

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:

ADVANCED MARKETING SERVICES, INC.,
a Delaware corporation, *et al.*,

Debtors.

Chapter 11

Case No. 06-11480-CSS

Jointly Administered

SIMON & SCHUSTER, INC., a New York corporation,

Plaintiff,

- against -

ADVANCED MARKETING SERVICES, INC., a
Delaware corporation,

Defendant.

Adv. Pro. No. 07-50004 (CSS)

**EMERGENCY APPLICATION OF SIMON & SCHUSTER FOR
TEMPORARY RESTRAINING ORDER PURSUANT TO BANKRUPTCY RULE 7065**

Simon & Schuster, Inc. ("Plaintiff"), a creditor and supplier of goods to defendant Advanced Marketing Services, Inc. ("Defendant"), brings this *Emergency Application of Simon & Schuster, Inc. For Temporary Restraining Order Pursuant to Bankruptcy Rule 7065* (the "Application") directing Defendant to (i) immediately stop selling any the Goods (defined below) subject to Plaintiff's reclamation claim until the Court can consider Plaintiff's Complaint¹ seeking reclamation of the Goods; (ii) segregate the Goods that remain in Defendant's possession from its other inventory; (iii) provide an accounting of the disposition of the Goods; and (iv) provide Plaintiff with access to inspect the Goods that remain in Defendant's possession. The facts and circumstances supporting this Application are set forth in the concurrently-filed

¹ On January 5, 2007, Plaintiff filed with this Court a Complaint for Reclamation of Goods Pursuant to 11 U.S.C. § 546(c) and Related Relief (the "Complaint").

Affidavit of David F. England (“England Aff.”). In further support of this Application, Plaintiff respectfully represents as follows:

I.
JURISDICTION AND VENUE

1. This adversary proceeding arises out of and is related to the above-captioned chapter 11 cases pending before this Court. Therefore, this Court has jurisdiction pursuant to 28 U.S.C. §§ 157 and 1334. This adversary proceeding is a core proceeding pursuant to 28 U.S.C. § 157(b)(2) and venue is proper in this Court pursuant to 28 U.S.C. §1409(a).

2. Plaintiff is entitled to the relief requested by the Application pursuant to sections 105 and 546(c) of title 11 of the United States Code (the “Bankruptcy Code”), Rule 7065 of the Federal Rule of Bankruptcy Procedure (the “Bankruptcy Rules”), and Rule 65 of the Federal Rules of Civil Procedure (“F.R.C.P.”).

II.
INTRODUCTION

3. On December 29, 2006 (the “Petition Date”), Plaintiff sent to Defendant a written Demand for Reclamation of the Goods. *See* England Aff., ¶ 7. Defendant has refused to return the Goods and has indicated that it is continuing to liquidate them on a post-petition basis. *See* England Aff., ¶ 8. The relief requested in this Application is appropriate because section 546(c) of the Bankruptcy Code provides Plaintiff with a clear statutory right to specific performance (*i.e.*, the return of the specific Goods subject Plaintiff’s reclamation claim). That right will be rendered valueless unless Defendant is immediately enjoined from continuing to liquidate the Goods.²

² Section 546(c) of the Bankruptcy Code provides :

(c)(1) Except as provided in subsection (d) of this section and in section 507(c), and subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof, the rights and powers of the trustee under sections 544(a), 545, 547, and 549 are subject to the right of a seller of goods that has sold

III.
BACKGROUND

4. Plaintiff is a global leader in the field of general interest publishing that provides a range of quality books and multimedia products across a wide variety of genres and formats. *See* England Aff., ¶ 4. Defendant is a wholesaler and distributor of books and other media.

5. Within 45 days immediately before December 29, 2006 (the “Petition Date”), Defendant received the books and related goods identified on the invoices attached as Exhibit B to the Complaint (the “Goods”). *See* England Aff., ¶ 5. The Goods, which have an aggregate value of \$5,105,629.65, are summarized in Exhibit A to the Complaint. *See also* England Aff., ¶ 5. The Goods include those published by Plaintiff, as well as those published by the companies for which Plaintiff acts as a distributor, including, without limitation: World Almanac Education Group, Inc., Reader’s Digest Children’s Publishing, Andrews McMeel Publishing, and Harlequin Retail, Inc. *See* England Aff., ¶ 5. Plaintiff provides various packages of services in connection with its agreements with these publishers, including, without limitation, sales, distribution of goods, billing on Plaintiff’s invoices, and collection services in connection with the invoicing. *See* England Aff., ¶ 5. Plaintiff is authorized to assert the claims and causes of action in the Complaint in accordance with Plaintiff’s agreements with these publishers. *See* England Aff., ¶ 5.

goods to the debtor, in the ordinary course of such seller’s business, to reclaim such goods if the debtor has received such goods while insolvent, within 45 days before the date of the commencement of a case under this title, but such seller may not reclaim such goods unless such seller demands in writing reclamation of such goods--

(A) not later than 45 days after the date of receipt of such goods by the debtor; or

(B) not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case.

(2) If a seller of goods fails to provide notice in the manner described in paragraph (1), the seller still may assert the rights contained in section 503(b)(9).

11 U.S.C. 546(c).

6. As of the Petition Date, Plaintiff had (and continues to have) an unpaid pre-petition claim against defendant in the amount of approximately \$26 million. *See* England Aff., ¶ 6.

7. On the Petition Date, Defendant filed, among other motions and applications, a Motion For an Order Establishing Procedures For Reconciliation of Reclamation and Related Claims Pursuant to Sections 105(a), 503(b)(9) and 546(c) of the Bankruptcy Code (the “Reclamation Motion”), which seeks to establish procedures for evaluating and processing reclamation and related administrative claims.

8. On December 29, 2006, Plaintiff sent to Defendant a written Demand for Reclamation of Goods (the “Reclamation Demand”) demanding the immediate return of the Goods to Plaintiff. *See* England Aff., ¶ 7.

9. On January 3, 2007, counsel for Plaintiff appeared at the first day hearing in these chapter 11 cases for the purpose of objecting to the Reclamation Motion, which Defendant withdrew in light of the various objections raised by creditors.

10. On January 4, 2007, David F. England, Plaintiff’s Senior Vice President and Chief Financial Officer, spoke with Curtis R. Smith, Defendant’s Executive Vice President and Chief Financial Officer. *See* England Aff., ¶ 8. During that conversation, Mr. Smith confirmed that Defendant had received Plaintiff’s Reclamation Demand and Mr. England confirmed that Plaintiff had exercised its rights to stop goods in transit. *See* England Aff., ¶ 8. Mr. Smith further confirmed that Defendant was continuing to sell the Goods on a post-petition basis irrespective of Plaintiff’s Reclamation Demand. *See* England Aff., ¶ 8. Mr. Smith also took the position that Defendant intended to treat any Goods returned to Plaintiff after the Petition Date as “post-petition activity.” *See* England Aff., ¶ 8. Plaintiff interpreted this to mean

that Defendant would dispute any effort by Plaintiff to offset the value of the post-petition return of books that were purchased pre-petition against Plaintiff's pre-petition claim. *See England Aff.*, ¶ 8.

11. On January 5, 2007, Plaintiff filed the Complaint, which seeks a judgment of this Court: (1) allowing the Plaintiff to reclaim the Goods pursuant to section 546(c) of the Bankruptcy Code; (2) allowing and compelling immediate payment to the Plaintiff of an administrative claim for the value of the Distributed Goods (as defined in the Complaint) pursuant to section 503(b)(1) of the Bankruptcy Code; (3) allowing and compelling immediate payment to Plaintiff of an administrative claim for the amount of the Goods received by Defendant within the 20 days preceding the Petition Date, pursuant to section 503(b)(9) of the Bankruptcy Code to the extent not reclaimed by Plaintiff; and (4) compelling Defendant to provide the Plaintiff with a comprehensive written accounting of the status and disposition of all of the Goods. *See Complaint*, p.5.

12. On January 8, 2007, Defendant filed an Amended Motion For an Order Establishing Procedures For Reconciliation of Reclamation and Related Claims Pursuant to Sections 105(a), 503(b)(9) and 546(c) of the Bankruptcy Code (the "Amended Reclamation Motion"), which seeks approval of a revised set of procedures for evaluating and processing reclamation and related administrative claims. The Amended Reclamation Motion seeks, among other things, entry of an order that:

- Requires any vendor asserting a claim for reclamation under section 546(c) or a related administrative claim under section 503(b)(9) of the Bankruptcy Code to send such claim or demand to counsel for the Debtors;
- Allows the Debtors 180 days (from the entry of the order) to review all such claims and demands and thereafter draft and file a report with the Bankruptcy Court indicating which, if any, reclamation and administrative claims the Debtors deem to be valid; and

- Bars any vendor from commencing any action in respect of such reclamation and administrative claims prior to the expiration of the 180 day period.

Amended Reclamation Motion, ¶ 31. Plaintiff opposes the relief sought in the Amended Reclamation Motion.

IV. RELIEF REQUESTED

13. Plaintiff requests a temporary restraining order (“TRO”) that will direct Defendant to (i) immediately stop selling the Goods until the Court can consider Plaintiff’s Complaint, (ii) segregate the Goods that remain in Defendant’s possession from its other inventory, (iii) provide an accounting of the disposition of the Goods, and (iv) provide Plaintiff with immediate access to inspect the Goods that remain in Defendant’s possession until the Court rules on the merits of the relief requested in the Complaint.

V. LEGAL ARGUMENT

A. STANDARD FOR TEMPORARY RESTRAINING ORDER

14. Bankruptcy Rule 7065, which makes F.R.C.P. 65 applicable in adversary proceedings, permits the Court to enter a temporary restraining order. In the Third Circuit, when considering a request for provisional injunctive remedy, a court must consider four factors: (1) the likelihood that the applicant will prevail on the merits at final hearing; (2) the extent to which the plaintiff is being irreparably harmed by the conduct giving rise to the cause of action in the complaint; (3) the extent to which the defendant will suffer irreparable harm if the injunction is issued; and (4) the public interest. *S&R Corp. v. Jiffy Lube Int’l, Inc.*, 968 F.2d 371, 375 (3d Cir. 1992) (citing *Hoxworth v. Blinder, Robinson & Co.*, 903 F.2d 186, 197-98 (3d Cir.1990)); see *Opticians Ass’n of Am. v. Indep. Opticians of Am.*, 920 F.2d 187, 191-922 (3d

Cir.1990) (citing *Bill Blass, Ltd. v. Saz Corp.*, 751 F.2d 152, 154 (3d Cir.1984)). Here, all four factors favor granting the requested TRO.

1. Plaintiff is Likely to Succeed on the Merits

15. There is a substantial likelihood that Plaintiff will succeed on the merits of its reclamation claim. However, because Defendant is currently in the process of selling the Goods, Plaintiff's right of reclamation will vaporize unless Defendant is prevented from disposing of the Goods.

16. There is no authority in the Bankruptcy Code or elsewhere that justifies depriving the Plaintiff of its reclamation right or altering the remedy provided to Plaintiff under section 546(c) of the Bankruptcy Code. Unlike the prior version of section 546(c) the amended statute no longer authorizes the Court to deny a seller's request for the return of its goods by instead granting a replacement lien or an administrative claim for the value of the goods.³ See 11 U.S.C. § 546(c) pre-2005 amendment. As highlighted in the blacklined comparison of the old against the amended versions of section 546(c) in Footnote 4, Congress specifically divested the

³ A black line of the prior version of section 546(c) against the amended statute follows:

(c)(1) Except as provided in subsection (d) of this section and in section 507(c), and subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof, the rights and powers of a trustee under section 544(a), 545, 547, and 549 of this title are subject to ~~any statutory or common law~~ the right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, *within 45 days before the date of the commencement of a case under this title*, but ~~(1)~~ such a seller may not reclaim ~~any~~ such goods unless such seller demands in writing reclamation of such goods—

(A) ~~before 10~~ not later than 45 days after the date of receipt of such goods by the debtor; or

(B) ~~if such 10~~ not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case, before 20 days after receipt of such goods by the debtor; and

~~(2) the court may deny reclamation to~~ If a seller with such a right of reclamation that has made such a demand only if the court— (A) grants the claim of such a seller priority as a claim of a kind specified of goods fails to provide notice in the manner described in paragraph (1), the seller still may assert the rights contained in section 503(b)(9) of this title, or (B) secures such claim by a lien.

court of the authority contained in the previous version of the statute to deny a reclamation claim where the seller is granted a replacement lien or administrative claim. The only remedy available under the current statute is reclamation of the specific goods by the seller.

17. The starting point of any statutory analysis, as Justice Scalia in the oft-quoted Supreme Court decision in the *Henhouse* case reminds us, is with “the understanding that Congress ‘says in a statute what it means and means in a statute what it says there.’” *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000) (quoting *Connecticut Nat. Bank v. Germain*, 503 U.S. 249, 254 (1992)). Here, the statute is clear; Congress has specifically eliminated the alternative remedy of a replacement lien or administrative claim for the reclaiming seller. Thus, unless the parties agree otherwise, the only remedy under the new section 546(c) is specific performance; *i.e.* the return of the Goods. Under the amended statute, so long as Plaintiff satisfies the requirements of the statute, the Court is precluded from denying Plaintiffs’ request for return of the Goods.

18. Defendant has argued in the Amended Reclamation Motion that reclamation claimants are not entitled to the return of their goods because the right of reclamation is subject to the prior rights of a holder of a security interest in the goods. *See* Amended Reclamation Motion, ¶ 38. However, Defendant fails to acknowledge that the pre-petition debt of the secured lender will be (or already has been) fully satisfied within the first month of the case. Accordingly, to the extent a secured lender holds “prior rights” to the Goods, such prior rights do not eliminate Plaintiff’s right of reclamation because the lender will be soon (as already has been) paid off. Moreover, to the extent any pre-petition amounts were owing at the times relevant to reclamation, the lender is overwhelmingly oversecured. *See* Amended Reclamation Motion, ¶ 17. Indeed, a creditors right to reclamation cannot be eliminated by

simply maintaining a nominal secured debt on the books secured by collateral worth millions more than the debt. *See, e.g., In re Phar-Mor, Inc.*, 301 B.R. 482 (Bankr. N.D. Ohio 2003). Importantly, because of the value of Defendant's assets in light of its speculative need for post-petition financing, no final order approving post-petition financing should encumber Plaintiff's Goods.

19. The only other defense potentially available to Defendant is the argument that Defendant was not insolvent at the time it received the Goods. Here, however, Defendant has failed to provide any estimation of its liabilities in the pleadings, has sought an extension of time to file its schedules, and by its own admission in the pleadings, has failed to state reliable financials for the past several years. *See Amended Reclamation Motion*, ¶ 19. Because Defendant controls access to such financials and has failed to provide them, Defendant should not be permitted to assert a solvency defense in the context of this Application for temporary relief. Rather, in this interim proceeding, Plaintiff should be entitled to a presumption (rebuttable only at a hearing or trial on full notice) that Defendant was insolvent at all times relevant to its Reclamation Demand.

2. The Proposed Reclamation Procedures Are Inadequate and Plaintiff Will Suffer Irreparable Harm Unless a TRO is Entered

20. As noted above, the procedures proposed in the Amended Reclamation Motion strip Plaintiff of its statutory right to the return of its Goods. Plaintiff objects to such treatment and wants its Goods back as quickly as possible so that it can sell them to others. Plaintiff is currently providing goods to other distributors who are coordinating with Defendant's customers to replace Defendant as a source of Plaintiff's books. *See England Aff.*, ¶ 9. Plaintiff understands that other publishers are doing the same. *See England Aff.*, ¶ 9. If Defendant loses these customers, Defendant will be unable to sell the Goods and Plaintiff will likely receive the

Goods back sometime in the future from a buyer of Defendant's assets who will be seeking a 100% credit from Plaintiff for the Goods. *See* England Aff., ¶ 9. By that time, Plaintiff will have already been required to replace the Goods. *See* England Aff., ¶ 9. Accordingly, it is critical for Plaintiff to obtain possession of the Goods as soon as possible, both to prevent any buyer of Defendant's assets from returning Goods back to Plaintiff and claiming a credit that they are not due, and to prevent Plaintiff from incurring additional expense to provide replacement Goods to the other distributors who are working to satisfy the demands of Defendant's customers. *See* England Aff., ¶ 9.

21. Because Plaintiff's statutory right to reclamation of the specific Goods will be eliminated if Defendant is permitted to sell the Goods, and because there is no remedy at law to compensate Plaintiff for the damages that Plaintiff will suffer as a result of the loss of its right, Plaintiff has satisfied its showing that it will be sufficiently harmed if the TRO is not granted.

3. Any Harm to Defendant Should Not be Considered and Does Not Outweigh the Harm to Plaintiff

22. The harm, if any, that Defendant will suffer if the requested TRO is granted is simply one of the many costs associated with compliance with the requirements of the Bankruptcy Code and does not compare with, let alone outweigh the irreparable harm to Plaintiff if the TRO is not granted. Moreover, any harm that Defendant may suffer if the requested TRO is granted should not be given any weight by the Court in considering Plaintiff's request for a TRO because Plaintiffs' right of reclamation under section 546(c) of the Bankruptcy Code is not subject to or conditioned on the harm that such reclamation may cause Defendant. Defendant commenced this bankruptcy case and should not be allowed to eviscerate express statutory rights

provided to Plaintiff on the grounds that the exercise of those rights by Plaintiff will decrease the value of Defendant's estate.

4. The Public Interest Favors Granting the TRO

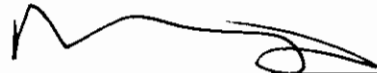
23. To the extent that the requested TRO has any impact on the public interest, it is furthered by preserving the value of the Goods and Plaintiff's right of reclamation under section 546(c) of the Bankruptcy Code until the Court has an opportunity to determine the merits of the Complaint. In addition, the public interest benefits when all parties expect that courts require compliance with the express textual requirements of statutory law rather than creating unauthorized judicial exceptions on a case by case basis. Denying the requested TRO would allow the Defendant to continue liquidating the Goods, undermine the express provisions of the Bankruptcy Code, and eventually render Plaintiff's reclamation rights under section 546(c) meaningless.

B. THE COURT SHOULD DISPENSE WITH THE BOND REQUIREMENT

24. Plaintiff requests that the Court dispense with the requirement of filing of a bond set forth in Bankruptcy Rule 7065(c) given the strength of Plaintiff's case. *See, e.g., Moltan Co. v. Eagle-Picher Industries, Inc.*, 55 F.3d 1171, 1176 (6th Cir. 1995) (affirming district court issuance of preliminary injunction and waiver of security given the strength of plaintiff's case). Plaintiff submits that security is unnecessary given the strength of its case in light of (a) Plaintiff's statutory right to reclamation and compliance with section 546(c), (b) the failure of Defendant to provide its creditors with information on the extent of its assets and liabilities to for the purposes of assessing solvency, and (c) the existence of no prior rights of a holder of a security interest in the Goods, or to the extent such prior rights still exist, the gross over collateralization of the secured lender.

WHEREFORE, Plaintiff respectfully requests that the Court (I) enter an order, substantially in the form attached hereto, directing Defendant to (A) immediately stop selling the Goods until the Court orders otherwise; (B) segregate from its other inventory the Goods that remain in Defendant's possession and any of Goods that return to Defendant's possession; (C) provide within 3 business days Plaintiff an accounting of the disposition of the Goods; and (D) provide Plaintiff within 4 business days access to inspect the Goods that are in Defendant's possession; and (II) grant such other and further relief as the Court deems just proper and equitable.

Dated: January 11, 2007



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UNITED STATES BANKRUPTCY COURT
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Debtors.

Chapter 11

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Jointly Administered

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Plaintiff,

- against -

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Delaware corporation,

Defendant.

Adv. Pro. No. 07-50004 (CSS)

Related to Docket No. _____

**TEMPORARY RESTRAINING ORDER ENJOINING
ADVANCED MARKETING SERVICES, INC. FROM, *INTER ALIA*,
DISPOSING CERTAIN GOODS DISTRIBUTED BY SIMON & SHUSTER, INC.**

Upon the *Emergency Application of Simon & Schuster, Inc. For Temporary Restraining Order Pursuant to Bankruptcy Rule 7065* filed on January 11, 2007; and no adverse interest being affected; and after due deliberation and sufficient cause appearing therefor; it is hereby

ORDERED, that the Application is GRANTED; and it is further

ORDERED, that Advanced Marketing Services, Inc. (“Defendant”) shall immediately stop selling the Goods¹ until this Court orders otherwise; and it is further

ORDERED, that Defendant shall immediately segregate from its other inventory the Goods that remain in Defendant’s possession and any of Goods that return to Defendant’s possession; and it is further

ORDERED, that Defendant shall within 3 business days provide an accounting of the disposition of the Goods; and it is further

ORDERED, that Defendant shall within 4 business days provide Simon & Schuster, Inc. with immediate access to inspect the Goods that are in Defendant’s possession; and it is further

ORDERED, that this Order and the injunction contained herein shall expire on _____, 2007.

Dated: January __, 2007

UNITED STATES BANKRUPTCY JUDGE

¹ “Goods” has the same meaning as ascribed to it in the *Complaint for Reclamation of Goods Pursuant to 11 U.S.C. § 546(c) and Related Relief* (the “Complaint”) filed by Simon & Schuster, Inc. on January 5, 2007.

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Plaintiff,

- against -

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Defendant.

Adv. Pro. No. 07-50004 (CSS)

CERTIFICATE OF SERVICE

I, Mark Minuti, Esquire of Saul Ewing LLP hereby certify that on January 11, 2007 service of the foregoing **Emergency Application Of Simon & Schuster For Temporary Restraining Order Pursuant To Bankruptcy Rule 7065** was made by First Class Mail on the parties identified on the attached Service List.

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