Retail Bankruptcy: Executory Contracts and Leases

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RETAIL BANKRUPTCIES – NON-RESIDENTIAL LEASES AND MORE

INTRODUCTION:

The Panel has been tasked with discussing issues related to retail bankruptcies, and in particular non-residential real property leases and other issues which are more commonly found in retail bankruptcy cases. We start with a review of the current provisions of Section 365(d)(4) regarding the time in which a debtor has to either assume or reject non-residential real property leases in a Chapter 11 case, looking at the history of Section 365(d) from its inception through the BAPCPA Amendments in 2005. We also look at the recommendations of the ABI Commission to Study the Reform of Chapter 11 in light of current economic conditions and lending practices. We explore whether the proposed changes to Section 365(d)(4), in light of 2015 conditions, would change the outcome for most retail bankruptcy matters.

Section 365: Where Are We, How Did We Get Here and Where Are We Going

- The 2005 Amendments - why did they come about?

When the Bankruptcy Code was first enacted in 1978, Section 365 did not provide a specific time for the assumption or rejection of executory contracts and non-residential real property leases. Indeed, Section 365(d)(2) as originally enacted read as follows:

> (2) In a case under chapter 9, 11 or 13 of this title, the trustee may assume or reject an executory contract or unexpired lease of the debtor at any time before the confirmation of a plan, but the court, on request of any party to such contract or lease, may order the trustee to determine within a specified period of time whether to assume or reject such contract or lease.

That provision, which allowed for an open-ended time to assume or reject leases, resulted in a flurry of activity from commercial landlords and their lobbyists. Indeed, the well documented statements of Senator Orrin Hatch in the legislative history of the 1984 Amendments to the Bankruptcy Code set forth this problem as one of the reasons for the initial amendments to Section 365. In an attempt to rectify what was perceived to be the havoc created by the original section, Section 365(d) was amended by adding Section 365(d)(4) providing that leases were to be assumed within sixty days following the petition date, unless the court on motion extended that sixty day deadline.

While the landlord industry may have believed that the 1984 Amendments would provide a fix to the open-ended time limit to assume or reject leases, as matters turned out courts regularly granted either repeated extensions of time to assume or reject leases or simply extended the time to assume or reject the leases through confirmation of the debtor's plan of reorganization . . . and sometimes even later. Accordingly, in yet a further attempt to put a halt to unlimited extensions of time to assume or reject leases, landlords, particularly led by the shopping center industry, were successful in having Congress amend Section 365 to provide the current initial 120 day time to assume or reject followed by the ability to grant a further 90 day extension for cause. Any extension beyond the 210 day time period required the landlord's

consent. In the landlords' minds, that would finally put a hard stop on the time to assume or reject leases. As we have seen, however, in at least a few cases, debtors have filed motions to assume leases within the 210 day period but were not forced to move forward on that motion, thereby further extending the period of time to assume or reject. In addition, at least one court has held that where the proposed assumption of leases was contained in the debtor's plan of reorganization, the filing of that plan of reorganization within the 210 days effectively stayed any automatic rejection of the affected leases until confirmation of the plan.

The 2005 Amendments setting the 210 day hard stop brought an immediate hue and cry from the debtors' side of the bar claiming that the change to Section 365(d)(4) would make it impossible to confirm a Chapter 11 retail bankruptcy case. Ten years later the debtor bar argues that empirical evidence has proven them correct and that there have been virtually no Chapter 11 reorganizations since the enactment of the 2005 Amendments. The landlord bar, on the other hand, argues that economic conditions, not the 210 day rule, and the positions taken by lenders as well as other factors (including the creation of Section 503(b)(9) claims) are the real culprit. The ABI Commission, in an attempt to address the issues raised by both sides of the aisle, proposes extending the time to assume or reject leases to a single one year period with no provision for further extensions for cause. That proposal is coupled with other proposed revisions such as the requirement of prompt payment and adoption of the accrual method of determining what rent is due. No specific language has thus far been suggested. *[See report of the Commission to Study the Reform of Chapter 11 at pages 129-135 attached hereto.]*

- Does the time to assume or reject really matter?
    - In today's economic environment, can retail cases be reorganized?
- Comparison of current law with ABI Commission recommendation.
    - Are businesses "too far gone" by the time the bankruptcy is filed?
    - Have all possibilities for reorganization been vetted prior to filing?

Administrative insolvency/pay-to-play.

- Should cases be run for the benefit of the secured lender alone?
- Section 503(b)(9) claims – are they really viewed as administrative?

Section 503(b)(9) Claims in Cases Under Section 363 of the Bankruptcy Code

With companies increasingly aware of the costs and uncertainty associated with "free fall" chapter 11 bankruptcies, would-be debtors have in recent years turned to speedier and more cost-effective strategies such as prepackaged plans and quick sales under Section 363 of the Bankruptcy Code. The increased prominence of the latter has brought to the forefront the appropriate treatment of creditors holding claims under Section 503(b)(9) of the Code. While the Bankruptcy Code affords Section 503(b)(9) claims administrative priority, in sale cases with limited estate funds, such claimants may be concerned that a debtor may give preference to post-petition trade payables, claims of critical vendors and other administrative claims.

For their part, bankruptcy courts have varied as to when, if ever, a debtor must ensure payment in full of section 503(b)(9) claims. In *In re Townsend's, Inc.*, No. 10-14092 (CSS), the U.S. Bankruptcy Court for the District of Delaware initially refused to approve the debtors' post-petition financing package, finding that the prospects for payment of Section 503(b)(9) claims were slim. *In re Townsend's, Inc.*, No. 10-14092 (CSS) (Bankr. D. Del.). The court there only approved the financing once the debtors' lender and the creditors' committee reached an agreement to pay Section 503(b)(9) claims from the proceeds of the sale. By contrast, in *Allen Family Foods*, No. 11-11764 (KJC), the Delaware bankruptcy court approved the sale of the debtors' assets despite there being no assurance of full payment of allowed Section 503(b)(9) claims due. *In re Allen Family Foods Inc.*, No. 11-11764 (KJC) (Bankr. D. Del.), Tr. of July 27, 2011 Hr'g at 44-45. Similarly, in *In re Real Mex Restaurants Inc.*, Case No. 11-13122 (BLS), the Delaware bankruptcy court approved a sale under section 363 despite the fact that the case was administratively insolvent. *In re Real Mex Restaurants Inc.*, Case No. 11-13122 (BLS) (Bankr. D. Del.), Tr. of Feb. 10, 2012 Hr'g.

In two cases decided in 2012, the Delaware bankruptcy court authorized sales pursuant to section 363 over objections relating to Section 503(b)(9), but required the debtors to establish a reserve for 503(b)(9) claims from the sale proceeds. In In re Blitz USA, Inc., Case No. 11-13603 (PJW), the Delaware bankruptcy court approved the sale of a division of the debtors' businesses over the objection of the unsecured creditors committee, but required the debtors to establish a reserve for 503(b)(9) claimants from the sale proceeds pending a determination of the final outcome of the cases. *In re Blitz USA, Inc.*, Case No. 11-13603 (PJW) (Bankr. D. Del.), Tr. of April 19, 2012 Hr'g at 42. Notably, in *Blitz*, the bankruptcy court stated that "where all assets are subject to a security interest, and if a sale of the entire enterprise produces proceeds less than the amount of the secured claim, then no creditor other than the secured creditor is entitled to anything." *Id.* In *In re AFA Investment Inc.*, Case No. 12-11127 (MFW), the bankruptcy court approved the sale, but also required the debtors to reserve the sale proceeds above the amount necessary to satisfy the debtor-in-possession financing and the first lien lenders in order to determine whether 503(b)(9) claimants were entitled to such amounts above the second lien lenders. *In re AFA Investment Inc.*, Case No. 12-11127 (MFW) (Bankr. D. Del.) Tr. of July 12, 2012 Hr'g at 46. The bankruptcy court reserved on the question of whether the 503(b)(9) claimants were entitled to be paid from sale proceeds above the second lien lenders but indicated that the 503(b)(9) claimants had "paid the freight" in that case. *See id.*

More recently, the Delaware bankruptcy court addressed Section 503(b)(9) claims in *In re NE Opco, Inc.*, No. 13-11483 (CSS). In *NE Opco*, the debtors had limited funds in their debtor in possession financing budget and a short timeframe within which to obtain a purchaser of their assets. Complicating the situation were the competing interests of the debtors' lender, the official committee of unsecured creditors, the debtors' non-debtor parent and the debtors' largest secured creditor. Without a prospective purchaser in place, the debtors negotiated a deal with the other parties that provided for, inter alia, the funding of a segregated escrow account for payment of allowed Section 503(b)(9) claims. The debtors then filed a motion (the "9019 Motion") seeking approval of the agreement under Bankruptcy Rule 9019. At the hearing on the 9019 Motion, several creditors asserting Section 503(b)(9) claims objected, arguing that despite the Bankruptcy Code's conferral of priority upon such claims, the settlement between the parties provided no assurance that such claims would be paid in full and, in fact, the financial constraints of the case made it speculative as to whether Section 503(b)(9) claims would be paid at all.

The bankruptcy court ultimately approved the settlement after careful consideration of a number of issues. Noting that a Section 363 sale was the best way to maximize value for the estate and its constituents, the court found that the settlement was the most likely path to facilitate such a sale. *NE Opco*, Tr. of July 19, 2013 Hr'g at 96. The court rejected the notion that the settlement had to guarantee the payment in full of all Section 503(b)(9) claims. *Id.* at 98-99. Instead, the court looked to whether there was a "reasonable likelihood, or more likelihood than not, that 503(b)(9) claims will be paid in full." *Id.* at 99. Having considered the extensive testimony and evidence that was presented at the hearing on the 9019 Motion, the bankruptcy court found that it was more likely than not that Section 503(b)(9) claims would be paid. *Id.* at 99-100. The court acknowledged the concern that some administrative claimants may be paid more than others, but indicated that this was sometimes a business reality, but its mere possibility was not sufficient to decline to approve the settlement. *Id.* at 103-04.

The Delaware bankruptcy court's ruling in *NE Opco* is the next step in the development of the general treatment of Section 503(b)(9) claims in sale cases under section 363 of the Bankruptcy Code. As Judge Carey stated in *Allen Family Foods*, "I don't think Congress ever really contemplated that Section 363 sales would develop in quite the way they have. But they have, and courts have endorsed them, including this one." *In re Allen Family Foods, Inc.*, Tr. of July 27, 2011 Hr'g at 44. While recent developments indicate that assurances of full payment of Section 503(b)(9) claims may not be necessary in order to obtain approval of debtor-in-possession financing or a quick sale under Section 363, the law remains far from settled. Accordingly, debtors, secured lenders and committees must be wary of potentially disgruntled Section 503(b)(9) claimants when negotiating Section 363 sales, especially in cases with limited funds or where a debtor may be close to administrative insolvency.

Consumer issues:

- Gift cards and Notice issues (known creditors, equitable mootness)
- Privacy, warranties and loyalty programs
- July 28th *Wall Street Journal* "The Examiners". (See attachment)

Section 365(h) revisited and the interplay with 363 (*In re: Revel*)

The issue of the conflict between Bankruptcy Code Sections 363(f) and 365(h) came to the fore with the Seventh Circuit's decision in *Precision Industries, Inc. v. Qualitich Steel SBQ, LLC*, 327 F.3rd 537 (7th Cir. 2003). In that case, a tenant sought to invoke its rights to remain in its premises after the premises had been sold in a bankruptcy sale pursuant to Section 363(f) free and clear of all interests. After a ruling adverse to the tenant was reversed by the District Court, an appeal was taken to the Seventh Circuit as one of first impression as to the interplay between Sections 365(h) and 363(f). Based upon the specific facts of that case, including the tenant's failure to object to the sale free and clear, the Seventh Circuit ruled that the tenant's rights were, indeed, cut off by the 363(f) sale, notwithstanding the provisions of 365(h). Needless to say, a groundswell of attention arose in the real estate industry regarding what had been believed to have been an almost inviolate protection granted to tenants by Section 365(h). Many commentators wondered what the value was in Section 365(h) if a debtor could simply sell the

underlying property after a lease was rejected and thereby cutoff all of the tenant's rights (subject, however, to the provisions of Section 365(e)).

There have been a number of cases that have been called upon to interpret this issue since *Precision Instruments*, but none of them have reached the Circuit Court level. Most recently, the United States Bankruptcy Court for the District of New Jersey considered the issue in *In Re Revel AC, Inc.*, 532 B.R. 216 (Bankr. D.N.J., 2015). In that case both the debtor and certain "tenants" filed cross-motions for determination of the tenants' rights under Section 365(h) where the tenants desired to remain in possession of their leasehold interests at a defunct and closed casino in Atlantic City, New Jersey. After first determining that the "tenants" were, indeed, tenants pursuant to "true leases" the Court ruled that a Section 363 sale does not and could not trump the rights granted to the tenants by Section 365(h). The Court stated "This Court previously has addressed the interplay between § § 363 and 365. In *In re Crumbs Bakeshop, Inc.*, 522 B.R. 766, 777 (Bankr. D.N.J. 2014), this Court held that nothing in § 363(f) trumps, supercedes, or otherwise overrides the rights of licensees under Section 365(n). The Court sees no reason to reach a different conclusion in the present case with regard to the tenants' rights under Section 365(h). . . . The *Crumbs* analysis is relevant here:

> It is well established that the appropriate way to construe a statute is to conclude that the specific governs over the general . . . *In re Churchill Properties III, Ltd. P'ship, 197 B.R. 283, 288 (Bankr. N.D. Ill. 1996).* In *Churchill*, the court recognized that § 365(h) is specific, as it grants a particular set of clearly stated rights to lessees of rejected leases. That is, Congress specifically gave lessees the option to remain in possession after a lease rejection. If the court were to allow a § 363(f) sale free and clear of the lessee's interest, "the application of [§ 365(h)] as it relates to non-debtor lessees would be nugatory." *In re Churchill Properties*, 197 B.R. at 288. Indeed, "it would make little sense to permit a general provision, such as [§] 363(f), to override [§ 365's] purpose. The Code is not intended to be read in a vacuum." *Id.*
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> Moreover, the legislative history of § 365(h) evinces that Congress had the desire to protect the rights of tenants.
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> > A 1978 Senate Report remarked that under the terms of § 365(h), "the tenant will not be deprived of his estate for the term for which he bargained." S.Rep. No. 95-989, at 60 (1978) . . . . The Section-by-Section Analysis of the 1994 amendments to the Bankruptcy Code further reflect a Congressional desire to protect the rights of those who are lessees of debtors:
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> > > This section clarifies section 365 of the Bankruptcy Code to mandate that lessees cannot have their

> rights stripped away if a debtor rejects its obligation as a lessor in bankruptcy. This section expressly provides guidance in the interpretation of the term "possession" in the contest of the statute. The term has been interpreted by some courts in recent cases to be only a right of possession (citations omitted). This section will enable the lessee to retain its rights that appurtenant to its leasehold. These rights include the amount and timing of payment of rent or other amounts payable by the lessee, the right to use, possess, quiet enjoyment, sublet and assign.
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> *In re Zota Petroleums, LLC*, 482 B.R. 154, 161-62 (Bankr. E.D. Va. 2012) (citations omitted). The court in *In re Haskell L.P.,*, 321 B.R. 1 (Bankr. D. Mass. 2005) also noted the legislative history to § 365(h), and denied the debtor's motion to sell real property free and clear of a leasehold interest under § 363(f) because such a sale would permit the debtor to achieve under § 365(h), namely, stripping the lessee of its rights to possession. This line of reasoning fits squarely with Congressional intent, and with the principle of statutory construction that the specific governs over the general."

In re Crumbs Bake Shop, Inc., 522 B.R. at 777-78

It appears that there is a developing majority opinion that a tenant's rights under Section 365(h) should prevail in any Section 363(f) sale, at least where the tenant party to the contract raises the issue. Alternatively, perhaps the adequate protection to be afforded to the tenant under Section 363(e) in an attempt to sell property free and clear under Section 363(f) would be the identical rights granted under Section 365(h).

Because many of the cases involving this issue are very fact sensitive, attention should also be given to *In re Spanish Peaks Holdings II, LLC*, _____B.R. ____(MT 2014) where the court held on the specific facts of that case (involving leases between the debtors and its affiliates) that the tenants would not be afforded the protection of Section 365(h).

Lessons learned: RadioShack, Anna's Linens, Family Christian, Dots.

- First Day Issues:
  - What are we doing at the beginning of the case
  - Pre-filing Auctions
  - Collusive Bidding (Court's admonition in A&P)
- Highest and Best Bids – Human relations and public policy

Structured dismissals and Conversions to Chapter 7

In re Jevic Holding Corp., et al., Opinion Digest

CASE: *Official Committee of Unsecured Creditors v. CIT/Business Credit, Inc. (In re Jevic Holding Corp., et al.)*, Case No. 14-1465 (3d Cir. May 21, 2015)

JUDGES: Thomas M. Hardiman, Maryanne Trump Barry, Anthony J. Scirica

DECIDED: May 21, 2015

TOPICS: Structured Dismissals; Absolute Priority Rule

BACKGROUND: In 2006, following a decline in its business, Jevic Transportation ("Jevic") was sold to a subsidiary of Sun Capital Group ("Sun Capital") in a leveraged buyout, which was financed by a syndicate of lenders led by CIT Group/Business Credit Inc. ("CIT"). Despite its new ownership, Jevic continued to struggle for the next two years. Ultimately, on May 19, 2008, Jevic gave its employees termination notices, and on the following day, Jevic filed voluntary petitions for relief under chapter 11.

During Jevic's bankruptcy case, two primary adversary proceedings were initiated. First, a group of Jevic's terminated truck drivers (the "Drivers") filed a class action lawsuit against Jevic and Sun Capital alleging violations of the federal and state Worker Adjustment and Retraining Notification Acts ("WARN"). Additionally, on the behalf of Jevic's estate, the Unsecured Creditors Committee ("Committee") brought fraudulent conveyance actions against CIT and Sun Capital in connection with the leveraged buyout.

In March 2012, the Committee settled the fraudulent transfer claims against CIT and Sun Capital. The settlement included, among other things, that the parties would release their claims against each other, CIT would pay money into an account earmarked to pay administrative creditors, and Sun Capital would assign to a trust its remaining collateral for the benefit of tax and administrative creditors first and then for general unsecured creditors on a pro rata basis. However, the settlement did not provide for payment to any Drivers on account of their asserted priority wage claims.

The bankruptcy court found that the settlement provided the best result for the estate, approved the settlement over the objection of the Drivers and the United States Trustee (the "UST"), and dismissed the chapter 11 case. The Drivers and the UST appealed to the district court, claiming that the structured dismissal violated section 507(a)(4) of the Bankruptcy Code and further that the Bankruptcy Code does not provide for structured

dismissals. The district denied the appeal and affirmed the bankruptcy court's decision. The Drivers and the UST then appealed to the Third Circuit. The Third Circuit also denied the appeal and affirmed the district court's decision.

DISCUSSION:

Bankruptcy Rule 9019 authorizes settlements so long as they are "fair and equitable." *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson (TMT Trailer Ferry)*, 390 U.S. 414, 424 (1968). In *In re Martin*, the Third Circuit gleaned from *TMT Ferry Trailer* four factors for bankruptcy courts to consider when examining settlements: (1) the probability of success in litigation, (2) the likely difficulties in collection, (3) the complexity of the litigation involved and the expense, inconvenience and delay necessarily attending it, and (4) the paramount interest of creditors. 91 F.3d 389 (3d Cir. 1996).

Bankruptcy courts are authorized to dismiss cases for cause. One form of cause is the substantial or continuing diminution of the estate. *See* 11 U.S.C. §§ 1112(b)(1) and 1112(b)(4)(A). Section 349(b) explicitly authorizes bankruptcy courts to alter the effect of dismissal "for cause," meaning that the *status quo* can be altered. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 338 (1977); *see also Matter of Sadler*, 935 F.2d 918, 921 (7th Cir. 1991).

The Third Circuit explained that while bankruptcy courts can alter the effects of dismissal "for cause," the parties cannot use a structured dismissal to circumvent the chapter 11 plan requirements or to avoid a viable conversion. The Third Circuit noted that "[a]bsent a showing that a structured dismissal has been contrived to evade the plan confirmation or conversion processes, a bankruptcy court has the discretion to order such a disposition."

The Third Circuit also noted that when Congress codified the absolute priority rule, it did so with respect only to the confirmation of plans. The text of section 1129 deals specifically with plans, not settlements, textually removing the absolute priority rule of section 1129(b)(2)(B)(ii) from settlements. Furthermore, according to the Third Circuit, the case law requiring the adherence to the absolute priority rule involves the confirmation of plans, not the approval of settlements. In so holding, the Third Circuit agreed with the Second Circuit, instead of the Fifth Circuit, with respect to priority deviations. The Fifth Circuit determined that the absolute priority rule applies to settlements. *Matter of AWECO, Inc.*, 725 F.2d 293, 298 (5th Cir. 1984). The Second Circuit adopted a more flexible rule, allowing structured dismissals in certain instances. *In re Iridium Operating LLC*, 478 F.3d 453, 464 (2d Cir. 2007) ("[A] noncompliant settlement [can] be approved when "the remaining [*TMT Ferry*] factors weigh heavily in favor of approving a settlement[.]").

Notwithstanding a settlement's deviation from the priority rules of the Bankruptcy Code, the critical inquiry according to the Third Circuit is whether the settlement optimizes value for the benefit of the estate, not a particular group of creditors.

HOLDING: The Third Circuit held that bankruptcy courts may approve settlements that deviate from the priority scheme of the Bankruptcy Code and result in a structured dismissal where the courts have specific and credible grounds to justify doing so.

Structured Dismissals in the
United States Bankruptcy Court for the District of Delaware

Case / Docket Nos.	Judge	Motion Granted?	Release / Exculpation Provision?	Distribution / claims reconciliation	Carveout / "gift" trust	Other / Conditions to dismissal?	Who Objected / basis?
In re SJC, Inc., No. 14-11763 [D.I. 294 & 321]	MFW	Yes	None	Dismissal of case occurred upon certification to Court of completion of claims resolution process.	None	1) completion of claims resolution process 2) adjudication of all final fee applications 3) payment all accrued but unpaid United States Trustee's fees	None
In re Beacon Power Corporation, No. 11-13450 [D.I. 302, 314 & 341]	KJC	Yes	None	Dismissal of case occurred upon certification to Court of completion of distribution process and request for dismissal order.	Yes - all funds which are not paid to DOE, Edwards Wildman or the Wind-Down Reserve will be held by the Manager for payment of the Professional Fee Claims.	1) distribution of $2,344,942 to DOE 2) distribution of $25,000 to Edwards Wildman Palmer LLP 3) establishment of a $300,000 reserve for administrative claims, priority wage claims and manager's fees 4) establishment of a professional fee reserve, if funds are available post distributions 5) payment of U.S. Trustee fees	One limited objection was filed by Edwards Wildman Palmer LLP regarding its secured and unsecured claims
In re ICL Holding Company, Inc., No. 12-13319 [D.I. 1103, 1137 & 1141]	KG	Yes	Yes- the Prepetition Secured Lenders, the lenders under the DIP credit agreement, the Committee, the	Dismissal of case occurred upon certification to Court of completion of claims reconciliation process.	Yes - part of settlement between Committee, Prepetition Secured Lenders and Purchaser of significant portion of	1) payment of U.S. Trustee fees 2) no further action with respect to certain	Informal comments from U.S. Trustee, Prepetition Secured Lenders, the lenders under the DIP credit

Case / Docket Nos.	Judge	Motion Granted?	Release / Exculpation Provision?	Distribution / claims reconciliation	Carveout / "gift" trust	Other / Conditions to dismissal?	Who Objected / basis?
			Purchaser and Vibra (another interested entity) agreed to release the Debtors, the Prepetition Secured Lenders, the lenders under the DIP credit agreement, the Committee, the Purchaser, Vibra, and their respective present or former officers, directors, employees, members, attorneys, consultants, advisors and agents from any and all claims of whatever kind or nature arising from or related in any way to the Debtors or their Chapter 11 Cases. These releases did not actually appear in the order.		Debtors' assets provided for contribution by Prepetition Secured Lenders to GUC Funds from a carve out of their collateral.	pending Appeals and no party to the Appeals entitled to file any further petition or appeal with respect thereto 3) Escrows (funded in connection with sales of substantially all of Debtors' assets) closed in accordance with their terms 4) Court order entered in connection with final fee applications	agreement, the Committee, the Purchaser and Vibra
In re Coach AM Group Holdings Corp., No. 12-10010 [D.I. 1482, 1496, 1497, 1501, 1505, 1506, 1508, 1509, 1512, 1513, 1514, 1520, 1521, 1568]	KG	Yes	Release of Debtors, Prepetition First Lien Agent, Prepetition First Lien Lenders and their respective present or former directors, officers, employees, members, attorneys, consultants, advisors and agents from any liablity related to motion to dismiss. Also, each of the parties above and the Lender Trustee, the Lender Trust and the Committee and their respective present or	General unsecured claimants would receive payments from GUC Trust established pursuant to settlement described in next column.	Settlement (the terms of which were set forth in and approved by the Final DIP Order) between Debtors, DIP Agent, Prepetition First Lien Agent and Committee authorized the formation of a trust for the benefit of the Debtors' general unsecured creditors. The GUC Trust was funded by a portion of the Prepetition Collateral that the Prepetition First Lien	Added in response to objections: 1) Lead case kept open until earlier of (a) 90 days from date of entry of order demising case or (b) resolution of all objections to claims filed on behalf of the GUC Trustee and 2) entry of orders on the final fee applications of all professionals retained in Chapter 11 Cases.	1) Various personal injury claimants - objected to release provisions; Debtors addressed by revising order to exclude personal injury claimants from releases and makes clear that the rights granted under prior stay relief order were preserved. 2) Bridgestone Americas Tire Operations LLC - objection based on

Case / Docket Nos.	Judge	Motion Granted?	Release / Exculpation Provision?	Distribution / claims reconciliation	Carveout / "gift" trust	Other / Conditions to dismissal?	Who Objected / basis?
			former officers, directors, employees, members, attorneys, consultants, advisors and agents were released from all other claims. Following objection by U.S. Trustee, the Debtors were removed as release parties from the order. Release also excluded any party to stay relief orders.		Lenders agreed to carve out for the benefit of the general unsecured creditors. The GUC Trust was funded with: (a) $1,740,000 minus any professional fees accrued on behalf of Committee; (b) a percentage of the sale proceeds (the method of calculation of this amount was set forth in further detail in DIP Order and Motion to Dismiss); and (c) 7.5% of the difference between budgeted amount for certain vendor claims and actual amount paid to holders of such claims.		unreleased accounts receivable issue; Debtors responded by filing claim objection. 3) Certain creditors - individuals whose objections were not precise, particularly given that they would be treated as general unsecured creditors entitled to potential distribution from GUC Trust. 4) The U.S. Trustee: a) proposed structured dismissal not appropriate use of section 105(a); b) release and exculpation provisions not appropriate outside the context of confirmed plan - proposed final order modified to address this concern; c) post-dismissal retention of jurisdiction improper - proposed final order modified to address this concern; d) no legal authority exists for approval of the Lender Trust Agreement.
In re TLG Liquidation LLC f/k/a Telogy, LLC, No. 10-10206 [D.I.	MFW	Yes	In connection with Settlement, released all claims against the Agent and Lender. See Motion	Claims allowed in amounts submitted in the dismissal motion, in the absence of an	None	None	None

Case / Docket Nos.	Judge	Motion Granted?	Release / Exculpation Provision?	Distribution / claims reconciliation	Carveout / "gift" trust	Other / Conditions to dismissal?	Who Objected / basis?
275, 314 & 494]			¶ 22(f). Released all claims under Chapter 5 of the Bankruptcy Code. See Motion ¶ 22(g). Debtors and Committee released claims in favor of certain directors and debtors. See Motion. ¶ 22(h).	objection. See Dismissal Order ¶ 4.			
In re Alternative Distrib. Sys. Inc., No. 09-13099 [D.I. 194 & 213]	PJW	Yes	No	None	None	Debtors' assets sold, but debtors were administratively insolvent and could not fund plan process	None
In re Butler Servs. Int'l, Inc., No. 09-11914 [D.I. 557, 603 & 642]	KJC	Yes	Yes - release of the Prepetition Secured Lien Agent and Prepetition Second Lien Lenders. See § V(1) of Settlement. Exculpation of Debtors, Committee, Prepetition Second Lien Parties or any of their directors, officers, etc. for any act taken in good faith in negotiation, formation, etc. of the Stipulation or Approval Order. See Settlement § V(II). *D&O Claims against former officers and directors were not released.	None	Pursuant to Settlement the Committee and the Prepetition Second Lender entered into a Creditors' Liquidated Trust Agreement to make distributions to their priority and unsecured creditors. See Dismissal Order ¶ 3.	None	U.S. Trustee to the Gift Trust. Ace Companies (Insurers) - based on its insurance agreements with the Debtors.
In re BT Holding III LLC, No. 09-11173	CSS	Bankruptcy Court	"From and after the date of this Order, none	Sought authorization to distribute "Remaining	None	None	U.S. Trustee called the dismissal "nothing more

Case / Docket Nos.	Judge	Motion Granted?	Release / Exculpation Provision?	Distribution / claims reconciliation	Carveout / "gift" trust	Other / Conditions to dismissal?	Who Objected / basis?
[D.I. 268, 350 & Transcript of 10/5/09 hearing]		denied debtors' and creditors' committee's joint motion for entry of structured dismissal order, questioning whether any basis existed in Bankruptcy Code for such an order (See Transcript of Oct. 5, 2009 Hr'g 16:6-48:18).	of the Debtors, nor the Committee, nor the Purchaser, and none of the Debtors', Committee's and Purchaser's respective parent or former directors, officers, employees, members, attorneys, consultants, advisors an agents (acting in such capacity), shall have or incur any liability to any person for any act taken or omitted to be taken in connection with or related to the formation, preparation, dissemination, implantation, confirmation or consummation of the Motion (other than an action in contravention of the Motion or the implementation of the Order), or any contract, instrument, release or agreement or document created or entered into, or any other act take or omitted to be taken in connection with the Motion or this Order." See Proposed Order ¶ 8:	Assets" to allowed unsecured claims, and authorization for the Debtors, with assistance of Counsel to the Committee, to identify allowed unsecured claims under a proposed claims resolution process. See Motion 20-22.			than a bare bones chapter 11 plan liquidating plan." Also, objected to the releases provided in the proposed Order.
In re G.I. Joe's Holding Corp., No. 09-10713 [D.I. 735, 743, 746, 753, 773, 804]	KG	Yes	Under the terms of the resolution of the Committee's objection to the DIP Financing, there was an agreement	Motion to dismiss sets forth a claims resolution process which would permit distributions to be made to holders of	In resolution of the Committee's objection to the DIP Financing, the Prepetition Term Loan B Secured Parties	1) Resolution of any and all pending claim objections, 2) distribution of amounts to administrative	The U.S. Trustee argued that cause did not exist to dismiss the bankruptcy proceeding. It also objected to the

Case / Docket Nos.	Judge	Motion Granted?	Release / Exculpation Provision?	Distribution / claims reconciliation	Carveout / "gift" trust	Other / Conditions to dismissal?	Who Objected / basis?
			that none of the Debtors, the Committee, the DIP Secured Parties, the Prepetition Secured Parties or the Prepetition Term Loan B Secured Parties would commence, or join in the prosecution of, any action under chapter 5 of the Bankruptcy Code against any Person without the prior written consent of the other parties.	allowed administrative claims and allowed unsecured claims.	agreed that 10% of the Net Proceeds received on account of the Prepetition Term B Loan B Liens less the amounts paid by the Prepetition Term Loan B Secured Parties pursuant to the DIP Order would be held in escrow by counsel for the Committee for the exclusive purpose of making a distribution to the prepetition general unsecured creditors. Further, the DIP Lenders agreed that any amounts received as payments of certain fees under the DIP Financing Agreement would be paid by the DIP Lenders to be added to the escrow amount for distribution to the prepetition general unsecured creditors. Further, $495,000 of the proceeds of the sale of the Debtors' assets was transferred to the GUC Escrow Account. A total of $730,000 remained in the GUC Escrow Account for distribution to administrative claim holders and prepetition	claimants and general unsecured creditors, and 3) payment of U.S. Trustee fees.	releases for the Secured Parties. Further, the U.S. Trustee argued that the requested case closing was improper and did not comply with the Local Rules. Finally, the U.S. Trustee argued that the absolute priority rule was implicated and violated.

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					general unsecured creditors. The Debtors estimated a 100% distribution to administrative claimants and a 1% distribution to general unsecured creditors.		
In re Foamex Int'l, Inc., No. 09-10560 [D.I. 712 & 761]	KJC	Yes	No	No funds available to distribute to unsecured creditors. See Motion ¶ 25.	Escrow Reserve used to pay wind-down expenses. See Dismissal Order.	Debtors' assets sold, but Debtors were administratively insolvent and could not fund plan process	Trade Vendor objection. U.S. Trustee until all quarterly fees were payable.
In re KB Toys, Inc., No. 08-13269 [D.I. 872, 914 & 993]	KJC	Yes	Yes - part of settlement Committee released all claims against certain entities for certain transfers prior to the petition date. See p. 15 of Motion. Release Debtors, Committee and Officers and Directors from any liability in negotiation, formation, etc. of Settlement Stipulation and Order. See § 42 of Motion.	Claims allowed in amounts submitted in the dismissal motion, in the absence of an objection. See Dismissal Order ¶ 8.	Placed funds in escrow to be distributed in accordance with claim resolution process. See Motion ¶ 35.	Completion of the distribution contemplated in the order, the funding of professional fees and payment of US Trustee, the Debtors shall file a COC with the Dismissal Order attached. See Dismissal Order.	U.S. Trustee based on the releases and claims resolution process. Objections based on taxes due. Limited Objections from Landlords.
In re Distrib. Energy Sys. Corp., No. 08-11101 [D.I. 844, 889, and 891]	KG	Yes	Debtors and Committee requested issuance of injunction, enjoining all entities who have actions against the Debtors, Creditors Trustee, and Committee and officers and directors shall be forever released and waived arising prior to the Chapter 11 cases in	None	Parties entered into a Credit Trust Agreement to distribute funds for distributions to general unsecured creditors. See Dismissal Motion § 5.	Condition to Dismissal: (i) entry of an order concerning the final fee applications and (ii) final resolution, settlement or adjudication of an Adversary Proceeding.	U.S. Trustee objection based on argument that Administrative Expense and Priority Claims are not required to be paid in full, distributions to a class of creditors without acceptance of a plan, improper injunctive release concerning release provisions.

Case / Docket Nos.	Judge	Motion Granted?	Release / Exculpation Provision?	Distribution / claims reconciliation	Carveout / "gift" trust	Other / Conditions to dismissal?	Who Objected / basis?
			any way related to the Chapter 11 cases. See Motion at ¶ 35 and Proposed Order with Motion. **However, not included in Final Order.**				
In re Pappas Telecasting, Inc., No. 08-10916 [D.I. 2085, 2121 & 2132]	PJW	Yes	Releasing Chapter 11 Trustee and its consultants, advisors and Agents in connection with the Motion. See Dismissal Order.	All claim objections filed by the Trustee have been prosecuted by entry of an order of the court and or otherwise resolved. See Motion ¶ 40.	All unpaid priority claims and administrative claims were paid by using Carve Out Cash. See Motion ¶ 44.	None	None
In re CFM U.S. Corp., No. 08-10668 [D.I. 1017, 1097 & 1282]	KJC	Yes	Yes - as Part of Settlement released Debtor, Committee, Ontario Teachers' Pension Plan Board and their board of directors, officers, etc. for matters dealt with in the Chapter 11 Cases. See Order Approving Settlement ¶ 12.	None	The parties agreed pursuant to the Distribution Agreement to put $3,100,000 in a Carve-Out to pay its professionals and unsecured creditors. See Disbursing Agreement	Disbursements had to be made as condition to dismissal. See Dismissal Order ¶ 9.	Limited Objection to the Settlement by U.S. Trustee based on not being fair and reasonable, unfair to priority creditors, and may not result in a distribution to creditors.
In re TSIC, Inc., No. 08-10322 [D.I. 2465, 2472, 2475 & 2541]	KG	Yes	None	The Committee was authorized to distribute $500,000 to the general unsecured creditors from the GUC Escrow Account. The procedure of this distribution was outlined in the motion for authorization to implement a structured dismissal.	In order to resolve the Committee's objection to the sale of certain of the Debtors' assets, including certain intellectual property, the Committee, the Debtors and the Purchaser, among other things, created for the exclusive benefit of the general unsecured creditors, an escrow account into which an amount equal to the lesser of (i) $500,000 or	None	Stopen, LLC (a landlord) objection to the Motion to the extent it proposed a distribution that does not include payment to Stopen on account of its claim.

Case / Docket Nos.	Judge	Motion Granted?	Release / Exculpation Provision?	Distribution / claims reconciliation	Carveout / "gift" trust	Other / Conditions to dismissal?	Who Objected / basis?
					(ii) 10% of the gross royalties earner and ultimately paid for the period of January 1, 2009 through December 31, 2009, in connection with the IP acquired from the Debtors. Ultimately, the purchaser funded the GUC Escrow Account in the amount of $500,000.		
In re Thompson Prods., Inc., No. 08-10319 [D.I. 485, 512 & 542]	PJW	Yes	No - removed from Final Order approving Stipulation and Dismissal	Stipulation provides for (i) debtors remaining cash to be distributed to creditors holding allowed administrative expenses; (ii) funding of professional fee escrow; and (iii) agreement of parties governing the allowance of administrative expenses. See Dismissal Order ¶ 4.	None	Disbursements had to be made as condition to dismissal. See Dismissal Order ¶ 5.	U.S. Trustee on the basis of the distribution to creditors without a plan, impermissible exculpation liability, and no legal basis for structured dismissal.
In re Wickes Holdings, LLC, No. 08-10212 [D.I. 1346 & 1418]	KJC	Yes	Debtors, Committee, and officer's directors in connection with Motion or the Order. See Dismissal Order ¶ 5.	Claims allowed in amounts submitted in the dismissal motion, in the absence of an objection. See Motion ¶ 25.	Carved out certain funds the secured lender was entitled to receive for the benefit of unsecured creditors. See Dismissal Order ¶ 2.	None	Objection by various parties with administrative claims. U.S. Trustee based on Distribution under the Trust Agreement.

Case / Docket Nos.	Judge	Motion Granted?	Release / Exculpation Provision?	Distribution / claims reconciliation	Carveout / "gift" trust	Other / Conditions to dismissal?	Who Objected / basis?
In re Magnolia Energy, L.P., No. 06-11069 [D.I. 183 & 196]	MFW	Yes	No	Debtors entered into a refinance agreement which allowed them to repay all secured and unsecured claims against the Debtors and administrative expenses. See Motion ¶ 10.	None	Disbursements had to be made as condition to dismissal and dismissal not effective until filed a Certification that the Closing had occurred. See Dismissal Order ¶ 7.	Limited Objection by the Committee to the extent the dismissal is preemptive and premature for failing to provide for payment of unsecured creditors. Limited Objection by the U.S. Trustee on the basis that the motion is premature prior to closing of the Refinancing Transaction.
In re New Weathervane Retail Corp., No. 04-11649 [D.I. 543 & 566]	PJW	Yes	Debtors and Committee and officers and directors, etc. in connection with the Motion. See Dismissal Order.	Creditors were required to object to amounts stated in the dismissal motion and pay the costs associated with contesting any such objection. See Dismissal Order	Carveout Fund created and distributed to creditors to be paid to Professionals and unsecured creditors. See Dismissal Order.	Debtors shall provide a report to the Trustee after distributions were made as contemplated in the Order. See Dismissal Order.	None
In re Golf America Stores, Inc., No-02-12131 [D.I. 534 & 544]	PJW	Yes	None	Portion of Leasehold Proceeds to be distributed to general unsecured creditors on a pro rata basis based upon claim amounts and proofs of claims. See Dismissal Order.	None	None	None

that section 365(n) should be amended to address certain unique aspects of trademark licenses, including a provision that would allow a debtor in possession to monitor quality control, but otherwise not impose obligations on the debtor in possession if the license is rejected. The Commission also agreed that section 365(n) needs to expressly require a nondebtor licensee electing to retain its rights under the trademark license to comply in all respects with the license and any related agreements, including with respect to (i) the products, materials, and processes permitted or required to be used in connection with the licensed marks; and (ii) any of its obligations to maintain the sourcing and quality of the products or services offered under or in connection with the licensed marks.

6. Real Property Leases

Recommended Principles:

- The trustee's time to assume or reject unexpired nonresidential real property leases under section 365(d)(4) of the Bankruptcy Code should be extended from 210 days to one year after the petition date or date of the order for relief, whichever is later, in the interest of enhancing prospects for reorganization.
- The calculation of postpetition rent under a real property lease should be calculated under the accrual method, allowing the trustee to treat rent accrued prior to the petition date as a prepetition claim and rent accrued on and after the petition date as a postpetition obligation. The trustee should be required to pay any such postpetition rent obligation on or before 30 days after the petition date or date of the order for relief, whichever is later. The trustee should pay all subsequent rent obligations accruing postpetition but prior to any rejection of the lease on a timely basis in accordance with the terms of the lease.
- A landlord's claim for unperformed obligations under section 365(d)(3) should apply only to monetary obligations. Such claim for unperformed monetary obligations should not receive superpriority treatment, but should instead constitute an administrative claim under section 503(b)(1) that is payable under section 507(a)(2).
- The meaning of the term "rent" under section 502(b)(6) should not be based on whether an obligation is labeled as "rent" under the lease. Rather, the Bankruptcy Code should define "***rent***" as any recurring monetary obligations of the debtor under the lease.
- The calculation of rejection damages for real property leases under section 502(b)(6) should be clarified as follows:

  The claim of a lessor for damages resulting from the termination of a lease of real property shall not exceed:

  (i) The greater of (A) the rent reserved for one year under the lease following the termination date and (B) the alternative rent calculation; plus
  (ii) Any unpaid rent due under the lease on the termination date.

For purposes of this section:

*The "**alternative rent calculation**" is the rent reserved for the shorter of the following two periods: (a) 15 percent of the remaining term of the lease following the termination date and (b) three years under the lease following the termination date.*

*The "**termination date**" is the earlier of the petition date and the date on which the lessor repossessed, or the lessee surrendered, the leased property.*

In calculating the rent due or reserved under the lease, such calculation should be done without acceleration.

- A landlord should be required to make reasonable efforts to mitigate damages in the event that the trustee rejects the lease under section 365, regardless of whether mitigation is required by applicable nonbankruptcy law. Any mitigation or cover received by, or security deposit held by, the landlord should reduce the landlord's prepetition claim for purposes of calculating the section 502(b)(6) claim. A landlord's obligation to mitigate damages should continue through the claims objection deadline or the date of the order allowing the claim, whichever is earlier.
- A landlord's claims for the debtor's acts and omissions resulting in damage to the real property, other than those claims relating to the rejection of the lease or for rent under the lease, should not be subject to section 502(b)(6). The landlord should be permitted to assert any such claim as a prepetition claim against the estate, subject to the trustee's or a party in interest's right to object and the general claims allowance process.

Real Property Leases: Background

Many chapter 11 debtors have one or more unexpired leases of nonresidential real property as of the petition date. These leases may be for the debtor's headquarters, stores, warehouses, or factories. They may be necessary to the debtor in possession's[470] reorganization efforts or otherwise represent valuable assets that the debtor in possession can use to maximize the value of the estate. Alternatively, they may be above-market leases or used in a part of the business being closed or downsized through the reorganization. In either scenario, a debtor in possession's ability to assume, assign, or reject unexpired leases of nonresidential real property is important to the resolution of its case.

The Bankruptcy Code includes several provisions that specifically address the rights and obligations of the debtor in possession and the nondebtor landlord under unexpired leases of nonresidential real property leases. For example, section 365(d)(3) requires the debtor in possession to timely perform obligations "arising from and after the order for relief under any unexpired lease of nonresidential real

470 As previously noted, references to the trustee are intended to include the debtor in possession as applicable under section 1107 of the Bankruptcy Code, and implications for debtors in possession also apply to any chapter 11 trustee appointed in the case. *See supra* note 76 and accompanying text. *See generally* Section IV.A.1, *The Debtor in Possession Model.*

property, until such lease is assumed or rejected."[471] In addition, section 365(d)(4) requires the debtor in possession to assume or reject any nonresidential real property lease within 120 days after the petition date, with one 90-day extension of that deadline for cause.[472] The debtor in possession generally is given until plan confirmation to assume or reject executory contracts and other kinds of leases.[473]

Commentators and practitioners have raised issues concerning several of these provisions. Many commentators have criticized the shortened deadline for the debtor in possession to assume, assign, or reject a nonresidential real property lease under section 365(d)(4) of the Bankruptcy Code.[474] Prior to the BAPCPA Amendments, a debtor in possession had an initial 60 days to review its unexpired nonresidential leases, but it could obtain one or more extensions of this deadline for cause and with court approval.[475] Some commentators and landlords believed that courts were granting debtors in possession very lengthy extensions of the section 365(d)(4) deadline on a routine basis.[476] They believed that these open-ended extensions significantly impaired the landlords' rights under the leases and nonbankruptcy law, as well as their ability to identify substitute lessees and negotiate substitute leases in a timely manner.[477]

As a result of the BAPCPA Amendments, section 365 provides a debtor in possession with 210 days following the petition date to decide whether it will assume or reject each of its nonresidential real property leases, unless the applicable landlord consents to an extension of this deadline. Some commentators suggested, immediately following the BAPCPA Amendments, that this single change to the Bankruptcy Code would discourage large retail chains from filing chapter 11 petitions.[478] Large retail chains, in particular, frequently have hundreds of unexpired nonresidential real property leases as of the petition date, and the prospect of reviewing and making prudent assumption or rejection decisions for each location within 210 days of the petition date, according to these commentators, would likely be too daunting and thus discourage filings in the first place.[479] Empirical and anecdotal evidence since 2005 suggests that this change in a debtor in possession's time to assume or assign nonresidential real property leases is at least a contributing factor to both the decline in retail filings and the results that were achieved in certain retail debtor cases since 2005.[480]

471 11 U.S.C. § 365(d)(3).
472 *Id.* § 365(d)(4).
473 *Id.* § 365(d)(2).
474 *Id.* § 365(d)(4).
475 *Circuit City Unplugged: Why Did Chapter 11 Fail to Save 34,000 Jobs?, Hearing before the H. Subcomm. on Commercial and Administrative Law*, 111th Cong. 96 (2009) (statement of Professor Jack F. Williams, Robert M. Zinman ABI Resident Scholar (2008–09)) [hereinafter Williams Statement].
476 *See, e.g., Written Statement of Elizabeth Holland on behalf of the International Council of Shopping Centers: NYIC Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, at 2 (June 4, 2013) (discussion prior law), *available at* Commission website, *supra* note 55. *See generally Transcript, NYIC Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, *available at* Commission website, *supra* note 55.
477 "The deadline was originally enacted to address problems caused by extended vacancies or partial operation by a debtor of tenant space located in shopping centers which reduced customer traffic to other nondebtor tenants due to delays in debtors deciding whether to assume or reject real property leases." *In re* FPSDA I, LLC, 450 B.R. 392, 399 (Bankr. E.D.N.Y. 2011).
478 *See, e.g.*, Williams Statement, *supra* note 475, at 97 ("Professor Ken Klee suggests one other possible outcome — retail debtors with a significant number of leases will simply refuse to file voluntary petitions during slower periods and will instead wait to be forced into involuntary cases.") (citations omitted).
479 *See, e.g., id.* at 96–97; *Written Statement of John Collen, Partner, Tressler LLP: NCBJ Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, at 2–3 (Apr. 26, 2012) (stating that 210 days may not be sufficient for a debtor to make an informed decision), *available at* Commission website, *supra* note 55; *Written Statement of Commercial Finance Association: CFA Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, at 8 (Nov. 15, 2012) (stating that the 210-day period to assume or reject a nonresidential lease is too short, discourages reorganization, and impairs secured creditor recoveries), *available at* Commission website, *supra* note 55.
480 *See* Kenneth Ayotte, *An Empirical Investigation of Leases and Executory Contracts*, (paper presented at 2014 symposium) (draft on file with Commission) (finding that BAPCPA is "associated with a significantly lower probability of reorganization for the most lease-intensive firms"). *See also Written Statement of Gerald Buccino: TMA Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, at 5 (Nov. 3, 2012) (arguing that the 210-day period is insufficient, particularly for retail debtors), *available*

Courts also take different approaches to calculating the timely payments a debtor in possession is obligated to make under its nonresidential real property leases pursuant to section 365(d)(3). Some courts determine the prepetition or postpetition status of rent amounts owed by a debtor in possession using a billing approach based on the landlord's invoice date.[481] Other courts take an accrual approach and allocate the outstanding amounts between the prepetition and postpetition periods accordingly.[482] Courts also differ on the priority accorded to any unpaid postpetition amounts due under section 365(d)(3).[483]

Similarly, if a debtor in possession rejects a nonresidential real property lease, the landlord's claim for rejection damages is generally subject to the cap provided by section 502(b)(6) of the Bankruptcy Code. Section 502(b)(6) generally "limits a landlord's 'damages resulting from the termination of a lease of real property' to an amount equal to the rent the debtor-tenant would have paid for a period of one to three years, depending on the remaining term of the lease."[484] The calculation of the section 502(b)(6) cap, as well as what constitutes rent or otherwise should be included in the calculation, often produces litigation and uncertain results in chapter 11 cases.[485] Notably, courts are split regarding the application of the section 502(b)(6) cap to nontermination damages relating to the lease, which could constitute millions of dollars and significantly impact unsecured creditors' *pro rata* share of estate assets.[486]

at Commission website, *supra* note 55; *Written Statement of Elizabeth Holland on behalf of the International Council of Shopping Centers: NYIC Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, at 4–5 (June 4, 2013) (testifying that the primary problem in retail reorganizations is lender control and stating that "[l]enders are sometimes willing to provide *only* enough financing to position a debtor for liquidation in the first few months of the case, and then impose restrictive covenants in post-petition financing agreements that either direct an immediate liquidation of the company, or include covenants or borrowing reserve rights that effectively allow the lender to 'pull the plug' on the retailer only a few months into the case"), *available at* Commission website, *supra* note 55; *Written Statement of Lawrence C. Gottlieb, Partner, Cooley LLP: NYIC Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, at 4–5 (June 4, 2013) (explaining the tension in the timing regarding the desire of the secured creditor to liquidate the debtors' assets and the ability of the debtor to effectively conduct going-out-of-business ("***GOB***") sales at its retail locations; given the 210-day limit set by BAPCPA and given the fact that a GOB sale takes at least 120 days in most cases, the debtor has 30 to 90 days to sell its company; landlords are also unwilling to negotiate, which increases the prevalence of quick liquidations in retail cases), *available at* Commission website, *supra* note 55; *Written Statement of Holly Felder Etlin: ASM Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, at 2–3 (Apr. 19, 2013) (stating that the 210-day limit to assume or reject nonresidential leases puts retailers in a timing pinch; because GOB sales generally take at least 120 days and must take place in their retail locations, the 210-day limit to assume or reject leases puts inordinate pressure on debtors to decide within 90 to 120 days after filing to either quickly file a chapter 11 plans while complying with all their lenders' requirements, or to liquidate; also stating that the 210-day deadline to assume or reject nonresidential leases means it is nearly impossible for a middle-market retail company to do anything but conduct a GOB sale), *available at* Commission website, *supra* note 55.

481 *See* Centerpoint Props. v. Montgomery Ward Holding Corp. (*In re* Montgomery Ward Holding Corp.), 268 F.3d 205, 209–10 (3d. Cir. 2001); *Written Statement of Elizabeth Holland on behalf of the International Council of Shopping Centers: NYIC Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, at 6–8 (June 4, 2013) (describing how this "stub rent" problem means that landlords are, perhaps unfairly, losing money because of the timing of debtors' bankruptcy filings), *available at* Commission website, *supra* note 55.

482 *See In re* Stone Barn Manhattan LLC, 398 B.R. 359, 362–65 (Bankr. S.D.N.Y. 2008) (using the accrual method but providing historical overview and case cites of the accrual versus billing date approach).

483 *Compare In re* Oreck Corp., 506 B.R. 500 (Bankr. M.D. Tenn. 2014) (holding that debtor's obligation to pay occurred prepetition was not subject to priority treatment) *with In re* Leather Factory Inc., 475 B.R. 710 (Bankr. C.D. Cal. 2012) (holding that "stub rent" owed to landlord was a priority administrative claim).

484 11 U.S.C. § 502(b)(6); Michael St. Patrick Baxter, *The Application of § 502(b)(6) to Nontermination Lease Damages: To Cap or Not to Cap?*, 83 Am. Bankr. L. J. 111 (2009).

485 *See, e.g., In re* Heller Ehrman LLP, 2011 WL 635224 (N.D. Cal. Feb. 11, 2011) (discussing challenges in determining remaining term of lease); *In re* Titus & McConomy, LLP, 375 B.R. 165 (Bankr. W.D. Pa. 2007) (holding that, because one year's rent was greater than 15 percent of remaining term of lease following petition date, section 502(b)(6)(A) determined amount of cap was equal one year's rent).

486 Baxter, *supra* note 484, at 113–14.

Real Property Leases: Recommendations and Findings

The Commission reviewed several issues relating to nonresidential real property leases. Several Commissioners voiced strong concerns regarding the shortened deadline for a debtor in possession to assume or reject nonresidential real property leases under section 365(d)(4). The Commissioners suggested that the current deadline is preventing potential debtors from using chapter 11, at least on a voluntary and timely basis, and is making it more difficult for retail chains to reorganize their businesses.[487] The Commissioners also noted that the 210-day deadline is misleading because postpetition lenders have been requiring debtors in possession to make their decisions about nonresidential real property leases as early as 120 to 150 days after the petition date to permit these lenders to preserve their security interests in the debtors' leaseholds before the expiration of the section 365(d)(4) deadline.[488]

Other Commissioners, while acknowledging these troubling facts, emphasized the need to balance the concerns raised by landlords before the BAPCPA Amendments when courts were granting very lengthy extensions.[489] They encouraged the Commission to find a compromise that would provide more flexibility to debtors in possession to secure financing and to review their unexpired leases within a reasonable time frame without eliminating the certainty that section 365(d)(3) currently

487 *See, e.g.*, Sharon Bonelli, Isabel Hu, Gregory Fodell, *U.S. Retail Case Studies in Bankruptcy Enterprise Value and Creditor Recoveries*, Fitch Ratings, Apr. 16, 2013; *Written Statement of Lawrence Gottlieb, Partner, Cooley LLP: NYIC Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, at 3 (June 4, 2013) ("The deadline established under BAPCPA for a debtor to assume or reject unexpired leases of nonresidential property has had a substantial and unfortunate affect on retailers' ability to meet liquidity needs and obtain extended postpetition financing — the lynchpin to any successful retail reorganization."), *available at* Commission website, *supra* note 55; *Written Statement of Gerald Buccino: TMA Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11* (Nov. 3, 2012) (noting that the maximum time limit to assume or reject nonresidential real property leases should be amended, as it takes time to thoroughly assess whether a lease should be maintained for the value of reorganization efforts), *available at* Commission website, *supra* note 55; *Oral Testimony of Grant Stein: AIRA Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, at 3 (June 7, 2013) (AIRA Transcript) (noting that the court should allow more time for the assumption or rejection if it is appropriate in the circumstances), *available at* Commission website, *supra* note 55; *First Report of the Commercial Fin. Ass'n to the ABI Comm'n to Study the Reform of Chapter 11: Field Hearing at Commercial Fin. Ass'n Annual Meeting*, at 8–9 (Nov. 15, 2012) ("Debtors and their secured and unsecured creditors must make decisions about whether to retain leases in a period of time that is often unrealistically short. As a result, businesses that might have been reorganized or sold as going concerns to new owners are liquidated instead. Because they know that debtors with significant leases will have difficulty reorganizing, lenders are less willing to support reorganizations with DIP financing. They do not want to begin lending money to a chapter 11 debtor only to have to choose, 7 months later, between agreeing to an unfavorable deal with a landlord that has such significant leverage and liquidating the debtor, possibly at a loss to the lender. So they simply refuse to provide DIP financing in the first place, forcing debtors to liquidate before they have had an opportunity to make operational changes, regardless of the potential for reorganization. In addition, going concern asset sales (a frequent form of 'reorganization' without a plan) become more difficult and less advantageous to creditors and owners because buyers have insufficient time to assess the value of an enterprise with important leases. Uncertainty about value always results in lower prices and therefore lower payments to creditors. Worse, such uncertainty can render going concern sales so difficult that they are not even pursued, again resulting in otherwise avoidable liquidations."), *available at* Commission website, *supra* note 55.

488 *See Written Statement of Lawrence C. Gottlieb, Partner, Cooley LLP: NYIC Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, at 4–5 (June 4, 2013) (stating that the deadline should be expanded to allow time for a debtor to secure postpetition financing and conduct a going-out-of-business sale and stating that prepetition lenders often demand provisions that result in a liquidation sale before the expiration of the 210-day period), *available at* Commission website, *supra* note 55. *But see Written Statement of David L. Pollack, Partner, Ballard Spahr LLP: NYIC Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, at 2–3 (June 4, 2013) (stating that neither section 365(d)(4) time limits nor commercial landlords are causing retailers to fail and providing specific case examples to support assertion; also noting that retailers are failing because of other reasons, such as DIP financing conditions and reluctance of trade creditors to continue to extend credit), *available at* Commission website, *supra* note 55. *See also* Ayotte, *An Empirical Investigation of Leases and Executory Contracts*, *supra* note 480 (finding that the seven-month limit to assume or reject a commercial lease instituted by BAPCPA (absent an extension from the landlord) "accelerated real estate lease disposition decisions"). *See generally supra* note 66 and accompanying text (generally discussing limitations of chapter 11 empirical studies).

489 *See, e.g., Written Statement of Elizabeth Holland on behalf of the International Council of Shopping Centers: NYIC Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, at 2 (June 4, 2013) ("The 2005 amendments that created more certainty for shopping center owners now provide an important 'firewall' which prevents the failure of one retailer from cascading to other businesses. Under the prior law, lingering uncertainty caused neighboring stores to suffer from reduced traffic and sales while potential new tenants were reluctant to rent space in a shopping center with an uncertain future. For property owners, the contraction in credit has been even more problematic; a bankrupt tenant can cause a shopping center to default on a mortgage with no ability to cure the default. Such defaults include covenants to maintain minimum occupancy and debt service coverage."), *available at* Commission website, *supra* note 55.

provides to landlords.[490] After considering and debating different approaches that ranged from reversion to the pre-BAPCPA standard to maintenance of the *status quo*, the Commission voted to provide the debtor in possession one year from the petition date to make its assumption, assignment, or rejection decision with respect to nonresidential real property leases.

The Commission also discussed the split in the courts regarding the method — *i.e.*, the billing approach or the accrual approach — that should be used to determine whether certain rent owed under the lease should be deemed a prepetition or a postpetition obligation. The Commission reviewed case law citing both approaches to determine which approach should be adopted and codified, and focused its efforts on creating, first and foremost, a uniform standard. Ultimately, the Commission decided that the accrual method, which allocates rent between the prepetition and postpetition periods based on the date of filing, was a fair method and most closely aligned with the purpose of section 365(d)(3).

The Commission further considered the scope of a debtor in possession's obligations under section 365(d)(3). Some of the Commissioners commented on the ambiguity in the case law regarding which obligations were captured by section 365(d)(3) and how those obligations, if deferred or unpaid, should be treated. With respect to which obligations should be deemed "rent," the Commission reviewed the language of section 365(d)(3), which references section 365(b)(2), but not historical nonmonetary obligations in section 365(b)(1). The Commissioners debated whether this omission in the statute suggests that a debtor in possession should be required to perform all nonmonetary obligations on and after the petition date as provided in section 365(d)(3). Several Commissioners, however, highlighted that such a reading of section 365(d)(3) may be inconsistent with the Commission's recommended policies and approaches. Specifically, these Commissioners asserted that a debtor in possession (i) should not be required to perform under any executory contracts or unexpired leases, except to pay for postpetition goods and services (including rent), pending assumption or rejection; and (ii) should not be required to cure nonmonetary defaults that occurred prior to assumption. In light of these recommendations and the Commission's proposal for a relatively modest extension of the section 365(d)(4) deadline, the Commission decided to recommend limiting section 365(d)(3) to monetary obligations under the leases and to provide ordinary administrative priority (not superpriority) to any such unpaid or deferred obligations under section 365(d)(3).

In addition, the Commissioners evaluated the inconsistent application of section 502(b)(6) to calculate the maximum amount of a landlord's rejection damages. The Commission agreed with courts that have held that whether a given obligation is labeled as "rent" under a lease should not determine whether such obligation is subject to the section 502(b)(6) cap. The Commissioners identified obligations that have been commonly considered as "rent" (*e.g.*, monthly payments for occupying the property (including base rent, additional rent, percentage rent), common area

490 *Id.* at 2 (June 4, 2013) (stating that the time limits for debtors to assume or reject a nonresidential lease introduced by BAPCPA have "provid[ed] shopping center owners with reasonable certainty as to the disposition of leases, have prevented deterioration in shopping center properties and helped owners have access to credit to finance construction and renovation"), *available at* Commission website, *supra* note 55; *Oral Testimony of the Honorable Melanie Cyganowski (Ret.), former U.S. Chief Bankruptcy Judge, E.D.N.Y.: CFA Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, at 19 (Nov. 15, 2012) (CFA Transcript) (stating that it would be beneficial to the court and will encourage more secured lenders to support middle-market borrowers if the BAPCPA Amendments relating to lease and plan deadlines were repealed, or at a minimum amended to provide judicial discretion to be exercised to modify the deadlines as appropriate), *available at* Commission website, *supra* note 55.

maintenance charges, taxes, and insurance) and determined that the definition of "rent" suggested by the advisory committee — "any recurring monetary obligations of the debtor under the lease" — adequately captured these obligations. The Commissioners also analyzed the varying interpretations and applications of the formula for calculating the cap on rejection damages under section 502(b)(6). The Commission agreed that many courts have confused or misapplied the formula and that, simply stated, the cap should be the rent reserved under the lease for the greater of (i) one year and (ii) the shorter of 15 percent of the remaining term and three years, plus unpaid rents. Accordingly, the Commission voted to recommend clarifying the calculation formula.

Finally, the Commission considered the treatment of nontermination damages that a landlord may assert against the estate. These claims typically arise out of the debtor's use or occupancy of the property and are not related to the debtor's rejection of the lease. Notably, section 502(b)(6) applies to, and limits, "the claim of a lessor for damages resulting from the termination of a lease of real property." Accordingly, the Commission agreed that a landlord should be able to file a prepetition claim against the estate, to the extent that the landlord can establish a legal basis and adequate factual support for such claim, for damages not resulting from the rejection of the lease. Such claim would be subject to the claims objection and allowance process under the Bankruptcy Code.

B. Use, Sale, or Lease of Property of the Estate

Section 363 of the Bankruptcy Code addresses the debtor in possession's use, sale, or lease of property during the chapter 11 case. Section 363(c) permits the debtor in possession to engage in certain of these transactions in the ordinary course of business without court approval.[491] If the debtor in possession wants to use, sell, or lease property outside the ordinary course of business, section 363(b) requires, among other things, notice and a hearing, and prior court approval.[492] Section 363(f), in turn, allows the debtor in possession to sell property free and clear of any interest in such property under certain circumstances.[493]

1. General Provisions for Non-Ordinary Course Transactions

Recommended Principles:

- Except in the context of a sale of all or substantially all of a debtor's assets (*i.e.*, a section 363x sale), the court should approve the use, sale, or lease of a debtor's assets outside the ordinary course of business only if the court finds by a preponderance of the evidence that the trustee exercised reasonable business judgment in connection with the proposed transaction. This approach often is

491 11 U.S.C. § 363(c)(1). Nevertheless, if a debtor is selling, leasing, or using assets that constitute "cash collateral," then the debtor must obtain the secured creditor's consent or court approval. *Id.* § 363(c)(2).
492 *Id.* § 363(b).
493 *Id.* § 363(f).

referred to as an "enhanced" or "intermediate" level of review that considers not only the process adopted by the board of directors (or similar governing body) to approve the transaction but also the reasonableness of the decision itself.

- Only the trustee should be able to propose the use, sale, or lease of a debtor's assets outside the ordinary course of business. Accordingly, no change to existing law is suggested on this point.
- A secured creditor's collateral should not be subject to a mandatory surcharge in favor of the estate but the court should retain the authority to make appropriate allocations of value to the estate as may be warranted under the circumstances pursuant to sections 506(c) and 552(b) of the Bankruptcy Code, as clarified by the related principles. *See* Section VI.C.3, *Section 506(c) and Charges Against Collateral*; Section VI.C.4, *Section 552(b) and Equities of the Case.*
- For the standard of review governing section 363x sales, see Section VI.B, *Approval of Section 363x Sales.*

General Provisions for Non-Ordinary Course Transactions: Background

In general, section 363(b) of the Bankruptcy Code provides that the debtor in possession,[494] "after notice and a hearing, may use, sell, or lease, outside the ordinary course of business, property of the estate."[495] The debtor in possession can use, sell, or lease a single asset, multiple assets, a division, or more. A sale of all or substantially all of the debtor's assets is addressed separately in these principles and is subject to a different standard of review and additional procedures.[496]

Under section 363(b), a debtor in possession generally must provide at least 21 days' notice of a motion to approve a proposed use, sale, or lease of property.[497] In general, any party in interest may object to the motion. At the hearing, the debtor in possession bears the burden of proof on the motion and generally must satisfy that burden by a preponderance of the evidence.[498] Courts generally evaluate section 363(b) motions under a business judgment standard. More precisely, courts often state they will approve the motion only if it represents an exercise of the debtor in possession's sound business judgment.[499] But, courts are not always clear or consistent in explaining the factors they consider under this business judgment standard.

494 As previously noted, references to the trustee are intended to include the debtor in possession as applicable under section 1107 of the Bankruptcy Code, and implications for debtors in possession also apply to any chapter 11 trustee appointed in the case. *See supra* note 76 and accompanying text. *See generally* Section IV.A.1, *The Debtor in Possession Model.*

495 *Id.* § 363(b).

496 *See* Section VI.B, *Approval of Section 363x Sales.*

497 Fed. R. Bankr. P. 2002.

498 *In re* Lionel Corp., 722 F.2d 1063, 1071 (2d Cir. 1983) ("[A] debtor applying under § 363(b) carries the burden of demonstrating that a use, sale or lease out of the ordinary course of business will aid the debtor's reorganization . . ."); *In re* Telesphere Commc'ns, Inc., 179 B.R. 544, 552 (Bankr. N.D. Ill. 1994) ("[T]he proponent of the sale bears the ultimate burden of persuasion . . ."); *In re* Ionosphere Clubs, Inc., 100 B.R. 670, 675 (Bankr. S.D.N.Y. 1989) ("[Debtor] clearly bears the burden of demonstrating that a sale of property out of the ordinary course of business under § 363(b) of the [Bankruptcy] Code will aid [debtor's] reorganization and is supported by a good business justification.").

499 *In re* On-Site Sourcing, Inc., 412 B.R. 817, 822 (Bankr. E.D. Va. 2009) ("'A § 363(b) sale is generally viewed as quicker. Only a motion and a hearing are required, and most courts apply a 'business judgment test' to determine whether to approve the sale.'") (quoting *In re* Gulf Coast Oil Corp., 404 B.R. 407, 415 (Bankr. S.D. Tex. 2009)).

Jul 28, 2015

The Examiners

The Examiners: Assure Consumers That Gift Cards, Privacy Will be Protected

- By Perry Mandarino

Do shoppers suffer too much in bankruptcy, or should they be expected to share the pain?

Many sectors go through cycles of restructurings and bankruptcies, but retail has consistently been a troubled sector that draws the watchful eye of lenders, trade creditors and restructuring professionals. The ever-changing tastes of consumers, technology and macroeconomic factors that drag on consumer spending and confidence are among the factors that put retailers at higher risk for operational and financial distress. Consumers' emotions tend to run high when they see their favorite store in a distressed situation, especially if they have a gift card or are part of a loyalty program.

The 2005 amendment to the bankruptcy code gave certain counterparties, specifically trade vendors and landlords, significant leverage and extra protection. These changes shifted the dynamic in retail cases as debtors have potentially more administrative claims and less time to reject leases. However, consumer programs—which include gift cards, return policies and other loyalty programs—have generally fallen under the protection of state attorneys general.

The impact of a retailer bankruptcy or restructuring on consumer programs varies depending on the nature of the case. For example, in a reorganization or sale of a company, it is common for a buyer to assume the full amount of the consumer program liabilities in order to protect the brand and maintain their customers' loyalty.

It is the instance of a liquidation in which things get a little tricky. Generally, in a liquidation, a third party is brought in to manage the process under an equity or fee arrangement. Through a process that includes competitive bidding, the liquidation firm will guarantee a recovery of the retailer's inventory, e.g. 107% of the cost value of the inventory. Included in that

guarantee will be a provision for customer programs. Generally, pre-petition customer programs are honored for a truncated time during the liquidation, due to economics. If the consumer programs were to be honored for the entire liquidation, the guaranteed recovery would be less, making an impact on the estate. Under this scenario, state attorneys general have become active and have taken positions to better protect consumers by requiring the lengthier honoring of pre-petition customer programs.

In the end, it's up to consumers to be cognizant of the potential they'll be affected. They need to understand what asset they have—whether it's a gift card or benefits of a loyalty program—and exercise it in an adequate amount of time. Consumers holding a gift card or store credit are unsecured creditors and under the bankruptcy code should be treated accordingly.

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- By Anders J. Maxwell

Do shoppers suffer too much in bankruptcy, or should they be expected to share the pain?

A plethora of laws and advocacy groups protect the interests of U.S. consumers. Of greater concern should be the escalating rate of store closures and business failures among retailers ranging from Target and J.C. Penney JCP -0.49%to RadioShack RSHCQ +8.25%and Wet Seal as these affect jobs, incomes and property values.

The issue is threefold. It has long been recognized that retail is overburdened by real estate. The country by most metrics is overstored with, for example, 20 square feet per capita of shopping center space compared to the runner-up, the U.K., at only 3 square feet. This fixed investment increases operating leverage on businesses already subject to volatile product cycles and compressed margins.

Second, consumer spending continues to be depressed by anemic household incomes. This pressure is compounded by increasing competition from large international retailers, such as H&M HM-B.SK +0.15%, Ikea and Uniqlo owner Fast Retailing 9983.TO +3.31%.

A third factor is the demonstrative shift in shopping habits reflected in a migration of sales to the internet. Mail order and ecommerce, which account for nine percent of total retail sales, are projected to continue to grow at double-digit rates. Not only does this shift force more closures, but it also further degrades margins due to price discovery afforded the consumer. The impact of the Internet's easy access to highly efficient distributors such as Amazon and Wal-Mart WMT +1.00%shows no sign of abating.

In addition to these daunting business issues, the bankruptcy code was amended in 2005 to reduce, to seven months, the time for a faltering retailer to assume or reject leases. Effectively curtailing the option on a selling season to recover sales, this compressed timetable increases the risk of liquidation for retailers forced into bankruptcy.

In short, disgruntled shoppers should stand in line behind struggling creditors and suffering shareholders as the retail industry charts a course through increasingly turbulent markets.

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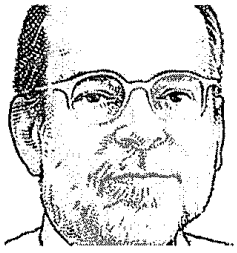
Jul 28, 2015

The Examiners

The Examiners: Assure Consumers That Gift Cards, Privacy Will be Protected

- By Mark Roe



Do shoppers suffer too much in bankruptcy, or should they be expected to share the pain?

Brick-and-mortar retailing is in upheaval. The Internet is changing the way people shop and buy, in case any brick-and-mortar retailer hasn't yet noticed. Traditional retailers that can't adjust quickly enough will end up in chapter 11. When one does, customers can face problems with their gift cards, warranty claims, return-if-not-satisfied privileges and assurances of privacy protection regarding their customer information.

RadioShack RSHCQ +8.25%is one of the retailers in bankruptcy. The Texas attorney general sued RadioShack over unused gift cards and vowed to protect consumer privacy in RadioShack's bid to sell consumer data.

How should these consumer claims be handled in bankruptcy? At base, they are unsecured claims, only some of which are entitled to any priority even among unsecured claims. For a nationwide retailer that closes some stores but restructures others with its basic business continuing, management typically will want to honor consumer claims and will want to announce that it is doing so right away so as to keep customers' goodwill. Even if the consumers' claims are technically debts that are subject to a haircut like other unsecured creditors' debts, there's good reason to think that the harm in goodwill to the organization from not honoring the consumer claims right away (irate customers, bad press, marketplace uncertainty) is a negative for the organization and even for the other creditors. Airlines in bankruptcy, for example, honor their tickets already written—which are no more than claims—and typically, so do retailers that expect to continue operating. It's common for retailers to seek and obtain the judge's approval to make good on their retail customers' claims, as if the retailer wasn't even in bankruptcy.

A case can be made to generalize this custom. While some retailers here or there may not want to honor consumers' claims, particularly if they plan to fully shut down, the economy could be better off if we generalized the custom and thereby made consumers confident that they can use their gift cards, return merchandise and look for warranty support. Consumers do get a priority, but only up to a certain dollar limit, for deposits they've made for purchases from the debtor. This priority could be expanded to cover consumer basics and allow the claims to be paid early or, better yet, to allow the gift cards to be used and the merchandise returned if the warranty permits, without the consumer filing a claim—a stressful process for the uninformed—and without consumers having to wait to be paid at the end of the bankruptcy.

Privacy concerns are in a different category from typical consumer dollar and warranty claims. We value privacy as something different from being just money, and that preference for privacy supports a privacy exception to bankruptcy's basic assignment, breach and sale rules, which allow the bankrupt debtor more leeway inside bankruptcy than outside it in complying with some obligations, like those to honor privacy promises. Just like bankrupt debtors have to comply with ongoing government regulation because it often represents a more substantial public obligation, privacy has a similar public, governmental quality for many Americans—one that should be respected by the bankruptcy process.

Mark Roe is a professor of law at Harvard Law School in Cambridge, Mass.

476 B.R. 812
United States Bankruptcy Court,
S.D. New York.

In re BGI, INC., f/k/a Borders Group, Inc. Debtor.

No. 11–10614 MG. | Aug. 14, 2012.

Synopsis
Background: Holders of unredeemed consumer gift cards issued by Chapter 11 debtors filed post-confirmation motions, seeking entry of an order authorizing them to file untimely proofs of claim, as well as class certification on behalf of all holders of debtors' gift cards. Liquidating trust, as successor to debtors, and liquidating trustee objected to both motions.

Holdings: The Bankruptcy Court, Martin Glenn, J., held that:

[1] the gift card holders were not "known" creditors to whom debtors were required to give direct and actual notice of the claims bar date;

[2] debtors provided adequate constructive notice of bar date to their unknown creditors, including gift card holders; and

[3] gift card holders' failure to act was not the result of excusable neglect.

Motions denied.

West Headnotes (25)

[1] **Bankruptcy**
Notice

Known creditors must be afforded notice reasonably calculated, under all the circumstances, to apprise them of the pendency of the claims bar date.

Cases that cite this headnote

[2] **Bankruptcy**
Notice

Adequate notice to known creditors entails actual written notice of debtor's bankruptcy filing and the claims bar date.

Cases that cite this headnote

[3] **Bankruptcy**
Notice

For unknown creditors, constructive notice of the claims bar date, such as notice by publication, will suffice.

1 Cases that cite this headnote

[4] **Bankruptcy**
Notice

Whether a creditor received adequate notice of a claims bar date in a Chapter 11 case depends upon the facts and circumstances of a given case.

Cases that cite this headnote

[5] **Bankruptcy**
Notice

"Known creditor" of Chapter 11 debtor, for notice purposes, includes both a claimant whose identity is actually known to the debtor or a claimant whose identity is reasonably ascertainable by the debtor.

1 Cases that cite this headnote

[6] **Bankruptcy**
Notice

"Known claim" against Chapter 11 debtor, for notice purposes, arises from facts that would alert the reasonable debtor to the possibility that a claim might reasonably be filed against it.

Cases that cite this headnote

[7] **Bankruptcy**
Notice

"Known creditors" are defined as creditors that a debtor knew of, or should have known of, when serving notice of the claims bar date.

Cases that cite this headnote

[8] **Bankruptcy**
Notice

Holders of unredeemed consumer gift cards issued by Chapter 11 debtors were not "known creditors" to whom debtors were required to give direct and actual notice of claims bar date; gift card holders' status as possible creditors was not known by or reasonably ascertainable to debtors, in that even if debtors could have identified gift cards' purchasers, the cards were not intended to be used by purchasers and debtors would have had no way to trace the ultimate recipients, debtors did not maintain list of card purchasers containing purchasers' contact information, in order to identify potential card purchasers or holders debtors would have had to cross-reference four separate databases run by different companies which contained different customer information, some of which might have been over a decade old, and resulting list would have comprised only fraction of holders of debtors' estimated 17.7 million outstanding gift cards.

1 Cases that cite this headnote

[9] **Bankruptcy**
Notice

With respect to the claims bar date, Chapter 11 debtors were not required to provide notice of the kind required for known creditors to unknown creditors.

Cases that cite this headnote

[10] **Bankruptcy**
Notice

Chapter 11 debtors provided adequate constructive notice of claims bar date to their unknown creditors, including the holders of their unredeemed consumer gift cards; bar date order required debtors to publish bar date notice once, in national edition of New York newspaper, at least 28 days preceding the general bar date, and debtors did so, debtors sent emails to their "rewards" program members, informing them about progress of cases and debtors' eventual liquidation sales, and debtors' notice and claim agent created link on company's reorganization website to lead viewers to page providing link to bar date notice, information about filing proofs of claim, and general bar date. Fed.Rules Bankr.Proc.Rules 2002(*l*), 9008, 11 U.S.C.A.

Cases that cite this headnote

[11] **Bankruptcy**
Notice
Bankruptcy
Process; service

113 termining its creditors, a Chapter 11 debtor is not obligated to try to find and serve notice on any individual who could potentially be a creditor.

Cases that cite this headnote

[12] **Bankruptcy**
Notice

In determining its creditors for notice purposes, it is generally sufficient for a Chapter 11 debtor to scrutinize its own records.

Cases that cite this headnote

[13] **Bankruptcy**
Extension of Time; Excuse for Delay

In cases where creditors have failed to file claims before the bar date despite having notice, the bankruptcy rules give the bankruptcy court the discretion to enlarge the time to file claims where the failure to act was the result of excusable neglect. Fed.Rules Bankr.Proc.Rule 9006(b)(1), 11 U.S.C.A.

1 Cases that cite this headnote

[14] **Bankruptcy**
Extension of Time; Excuse for Delay

"Excusable neglect," as used in bankruptcy rule permitting court to enlarge time to file claims, is a flexible standard that may include inadvertence, mistake, or carelessness, as well as intervening circumstances beyond the party's control. Fed.Rules Bankr.Proc.Rule 9006(b)(1), 11 U.S.C.A.

Cases that cite this headnote

[15] **Bankruptcy**
Extension of Time; Excuse for Delay

Determination of whether party's failure to act was the result of "excusable neglect," within meaning of bankruptcy rule permitting court to enlarge time to file claims, is at bottom an equitable one that must take account of all relevant circumstances surrounding the party's omission. Fed.Rules Bankr.Proc.Rule 9006(b)(1), 11 U.S.C.A.

Cases that cite this headnote

[16] **Bankruptcy**
Extension of time

Four *Pioneer* factors considered by bankruptcy courts in evaluating excusable neglect are as follows: (1) danger of prejudice to debtor, (2) length of delay and its potential impact on judicial proceedings, (3) reason for delay, including whether it was within reasonable control of movant, and (4) whether movant acted in good faith. Fed.Rules Bankr.Proc.Rule 9006(b)(1), 11 U.S.C.A.

Cases that cite this headnote

[17] **Bankruptcy**
Extension of Time; Excuse for Delay

Second Circuit strictly observes bar dates and has adopted what has been characterized as a "hard line" in applying the *Pioneer* test, meaning that bankruptcy courts should focus their analyses primarily on the reason for the delay, and specifically whether the delay was in the reasonable control of the movant. Fed.Rules Bankr.Proc.Rule 9006(b)(1), 11 U.S.C.A.

Cases that cite this headnote

[18] **Bankruptcy**
Extension of Time; Excuse for Delay

Under the *Pioneer* test for evaluating excusable

neglect, the prejudice factor calls for consideration of the overall negative effect, if any, on a debtor and its estate resulting from allowing a late claim. Fed.Rules Bankr.Proc.Rule 9006(b)(1), 11 U.S.C.A.

Cases that cite this headnote

[19] **Bankruptcy**
Extension of time

Under the *Pioneer* test for evaluating excusable neglect, the court must avoid finding prejudice based on unsupported speculation or hypothetical harm, and draw conclusions of prejudice from facts in evidence. Fed.Rules Bankr.Proc.Rule 9006(b)(1), 11 U.S.C.A.

Cases that cite this headnote

[20] **Bankruptcy**
Extension of Time; Excuse for Delay

Under the *Pioneer* test for evaluating excusable neglect, factors to consider in assessing the prejudice factor include the size of a late claim in relation to the estate, whether a disclosure statement or plan has been filed, and the disruptive effect permitting the late claim would have on plan formation. Fed.Rules Bankr.Proc.Rule 9006(b)(1), 11 U.S.C.A.

Cases that cite this headnote

[21] **Bankruptcy**
Extension of Time; Excuse for Delay

Determining the foreseeable impact of late-filed claims, in assessing prejudice under the *Pioneer* test for evaluating excusable neglect, is an uncertain process that requires a certain amount of "crystal ball gazing." Fed.Rules Bankr.Proc.Rule 9006(b)(1), 11 U.S.C.A.

Cases that cite this headnote

[22] **Bankruptcy**
Extension of Time; Excuse for Delay

Gift card holders' failure to file timely proofs of claim was not due to excusable neglect; allowing holders to file late claims and certify a class would have disastrous effect on remainder of Chapter 11 debtors' estates and final plan distributions and would result in massive prejudice, as there were estimated 17.7 million outstanding gift cards with unredeemed balances totaling approximately $210.5 million, liquidating trust currently had approximately $110 million in cash and, after paying administrative and priority claims and pursuing other avenues to collect assets, did not expect to have more than $90 million to pay unsecured creditors, allowing late-filed claims thus would severely impact distributions to creditors with timely claims, plan had been substantially consummated, holders filed motion to allow untimely claims more than seven months after general bar date and proofs of claim a month later, and holders, as unknown creditors, received adequate constructive notice of bar date. Fed.Rules Bankr.Proc.Rule 9006(b)(1), 11 U.S.C.A.

3 Cases that cite this headnote

[23] **Bankruptcy**
Modification or revocation

Chapter 11 plan can only be modified before substantial consummation of such plan. 11 U.S.C.A. § 1127(b).

1 Cases that cite this headnote

[24] **Bankruptcy**
Extension of Time; Excuse for Delay

In determining whether a claimant's delay is due to excusable neglect, there is no bright-line rule regarding the length of the delay in filing a proof of claim. Fed.Rules Bankr.Proc.Rule 9006(b)(1), 11 U.S.C.A.

Cases that cite this headnote

[25] **Bankruptcy**
Parties

Class representative must be a member of the class he seeks to represent with a personal stake in the outcome. Fed.Rules Civ.Proc.Rule 23(a), 28 U.S.C.A.

Cases that cite this headnote

Attorneys and Law Firms

***815** Lowenstein Sandler PC, By: Bruce Buechler, Esq., Timothy R. Wheeler, Esq., Roseland, NJ, for Liquidating Trustee.

Krislov & Associates, Ltd., By: Clinton A. Krislov, Esq., Kenneth T. Goldstein, Esq., Eli Korer, Esq., Chicago, IL, Perkins Coie LLP, By: Schuyler Caroll, Esq., Jeffrey D. Vanacore, Esq., Shan Haider, Esq., Aaron D. Coombs, Esq., New York, NY, for the Gift Card Holders.

MEMORANDUM OPINION DENYING GIFT CARD CLAIMANTS' MOTION TO FILE LATE CLAIMS AND CLASS CERTIFICATION

MARTIN GLENN, Bankruptcy Judge.

Weeks after this Court confirmed the Debtors' chapter 11 plan of liquidation, certain holders of the Debtors' consumer gift-cards filed a motion seeking entry of an order authorizing them to file untimely proofs of claim based on the amounts remaining on their consumer gift-cards. The gift-card holders also filed a motion seeking class certification on behalf of all holders of Borders' gift-cards. The gift-card holders argue that they should have received actual notice of the bar date, and because the Debtors failed to provide them with such notice, they should be permitted to file late claims. The gift-card holders, however, failed to submit any affidavits or declarations in support of their motions. Additionally, the Court concludes that, as a matter of law, the gift-card holders were not "known" creditors and were provided sufficient notice of the bar date through the Debtors' notice of bar date published in *The New York Times*. Therefore, the Court denies the motion to file untimely proofs of claim, and denies the motion for class certification as moot.

I. BACKGROUND

A. Procedural History

The history of this case has been well-documented in the various opinions issued by the Court. However, for the purposes of the motions at issue, the following procedural history is relevant. On February 16, 2011 (the "Petition Date"), each of the Debtors filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code. On the Petition Date, the Court approved the Debtors' motion (the "Customer Programs Motion") (ECF Doc. # 18) to honor certain prepetition customer programs, including their gift-card program (the "Gift Card Program"). (ECF Doc. # 63.)

On April 8, 2011, the Court entered an order establishing the deadline for filing proofs of claim and approving the form and manner of notice (the "Bar Date Order"). (ECF Doc. # 580.) The Bar Date Order established June 1, 2011, at 5:00 ***816** p.m. (prevailing Eastern Time) as the deadline (the "General Bar Date") for each person or entity to file proofs of claim based on claims (as the term "claim" is defined in section 101(5) of the Bankruptcy Code) that arose on or prior to the Petition Date, including claims pursuant to section 503(b)(9) of the Bankruptcy Code (other than by governmental units as defined in section 101(27), which were required to file proofs of claim by August 15, 2011). *See* Bar Date Order at 2. The Bar Date Order also approved the notice of the bar date (the "Bar Date Notice") and deemed the notice adequate and sufficient if served by first class mail at least thirty-five days prior to the General Bar Date on, among others, "all known creditors and other known holders of claims as of the date of [the Bar Date Order], including all persons or entities listed in the Schedules as holding claims for which the Debtors have addresses...." Bar Date Order at 6. The Bar Date Order further directed that the

Debtors publish notice of the General Bar Date (the "Publication Notice") once, in the national edition of *The New York Times,* at least twenty-eight days before the General Bar Date. *See* Bar Date Order at 7.

On April 22, 2011, the Debtors' claims and noticing agent created a link on the Borders Reorganization Website entitled "Notice of Deadlines to File Claims and Proof of Claim Form," which led visitors to a webpage that provided a link to the court-approved Bar Date Notice, information about filing proofs of claim and the associated deadlines. On April 25, 2011, the Debtors published the Bar Date Notice in *The New York Times.*

After a failed sales process, the Debtors sought approval of a full-chain liquidation. The store closing sales were concluded by September 20, 2011, thus ending the Debtors' retail store operations. On September 27, 2011, the Court entered an order authorizing the sale of the Debtors' intellectual property assets to Barnes & Noble. (ECF Doc. # 1876.) As of September 27, 2011, all e-commerce transactions on the Debtors' website ceased, including the processing and honoring of gift-cards.

On October 12, 2011, the Court entered an order setting the bar date for filing proofs of claim asserting administrative expenses (the "Administrative Bar Date") and approving the form and manner of the notice of the Administrative Bar Date (the "Administrative Bar Date Order"). (ECF Doc. # 1927.) The Administrative Bar Date Order expressly stated:

> [A]ny holder of a claim for gift cards or gift certificates issued by the Debtors preCommencement Date ("Prepetition Gift Card Claims"), which claim was required to be asserted by June 1, 2011 pursuant to the General Bar Date Order, is ***not*** now permitted to assert such a claim. As set forth in the General Bar Date Order, any unsecured claim against the Debtors arising prior to the Commencement Date has already been deemed disallowed and any claimant holding such a claim is forever barred and estopped from asserting such a claim, unless the holder of a Prepetition Gift Card timely filed a proof of claim....

Administrative Bar Date Order at 3. (emphasis in original). In addition to mailing the Administrative Bar Date Order to known creditors, the Administrative Bar Date Order was also published in *USA Today* on October 18, 2011.

On December 21, 2011, the Court entered an order (the "Confirmation Order") (ECF Doc. # 2384), confirming the *First Amended Joint Plan of Liquidation Pursuant to Chapter 11 of the Bankruptcy Code Proposed by the Debtors and the Official Committee of Unsecured Creditors,* ***817** dated as of November 10, 2011 (the "Plan") (ECF Doc. # 2110, Ex. A). The Plan went effective on January 12, 2012 (the "Effective Date") (ECF Doc. # 2465), and, to date, the Trust has made distributions to holders of allowed administrative and priority claims totaling at least $17 million.

On January 4, 2012, Eric Beeman and Jane Freij, holders of the Debtors' consumer gift cards (the "Gift Card(s)," and collectively, Mr. Beeman, Ms. Freij, and Robert Traktman,[1] the "Gift Card Holders") filed a motion (the "Late Claim Motion") seeking entry of an order authorizing the Gift Card Holders to file untimely proofs of claim against Borders, Inc. and Borders Properties, Inc., respectively. (ECF Doc. # 2415.) On January 9, 2012, the Gift Card Holders filed a separate motion (the "Class Action Motion") seeking to certify a class of all holders of prepetition Borders Gift Cards (the "Proposed Class") and to pursue priority unsecured creditor status for all holders of the Debtors' Gift Cards. (ECF Doc. # 2450.) In response, the BGI Creditors' Liquidating Trust (the "Trust"), as successor to the Debtors, and Curtis R. Smith, the Liquidating Trustee, filed an objection to the Motion (the "Objection") (ECF Doc. # 2699), as well as an objection to the Class Action Motion (ECF Doc. # 2698). In support of these objections, the Trust filed the declaration of James Toner, the former Senior Associate General Counsel for Borders Group, Inc. (the "Toner Declaration") (ECF Doc. # 2700) and the declaration of Kate Matson, a manager at BDO Consulting (retained as financial advisors to the Debtors, the Trustee and the Trust), (the "Matson Declaration") (ECF Doc. # 2701). The Gift Card Holders filed a reply to the Objection (the "Reply"). (ECF Doc. # 2720.)

1 Robert Traktman was not originally included in the Late Claim Motion. Traktman joined the Class Action Motion, but never filed a joinder to the Late Claim Motion. However, based on the arguments in the Class Action Motion, it appears that he is seeking to file an untimely claim. For ease of reference in this opinion, the Court will refer to Mr. Beeman, Ms. Freij and Mr. Traktman as the Gift Card Holders. However, the Court has neither seen nor granted a request by Mr. Traktman to join in the Late Claim Motion and does not rule on any such request in this Opinion.

After certain discovery disputes, the Court entered an order permitting the Gift Card Holders to depose Kate Matson and James Toner on limited issues. (ECF Doc. # 2734.) Specifically, the Gift Card Holders were limited to cross examining the declarants regarding those facts contained in the Toner Declaration and Matson Declaration that directly related to the three Gift Card holders. On June 20, 2012, counsel for the Gift Card Holders took the deposition of James Toner (the "Toner Deposition") and Kate Matson (the "Matson Deposition"). Upon conclusion of these depositions, the Court permitted the parties to file supplemental briefs in support of their arguments. On June 29, 2012, the Trust filed a supplemental brief (the "Supplemental Brief") (ECF Doc. # 2751) in further support of the Objection, while the Gift Card Holders filed a supplemental reply brief (the "Supplemental Reply") (ECF Doc. # 2752). Copies of the Toner Deposition and Matson Deposition transcripts are annexed to the Supplemental Brief as Exhibits A and B, respectively.

B. Borders Gift Card Program and Databases

1. The Gift Card Program

In or about 1998, the Debtors instituted an electronic gift card program (the "Gift Card Program") under which they sold ***818** Gift Cards at Borders retail locations, which at one point included over 1000 stores in all fifty of the United States, the District of Columbia, and the Commonwealth of Puerto Rico; third-party retail locations such as Walgreens and Safeway; and, commencing in May 2008, on the Debtors' e-commerce website, www.borders.com (the "Borders Website").[2] Customers could purchase Gift Cards with cash, personal check or credit/debit card at Borders stores and from third-party retailers, or by credit/debit card at the Borders Website. Borders also issued Gift Cards as store credit in certain situations, such as when customers returned merchandise without a receipt. The Debtors did not attach any personally identifiable information to a Gift Card when they issued one. Therefore, the Debtors did not maintain a list of Gift Card purchasers that contained the Gift Card purchaser's contact information.

[2] From 2000 to May 2008, the Borders Website was operated by Amazon, Inc., which fulfilled all orders and served as the merchant of record for all transactions. Though a customer could purchase a Gift Card from the Borders Website during this time, holders of Gift Cards could not use their Gift Cards on the Borders Website until May 2008. When Borders ended its relationship with Amazon in May 2008 and Borders assumed operational control over the Borders Website, Amazon did not transfer to Borders any customer contact information regarding e-commerce transactions that occurred while Amazon operated the Borders Website.

2. The Debtors' Customer Databases

The Debtors stored customers' contact information on four different databases, depending on where a particular customer's sale originated and the status of the particular customer. First, the Debtors engaged First Data Corporation ("First Data"), a third-party database management firm that offers gift-card program solutions for merchants worldwide, to monitor and maintain the stored value and redemption history of all Borders Gift Cards in a database on the Debtors' behalf (the "First Data Database"). The Debtors relied on the First Data Database and considered it the authoritative source of information regarding the activation, balance, and redemption history of Gift Cards dating back to October 1998. Toner Decl. ¶ 8. However, the First Data Database does not contain any personally identifiable information regarding the purchaser of a Gift Card or the ultimate holder of a Gift Card. Rather, the First Data Database contains information solely about Gift Card accounts such as the 16–digit account number associated with each Gift Card, activation date of the Gift Card, individual transaction amounts, location of individual transactions, dates and times of individual transactions, and remaining Gift Card account balance. *Id.* ¶ 9.

Second, the Debtors maintained a point-of-sale database for all retail transactions (the "POS Database") in their retail store locations. The POS Database recorded the items purchased and the method of payment of the transaction, as well as the date, time and location of a transaction. However, the Debtors did not include any personally identifiable information in the POS Database. If, however, a purchaser elected to identify herself as a member of the Borders' "Borders Rewards" ("BR") customer loyalty program, the purchaser's 10–digit BR member number would be included in the POS Database as part of the record for that transaction. *Id.* ¶ 10. If such a customer purchased or used a Gift Card as part of the transaction, the 16–digit Gift Card number would also be stored in the POS Database.

Third, the Debtors recorded certain information pertaining to the members of the BR program. As part of the enrollment ***819** in the BR program, customers provided Borders with a name, email address and a seven-digit phone number (without area code). BR members were not required to provide a street address. The Debtors also engaged two third-party database management firms, neither of which was First Data, to maintain the BR member information in one or more of their databases on Borders' behalf (collectively, the "BR Database"). Along with a BR member's name, email address and seven-digit phone number (without area code), the BR Database contained a BR member's purchase history (by title and SKU), BR "points" balance, and street address if it was provided by the BR member.

Fourth, from May 2008 until September 2011, the Debtors maintained transactional data for online purchases at the Borders Website in a data warehouse (the "Data Warehouse"). The Debtors stored in the Data Warehouse the customer name, phone number, billing and shipping addresses, and email addresses that were provided by the customers at the time of purchase. For transactions at the Borders Website involving the use of a Gift Card as the method of payment, Borders retained the first six and the last four digits of the 16–digit Gift Card number in the Data Warehouse, but did not store the 16–digit Gift Card account number if a Gift Card was purchased online. *Id.* ¶ 15.

C. Relief Sought in the Motions

1. The Late Claim Motion

On February 4, 2012, approximately eight months after the General Bar Date had passed, the Gift Card Holders filed their individual proofs of claim. Copies of the Gift Card Holders' proofs of claim are attached as Exhibit A to the Late Claim Motion. Through the Late Claim Motion, the Gift Card Holders seek entry of an order authorizing them to file untimely proofs of claim against Borders, Inc. and Borders Properties, Inc. The Gift Card Holders allege that Mr. Beeman holds a gift card in the amount of $100.00 and Ms. Freij holds a gift card in the amount of $25.00; both of which they received as gifts prior to the Petition Date. *See* Late Claim Motion ¶¶ 15–16. The Trust has verified that the amounts remaining on the Gift Cards of Mr. Beeman and Ms. Freij are $100.00 and $25.00, respectively. Toner Decl. ¶ 17.

The Gift Card Holders argue that they were not provided adequate notice of the General Bar Date through its publication in *The New York Times* because they were "known" creditors and should have received actual notice of the General Bar Date. Therefore, according to the Gift Card Holders, their failure to comply with the General Bar Date was due to "excusable neglect," and they should be permitted to file untimely proofs of claim. *See* FED. R. BANKR.P. 9006(b)(1); *Pioneer Inv. Servs. Co. v. Brunswick Assocs. Ltd. P'ship,* 507 U.S. 380, 388, 113 S.Ct. 1489, 123 L.Ed.2d 74 (1993). Moreover, the Gift Card Holders argue that allowing them to file untimely proofs of claim at this stage would not prejudice the Debtors' estates or other creditors because the Debtors and the creditor body were on notice that the holders of the Debtors' Gift Cards could potentially assert claims against the Debtors' estates.

2. The Class Action Motion

Through the Class Action Motion, the Gift Card Holders seek: (1) class certification of all holders and purchasers of unredeemed Gift Cards; (2) allowance of the proposed class' proof of claim pursuant to section 502 of the Bankruptcy Code; and (3) priority status for the class' proof of claim pursuant to section 507(a)(7) of the Bankruptcy Code. The Gift Card Holders argue that class certification is warranted ***820** because doing so will not adversely affect the administration of the bankruptcy cases where the proposed class did not receive actual notice of the Bar Date.[3] Additionally, the proposed class members argue that certifying this class is consistent with and will foster certain bankruptcy goals. Finally, the proposed class members assert that the Proposed Class satisfies the criteria of Rule 23(a) of the Federal Rules of Civil Procedure.

[3] As explained below, as of June 2011, the Debtors' records reflect approximately 17.7 million outstanding Gift Cards with unredeemed balances aggregating approximately $210.5 million. Toner Decl. ¶ 7. Permitting late claims in this amount—particularly if the claims are entitled to priority status—would destroy the basis on which the Plan was confirmed.

II. DISCUSSION

As an initial matter, since the Court concludes that the Gift Card Holders are not permitted to file untimely

proofs of claim, the Court need not reach a decision on the merits of the Class Action Motion. Since the Gift Card Holders were not "known" creditors, the Debtors were not required to give them direct and actual notice of the Bar Date; nor do the Gift Card Holders have standing to seek class certification on behalf of any other holders of Borders' Gift Cards. With respect to the Gift Card Holders, after being provided with discovery, they failed to provide any evidence that Borders had information in any of its databases showing that they were holders of Borders' Gift Cards. Therefore, the Court concludes that the Gift Card Holders were not entitled to actual notice of the General Bar Date, and the Publication Notice was sufficient to put them on notice of the General Bar Date.

A. The Debtors Were Required to Provide Actual Notice Only to Known Creditors

[1] [2] [3] [4] It is long-held that known creditors must be afforded notice "reasonably calculated, under all the circumstances to apprise" them of the pendency of the Bar Date. *Mullane v. Cent. Hanover Bank & Trust Co.*, 339 U.S. 306, 314, 70 S.Ct. 652, 94 L.Ed. 865 (1950). Adequate notice entails actual written notice of the bankruptcy filing and the bar date. *See In re Drexel Burnham Lambert Grp., Inc.*, 151 B.R. 674, 680 (Bankr.S.D.N.Y.1993). For unknown creditors, constructive notice, such as notice by publication, will suffice. *Id.* Whether a creditor received adequate notice of a claims bar date in a chapter 11 case depends upon the facts and circumstances of a given case. *See The Grand Union Co.*, 204 B.R. 864, 871 (Bankr.D.Del.1997).

[5] [6] [7] A "known" creditor includes "both a claimant whose identity is actually known to the debtor or a claimant whose identity is 'reasonably ascertainable' by the debtor." *In re XO Commc'ns, Inc.*, 301 B.R. 782, 793 (Bankr.S.D.N.Y.2003) (quoting *Chemetron Corp. v. Jones*, 72 F.3d 341, 346 (3d Cir.1995)). "A known claim arises from facts that would alert the reasonable debtor to the possibility that a claim might reasonably be filed against it." *In re Drexel Burnham Lambert Grp., Inc.*, 151 B.R. at 681. Indeed, "[k]nown creditors are defined as creditors that a debtor knew of, or should have known of, when serving notice of the bar date." *Id.*

B. The Movants Are Not "Known" Creditors

[8] In the Late Claim Motion, the Gift Card Holders assert that they should be allowed to file untimely proofs of claim because they never received notice of the General Bar Date, and allege that "no ***821** notice was ever sent or published that explained to the Gift Card Holders (ordinary consumers) that they would be required to file proofs of claim." Late Claim Mot. ¶ 1. In the Reply, the Gift Card Holders reiterated this belief, alleging that the Debtors' databases contained enough information about the Gift Card Holders to render them known creditors and entitled to actual notice. *See* Reply ¶¶ 25–27.

However, as explained more fully below, the Gift Card Holders' status as possible creditors was not known or reasonably ascertainable to the Debtors. As an initial matter, gift cards, as their name illustrates, are not intended to be used by the purchaser but are instead intended as gifts, so even if the Debtors were able to identify the purchasers of the Gift Cards, they would have no way of tracing the ultimate recipients. And, in fact, the Gift Card Holders, by their own admission, received their Gift Cards as gifts. Mot. ¶¶ 15–16.[4] Therefore, the Debtors had no way of tracing their identities.

[4] The Gift Card Holders claim that Freij, Beeman, and Traktman had all received their Gift Cards as a gift. However, in later filings, the Gift Card Holders contradict their earlier statement with respect to Mrs. Freij and state that she received her Gift Card as a gift. Mr. Beeman was not a BR member and, according to the Trust, his personal information was not found in any of the Debtors' databases. Suppl. Brief ¶ 3. Mr. Traktman never activated his Gift Card, and it still retains the original activated amount of $100. *Id.* ¶ 9.

Furthermore, Mr. Toner's uncontested testimony illustrates that "Borders does not maintain and never maintained a list of Gift Card purchasers containing the Gift Card purchasers' contact information." Toner Decl. ¶ 6. The Gift Card Holders, however, assert that at least two of them (Freij and Traktman) were found with contact information on the Debtors' databases, and that therefore they were known creditors. Suppl. Reply ¶ 1. Additionally, they argue that because Freij was a BR member and Traktman was a Borders Website consumer, they were known creditors. *Id.* ¶¶ 2–3. However, Freij and Traktman fail to establish any connection between any contact information or transactional information and their Gift Cards. Mr. Toner acknowledged that Freij's name and email address were found in the BR Database (Toner Dep. 45:23–25) and Traktman's address was found in the Data Warehouse (Toner Dep. 49:1–7). However, the presence of this information does not imply that Freij and Traktman were known creditors. The Gift Card Holders fail to demonstrate that the Debtors had any way of connecting their information with the Gift Card information. This conclusion appears reasonable since they were not the initial purchasers of the Gift Cards. Therefore, the Debtors had no way of knowing that these

individuals possessed unused Gift Cards. Additionally, at the hearing on August 9, counsel for the Gift Card Holders admitted that the Debtors did not have any information in their databases that showed that the Gift Card Holders actually held Gift Cards. The fact that Freij's and Traktman's names and email or street addresses were found in the Debtors' databases merely proves that they were, at one time, BR members or Borders Website customers. Therefore the Gift Card Holders could not be considered *known* creditors.

In their Reply, the Gift Card Holders argue that the "the Liquidating Trustee implicitly acknowledged that all Borders Website customers that used or purchased a Gift Card ... were known creditors because the Debtors knew their contact information." Reply ¶ 16. However, the Debtors only "retained the first six and last four digits of the 16–digit Gift Card number in the Data Warehouse" for Borders ***822** Website purchases where a Gift Card was used, "but did not store the 16–digit Gift Card account number if a Gift Card was purchased online." *Id.* ¶ 15. It would have been extremely difficult, if not impossible, to try to single out purchasers who bought or used Gift Cards and then cross-reference their information with the Gift Cards to determine which of these individuals might be creditors. Such information is not "reasonably ascertainable."

The Gift Card Holders also argue that participation in the BR program elevated BR members to "known" creditors and entitled them to actual notice. According to the Gift Card Holders, the Debtors should have contacted all BR members, or everyone known to have purchased a Gift Card on the BR Database. However, the majority of BR members provided only their name, email address, and phone number without area code. Obj. ¶ 37. Borders did, in fact, warn BR members that Borders was going out of business and that gift cards would be honored during the liquidation sales. On July 21, 2011, the Debtors' CEO, Mike Edwards, sent an email to all BR members warning them that Borders would be going out of business permanently and completely liquidating, and that "gift cards will be honored during the liquidation sales." Matson Decl. ¶ 19, Ex. L. The email represented that the Gift Cards would be honored during liquidation sales, implying that they would not be honored after that, and customers had two months in which to redeem their Gift Cards at their full value.[5] Furthermore, as most Gift Cards are purchased as gifts for others, it seems unlikely that BR members who purchased Gift Cards actually still held those Gift Cards during the pendency of the Debtors' cases.

[5] There was a substantial increase in Gift Card redemptions after the public was made aware that Borders was closing, supporting the Debtors' assertions that there was widespread publicity regarding the liquidation and need to use Gift Cards before the liquidation was complete. *See* Matson Decl. ¶ 24 and Ex. E. It is difficult to fathom how anyone could have gathered from this that Borders would honor the Gift Cards after it ceased operations, as the Gift Card Holders claim to have believed.

The Gift Card Holders also argue that the Debtors should have attempted to obtain all Gift Card holders' contact information from Amazon, which ran the Borders Website from 2001–2008. Reply ¶ 29. The Gift Card Holders have not presented any evidence that Amazon maintained these specific records or whether, if it did, that the contact information in any records (some of which would be over ten years old) was still accurate. According to Mr. Toner, while customers could purchase a Gift Card from the Borders Website and Gift Card holders could use their Gift Cards to make purchases on the site, Amazon provided Borders only with the names, street addresses and dollar amounts of monthly purchases of their customers and "specifically excluded email addresses, credit card information or product information about the item(s) a customer had purchased, be it a Gift Card, book, stationery, etc." *See* Errata to the Toner Declaration (the "Toner Errata") (ECF Doc. # 2740) ¶ 2. Additionally, in May 2008, upon termination of the arrangement between Borders and Amazon, Amazon provided Borders with approximately 30,000 email addresses, representing "only those customers who had made purchases on the Borders website and who had affirmatively authorized Amazon to release their email addresses to Borders." *Id.* In other words, while Borders received some names, some addresses, and some email addresses from Amazon, Borders still had no way of linking any names, addresses or email addresses with any Gift Cards.

***823** The Gift Card Holders additionally allege that the Debtors sent correspondence to Gift Card holders but failed to alert them of the General Bar Date. Suppl. Reply ¶ 10. However, the Debtors did not send emails specifically to Gift Card holders, but rather to all BR members or all Borders' customers for whom they possessed email addresses to inform them about the progress of the cases and the eventual liquidation sales. The Debtors had no reasonable method of determining which email addresses belonged to Gift Card holders, as opposed to BR members or consumers who had made purchases through the Borders Website.

For the reasons stated above, the Court finds that the Gift Card Holders were unknown creditors and only entitled to

constructive notice of the General Bar Date, which they received through the Publication Notice.

C. Adequate Notice Was Provided to the Holders of Borders' Gift Cards

[9] [10] The Debtors were not required to provide notice of the kind required for known creditors to unknown creditors. *In re XO Commc'ns,* 301 B.R. at 793 (holding that unknown creditors are those whose claims are "not readily ascertainable," or are merely "conceivable, conjectural, or speculative.") According to Bankruptcy Rule 2002(1), "the court may order notice by publication if it finds that notice by mail is impracticable or that it is desirable to supplement the notice." FED. R. BANKR.P. 2002(*l*). Because the Gift Card Holders were unknown creditors, and the Debtors had no reasonable method for ascertaining addresses or identifying information for them, the Debtors were required to provide only constructive notice of the General Bar Date to them. *See Chemetron Corp. v. Jones,* 72 F.3d 341, 346 (3d Cir.1995) (holding that constructive notice is adequate as to a debtor's unknown creditors); *In re XO Commc'ns, Inc.,* 301 B.R. 782, 792 (Bankr.S.D.N.Y.2003) (same) (citation omitted).

[11] [12] In determining its creditors, a debtor is not obligated to try to find and serve notice on any individual who could potentially be a creditor. *See In re Brooks Fashion Stores, Inc.,* 124 B.R. 436, 445 (Bankr.S.D.N.Y.1991). It is generally sufficient for the debtors to scrutinize their own records. In order to try to identify any more potential Gift Card purchasers or holders, the Debtors would have had to cross-reference four separate databases, run by different companies, which were used to contain different information. This would have necessitated more than merely scrutinizing the Debtors' records, and would have required the Debtors to try and pick out which of the customers in their separate databases had purchased or used Gift Cards, and which of those customers had value left on the Gift Cards that could make them potential creditors. Even if the Debtors had attempted to cross-reference their databases, access Amazon's records (if they are still in existence, and if the email addresses and mailing addresses, some of which are over a decade old, are still valid) and parse through the BR Database, the resultant Gift Card class would only comprise a fraction of the Proposed Class, and would not include any of the Gift Card Holders.

The Bar Date Order required the Debtors to publish the Bar Date Notice once, in the national edition of *The New York Times,* at least 28 days preceding the General Bar Date. *See* FED. R. BANKR.P. 9008 (specifying that when the Rules require notice by publication, "the court shall, to the extent not otherwise specified in these rules, determine the form and manner thereof, including the newspaper or other ***824** medium to be used and the number of publications"). The Debtors did so on April 25, 2011. The Debtors' notice and claims agent also created a link on the Borders Reorganization Website to lead viewers to a page that provided a link to the Bar Date Notice, information about filing proofs of claim, and the General Bar Date. *See* Objection ¶ 17. Through the Publication Notice (in addition to the aforementioned websites and emails), the Debtors provided its unknown creditors, including all holders of Gift Cards, with constructive notice of the General Bar Date. This was all that was required under the Bar Date Order, according to both the Federal Rules of Bankruptcy Procedure and pursuant to established case law. In short, the Debtors provided adequate actual notice to their known creditors, and adequate constructive notice to their unknown creditors, including all holders of Gift Cards. Notice beyond this was not required, nor should it have been expected.

D. The Gift Card Holders' Failure to Act was Not the Result of Excusable Neglect

[13] [14] [15] [16] [17] In cases where creditors have failed to file claims before the bar date despite having notice, "Bankruptcy Rule 9006(b)(1) gives the court the discretion to enlarge the time to file claims 'where the failure to act was the result of excusable neglect.' " *In re Lehman Bros. Holdings Inc.,* 433 B.R. 113, 119 (Bankr.S.D.N.Y.2010) (quoting FED. R. BANKR.P. 9006(b)(1)). "The Supreme Court has interpreted 'excusable neglect' to be a flexible standard—one that can include 'inadvertence, mistake, or carelessness, as well as by intervening circumstances beyond the party's control.' " *Id.* (quoting *Pioneer,* 507 U.S. 380, 395, 113 S.Ct. 1489, 123 L.Ed.2d 74 (1993)). "However, 'the determination is at bottom an equitable one' that must take 'account of all relevant circumstances surrounding the party's omission.' " *Id.* (quoting *Pioneer,* 507 U.S. at 395, 113 S.Ct. 1489). The *Pioneer* Court established four factors to assist bankruptcy courts in evaluating excusable neglect: (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. *Pioneer,* 507 U.S. at 395, 113 S.Ct. 1489. "The Second Circuit strictly observes bar dates and has adopted what has been characterized as a 'hard line' in applying the *Pioneer* test," meaning that this Court should focus its

analysis "primarily on the reason for the delay, and specifically whether the delay was in the reasonable control of the movant." *In re Lehman Bros.*, 433 B.R. at 119–20.

1. Danger of Prejudice to the Debtors

[18] [19] [20] [21] "The prejudice factor calls for consideration of the overall negative effect, if any, on a debtor and its estate resulting from allowing a late claim." *Id.* at 120. To that end, "[t]he court must avoid finding prejudice based on unsupported speculation or hypothetical harm and draw conclusions of prejudice from facts in evidence." *Id.* Factors to consider include "the size of a late claim in relation to the estate, whether a disclosure statement or plan has been filed, and the disruptive effect permitting the late claim would have on plan formation." *Id.*; *see also In re Keene Corp.*, 188 B.R. 903, 910 (Bankr.S.D.N.Y.1995). "Determining the foreseeable impact of late-filed claims ... is an uncertain process that 'requires a certain amount of crystal ball gazing.' " *In re Lehman Bros.*, 433 B.R. at 120 (quoting *In re Enron*, 419 F.3d 115, 130 (2d Cir.2005)).

***825** [22] However, in this case, it is clear that allowing the Gift Card Holders to file late claims and certifying a class of Gift Card holders would have a disastrous effect on the remainder of the Debtors' estates and the final distributions of the Plan. As of June 2011, "the Debtors' books and records indicated the existence of approximately 17.7 million outstanding gift cards with unredeemed balances aggregating approximately $210.5 million." Toner Decl. ¶ 7. The Trust currently has approximately $110 million in cash and, after paying all administrative and priority claims and pursuing other avenues to collect assets, does not expect to have more than $90 million to pay unsecured creditors. *Id.* ¶ 20. Allowing the late filed claims of the Gift Card Holders and the certification of the Proposed Class would result in massive prejudice to the estate because the distributions to general unsecured creditors who filed timely proofs of claim would be severely impacted. Specifically, under the Plan, Class 3, general unsecured claims, totaled approximately $812 to $850 million. Class 1, priority non-tax claims, totaled approximately $300,000 to $400,000. The Debtors estimated that general unsecured creditors would only receive a 4%–10% recovery under the Plan while priority non-tax claimants would receive a 100% recovery under the Plan. If the Court granted the motions, an additional $210.5 million in claims would be added to either Class 1 (if the Court found that the Gift Card claims were entitled to priority treatment under 11 U.S.C. § 507(a)(7)) or Class 3. This would drastically change the estimated recovery for unsecured creditors and warrant a modification of the Plan and a re-solicitation of votes.

[23] However, at this point, the Trust cannot modify the Plan because it has been substantially consummated, and, according to section 1127(b) of the Bankruptcy Code, a chapter 11 plan can only be modified before "substantial consummation of such plan." 11 U.S.C. § 1127(b); *see also In re Fansal Shoe Corp.*, 119 B.R. 28, 30–31 (Bankr.S.D.N.Y.1990) (holding that the debtor was precluded from modifying the terms of a confirmed plan to add omitted unsecured creditors when the plan was substantially consummated because the debtor had commenced distribution under the plan and had fully paid the class of administrative claims as well as priority tax claims). Here, the Plan has been substantially consummated because: (i) the Plan transferred all of the property proposed to be transferred by the Plan from the Debtors to the Trust on the Effective Date; (ii) the Trust, as successor to the Debtors under the Plan, is managing the assets and liabilities, and administering claims dealt with by the Plan as of the Effective Date; and (iii) the Trust has begun making distributions to holders of allowed administrative and priority claims pursuant to the Plan and, to date, has made distributions to holders of allowed administrative and priority claims totaling at least $17 million (including the Trust's administrative costs). Thus, at this late stage, the Trust could not proceed with modifying the Plan if the Court granted the motions.

2. Length of Delay and Impact on Proceedings

[24] Here, the Debtors filed their petitions on February 16, 2011. The Court established the General Bar Date on April 8, 2011, and set the Bar Date for June 1, 2011, providing nearly three months for claimants to file proofs of claim. The Debtors provided actual notice to all known creditors on April 18, 2011, and constructive notice by publication to the remaining, unknown creditors on April 25, 2011. The Gift Card Holders filed their motion on January 4, 2012, more than ***826** seven months after the General Bar Date passed, and waited another month to file their proofs of claim on February 4, 2012. Although there is no bright-line rule regarding the length of the delay in filing a proof of claim, the Gift Card Holders failed to file their claims for nearly eight months after the General Bar Date even though they had constructive notice of the General Bar Date. Thus, this factor also weighs against finding excusable neglect. *See, e.g., In re XO Commc'ns*, 301 B.R. at 797–98 ("[T]he Court

emphasizes that the Bar Date Order was meant to function as a statute of limitations and effectively exclude such late claims in order to provide the Debtor and its creditors with finality to the claims process and permit the Debtor to make swift distributions under the Plan. To find otherwise, that is, outside of the context of excusable neglect, would vitiate the very purpose of the Bar Date Order and would clearly impact the Debtor's reorganization process. The Court, therefore, finds that the length of delay factor weighs in favor of the Debtor.").

3. Reason for the Delay

The Gift Card Holders claimed that the reason for the delay in filing was the Debtors' failure to provide them with adequate notice. However, as discussed above, the Court finds that the Gift Card Holders were unknown creditors and only entitled to constructive notice, which they adequately received. The Gift Card Holders also assert that they were led to believe that further action was unnecessary because the Debtors assured them that all Gift Cards would be honored "during the sale process." *See* Mot. ¶ 11. However, the Gift Card Holders assert that they attempted to use their Gift Cards "this holiday season" (presumably November or December of 2011), which would have been months after all Borders stores had been liquidated, transactions stopped, and the website and intellectual property had been transferred to Barnes & Noble. *Id.* ¶ 7. The Gift Card Holders had the opportunity to at least use their Gift Cards and mitigate their losses, and merely chose not to do so. The claimants have provided no other credible reason for their lengthy delay in filing.

4. Good Faith of the Movants

There is nothing in the record to suggest that the Gift Card Holders' claims and motions were filed in bad faith. However, at this time, due to the lack of evidence provided by the Gift Card Holders, the Court finds that the movants have not met their burden to establish that they acted in good faith. Accordingly, this factor does not support a finding of excusable neglect. *See In re Lehman Bros.*, 433 B.R. at 121 (although there was no evidence of movants' having acted in bad faith, movants' good faith was insufficient to overcome their inability to demonstrate excusable neglect).

III. CONCLUSION

After weighing the *Pioneer* factors, the Court concludes that the Gift Card Holders' failure to act was not caused by any reason that could constitute "excusable neglect." The Gift Card Holders were "unknown" creditors and received adequate constructive notice of the General Bar Date. The movants offer no valid reason for their extended delay in filing proofs of claim, and the delay was not caused by circumstances beyond their control. Therefore, the Late Claims Motion is **DENIED.**

[25] Since the Court denies the Late Claims Motion, the Class Action Motion is **DENIED** as moot. A class representative must be a member of the class he seeks to represent with a personal stake in the outcome. *See, e.g.,* ***827** *Sosna v. Iowa*, 419 U.S. 393, 411–12, 95 S.Ct. 553, 42 L.Ed.2d 532 (1975) ("[A]n attorney may not initiate a class action without having a client with a personal stake in the controversy who is a member of the class.... The Court recently made this very clear when it said that 'if none of the named plaintiffs purporting to represent a class establishes the requisite of a case or controversy with the defendants, none may seek relief on behalf of himself or any other member of the class.' ") (quoting *O'Shea v. Littleton*, 414 U.S. 488, 494, 94 S.Ct. 669, 38 L.Ed.2d 674 (1974) (footnote omitted)).

IT IS SO ORDERED.

All Citations

476 B.R. 812, 68 Collier Bankr.Cas.2d 10, 56 Bankr.Ct.Dec. 238

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