel the reduction of a creditor's new value defense by the amount of its allowed 503(b)(9) claims.

The *Commissary* Court refused to deviate from the plain language of the Bankruptcy Code and noted that creditors holding allowed 503(b)(9) claims should be treated no differently than critical vendors. Under Middle District of Tennessee precedent, critical vendors are often permitted to assert as new value invoices for goods that are delivered prepetition, but paid postpetition, pursuant to critical vendor orders. Like critical vendors, 503(b)(9) claimants

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against their preference liability without forfeiting the right to payment on such claims, discusses a new wrinkle to the excusable neglect standard for late claim filings and highlights the recent efforts of the Advisory Committee on Bankruptcy Rules to add some much needed clarity to the ad hoc committee disclosure requirements of Bankruptcy Rule 2019.

As always, the Cooley bankruptcy group has been busy representing creditors' committees in most of today's prominent retail bankruptcy cases, debtors attempting to restructure their businesses in chapter 11 and 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.

Gottlieb Honored As Most Admired Attorney

Partner and former Bankruptcy and Restructuring group chair Lawrence Gottlieb was recently profiled in Law360's "Most Admired Bankruptcy Attorneys" series. The article states: "Not only is Gottlieb an excellent negotiator and speaker, but he is good with numbers and knowledgeable about transactions." One client that successfully emerged from chapter 11 bankruptcy proclaimed that "ever since we retained Larry and Cooley, we just said to each other, 'That was the best decision we ever made.'" •

Cooley Named Restructuring Law Firm of the Year

Cooley was selected as the "Restructuring Law Firm of the Year" at the 2010 Turnaround Atlas Awards, recognizing outstanding performances from the distressed M&A, restructuring and reorganization communities. The Firm also received the "Chapter 11 Reorganization of the Year" award for its representation of Crabtree & Evelyn in the retailer's successful emergence from bankruptcy. •

In the News

Current Cooley Representations

In re Uno Restaurant Holdings Corporation, et al., Case No. 10-10209 (Bankr. S.D.N.Y. 2010) Uno owned and operated 99 Uno Chicago Grill full-service casual dining restaurants (formerly known as Pizzeria Uno) as of the petition date. As counsel for the creditors' committee, Cooley engineered a global settlement with the debtors and a majority of their noteholders, providing for the reorganization of Uno's, the purchase of a percentage of each unsecured claim and an agreement amongst the parties that preference actions will not be pursued. The debtors confirmed a plan of reorganization, with the committee's support, which became effective in July 2010.

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 in July 2008 and subsequently liquidated its assets. Cooley represents the official committee of unsecured creditors in its pursuit of a complex $1.2 billion litigation

"Justifiable Confusion": A New Wrinkle To The "Excusable Neglect" Standard For Late Claim Filings

In a recent decision in the *Lehman Brothers* bankruptcy case, Judge Peck denied several motions for leave to file late claims, concluding that the claimants did not meet the Second Circuit's strict standards for showings of excusable neglect. *In re Lehman Brothers Holdings, Inc., et. al.*, Case No. 08-13555 (JMP) (May 20, 2010). The motions before the court were filed by individual creditors seeking authorization to file claims after the expiration of the applicable bar dates in what the Court described as the "largest claims allowance process in the history of bankruptcy practice." In denying the creditors' motions, Judge Peck enunciated a new wrinkle to the stringent "excusable neglect" standard for late claim filings:

> *Neglect in filing a claim before the expiration of a clear bar date is excusable when the creditor, after conducting a reasonable amount of diligence, is justifiably confused or uncertain as to whether a particular transaction giving rise to a claim is or is not subject to the bar date order.*

Bankruptcy Rule 3003(c) mandates the setting of a bar date after which proofs of claim may not be filed. Bankruptcy Rule 9006(b)(1) gives courts the discretion to enlarge the time to file claims "where the failure to act was the result of excusable neglect." In the seminal case *Pioneer Investment Services Company v. Brunswick Associates L.P.*, 507 U.S. 380 (1993), the Supreme Court interpreted "excusable neglect" as a flexible standard—one that may include "inadvertence, mistake, or carelessness, as well as by intervening circumstances beyond the party's control." The Supreme Court cautioned, however, that "the determination is at bottom an equitable one" that must take "account of all relevant circumstances surrounding the party's omission." The Supreme Court enunciated four factors that courts must consider in applying the excusable neglect standard:

(1) the danger of prejudice to the debtor; (2) the length of the delay and its potential impact on judicial proceedings; (3) the reason for the delay, including whether it was within the reasonable control of the movant; and (4) whether the movant acted in good faith.

In applying the *Pioneer* factors, the Second Circuit has adopted the so-called "hard line" test for determining whether a party's neglect is excusable. *See Midland Cogeneration Venture L.P. v. Enron Corp. (In re Enron Corp.)*, 419 F.3d 115, 122 (2nd Cir. 2005). This approach focuses primarily on the purported reason for the creditor's delay and whether such delay was in the creditor's reasonable control. The Second Circuit has reasoned that "the equities will rarely if ever favor a party who fails to follow the clear dictates of a court rule, and . . . where the rule is entirely clear . . . a party claiming excusable neglect will, in the ordinary course, lose under the Pioneer test." *Id.* at 123 (internal quotations omitted).

In *Lehman Brothers,* Judge Peck entered a bar date order providing for two distinct bar dates: September 22, 2009 for general claims (the "General Bar Date") and November 2, 2009 for securities-based claims (the "Securities Bar Date"). In addition to the submission of a traditional proof of claim form, claims based on derivatives contracts or guarantees required the submission of a questionnaire by October 22, 2009 (the "Questionnaire Deadline"). Each of the creditors seeking leave to file late claims conceded to having received actual notice of the bar date order.

Applying the *Pioneer* standard for excusable neglect to the creditors' motions, Judge Peck first set out to analyze the prejudicial

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Break-Up Fees in Section 363 Sales: Still Buyer Beware In Third Circuit

In *Kelson Channelview LLC v. Reliant Energy Channelview (In re Reliant Energy Channelview LP)*, 594 F.3d 200 (3d Cir. Jan. 15, 2010), a recent decision illustrating the close scrutiny under which courts review "break-up" fee requests made in connection with asset sales conducted pursuant to section 363 of the Bankruptcy Code, the Third Circuit affirmed two lower court decisions that denied a debtor's request to provide its "stalking horse" bidder with a break-up fee on the grounds that the requested fee was determined to be unnecessary to induce the stalking horse bidder's offer or ensure its participation at auction.

Break-up fees typically play a significant role in facilitating section 363 sales – asset sales conducted outside of a debtor's ordinary course of business and plan of reorganization or liquidation. Sales conducted pursuant to section 363 of the Bankruptcy Code are generally public sales, with the assets awarded to the party that submits the highest or otherwise best offer at a public auction. The initial bidder is commonly referred to as the "stalking horse", because its bid often serves as a catalyst for auction bidding by setting a floor price for the assets in order to attract other bidders. Stalking horse bidders routinely condition their bids on the debtor's receipt of court authorization to pay a break-up fee, as well as to reimburse the bidder for its due diligence expenses incurred in making the bid. Although debtors usually seek this authorization well in advance of the auction, break-up fees are payable only in the event that the stalking horse bidder is subsequently outbid at auction.

Some commentators believe that break-up fees represent a "win-win" deal for the estate and the bidder because, in most circumstances, the court approved bidding procedures require interested bidders to "over-bid" the staking horse bid by an amount greater than the bid plus the amount of the break-up fee and any other bid protection provided to the stalking horse bidder. This view is not universal, however, as some argue that excessive break-up fees can chill the auction process and are often unnecessary to establish a floor price or induce other bidders to participate in the auction.

The standard governing the approval of break-up fees in the Third Circuit was established in *Calpine Corp. v. O'Brien Env't Energy, Inc. (In re O'Brien Env't Energy, Inc.)*, 181 F.3d 527 (3d Cir. 1999). In that case, the Third Circuit ruled that a break-up fee may only be approved if the payment of the fee is necessary to preserve the value of the debtor's estate by either (1) inducing the stalking horse bidder to make its initial bid, or (2) by inducing the stalking horse bidder to adhere to its bid after the court orders an auction. The *O'Brien* decision underscores the fact that a stalking horse bidder must satisfy the requirements of section 503(b) of the Bankruptcy Code, which provides that only those claims that reflect the actual, necessary costs and expenses of preserving the bankruptcy estate are entitled to administrative priority status.

In *Reliant*, the debtors filed for bankruptcy and elected to sell their largest asset, a power plant in Texas, early in the case. At the conclusion of the debtors' marketing process, Kelson Channelview was selected as the highest bidder with a bid of $468 million. The parties negotiated an asset purchase agreement that required the debtors to immediately seek bankruptcy court approval of the sale. The agreement further provided that, if the bankruptcy court was to determine that an auction should be conducted, the debtors would ask the court to approve certain bid protections, including

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related to the 2004 acquisition of Mervyn's from Target Corporation by various private equity firms, which stripped Mervyn's retail operations from its valuable real estate pursuant to an "opco/propco" structure.

In re St. Vincent Catholic Medical Centers of New York, Case Nos. 05-14945 (Bankr. S.D.N.Y. 2005) and 10-11963 (Bankr. S.D.N.Y. 2010) After representing the tort claimants' committees in St. Vincent's first bankruptcy case, Cooley represents the monitor of medical malpractice trusts in St. Vincent's second bankruptcy case, which were established to pay medical malpractice claims pursuant to the plan of reorganization confirmed in the first bankruptcy case. Cooley was instrumental in achieving significant value for the debtors' "staff house" residential apartment building in Manhattan, upon which the trusts have a second lien.

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 represents Hypo Real Estate Capital Corporation, the DIP lender and first lien lender owed approximately $98 million as of the petition date.

In re Crabtree & Evelyn, Ltd., Case No. 09-14267 (Bankr. S.D.N.Y. 2009) 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. During the bankruptcy case, Cooley assisted the debtor in the closure of 35 unprofitable retail locations. In addition, Cooley formulated the debtor's plan of reorganization, which reorganized the debtor around a smaller retail platform,

and proposed a consensual plan through negotiations with the creditors' committee and the debtor's other constituents. Cooley currently assists the reorganized debtor with all post-confirmation issues, including claims analysis.

In re Pacific Ethanol Holding Co. LLC, et al., Case No. 09-11713 (Bankr. D. Del. 2009) In May 2009, Pacific Ethanol Holding Co. LLC and its four plant subsidiaries filed for chapter 11 protection due to sizeable fluctuations in the price of corn, natural gas and ethanol, coupled with the continued lack of liquidity in the credit markets. Cooley represented the debtors throughout their chapter 11 cases and most recently with regard to the formulation, negotiation, and confirmation of the debtors' joint plan of reorganization and exit financing. Cooley currently assists the reorganized debtors with all post-confirmation issues, including the wind-down of the chapter 11 cases.

In re Eddie Bauer Holdings, Inc., et al., Case No. 09-12099 (Bankr. D. Del. 2009) Cooley represented 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 in June 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. Cooley has been retained by the liquidating trustee,

Third Circuit Embraces Stringent Test for Termination of Retiree Benefits

In its landmark decision in *In re Visteon Corp.*, Case No. 10-1944, 2010 WL 2735715 (3d Cir. July 13, 2010), the Third Circuit recently held that a debtor may not terminate retiree health and life insurance benefits postpetition (or even in the six month period prior to the bankruptcy filing) without first complying with the rigorous procedures set forth in section 1114 of the Bankruptcy Code—regardless of whether the debtor enjoys the unilateral contract right to terminate such benefits outside of bankruptcy.

Prior to filing for bankruptcy in May 2009, Visteon, an automotive parts supplier, provided certain health and life insurance benefits to its retirees under collective bargaining agreements. Importantly, Visteon retained rights under these agreements to unilaterally modify or terminate coverage. Shortly after filing its bankruptcy petitions, Visteon moved to terminate all U.S. retiree benefit plans pursuant to section 363 of the Bankruptcy Code. Several groups of retirees, including those represented by the IUE-CWA union, objected on the grounds that Visteon could not terminate retiree benefits without first complying with the requirements of section 1114 of the Bankruptcy Code.

Section 1114 of the Bankruptcy Code provides that "[n]otwithstanding any other provision of this title, the [trustee] shall timely pay and shall not modify any retiree benefits" unless the court so orders or the trustee and the authorized representative of the retirees agrees to the modification." 11 U.S.C. § 1114(e). Other subsections of section 1114 provide for a process by which the trustee must attempt to reach agreement with retirees before asking the bankruptcy court to modify or terminate the benefits. A court will grant a motion to modify retiree benefits only if the retirees refuse to accept the trustee's proposal without "good cause" and the "modification is necessary to permit the reorganization of the debtor and assures that all creditors, the debtor, and all of the affected parties are treated fairly and equitably, and is clearly favored by the balance of the equities." 11 U.S.C. § 1114(g).

Section 1114(l) also provides that the debtor may not modify retiree benefits "during the 180-day period ending on the date of the filing of the petition." If the debtor does so, and the court ultimately determines that the debtor was "insolvent on the date such benefits were modified," then the court "shall issue an order reinstating as of the date the modification was made, such benefits as in effect immediately before such date unless the court finds that the balance of the equities clearly favors such modification." Accordingly, the protections afforded retirees under section 1114 of the Bankruptcy Code not only cover postpetition modifications sought by debtors, but also extend well into the prepetition period.

Both the bankruptcy court and the district court found that since Visteon had the right under non-bankruptcy law to terminate benefits unilaterally, the procedural pretermination requirements of section 1114 did not apply. As noted by the bankruptcy court, the union's argument "would expand retiree rights beyond the scope of state law for no legitimate bankruptcy purpose." After a limited stay pending appeal expired, Visteon stopped all payments for the retiree benefits at issue, and retirees received health insurance only if they paid for COBRA coverage.

The Third Circuit reversed the bankruptcy and district courts' interpretations of section 1114 of the Bankruptcy Code. The Third Circuit found that because section 1114 applies to all retiree benefits and

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Clarity for Ad Hoc Creditor Groups: Proposed Changes to Rule 2019 Disclosure Requirements

Creditors with similar interests in a bankruptcy case often organize into informal groups or ad hoc committees in order to share costs, gain leverage, and generally coordinate their efforts in the bankruptcy case. Bankruptcy Rule 2019 requires every "entity or committee representing more than one creditor or equity security holder" to disclose information about: itself, its claims, circumstances in connection with the formation of a group or ad hoc committee, or the hiring of an indenture trustee, information about the amounts of claims or interests "owned by the entity, the members of the committee, or the indenture trustee," and information about the acquisition of the claims, including the amounts paid. Despite these requirements, creditor groups appearing in bankruptcy court often fail to file 2019 statements and, until recently, action was rarely taken to enforce their compliance. Courts have since struggled with the enforceability of Rule 2019's disclosure requirements, resulting in decisions that have raised more questions than answers as to when and how Rule 2019 will be enforced. In fact, two divergent schools of thought have emerged among courts considering Rule 2019's disclosure requirements—those courts that have broadly construed the disclosure requirements and those that have more narrowly interpreted them to protect the confidentiality of creditor interests.

The Broad View:

- *In re Northwest Airlines Corp.*, 363 B.R. 701 (Bankr. S.D.N.Y. 2007): Judge Gropper reasoned that "by appearing as a 'committee' of shareholders, the members purport to speak for a group and implicitly ask the court and other parties to give their position a degree of credibility appropriate to a unified group with large holdings." Judge Gropper found that a shareholders' committee fell within the purview of Rule 2019 and required its members' disclosure of the amounts, trade dates and prices paid for claims.
- *In re Washington Mutual, Inc.*, 419 B.R. 271 (Banrk. D. Del. 2009): Judge Walrath required a noteholders group to comply with Rule 2019, finding that the group possessed "virtually all the characteristics typically found in an ad hoc committee." The group consisted of multiple creditors holding similar claims, filed pleadings and appeared in the case collectively, and collectively retained counsel.
- *In re Accuride Corp., et al.*, No. 09-13449 (Bankr. D. Del. 2010): Judge Shannon required an ad hoc noteholder group to comply with Rule 2019, concluding that "the concept of disclosure is a central element of the Bankruptcy Code" and that he could see "no justification or purpose to be served by a narrow or constricted reading of Bankruptcy Rule 2019."

The Narrow View:

- *In re Scotia Development LLC, et al.*, Case No 07-20027 (Bankr. S.D. Tex 2007): Judge Schmidt denied the debtors' efforts to compel a group of noteholders to comply with Rule 2019, finding that the noteholder group was not an ad hoc committee, but simply a group of creditors that happened to be represented by the same law firm.
- *In re Premier Int'l Holdings, Inc., et al.*, Case No. 09-12019 (Bankr. D. Del. 2010): Judge Sontchi held that an informal committee of noteholders was not a "committee representing more than one creditor." Upon thorough examination of the plain meaning of the term "com-

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who was appointed to oversee the wind down of the estate and the claims reconciliation process.

In re EPV Solar, Inc., Case No. 10-12153 (Bankr. D.N.J. 2010) EPV Solar, a corporation that designs, develops, manufactures, and markets low-cost amorphous silicon thin-film photovoltaic solar modules for the international renewable energy market, commenced a chapter 11 proceeding in February 2009. Cooley, on behalf of the official committee of unsecured creditors, actively pursued a strategy that resulted in a settlement approved by the Court providing for cash and stock in the reorganized debtor to the unsecured creditors. Unfortunately, the plan was contingent upon a sale that never consummated and an alternative sale structure was approved.

In re Trade Secret, Inc., et al., Case No. 10-12153 (Bankr. D. Del. 2010) Trade Secret and its debtor affiliates own and operate approximately 600 retail and salon locations, through which they sell hair care and beauty products and provide hair care services. As counsel to the official committee of unsecured creditors, Cooley has taken an aggressive stance at the outset of the case in an effort to ensure that the proposed sale of the debtors' assets to insiders confers a cognizable benefit on general unsecured creditors.

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.

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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 six owned real estate properties, and is a co-proponent of the confirmed plan of liquidation.

In re Filene's Basement, Inc., et al., Case No. 09-11525 (Bankr. D. Del. 2009) Nearly 10 years following its first bankruptcy filing in 1999, Filene's again filed for bankruptcy protection in May 2009 in which Cooley represented the official committee of 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. The sale assured that Filene's would continue to operate throughout the Northeast and Midwest. Pursuant to the confirmed plan, preferences will not be pursued and creditors are expected to receive a return of over 75% of their allowed claims, a portion of which has already been distributed.

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. Cooley, as counsel for creditors' committee, has been actively involved in all aspects of these cases, including the sale of Boscov's to members of its founding families 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

SECURED CREDITORS BARRED FROM CREDIT BIDDING continued from page 1

against the purchase price. This is a significant protection and many courts have held that secured creditors are entitled to credit bid the "face amount" of their claims, even if the underlying collateral is valued at less than such claim amount.

The Bankruptcy Code also permits debtors to sell assets outside of the ordinary course of business 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 of the assets of an 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) of Bankruptcy Code. This process imposes additional requirements on the debtor that would not otherwise be required. Specifically, section 1129(b)(2)(A) requires that the proposed plan be "fair and equitable" to the objecting creditors. The debtor may satisfy the fair and equitable standard by meeting one of the following 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 the company to a stalking horse bidder, with the consummation of such sale subject to higher or better bids received by the debtors at auction. The stalking horse bid contemplated the purchase of the company 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 and collateralized by the assets being sold.

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 their claims at the auction, which the debtors argued was permissible since the assets were being sold pursuant to a plan and not section 363 of the Bankruptcy Code. The secured creditors objected to this proposed bar, arguing that because they intended to reject the plan, the debtors could only confirm

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the plan under the "cramdown" provisions of section 1129(b) of the Bankruptcy Code—which section 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 the debtors satisfy 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' right to credit bid their claims at auction.

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 for secured creditors to be permitted to credit bid their claims in full at *any* sale of collateral in bankruptcy. But the district court reversed on appeal, concluding that the absence of an express credit bid reservation in the "indubitable equivalent" requirement is clear and unambiguous on its face, and that the bankruptcy court's consideration of the legislative history was therefore unwarranted. The district court adhered to what it viewed as 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 need 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.

The secured lenders appealed the district court's decision, and a split panel of the Court of Appeals for the Third Circuit affirmed. The Third Circuit found that the second prong of the fair and equitable test, which expressly preserves the secured creditor's right to credit bid, is not the exclusive means for conducting a sale of assets free and clear of liens under a chapter 11 plan, and that an asset sale conducted pursuant to the third prong of the fair and equitable test, which does not expressly preserve the right to credit bid, is also permissible. The Third Circuit reasoned that while the requirement that secured creditors be entitled to credit bid under sales conducted under the second prong may reflect a special Congressional concern regarding free and clear asset sales, Congress's inclusion of the "indubitable equivalent" prong intentionally left open the potential for other methods of conducting asset sales so long as those methods adequately protect the secured creditor's interests. Notably, the Third Circuit did not opine as to whether the specific plan treatment proposed by the *Philadelphia News* debtors to provide the secured creditors with the indubitable equivalent of their claims satisfied section 1129(b), stating that such a determination was a question for plan confirmation and could not be answered prior to the auction.

In a lengthy dissent, Judge Thomas Ambro, a former bankruptcy practitioner, argued that the fair and equitable requirements are ambiguous and that more than one reading of the provision was reasonable. He reasoned that a fair interpretation of the Bankruptcy Code as a whole, and the legislative history of section 1129 in particular, supports the conclusion that *all* chapter 11 asset sales that are free and clear of liens must be subject to the right of secured creditors to credit bid the value of their claim. In refuting the majority's holding, Judge Ambro highlighted what he viewed as the practical consequences of the court's ruling, noting that the decision "frustrates the settled expectations for lend-

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benefit unsecured creditors. The debtors' plan was confirmed in September 2009, and the liquidating trustee has commenced the claims reconciliation process with an eye towards making an initial distribution to unsecured creditors by the end of 2010.

In re BT Tires Group Holding, LLC, et al., Case No. 09-11173 (Bankr. D. Del. 2009) Cooley represented the official committee of unsecured creditors of Big 10 Tire Stores, one of the largest independent tire dealers in the Southeastern United States. In April 2009, Big 10 Tires filed a chapter 11 petition and in June 2009, the Delaware bankruptcy court approved the sale of Big 10 Tires 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 assisted with the confirmation of a liquidation plan as well as the 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 maximizing value for unsecured creditors by negotiating a stalking horse asset purchase agreement for the sale of the debtor's inventory, fostering a robust auction for the conduct of going out of business sales, negotiating agreements for the sale of Gottschalk's lease portfolio and owned real property, and developing 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

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2009, and is likely to become effective later this year.

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 The Ski Market, Ltd., Inc., Case No. 09-22502 (Bankr. D. Mass. 2009) Prior to filing for bankruptcy protection, 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 and Cooley, as counsel to the creditors' committee, assumed a critical role in the sale process and negotiated a carve-out agreement establishing a trust for the benefit of unsecured creditors. Absent this 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

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the confirmation of a plan of reorganization and the manner of treatment to be accorded the claim under a plan.

The *Jeld-Wen* Case

In the *Jeld-Wen* case, a claimant was allegedly exposed to asbestos when she used the debtors' products in 1977. The debtors filed their chapter 11 cases in 1997 and the claimant was diagnosed with mesothelioma, a cancer linked to asbestos exposure, in 2007. Shortly thereafter, the claimant commenced a state court tort and breach of warranty action against the debtors' successor-in-interest and other companies that allegedly manufactured the asbestos-containing products. In response, the debtors' successor brought an adversary proceeding in the bankruptcy court to enjoin the action and for a determination that any liability on the claims had been discharged pursuant to the debtors' chapter 11 plan of reorganization.

Relying on the Third Circuit's *Frenville* decision, the bankruptcy court concluded that the asbestos claims were not discharged by the debtors' chapter 11 plan because the claims arose subsequent to the plan's effective date. The bankruptcy court entered judgment in favor of the claimant and allowed the state court action to proceed against the debtors' successor. On appeal, the district court reversed with respect to the claimant's breach of warranty claim, but affirmed the bankruptcy court's holding with respect to the tort claims. The debtors' successor appealed to the Third Circuit.

The Controversial *Frenville* Accrual Test

In *Frenville*, the Third Circuit applied the "accrual test" to determine when a claim arises under the Bankruptcy Code. Under the accrual test, the existence of a valid claim depends upon (1) whether the claimant possesses a right to payment and (2) when that right arose, as determined by reference to applicable non-bankruptcy law. In *Frenville*, a group of banks that loaned money to the debtor sued the debtor's accounting firm for negligently and recklessly preparing the debtor's prepetition financial statements. The lawsuit was commenced by the banks approximately 14 months after the debtor had filed its bankruptcy case. The accounting firm sought to implead the debtor in the lawsuit and also commenced an adversary proceeding against the debtor related to the debtor's bankruptcy case. The debtor argued that the litigation commenced by the accounting firm violated the automatic stay of section 362 of the Bankruptcy Code. The Third Circuit held that the automatic stay did not bar the litigation against the debtor because, under the applicable New York law, the accounting firm's claim against the debtor arose postpetition (even though the underlying conduct occurred prepetition) because the cause of action against the debtor could not have arisen until the banks actually commenced the lawsuit against the accounting firm.

Courts outside the Third Circuit routinely declined to follow *Frenville's* accrual test, reasoning that a test focusing exclusively on when a right to payment accrues or matures conflicts with the Bankruptcy Code's expansive treatment of the term "claim." According to these courts, the accrual test failed to give sufficient weight to the language in the Bankruptcy Code which states that a "claim" also includes rights to payment that are contingent, unmatured and/or unliquidated.

The New *Jeld-Wen* Test

The Third Circuit surveyed other circuit's jurisprudence governing the time when a claim arises under the Bankruptcy Code, and observed that two divergent lines of thinking have emerged among courts. One

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THE DEATH OF *FRENVILLE* continued from page 10

group has applied the so-called "conduct test" and the other has applied the so-called "prepetition relationship test."

Under the conduct test, courts generally look to when the act giving rise to the liability was performed, not when the harm caused by those acts was manifested. But the conduct test has been criticized as defining a "claim" too broadly. In the tort context, for example, the conduct test could result in the discharge of a debtor's liability to claimants who did not use or have any exposure to the debtor or its product until after the bankruptcy case was closed. See Alan N. Resnick, *Bankruptcy as a Vehicle for Resolving Enterprise-Threatening Mass Tort Liability*, 148 U. Pa. L. Rev. 2045, 2071 (2000). The prepetition relationship test similarly looks to the underlying conduct giving rise to the liability, but also considers whether there is a prepetition relationship between the debtor and the claimant, such as the purchase, use, operation of or exposure to the debtor's product. In contrast to the conduct test, the prepetition relationship test has been criticized for too narrowly defining a "claim," given that a strict application of the test would deny recourse to individuals lacking a prepetition relationship with the debtor, but who nevertheless may be subject to future exposure of its harmful product or actions.

In *Jeld-Wen*, the Third Circuit concluded that "[i]rrespective of the title used, there seems to be something approaching a consensus among the courts that a prerequisite for recognizing a 'claim' is that the claimant's exposure to a product giving rise to the 'claim' occurred pre-petition, even though the injury manifested after the reorganization." In the end, the Third Circuit held that a "claim" arises when an individual is exposed prepetition to a product or other conduct giving rise to an injury, which underlies a "right to payment" under the Bankruptcy Code. Acknowledging that its holding provides little guidance on the discharge concerns noted above, the Third Circuit was quick to note that any application of this test "cannot be divorced from fundamental principles of due process." In applying its new test, the Third Circuit found that the claim at issue arose prepetition. Nevertheless, before it would conclude that claimant's prepetition claim was discharged by the debtor's confirmed plan, the court stated that it must be decided "whether discharge of the claim would comport with due process." Thus, the Third Circuit remanded the case to the bankruptcy court for determination of whether the claimants had sufficient notice of the bankruptcy case and its implications to justify a discharge and insulate the debtors' successor from liability. •

503(B)(9) CLAIMS continued from page 3

should be permitted to assert their 20-day goods as new value, despite the fact that they may ultimately receive postpetition payment on account of such goods pursuant to a confirmed chapter 11 plan.

The *Commissary* decision comes in the wake of the recent Pillowtex decision, discussed in the Winter 2010 edition of *Absolute Priority*, in which Judge Carey of the Bankruptcy Court for the District of Delaware held that "new value" need not remain unpaid by a debtor in order for the creditor to reduce its preference liability under section 547(c)(4) of the Bankruptcy Code. Taken together, the *Pillowtex* and *Commissary* are encouraging decisions for unsecured creditors seeking the benefits of liability-reducing preference defenses without sacrificing the potential for payment on account of such claims in the underlying bankruptcy proceeding. •

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represent the official committee of unsecured creditors shortly after the company filed for chapter 11 protection in October 2009. Despite substantial secured debt and a challenging retail environment, Long Rap is attempting to reorganize and emerge from chapter 11 as a going concern. To that end, Long Rap filed a chapter 11 plan of reorganization which was confirmed in May 2010. The plan, which contemplates the partial payment of general unsecured claims, has not yet become effective.

In re Innovation Luggage, Inc., Case No. 09-10564 (Bankr. S.D.N.Y. 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 in February 2009, Cooley was retained to represent the official committee of unsecured creditors and worked closely with the debtor in formulating a consensual plan of reorganization, which was confirmed in March 2010 and allowed the company to continue as a going concern while providing a return to unsecured creditors.

In re Pacific Metro, LLC (f/k/a The Thomas Kinkade Company, LLC), Case No. 10-55788 (Bankr. N.D. Cal. 2010) Pacific Metro, LLC (formerly known as The Thomas Kinkade Company, LLC), which commenced chapter 11 proceedings in June 2010, produces, distributes and sells works of art incorporating images licensed to the debtor by the artist Thomas Kinkade. Cooley, on behalf of the official committee of unsecured creditors, has commenced an investigation into the prepetition transactions between the debtor and its non-debtor affiliates, and

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has begun analyzing the debtor's business plan in furtherance of negotiating a plan of reorganization that will maximize value for all creditors.

In re Alfred J.R. Villalobos, et al., Case No. 10-52248 (Bankr. D. Nev. 2010) In May 2010, the State of California commenced a civil enforcement action against Alfred J.R. Villalobos and one of his companies. As a result of the action, a state court issued a temporary restraining order and appointed a receiver to administer the assets of Mr. Villalobos and one of his companies. As a result, Mr. Villalobos and three of his companies filed voluntary chapter 11 petitions in the Bankruptcy Court for the District of Nevada. Cooley is co-counsel to the debtors. In that capacity, Cooley litigators and bankruptcy attorneys are assisting the debtors in complex and contentious litigation concerning the appointment of a chapter 11 trustee and other issues arising in the bankruptcy cases, including a motion by the State of California for relief from the automatic stay to continue to pursue the civil enforcement action.

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 fifteen stores in Connecticut, Massachusetts, and Rhode Island. Cooley was retained to represent the creditors' committee after Bernie's filed for chapter 11 protection in January 2010.

In re Patrick Hackett Hardware Company (Bankr. N.D.N.Y. 09-63135) Cooley is counsel to the official committee of unsecured creditors of Patrick Hackett Hardware Company, whose chapter 11 case is pending in the Northern District of New York. Hacketts began in 1830 as a

THIRD CIRCUIT UPHOLDS RULING ON STUB RENT continued from page 2

In the Winter 2010 edition of *Absolute Priority*, we reported on a Delaware bankruptcy court decision authored by Judge Sontchi in the *In re Sportsman's Warehouse, Inc.* case. In that case, Judge Sontchi, following the Third Circuit's *Montgomery Ward* precedent, concluded that rent due prepetition under the terms of a lease precludes the landlord's entitlement to payment under section 365(d)(3) of the Bankruptcy Code. *In re Sportsman's Warehouse, Inc.*, 2009 WL 2382625 (Bankr. D. Del. Aug. 3, 2009). The landlords in that case also sought payment of stub rent as an administrative expense pursuant to Section 503(b)(1) of the Bankruptcy Code. Section 503(b)(1) provides for the allowance of administrative claims for the "actual, necessary costs and expenses of preserving the estate." Judge Sontchi held that while the landlords were entitled to seek administrative expense status for their stub rent claims under section 503(b)(1), they must still prove that the debtor's use and occupancy of the leased premises during the stub rent period constituted actual and necessary costs of preserving the debtor's estate. This evidentiary requirement was a retraction from an earlier stub rent decision authored by Judge Sontchi in the *In re Goody's Family Clothing, Inc.* case, in which he concluded 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).

The debtors in the *Goody's* case appealed Judge Sontchi's decision allowing the stub rent claims as administrative expenses of the estate pursuant to section 503(b)(1) of the Bankruptcy Code. The debtors argued, inter alia, that landlords may not look to section 503(b)(1) to obtain administrative expense priority status for stub rent because section 365(d)(3) provides the exclusive statutory basis by which non-residential landlords may be compensated under the Bankruptcy Code. Judge Sontchi's ruling was affirmed by the district court and the debtors appealed to the Third Circuit.

Although the Third Circuit confirmed its adherence to the billing date approach under *Montgomery Ward*, it nevertheless rejected the *Goody's* debtors' arguments that the language of section 365(d)(3) of the Bankruptcy Code preempts landlords from seeking administrative expense status for their stub rent claims under section 503(b)(1). The Third Circuit held that the Goody's landlords were entitled to receive payment under section 503(b)(1) for the debtors' use of the landlords' nonresidential real property during the stub rent period. Noting that the "mere occupancy [of a leased premises] is not always an actual and necessary expense that benefits the estate," the Third Circuit concluded that the Goody's estate undoubtedly benefitted through the use and occupancy of the leased premises during the stub rent period in which it conducted going-out-of-business sales.

Although the *Goody's* decision clarifies that landlords may be entitled to administrative expense claims for unpaid stub rent under section 503(b)(1) of the Bankruptcy Code, the Third Circuit's decision places the burden on landlords to prove that the debtor's use of the leased premises actually benefitted the bankruptcy estate. Although not necessarily difficult to satisfy, this evidentiary requirement can be costly for landlords, particularly in view of the fact that the landlord's best case scenario is the procurement of an administrative claim that may or may not ultimately be paid at the conclusion of the bankruptcy case. •

"JUSTIFIABLE CONFUSION" continued from page 4

effect, if any, on the estate that would result from late claim allowance. The Court noted that the bar date order had serve its intended purpose, as creditors from all over the world had filed over 66,000 claims in an aggregate liquidated amount exceeding $899 billion. The extraordinary size of the claims pool was of significant importance to Judge Peck, who concluded that the estate would be severely prejudiced if even a few late claim allowances encouraged others to seek similar leniency. Thus, the Court held that the prejudice factor favored denial of the requested late claim allowances. The Court also quickly dispensed with the length of delay and good faith factors, reasoning that the filing delays were not unreasonably long and that Lehman Brothers had no reason to question the good faith of the movants. The court was quick to point out, however, that thought these two factors were helpful to the movants, they were insufficient to prove their excusable neglect.

As for the final and most important factor —the reason for the delay—the creditors made various arguments to justify their late filings that the Court did not find persuasive. Certain of the creditors argued that their late-filed claims were solely the result of mistakes made by their agents, attorneys or advisors and urged the Court not to penalize them for their representatives' errors. Quoting *Pioneer's* application of the long-standing principle that clients "are held accountable for the acts and omissions of their attorneys" in failing to timely file a proof of claim, the Court easily dismissed these arguments. The Court reasoned that the creditors' choice of representation was solely within their control and they must therefore be bound by the actions (or inactions) of their authorized representatives.

Another creditor argued that its late claim filing was the product of an internal corporate policy dividing responsibility for filing the company's proofs of claim in various bankruptcy cases among two employees —one who handles domestic derivative claims and another who handles foreign derivative claims. The creditor explained that both employees believed the other was responsible for the claim filing and, accordingly, neither filed a timely proof of claim. Concluding that the communication failure was within the creditor's reasonable control, the Court denied the late claim filing allowance.

Two other creditors filed practically identical motions to have their late filed claims deemed timely. The claims were based on obligations of a foreign subsidiary that were guaranteed by Lehman Brothers Holdings Inc ("LBHI"). Both creditors asserted that they were unaware of their guarantee claims against LBHI until after the General Bar Date and, upon learning of such claims, filed late proofs of claim and timely questionnaires. These creditors asserted that their delay was not the result of carelessness, and was not even within their control, as the guarantees had been issued *after* the creditors had executed the underlying agreements with the foreign subsidiary. Nevertheless, the Court denied the motions, finding that the creditors, with the exercise of reasonable diligence, could have discovered that the guarantees had been issued. The Court explained that creditors must bear the responsibility for investigating and performing reasonable diligence to identify those claims that they have against debtors in bankruptcy.

At the conclusion of its opinion denying the motions, the Court explained that it had previously found excusable neglect in those instances where creditors consciously endeavored to comply with the bar date and established that their delay was the result of justifiable confusion over the application of the bar date to their particu-

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hardware store in upstate New York and now sells clothes, consumer electronics, cell phones, shoes, housewares, hardware and more.

In re Hawaii Biotech, Inc., Case No. 09-02908 (Bankr. D. Haw. 2009) The debtor, one of the oldest biotech companies in Hawaii, has developed vaccines for Dengue fever and West Nile virus. In conjunction with its chapter 11 case filed in December 2009, the debtor sought debtor in possession (DIP) financing from certain of its investors. Cooley represents the agent for the DIP lenders, who provided DIP financing to fund the debtor's operations and clinical trials. After robust bidding, the debtor's assets were recently sold pursuant to an overbid that was in an amount sufficient, upon closing, to repay the DIP loan in full and provide a recovery for unsecured creditors.

In re Mount Diablo Young Men's Christian Association, Case No. 10-44367 (Bankr. N.D. Cal. 2010) The debtor, a California non-profit corporation headquartered in Contra Costa County, California, had been in existence as a YMCA for more than 50 years. The debtor filed its chapter 11 case in April 2010, and immediately sought bankruptcy court approval of the sale of its ongoing operating YMCA facilities to another YMCA in the area, as well as certain of its after-school day care programs and facilities. As counsel to the official committee of unsecured creditors, Cooley has advised the committee with regard to the sale of the debtor's operating facilities, assisted in working to maximize the value of the debtor's remaining assets, including partially developed land on which another YMCA facility was intended to be built, and has also commenced an investigation

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into the pre-petition financial management of the debtor.

In re Michael Anthony Management, Inc. (d/b/a Sierra Snowboard), Case No. 10-55755 (Bankr. N.D. Cal.) Sierra Snowboard is one of the largest online retailers of winter sporting goods, apparel and accessories. Sierra filed for chapter 11 bankruptcy protection in June 2009 in the Northern District of California with the goal of reorganizing. The case is still in its early stages and the official committee of unsecured creditors, represented by Cooley, is actively engaged in exploring options for maximizing the recovery to unsecured creditors.

In re Lower Bucks Hospital, et al., Case No. 10-10239 (Bankr. E.D. Pa. 2010) Lower Bucks Hospital is a 183-bed acute care hospital and ambulatory surgical facility located on a 36-acre campus in Bristol, Pennsylvania. Cooley is representing Eric Huebscher, the Court-appointed patient care ombudsman, in this chapter 11 case. In connection therewith, Cooley has advised Mr. Huebscher regarding the noticing and preparation of his interim reports to the Court, and ensured that the content and dissemination of the reports complies with applicable federal rules.

Securities Investor Protection Corp. v. Bernard L. Madoff Investment Securities, LLC, Adv. Proc. No. 08-1789 (Bankr. S.D.N.Y. 2008) Cooley has provided ongoing legal advice to various foreign institutions regarding potential claims by the trustee appointed in the Madoff Ponzi scheme litigation. Cooley has advised its clients with respect to a wide variety of substantive and procedural aspects of U.S. bankruptcy and other laws. •

BREAK-UP FEES IN SECTION 363 SALES continued from page 5

(i) payment of a $15 million break-up fee to Kelson Channelview if a competing bid for the plant was accepted by the debtors at the conclusion of the auction, and (ii) the requirement that any subsequent bids be no less than the amount of the Kelson Channelview bid plus $20 million (the sum of the initial over-bid amount and the amount of the proposed break-up fee). The bankruptcy court did require the debtor to conduct an auction and Fortistar, a prospective bidder, objected to the debtor's request for approval of the break-up fee. Fortistar argued that it was willing to exceed Kelson's $468 million bid, but not by an amount exceeding Kelson's bid plus the $15 million break up fee.

The bankruptcy court sustained the objection and denied approval of the break-up fee following an evidentiary hearing. The court did not specifically address the Third Circuit's O'Brien standard for evaluating proposed break-up fees, but rather focused on whether the break-up fee would enhance or chill bidding at the auction. The court concluded that because alternative bidders were ready and willing to submit higher bids at auction, the proposed break-up fee was not in the best interests of the estate. Kelson Channelview ultimately decided not to participate in the auction and the winning bid exceeded its stalking horse bid by $32 million. Kelson Channelview appealed the bankruptcy court's order denying the break-up fee to the district court, which affirmed the bankruptcy court's decision.

The Third Circuit applied the O'Brien standard and affirmed the lower court decisions, concluding that the break-up fee was not necessary to preserve the value of the debtor's estate. The court found that the break-up fee did not induce Kelson Channelview to make its stalking horse bid, the first prong of the O'Brien test, because Kelson did not expressly condition its bid on the approval of the break-up fee, but had rather made its bid contingent on the debtor's promise to seek approval of the break up fee in the event that the court ordered an auction. The court reasoned that while allowance of the break-up fee might have benefitted the estate, Kelson Channelview made its bid with the knowledge that the debtor might not receive bankruptcy court authorization to pay the fee. In ruling that the break-up fee was unnecessary to induce Kelson Channelview to adhere to its bid after the court ordered the auction, the second prong of the O'Brien standard, the court was swayed by the lack of evidence in the record that Kelson Channelview was prepared to abandon its fully negotiated asset purchase agreement with the debtors simply because the break-up fee was denied. Further, the court noted that, while the approval of a break-up fee might have conferred a benefit to the estate by assuring that Kelson Channelview would adhere to its bid, there was potential harm to the estate that the break-up fee would deter Fortistar and other potential bidders from submitting bids that outweighed any such benefit.

The *Reliant* decision serves as a reminder that there are no guarantees when it comes to obtaining court approval of break-up fee requests in the context of section 363 sales. The decision offers important lessons to debtors and prospective bidders regarding the steps that should be taken to minimize the risk that a court will conclude that stalking horse bid protections are unwarranted. As an initial matter, bidders should assume from the outset that courts will require debtors to conduct an auction before approving an asset sale, particularly when multiple parties express interest in the assets. Second, in the aftermath of *Reliant,* it is incumbent upon stalking horse bidders to demonstrate to bankruptcy courts that the break-up fee is an essential

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TERMINATION OF RETIREE BENEFITS continued from page 6

"could hardly be clearer," Visteon must comply with its procedural requirements. Recognizing that the majority of bankruptcy and district courts, as well as the Second Circuit Court of Appeals, permit debtors to terminate benefits during bankruptcy when they have reserved the right to do so in the applicable prepetition documents, the Third Circuit found that "these courts mistakenly relied on their own views about sensible policy." The Third Circuit reasoned that statutory interpretation "should be made of sterner stuff than that."

The Third Circuit also looked to the legislative history of section 1114, which was enacted as part of the Retiree Benefits Bankruptcy Protection Act of 1988 (RBBPA), and concluded that its interpretation of section 1114 was consistent with RBBPA's legislative history. RBBPA was enacted in response to LTV Corporation's termination of the health and life insurance benefits of 78,000 retirees during its 1986 bankruptcy, with no advance notice to the affected retirees. While acknowledging that its holding might provide retirees with more rights in bankruptcy than they obtained for themselves in negotiating the collective bargaining agreements prepetition, the Third Circuit reasoned that this would be appropriate in view of the unique protections afforded retirees under the RBBPA.

Upon emergence from bankruptcy, debtors continue to be free to terminate retiree benefits if they could do so prior to filing, so long as they do not take on new durational obligations in any section 1114 negotiations. However, the Third Circuit's decision will undoubtedly result in careful consideration by prospective debtors of their retiree benefit termination options. •

"JUSTIFIABLE CONFUSION"

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lar claims. While Judge Peck's articulation of the "justifiable confusion" wrinkle to the excusable neglect standard may serve to protect creditors in complex bankruptcy cases such as *Lehman Brothers* who fail to properly analyze the nature of the transaction underlying their claim, it should not be viewed as a general relaxation of the excusable neglect standard. Creditors will rarely be excused from the mistakes of their employees, agents or representatives in failing to timely file proofs of claim. •

BREAK-UP FEES continued from page 14

element of its bid. A stalking horse bidder can evidence this intent by expressly conditioning its bid on court approval of a break-up fee or by including a clause in the purchase agreement providing that that failure to obtain approval of the break-up fee results in the termination of the agreement and extinguishes all further obligations of the purchaser. Finally, parties should be prepared to defend the necessity of the proposed break-up fee with evidence as to how the stalking horse bid will spur competitive bidding at the auction, including by providing examples of break-up fees of comparable size (as a percentage of the overall purchase price) that have been approved by courts in other asset sales of similar size or nature. •

Bankruptcy & Restructuring Event Calendar
Fall 2010 Speaking Appearances

Event	Date/Location	Cooley Participant/Topic
Financial Services Presentation	Sept. 17, 2010 New York, NY	Jay Indyke/Presenter "Recent Chapter 11 Issues"
Legal Publishing Group Bankruptcy: Attorney-Client Privilege and Work Product	Sept. 30, 2010 Teleconference	Ron Sussman/Speaker "Protecting and Maintaining Confidentiality and the Work Product Defense"
International Council of Shopping Centers: 2010 US Shopping Center Law Conference	Nov. 4, 2010 Hollywood, FL	Cathy Hershcopf/Speaker "Advanced Retail Bankruptcy Issues"
Association of Insolvency & Restructuring Advisors 9th Annual Advanced Restructuring & Plan of Reorganization Conference	Nov. 15, 2010 New York, NY	Jay Indyke/Speaker "The Changing Face of Chapter 11"

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mittee," Judge Sontchi concluded that since the informal noteholders committee did not represent—either by consent or operation of law—any persons other than its members, it was not a "committee" under Rule 2019 and its members were therefore not required to make any disclosures. Judge Sontchi also examined the legislative history of Rule 2019 and concluded that the original purpose of the rule no longer applied to today's informal committees. The "protective committees" in equity receiverships that the disclosure rules were originally designed to reign in, had much more expansive powers than the informal ad hoc committees of today. Thus, according to Judge Sontchi, Rule 2019 is "for all intents and purpose, superfluous—the problem it was designed to address by requiring certain disclosures simply no longer exists."

- *In re Philadelphia Newspapers, LLC,* et al., No. 09-11204 (Bankr. E.D. Pa. 2010): Judge Raslavich held that Rule 2019 did not apply to a steering group of prepetition lenders, because, borrowing from Judge Sontchi's interpretation of the term "committee," the steering group formed itself and had not been appointed by any larger or more comprehensive creditor body.

Against the backdrop of these conflicting bankruptcy court decisions, the Advisory Committee on Bankruptcy Rules (the "*Advisory Committee*") published large scale revisions to Rule 2019 in August 2009. The Advisory Committee held a public hearing in New York on February 5, 2010 and received feedback from a variety of constituencies, the majority of whom stressed that if claim holders are required to divulge sensitive and proprietary pricing information, distressed investors would be less willing to participate in ad hoc committees. In particular, the Advisory Committee's proposal included a requirement that ad hoc committee and group members disclose the date that they acquired their claims or interests, but no requirement concerning the disclosure of pricing information.

On May 27, 2010, the Advisory Committee issued a report to the Standing Committee on Rules of Practice and Procedure (the "*Standing Committee*") recommending approval of its proposed amendments to Rule 2019. The proposed amendments endeavor to ease concerns about the disclosure of proprietary information by eliminating the discretion of bankruptcy courts to compel the disclosure of pricing information. Further, the revised amendments limit the requirement to disclose the date of acquisition to situations where an ad hoc committee or unofficial committee purports to represent an entity other than its members, and then only requiring disclosure of the calendar quarter of acquisition, not the specific day. The revised proposed amendment does note, however, that Rule 2019 does not affect the right of any party to obtain such further information by means of discovery or as ordered by the bankruptcy court under authority that may be granted to the court pursuant to other provisions of the Bankruptcy Rules.

On June 15, 2010, the Advisory Committee's revised proposed amendments were approved by the Standing Committee. The path to approval continues next to the Standing Committee's presentation of the Rule 2019 amendments to the Judicial Conference of the United States in September 2010. If approved, the Judicial Conference will recommend the revised rule be approved by the United States Supreme Court, which will meet in April 2011 to consider the amendment. Once approved by the Supreme Court, the amendments would become effective on December 1, 2011 absent Congressional veto. We will certainly keep you posted on this progression in future issues of *Absolute Priority*. •

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ers' interests in bankruptcy" which were relied on by the lenders in the *Philadelphia Newspapers* case in extending credit to the debtors. Judge Ambro further predicted that the decision would lead to the systemic undervaluation of collateral property in future asset sales conducted without credit bidding, which in turn could reduce the amount of secured creditor recoveries and depress the trading value of distressed debt.

The Third Circuit's ruling will undoubtedly have a profound impact on the chapter 11 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 case and sale process through their previously unfettered ability to credit bid claims at auction—a power that often chills the bidding process by creating a disincentive for third parties to compete at auction. Although the secured lenders in the *Philadelphia Newspapers* case ultimately tendered a cash bid for their collateral that was deemed the highest or best bid at the auction, other secured lenders may not be so fortunate in the future. Stripped of the ability to credit bid in asset sales conducted pursuant to a chapter 11 plan, secured creditors will unquestionably hold less leverage over those chapter 11 cases where the debtor can provide the secured creditor with the indubitable equivalent of its claim. Of course, such a "victory" for debtors cuts both ways. Going forward, secured creditors whose cash collateral is needed by the debtors to fund the chapter 11 process and secured creditors who provide debtor-in-possession financing to fund the debtor's chapter 11 process will likely permit the debtor's use of cash collateral or extend additional financing only on the condition that debtor agree not to take any action that might preclude the creditor from credit bidding in any sale of its collateral. •