UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	Chapter 11
BLITZ U.S.A. Inc., *et al.*,[1]	Case No. 11-13603 (PJW)
Debtors.	(Jointly Administered)
	Related Docket Nos. 230, 351, 375 and 376

REPLY OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS TO RESPONSES OF THE DEBTORS AND THE PRE-PETITION AND POST-PETITION LENDERS' AGENTS REGARDING THE RELEASE OF RESERVE ESTABLISHED FOR CLAIMS UNDER SECTION 503(b)(9) OF THE BANKRUPTCY CODE

The Official Committee of Unsecured Creditors (the "Committee") of Blitz U.S.A. Inc., *et al.*, the above-captioned debtors and debtors-in-possession, (the "Debtors"), by and through its undersigned counsel, submits this reply (the "Reply") to the (I) *Debtors' Response Regarding Release of Reserve Established for Claims under Section 503(b)(9) of the Bankruptcy Code in Connection with the Sale of Assets Relating to the F3 Brands LLC Business* [Docket No. 376] (the "Debtors' Response") and (II) *Pre-Petition and Post-Petition Lenders' Agents' Response Regarding Release of Reserve Established for Claims under Section 503(b)(9) of the Bankruptcy Code in Connection with the Sale of Assets Relating to the F3 Brands LLC Business* [Docket No. 375] (the "Lenders' Response,"), and in further support of the Committee's limited objection [Docket No. 351] (the "Limited Objection") to the Debtors' *Motion Pursuant To 11 U.S.C. Sections 105(A), 363, And 365 And Bankruptcy Rules 2002, 6004, And 6006 For (I) Entry Of An Order (A) Establishing Bidding And Auction Procedures Related To The Sale Of Certain Of The*

[1] The Debtors in these Chapter 11 Cases, along with the last four digits of each Debtor's federal tax identification number, are: LAM 2011 Holdings (8742); Blitz Acquisition Holdings, Inc. (8825); Blitz Acquisition, LLC (8979); Blitz U.S.A., Inc. (8104); and F3 Brands LLC (2604).

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Debtors' Assets; (B) Establishing Procedures For Approval Of Related Bid Protections; (C) Scheduling An Auction And Sale Hearing; (D) Establishing Notice Procedures For Determining Cure Amounts For Executory Contracts And Leases To Be Assigned; (E) Granting Related Relief; And (II) Entry Of An Order (A) Approving The Sale Of Certain Of The Debtors' Assets Free And Clear Of All Liens, Claims, Encumbrances And Interests; (B) Authorizing The Assumption And Assignment Of Certain Executory Contracts And Unexpired Leases [Docket No. 230] (the "Sale Motion"). In support of this Reply, the Committee respectfully states as follows:

PRELIMINARY STATEMENT[2]

1. By Order dated March 29, 2012, the Court approved the sale of substantially all of the assets of F3 Brands LLC to Hopkins Manufacturing Corporation for the sum of $15,025,000.00, together with the assumption by Hopkins of certain post-petition obligations of the estate of F3 Brands, and the payment of a break-up fee in the amount of $438,500. The sale represents the sale of substantially all of the assets of the F3 Brands' estate, and the Lenders have demanded that virtually all of the net sale proceeds of the sale be turned over and applied to reduce the amount of the Debtors' pre-petition debt owed to them.

2. Bankruptcy Courts in this District have long recognized that where a debtor utilizes the chapter 11 process to liquidate a secured lender's collateral, the secured lender must bear the costs of the chapter 11 case and ensure that the case is not rendered administratively insolvent as a result of the sale. Neither the Debtors nor the Lenders dispute this obligation.

3. Nevertheless, the Debtors and the Lenders have improperly refused to provide for payment of all administrative expense claims incurred by the F3 Brands estate. Although Hopkins agreed to assume certain administrative claims and other administrative claims will be paid from the proceeds of the sale with the Lenders' consent, the Debtors and Lenders have

[2] Undefined capitalized terms shall have the meanings ascribed to them below.

made no provision for the estimated $560,000 of administrative expenses arising under section 503(b)(9) of the Bankruptcy Code, despite the fact that these claims are also indisputably administrative expense claims under the Bankruptcy Code, and are, therefore, entitled to equal treatment with all other administrative claims.[3] The Debtors and the Lenders thus improperly seek to limit the expenses that must be borne by the Lenders by unilaterally labeling certain administrative expense claims as "true" administrative expense claims which must be paid, and leaving other administrative expense claims that are less desirable in their view unpaid.

4. In contrast, Congress has made plain that section 503(b)(9) claims are indeed administrative expenses to be treated the same as all other administrative expenses. Moreover, one of the chief factors considered by courts in determining the timing of payments made on administrative expense claims is equal distribution among creditors. Consequently, prior to confirmation of a plan, payments to administrative creditors should be disallowed when the estate may be administratively insolvent and may not be able to pay all administrative expenses in full. Indeed, upon conversion to chapter 7, professional fees paid in chapter 11 cases will be subject to disgorgement if necessary to achieve *pro rata* distribution among holders of chapter 11 administrative expense claims.

5. Therefore, the Debtors' attempt to re-classify section 503(b)(9) claims that have been defined by Congress as administrative expenses, or otherwise pick and choose which administrative expense claims are entitled to payment now, must be rejected. Having agreed to provide for payment of some administrative expenses in connection with the sale of the F3 Brands' Assets, rather than upon confirmation of a plan of reorganization (if any), the Debtors

[3] Although $750,000 has been held in reserve, the Debtors claim that their "maximum potential exposure" for claims under section 503(b)(9) relative to the F3 Brands' estate is approximately $560,000. [Debtors' Response at ¶ 15].

are in no position to compel the holders of legitimate section 503(b)(9) claims to wait and hope that the F3 Brands' estate is not, or will become administratively insolvent.

6. The Committee's objection to the proposed distribution of the net sale proceeds of the sale of the F3 Brands' Assets is not an attempt to elevate the status of section 503(b)(9) claims over the claims of any secured creditor. Rather, (i) the Lenders must pay the freight to have their collateral liquidated through these proceedings, (ii) the cost of the freight is an administratively solvent estate, and (iii) all administrative expense claims are entitled to equal treatment.

7. Therefore, for the reasons set forth in the Limited Objection and below, the Committee respectfully submits that the reserve established for payment of section 503(b)(9) claims should be released and the Debtors should be directed to use those funds to pay section 503(b)(9) claims along with the other administrative expense claims being paid in connection with the sale of the F3 Brands' Assets.

GENERAL BACKGROUND

8. On November 9, 2011 (the "Petition Date"), the Debtors each filed a voluntary petition for relief under title 11 of chapter 11 of the United States Code (the "Bankruptcy Code"). Pursuant to sections 1107(a) and 1108 of the Bankruptcy Code, the Debtors continue to operate their businesses and manage their properties as debtors in possession. By Order dated November 10, 2011, the Court approved the joint administration of these cases for procedural purposes only. [Docket No. 31].

9. On November 21, 2011, the Office of the United States Trustee appointed the Committee pursuant to section 1102(a)(1) of the Bankruptcy Code. The Committee retained

Lowenstein Sandler PC to serve as its counsel, Womble Carlyle Sandridge & Rice LLP, to serve as its Delaware co-counsel, and FTI Consulting, Inc., to serve as its financial advisor.

10. No trustee or examiner has been appointed in the Debtors' bankruptcy cases (the "Chapter 11 Cases").

The DIP Order

11. On December 12, 2011, the Court entered the *Final Order (I) Authorizing Debtors to Incur Post-Petition Secured Indebtedness, (II) Granting Security Interests and Superpriority Claims, (III) Approving Use of Cash Collateral* (the "DIP Order") [Docket No. 132]. The DIP Order authorized the Debtors to obtain up to $5,000,000 in post-petition financing from the pre-petition lenders under a revolving credit facility.

12. The DIP Order also provides, without prejudice to the rights of the Committee, that as of the Petition Date, certain of the Debtors had outstanding debt obligations to the pre-petition lenders pursuant to a certain First Amended and Restated Credit Agreement. The Debtors claim that as of the Petition Date, the principal amount outstanding under Prepetition Revolver Facility was $18,968,464.29, and the principal amount outstanding under the Prepetition Term Note Facility was $21,845,180.46 (together, the "Prepetition Indebtedness"). [DIP Order at ¶11(g)].

The DIP Financing Agreement

13. Debtors have not drawn any funds made available under the DIP Financing Agreement. Nevertheless, the terms of the DIP Financing Agreement purport to require the Debtors to sell the assets of F3 Brands and non-debtor affiliate Reliance Products Holdings, Inc. and to remit the net proceeds of the sales to the Lenders to be applied towards satisfaction of the Prepetition Indebtedness.

14. In addition, the DIP Financing Agreement requires the Debtors to formulate and present to the Lenders a business plan addressing, among other items, "milestones for resolution of the Chapter 11 Cases (including filing of a Plan of Reorganization and outline thereof)." [DIP Financing Agreement (Docket No. 73), at ¶3.1 (G)]. Thus, notwithstanding their purportedly obligating the Debtors to sell valuable assets and turnover all of the proceeds to the Lenders to satisfy the Prepetition Indebtedness, the Lenders also required the Debtors to formulate a plan of reorganization, which would necessarily require satisfaction of all administrative expense claims, including the section 503(b)(9) claims.

The Sale Motion And Auction

15. Debtors filed the Sale Motion on February 7, 2012, seeking entry of an Order approving, *inter alia*: (i) certain bidding and auction procedures; and (ii) sale of substantially all of the assets of the Debtor's F3 Brands LLC business division (the "F3 Brands' Assets") free and clear of liens, claims, encumbrances and other interests pursuant to an asset purchase agreement by and between certain Debtors and Scepter Holdings, Inc., subject to higher and better offers (the "Asset Purchase Agreement").

16. At an auction held on March 26, 2012, the Debtors selected the bid submitted by Hopkins Manufacturing Corporation ("Hopkins") as the highest and best bid for the F3 Brands Assets. Although the bid submitted by Hopkins provided for the assumption by Hopkins of certain administrative expenses and that certain administrative expenses will be reserved for and paid by F3 Brands' bankruptcy estate, other administrative expenses, including taxes, post-petition medical plan obligations and costs, claims under section 503(b)(9) of the Bankruptcy Code, and estate wind-down costs were not accounted or allocated for.

17. Consequently, the Committee filed the Limited Objection seeking, among other relief, that an amount sufficient to satisfy all administrative claims not being assumed by Hopkins or otherwise paid in connection with the sale of the F3 Brands' Assets be held in escrow.

The Sale Order

18. At the hearing to approve the sale held on March 28, 2012, the Debtors confirmed to the Committee that all administrative claims against F3 Brands' estate were accounted for other than claims arising under section 503(b)(9) of the Bankruptcy Code. On March 29, 2012, the Court entered the *Order (A) Approving the Sale of Certain of the Debtors' Assets Free and Clear of All Liens, Claims, Encumbrances; and (B) Authorizing the Assumption and Assignment of Certain Executory Contracts and Unexpired Leases* [Docket No. 362] (the "Sale Order"). Although the Sale Order granted the Sale Motion, the Debtors were ordered to "hold $750,000 of the proceeds from the Sale in escrow pending the Court's determination in respect of the Committee's objection as related to section 503(b)(9) claims." [Sale Order at ¶23].[4]

19. As demonstrated below, the reserve established for section 503(b)(9) claims should be applied by the Debtors to pay allowed section 503(b)(9) claims because (i) the Lenders must pay the freight to have their collateral liquidated through these proceedings, (ii) the cost of the freight is an administratively solvent F3 Brands' estate, and (iii) all administrative expense claims are entitled to equal treatment.

[4] As set forth above, the Debtors have confirmed that "Hopkins has agreed to assume the known postpetition administrative expenses calculated by the Debtors as of the closing, including accrued payroll liabilities, accrued profit sharing bonus liabilities, accrued group insurance liabilities, accrued workers compensation, accrued unpaid vacation, accrued advertising, accrued discounts, accrued taxes, accrued commissions of independent contractors accrued postpetition payable up to $360,000 and certain miscellaneous expenses." (Debtors' Response at ¶15).

THE REPLY

A. The Chapter 11 Cases Should Not Be Administered For The Benefit Of The Lenders

20. The Debtors and the Lenders are improperly seeking to administer the Chapter 11 Cases for the benefit of the Lenders by attempting to enable them to liquidate their collateral through the Chapter 11 Cases without paying all of the administrative costs incurred in accomplishing that objective.

21. The Debtors and the Lenders freely chose to use this proceeding as their vehicle to conduct sales of F3 Brands' and other businesses. The Lenders, of course, were always free to enforce their rights under state law and conduct UCC Article 9 foreclosure sales of their collateral and avoid the expense of paying all of the estates' administrative expense claims, including claims under section 503(b)(9) for goods provided to the Debtors with 20 days prior to the Petition Date. Rather, the Debtors and the Lenders chose chapter 11 to conduct a section 363 sale and realize a windfall over what they would have recovered outside of chapter 11. Consequently, they should not be permitted to receive the benefits of chapter 11 while unpaid administrative claims, such as claims under section 503(b)(9), are left in the lurch, particularly where other administrative expense claims are being paid in full in connection with the sale.

22. Courts in this District and other districts have concluded that a chapter 11 proceeding should not be run for the benefit of a secured lender unless the secured lender pays the costs associated with running the chapter 11 case. This Court, in *In re NEC Holdings Corp., et al.*, Case No. 10-11890, concluded that "I can't let a case . . . [run] that's administratively insolvent." *In re NEC Holdings Corp., et al.*, Case No. 10-11890, July 13, 2010 Hearing Transcript (the "NEC Transcript"),[5] p. 78:18-20. Rather, in the context of a liquidation

[5] Copies of the relevant pages of the *NEC* Transcript are attached hereto as Exhibit A.

proceeding, the secured creditor is required to pay the freight in the form of providing for payment of administrative expense claims so that the estate is not rendered administratively insolvent following the sale of substantially all of the estate's assets:

> [While] I generally have held in the past that you can run a case for the benefit of a secured creditor . . . [t]hey've got to pay the freight, and the freight is . . . certainly an administratively solvent estate. And while there's not a guarantee, there has to be something other than a wing and prayer on the payment of admin claims. And counsel very honestly and appropriately answered the question here that at least it's unclear, as we stand here, and it's quite unclear whether 503(b)(9) claims would be paid.

NEC Transcript, p. 100:14-20. *See also, In re Townsends, Inc., et al.*, Case No., No. 10-14092, January 21, 2011 Hearing Transcript (the "Townsends Transcript"), at pp. 23:25–24:9; 24:9-22 (recognizing that it is inappropriate to run a case that is administratively insolvent).[6]

23. In other words, it is inappropriate for a case to remain in chapter 11 where there is no realistic possibility that a plan will be confirmed and where secured creditors are simply utilizing the chapter 11 process to arrange a section 363 sale to be followed by a conversion to chapter 7, all while not providing for payment of all chapter 11 administrative expense claims. *See, e.g., In re Encore Healthcare Assocs.*, 312 B.R. at 54-55 (Bankr. E.D. Pa. 2004) (court denied bid procedures motion finding that section 363 sale served no legitimate business purpose). *Accord In re Duro Industries, Inc.*, 2002 WL 34159091 (Bankr. D. Mass. 2002); *In re Fremont Battery Company*, 73 B.R. 277, 279-80 (Bankr. N.D. Ohio 1987); *In re Au Natural Restaurant, Inc.*, 63 B.R. 575, 581 (Bankr. S.D.N.Y. 1986) (need for expedited sale is not a sufficient business justification to sell substantially all of the debtor's assets when the debtor's prospect of proceeding to confirmation and making distributions to unsecured creditors is unlikely).

[6] Copies of the relevant pages of the *Townsends* Transcript are attached hereto as Exhibit B to the Debtors' Response.

24. The Debtors acknowledge in their Response (and the Lenders incorporate by reference) that "he who benefits [from conducting business in a chapter 11 proceeding] has to pay the freight for that." (Debtors' Response at ¶ 27). The Lenders were clearly seeking to use the chapter 11 process to engineer an asset sale that yielded them far more that they would have recovered from a state law UCC Article 9 foreclosure sale. Nevertheless, they seek to reduce the Lenders' obligation by improperly attempting to distinguish between "true" administrative expense claims they have agreed to pay (Debtors' Response at ¶ 13), and other administrative expense claims such as section 503(b)(9) administrative expense claims, that they choose not to pay. That is contrary to section 503(b), which sets forth several categories of administrative expense claims that are entitled to the same treatment. Since Congress has decreed that section 503(b)(9) claims are administrative expense claims that are entitled to the same treatment, the Debtors' manufactured distinction is of no moment, and the section 503(b)(9) claims must be included among the administrative expense claims to be paid in connection with that sale.

B. The Section 503(b)(9) Claims Are Administrative Expense Claims And Are Entitled To Equal Treatment

25. Pursuant to section 503(b)(9) of the Bankruptcy Code, an entity is entitled to payment of an administrative expense for "the value of any goods received by the debtor within 20 days before the date of commencement of the case . . . in which the goods have been sold to the debtor in the ordinary course of such debtor's business." 11 U.S.C. § 503(b)(9). "The language of the statute provides for *the allowance of an administrative claim* provided the claimant establishes: (1) the vendor sold 'goods' to the debtor; (2) the goods were received by the debtor within twenty days prior to filing; and (3) the goods were sold to the debtor in the ordinary course of business." *In re Goody's Family Clothing, Inc.*, 402 B.R. 131, 132 (Bankr. D. Del. 2009) (emphasis added).

26. There is precedent in this Court and in other jurisdictions supporting the proposition that the costs of a chapter 11 case that must be borne by the secured lender include payment of section 503(b)(9) claims. In *In re NEC Holdings Corp., et al.*, Case No. 10-11890 (CSS) (Bankr. D. Del.), the Court stated as follows:

> And again, you're not a guarantor. Nobody's a guarantor. But I need some evidence that there's a probability that admin claims are going to get paid in full, including 503(b)(9) claims or I won't approve the financing.

NEC Transcript, at 108:1-4.

27. Similarly, in *In re Townsends, Inc., et al.*, Case No. 10-14092 (CSS) (Bankr. D. Del.), the Committee objected to the entry of a final DIP financing order, arguing, in part, that the debtors' chapter 11 cases were administratively insolvent because the budget did not include sufficient funding to pay all the administrative claims. Of particular concern to the *Townsends* court was the fact that the debtors had proposed to pay most administrative claims in full – with the exception of section 503(b)(9) claims. After learning that the budget only provided $1.8 million for payment of an estimated $16 million in 503(b)(9) Claims, the court stated as follows:

> Well, we've got a problem. Not going to run an administratively insolvent estate. There are benefits to the current administrative claims that are accruing. There are benefits to the unsecured creditors. But it can't be done on the back of the 503(b)(9) admin claims, which are admin claims. Congress has made that determination. So certainly I would have a problem running any case that was administratively insolvent. But one that is both administratively insolvent and prefers one set of administrative creditors over another is doubly troubling. So that's -- well, I'm not going to do it. . . . [T]o go in with a path forward that indicates . . . that a certain type of administrative expense claim won't get paid in full but yet others will, I just – I can't run that kind of case.

Hearing Transcript, *In re Townsends, Inc., et al.*, Case No. 10-14092 (CSS) (Bankr. D. Del.), Jan. 21, 2011 ("Townsends Transcript"), at 23:25–24:9; 24:18-22.

28. The Court continued that "if it appears that the case is administratively insolvent, I would be inclined to either, upon motion or *sua sponte*, either convert or dismiss the case. . . . Not all cases are appropriate to be handled in Chapter 11." Townsends Transcript at 25:8-25:11; 26:10-11.[7]

29. As a result of the *Townsends* court's refusal to approve a DIP financing agreement that did not provide for payment in full of section 503(b)(9) claims, and after an evidentiary hearing on the matter, the court approved a revised DIP financing agreement that included a carve-out with sufficient funds to pay the section 503(b)(9) claims in full. *See Final Order Authorizing the Debtors (A) to Obtain First-Priority Secured Post-Petition Financing, and (B) to use Cash Collateral of Secured Lenders and Providing Related Adequate Protection* [Docket No. 227], entered on January 28, 2011, *In re Townsends, Inc., et al.*, No. 10-14092 (CSS).[8]

30. Likewise, in *In re Atlantis Plastics, Inc.*, Case No. 08-75473 (Bankr. N.D. Ga.), Judge Bonapfel noted that provision should be made for *all administrative expense claims*, including those arising under section 503(b)(9), in a case where the debtors filed motions to sell substantially all of their assets on the first day of the case. At the hearing on the first-day motions in *Atlantis Plastics*, the court advised the postpetition lenders that discriminating between section 503(b)(9) claims and other administrative expenses was inappropriate and not justified by the language of the Bankruptcy Code. The following excerpt from the transcript of

[7] In a chapter 7 case, section 726(b) of the Bankruptcy Code dictates the same treatment of all section 503(b) administrative expense claims, including claims under section 503(b)(9).

[8] A copy of this Order is attached hereto as Exhibit B.

the hearing on the first-day motions expresses the court's view concerning section 503(b)(9) claims:

> THE COURT: Okay. There's a provision in here about no duty to monitor compliance, on Page 16 of the lender [sic].
>
> MR. BACON [counsel to Postpetition Lenders]: Yes sir.
>
> THE COURT: I wouldn't rely on that. And, the reason I say that is, as I said, it's your money, you look after it, if you don't like the way the debtor is spending it, get the stay lifted or get a trustee appointed. But we're not going to balance this case on the backs of administrative claims.
>
> MR. BACON: Understood, Your Honor.
>
> THE COURT: What were the -- MR. BACON: Your Honor – THE COURT: Go ahead.
>
> MR. BACON: -- there's an issue on administrative expense claims that didn't exist the last time I was in your court, and I don't know how much focus it has drawn in other cases that have come before Your Honor since the '05 amendments, but I don't want to, obviously, don't want to play any kind of cat and mouse with this Court on any issues, but that's 503(b)(9) which is an administrative claim as Your Honor knows for goods delivered within 20 days. We think there's a material difference between that and the kind of operating expenses that the Court is rightfully concerned about and we're not asking for a 503(b)(9) ruling today, but we do want to flag that as an issue where, you know, other parties may disagree with the lender's position.
>
> THE COURT: Well, if I'd been in Congress I'd have voted against that amendment, but I wasn't, so I we've got to deal with that administrative expense being there. ***And, I don't see that Congress says we can pay one administrative expense and not another.***
>
> MR. BACON: Well, Your Honor, we do have to deal with it and that's why I bring it up and we're not asking that it be ruled on today, but it could be a material issue in this case and it could have — and there could be some facts attached to those issues that merit a real hearing on the issue.
>
> For example, we believe we're going to find that to the extent there were any deliveries in the last 20 days, we believe, but we can't prove and don't know yet, that most of those deliveries will have effectively been cash in advance deliveries but the creditors, in

> effect, manufacture 503(b)(9) claims by applying the payments to all deliveries, thereby getting preferences and those are the sort of issues I think the Court ought to have a chance to consider with some facts before that issue is ruled on one way or the other.
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> THE COURT: Well, I'm not going to rule on anything today, like that. And I understand your problem but, again, I wouldn't have done the law that way because it skews the priorities improperly. But I didn't make the law and you come back to the proposition, this case is primarily, not predominantly, maybe we'll hit a home run, I hope we do, but it doesn't look like there's anything for unsecured creditors here. And, as I said, I'm worried about an administratively insolvent case. So we'll leave that in, but it may come out by the time of the final order. . . .

Transcript of First Day Motions Hearing, *In re Atlantis Plastics, Inc.*, Case No. 08-75473 (Bankr. N.D. Ga.), August 11, 2008, at 41:4-43:8 [Docket No. 58] (emphasis added).[9]

31. As a result, the court in *Atlantis Plastics* entered a final financing order that included the following provision:

> the Estimated Section 503(b)(9) Amount will, subject to further order of this Court, be reserved from the proceeds of any sale transaction described in Section 5.14 of the Postpetition Credit Agreement in a segregated interest-bearing account held by the Postpetition Agent, and shall not be distributed to the Postpetition Lenders or Prepetition Secured Lenders absent further order of this Court (the amount reserved based upon the Estimated Section 503(b)(9) Amount, the "Reserved Amount").

See Final Order (I) Authorizing the Debtors to Obtain Post-Petition Secured Financing Pursuant to 11 U.S.C. § 364, (II) Authorizing the Debtors' Limited Use of Cash Collateral Pursuant to 11 U.S.C. § 363, and (III) Granting Adequate Protection to Prepetition Secured Lenders Pursuant to 11 U.S.C. §§ 361, 362, 363 and 364 [Docket No. 165], entered on September 5, 2008, *In re Atlantis Plastics, Inc.*, Case No. 08-75473 (Bankr. N.D. Ga.), at ¶ 36.c.[10]

[9] A copy of the relevant pages of the *Atlantis Plastics* Transcript is attached hereto as Exhibit C.

[10] A copy of this Order is attached hereto as Exhibit D.

32. Although the *Atlantis Plastics* court chose to defer the issue until a later day, the court ensured that in the event of any sale, there would be a reserve established for the full estimated amount of section 503(b)(9) claims in order to avoid the substantial practical difficulty of creditors holding section 503(b)(9) claims seeking to have other administrative claimants disgorge payments made to them. As correctly pointed out by the *Atlantis Plastics* court, there is no statutory basis for satisfying other administrative expenses and not satisfying section 503(b)(9) claims.

33. The treatment provided to section 503(b)(9) claims by these decisions is justified by one of the core bankruptcy principles; namely, equal treatment of creditors in the same class. While section 503(b)(9) of the Bankruptcy Code is unique in that it accords administrative priority to obligations incurred by debtors prior to the petition date, nothing in the language of the Bankruptcy Code allows section 503(b)(9) claims to receive disparate treatment from other administrative expense claims. Indeed, it is axiomatic that all administrative expenses are on equal footing, and section 503(b)(9) claims must be treated just as any other administrative expense claim. *See generally In re Plastech Engineering*, 394 B.R. 147 (Bankr. E.D. Mich. 2008) (rejecting application of section 502(d) of the Bankruptcy Code to section 503(b)(9) administrative expenses because such claims should be treated like any other administrative claim); *see also* 11 U.S.C. § 726(b) .

34. In this regard, this Court has made clear that in determining the timing of payments made on administrative expense claims, "one of the chief factors courts consider is bankruptcy's goal of an orderly and equal distribution among creditors and the need to prevent a race to a debtor's assets." *In re HQ Global Holdings, Inc.*, 282 B.R. 169, 173 (Bankr. D. Del. 2002) (citations omitted). "Thus, distributions prior to confirmation of a plan are usually

disallowed when the estate may not be able to pay *all administrative claims in full*." *Id*. citing *In re Standard Furniture*, 3 B.R. 527, 532 (Bankr. S.D. Cal. 1980) (emphasis added).

35. For example, in *In re Chips'N Twigs, Inc.*, 58 B.R. 109 (Bankr. E.D. Pa. 1986), the court denied the applications for payment of administrative expense claims of a creditor that "supplied goods in the ordinary course of business to the debtor after the filing of the petition" (58 B.R. at 110), and counsel for the unsecured creditors' committee, because "[q]uite simply, interim fees can be paid only when it is reasonably clear that the assets of the estate will be sufficient to pay all administrative expenses. The majority of the cases addressing this issue have thus concluded." 58 B.R. 112. The court further noted that "if there are insufficient assets to cover all administration expenses in a chapter 11 case, typically expenses should not be incurred in the ordinary course of operating the business, but rather the case should be converted to a liquidation proceeding under chapter 7." *Id*.

36. In *In re Western Farmers Assoc*., 13 B.R. 132 (Bankr. W.D. Wa. 1981), the court similarly held, among other things, that "[a]ll expenses of administration, including those granted under Section 546(c) are on a parity." 13 B.R. at 136.[11] Consequently, the court further held

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[11] Prior to 2005, section 546(c) provided that:

(c) Except as provided in subsection (d) of this section, the rights and powers of a trustee under sections 544(a), 545, 547, and 549 of this title are subject to any statutory or common-law right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, but-

> (1) such a seller may not reclaim any such goods unless such seller demands in writing reclamation of such goods-
> (A) before 10 days after receipt of such goods by the debtor; or
> (B) if such 10-day period expires after the commencement of the case, before 20 days after receipt of such goods by the debtor; and
> (2) the court may deny reclamation to a seller with such a right of reclamation that has made such a demand only if the court-
> (A) grants the claim of such a seller priority as a claim of a kind specified in section 503(b) of this title; or
> (B) secures such claim by a lien.

that, based on section 726(b), "when a debtor's assets *may* not be sufficient to pay all expenses of administration in full, it is improper, except as indicated below, to pay one such expense during the progress of the case and to defer payment of another expense of the same class to a later time." 13 B.R. at 135.

37. In *Western Farmers Assoc*., several reclamation claimants were granted allowed administrative priority expense claims. 13 B.R. at 133. Thereafter, the debtors filed multiple applications for authority to pay interim professional fee applications. "However, Pfizer, Inc., one of the parties who had been granted an administrative expense under Section 546(c), objected to the payment of any interim allowances on the ground that such payments at this time would effectively prefer one group of creditors entitled to an administrative expense over another group of creditors of the same class." 13 B.R. at 134. "At [that] stage of the case, the debtor ha[d] not filed a plan of reorganization and ha[d] not obtained a commitment for the funds necessary to finance a plan." *Id*.

38. In denying the interim payment of professional fees, the court first considered section 726(b): "Section 726(b) requires that when there are inadequate funds in an estate to pay the holders of all claims of a particular class in full, the claims are to be paid pro rata." *Id*. After recognizing the debtor's need for professional representation, the court then concluded that:

> there is another factor which dictates that the interim allowances not be paid at this time. Simply stated there is more than a possibility in this case that a plan will not be filed, that the secured creditor will exhaust all of the assets, and that there will be nothing left to pay other expenses. Counsel for the debtor argue that a trustee could demand the return of the earlier payments. However, such efforts would undoubtedly be costly, time consuming and of doubtful result.

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11 U.S.C. § 546(c) (1998). In 2005, Congress amended the Bankruptcy Code to include section 503(b)(9), and amended section 546(c)(2) to provide that "[i]f a seller of goods fails to provide notice in the manner described in paragraph (1), the seller still may assert the rights contained in section 503(b)(9)."

13 B.R. at 135.

39. Consequently, the court refused to authorize payment of interim professional fees "until such time as the administrative expense awarded under section 546(c) to Pfizer, Inc., and to other claimants similarly situated are paid." 13 B.R. at 136; s*ee also In re Standard Furniture*, 3 B.R. at 532 ("it must be recognized that an interim allowance should not be authorized for any Section 507(a)(1) claim in an amount which exceeds the anticipated pro-rata payout to be received during the entire administration of the case"); *Fokkena v. Fredrikson & Byron, P.A. (In re Hyman Freightways, Inc.)*, 2006 WL 3757972, * 2 (Bankr. D. Mn. December 20, 2006) ("[t]he *pro rata* distribution requirement correlates with the Bankruptcy Code's policy of equal distribution among creditors with the same priority") citing *Begier v. I.R.S.*, 496 U.S. 53, 58, 110 S.Ct. 2258, 110 L.Ed.2d 46 (1990).

40. Here, the sale of the F3 Brands' Assets failed to generate sufficient funds to satisfy the Lenders' claim. In addition, the Debtors' (likely inflated) estimated values for the remaining assets which may provide or otherwise generate cash for the estate of F3 Brands is limited to: (i) $300.00 in petty cash, (ii) $2,964.20 in cash, (iii) $1,685,119.64 in accounts receivable, (iv) $34,649.38 in office equipment, (v) $6,034,333.66 in machinery, and (vi) $4,159,892.10 in inventory. [Docket No. 148] The Debtors acknowledge, however, that the Lenders will still be owed approximately $27.4 million plus accrued interest after their receipt of the net proceeds of the sale of the F3 Brands' Assets. (Debtors' Response at ¶ 14). Consequently, the value of the estate's remaining assets is unlikely to generate adequate funds to satisfy the balance of the Lenders' claim, any future administrative expense claims, and section 503(b)(9) claims that the Debtors and Lenders are refusing to pay.

41. Moreover, the Debtors freely concede that confirmation of a plan for F3 Brands is unlikely. (Debtors' Response at ¶ 35). Therefore, the payment in full of some, but not all administrative expense claims now in connection with the sale of the F3 Brands' Assets significantly increases the likelihood that the unpaid section 503(b)(9) claims will not receive the same distribution being provided to the administrative expense claims that are being paid in connection with sale of the F3 Brands' Assets, as required by Congress. *See* 11 U.S.C. § 726(b).

42. In the event the Chapter 11 Cases are converted to Chapter 7, the fees paid to professionals would be subject to disgorgement in order to prevent the unequal treatment of the holders of the unpaid section 503(b)(9) claims. *In re Vernon Sand & Gravel*, 109 B.R. 255 (Bankr. N.D. Ohio 1989) (Bankruptcy court can require professional fees to be disgorged to achieve prorated deduction when, upon conversion of Chapter 11 case to Chapter 7, there are insufficient funds to pay Chapter 11 administrative expenses); *In re Gherman*, 114 B.R. 305 (Bankr. S.D. Fla. 1990) (interim compensation would be allowed, subject to duty to later disgorge such amounts if it is determined that insufficient funds existed to similarly pay other administrative claims); *Stump v. Creel & Atwood, P.C. (In re Lockwood Corp.)*, 216 B.R. 628, 635 (Bankr. D. Neb. 1997) ("[t]he clear majority of courts that have addressed this issue have uniformly held a cause of action for disgorgement does exist if the chapter 7 estate is administratively insolvent"). This potential costs, expense and uncertain result can be avoided by providing for payment of section 503(b)(9) claims now, along with the other administrative expense claims being paid in connection with the sale of the F3 Brands' Assets.

C. The Debtors Have No Basis To Distinguish The Section 503(b)(9) Claims From The Other Administrative Expense Claims Being Paid Now

43. The Debtors seek to unilaterally pick and choose which administrative expense claims will be paid, and which administrative expense claims will be left to linger and likely go

unpaid. In support of this proposition, the Debtors attempt to create a distinction between administrative expenses that accrue post-petition that they characterize as "true" administrative expense claims and other administrative expense claims, including section 503(b)(9) claims. Unfortunately for the Debtors, Congress made no such distinction, and no definition of “true administrative claims” is found in the Bankruptcy Code. Under the Bankruptcy Code, all administrative claims, “true” or otherwise, under section 503(b)(1) or section 503(b)(9), are entitled to the same treatment.

44. The reasons articulated by the Debtors in an effort to justify the disparate treatment between administrative expenses claims fall flat. Debtors argue that section 503(b)(9) claims are not entitled to the same treatment provided for other administrative expense claims because they are “fixed as of the petition date” and therefore “are simply not a cost of doing business in chapter 11.” (Debtors’ Response at ¶ 29). These purported distinctions are wholly inadequate to disregard Congressional mandate that all administrative expense claims, whether they be based on section 503(b)(1) or section 503(b)(9), must be treated the same for distribution purposes.

45. The notion that goods provided to a debtor within 20 days of the commencement of a chapter 11 proceeding do not provide post-petition benefits is also unwarranted. Clearly, for example, raw materials provided within 20 days of a petition date will be used by a debtor in its post-petition production of goods sold to generate post-petition accounts receivable, which in turn will increase the amount of a secured creditor’s cash collateral, or otherwise provide adequate protection for the use of such cash collateral. In addition, this argument assumes that the freight to be charged to a secured creditor for utilizing a chapter 11 proceeding for purposes of liquidating its collateral is limited to the costs and expenses incurred to preserve the value of a

secured creditor's collateral, rather than to preserve the administrative solvency of the estate as a whole in order for it to remain in chapter 11 in the first place.

46. Likewise, the Debtors make the over dramatic claim that requiring the payment of all administrative expense claims, including section 503(b)(9) claims, in connection with an asset sale that would otherwise solely benefit a secured creditor, will both fundamentally alter the credit industry which fuels our Nation's economy (Debtors' Response at ¶ 29), and lead to the demise of section 363 sales as we know it (Debtors' Response at ¶¶ 32-34). These claims are inconsistent, if not counterintuitive.

47. As set forth above, the Debtors first argue that section 503(b)(9) claims are not entitled to the same treatment provided for other administrative expense claims (despite the clear language of 11 U.S.C. § 726(b)), because they are "fixed" as of the petition date (Debtors' Response at ¶ 29). Then, however, the Debtors argue that if the freight charged to a lender includes payment of section 503(b)(9) claims, "a lender may be unwilling to fund a sale process because of the difficulty determining its ultimate exposure to section 503(b)(9) claims until the sales process is complete." (Debtors' Response at ¶ 33). Thus, the Debtors seek to avoid providing for payment of section 503(b)(9) claims all costs; first because they are fixed as of the petition date, and then because of the purported difficulty in determining their amounts until after a post-petition closing.

48. Clearly, it is more likely that the amount payable for the "other" administrative expense claims that the Debtors have agreed to fund in connection with the sale of the F3 Brands' Assets that will be more difficult to determine until completion of the sale process than the amount of the section 503(b)(9) claims which are "fixed" as of the Petition Date; hence, the

asset purchase agreement between the Debtors and Hopkins placing a cap on the amount of the administrative expense claims to be assumed by Hopkins.

49. Accordingly, the Debtors provide no justification for ignoring the clear terms of the Bankruptcy Code and not providing the same treatment for section 503(b)(9) claims as for all other section 503(b) claims (and in particular those being paid as part of the sale). Nor will making provision for the payment of section 503(b)(9) claims in connection with the sale of the F3 Brands' Assets lead to the collapse of chapter 11 cases or the U.S. economy, or the disappearance of section 363 asset sales.

50. The Debtors' reliance on court orders approving sections 363 sales in other cases fares no better. First, the court *In re Real Mex Restaurants, Inc.* was faced with a situation where, unlike here, "denial of the sale, would yield only a more substantial administrative insolvency." [Exhibit C to Debtors' Response at Tr. 186:17-18]. The court made clear that going forward the administrative claims would have to be paid, without any ability to "pick and choose those administrative obligations going forward from today that they would chose to pay or not pay." [*Id*. at Tr. 192:18-193:12].

51. Likewise, although the Committee recognizes that Judge Carey did not require payment of all section 503(b)(9) claims in *In re Allen Family Foods, Inc.*, the court made clear that it was "troubled by the fact that all 503(b)(9) expenses were not covered." [Exhibit D to Debtors' Response at Tr. 44:23-24]. Moreover, the debtor's equipment of significant value was sold as part of the section 363 sale, and was unencumbered and available for use to pay section 503(b)(9) claims in the future. Here, however, substantially all of the assets of F3 Brands have been sold, there are no unencumbered assets of any significant value, and the only preserved

potential causes of action against the Lenders relate to the Reliance business and will not inure to the benefit of the F3 Brands' estate or its creditors.[12]

52. The Debtors' remaining arguments, and those asserted by the Lenders, are either irrelevant, or are essentially objections to the principle that the Lenders must pay freight for using the Chapter 11 Cases to liquidate their collateral, rather than objections to the inclusion of the section 503(b)(9) claims within the freight to be charged. The cases addressing the timing of payment on individual section 503(b)(9) claims involved debtors that were operating on-going businesses, and no issue with regard to the potential administrative insolvency of the estates were raised.

53. In addition, the objections (i) to paying administrative expense claims in connection with a section 363 sale in the context of a liquidation proceeding (Debtors' Response at ¶ 30), (ii) the DIP Order precluding the subordination of the Lenders' security interests (Debtors' Response at ¶ 38), and (iii) the Lenders' claim of entitlement to adequate protection, or otherwise that its security interests cannot be subordinated to section 503(b)(9) claims, are all objections to being charged the freight, rather than the inclusion of the section 503(b)(9) claims as part of the freight. In other words, each of these arguments is equally applicable to the administrative expense claims that the Debtors and the Lenders have agreed to provide for in connection with the sale of the F3 Brands' Assets, as they are to the section 503(b)(9) claims. As set forth above, however, freight must be charged in the form of an administratively solvent estate, and the Debtors have no discretion to determine for themselves which administrative expense claims are entitled to priority treatment and which are not.

[12] The Debtors' argument that avoidance claims being available to pay the remaining unpaid administrative expense claims lacks any basis. All trade preference claims related to F3 Brands have been assigned to the purchaser and there is no indication that any retained avoidance claims of F 3 Brands has any value.

54. Likewise, the Debtors' complaint about somehow being improperly compelled to guarantee the payment of all administrative expense claims misses the mark. To the extent any such guaranty arose, it arose as a result of the Lenders' decision to liquidate their collateral through the chapter 11 process. In other words, having caused the Debtors to incur administrative expenses for their benefit, the Lenders must bear those administrative costs, including the section 503(b)(9) claims, to ensure equal treatment between and among all administrative expense claims as required under the Bankruptcy Code.

55. Moreover, since the Lenders required the Debtors to formulate and present a business plan addressing, among other items, the filing of a plan of reorganization (rather than liquidation) [DIP Financing Agreement, at ¶3.1 (G)], the Lenders were fully on notice of the requirement of paying *all administrative expense claims in full*, including section 503(b)(9) claims, and in fact required the Debtors to formulate a plan providing for the payment of all administrative expense claims in full, including section 503(b)(9) claims, under the terms of the DIP Financing Agreement. *See* 11 U.S.C. 1129(a)(9).

56. Based on the foregoing, the funds held in reserve under the terms of the Sale Order should be released for payment of section 503(b)(9) claims because (i) the Lenders must pay the freight to have their collateral liquidated through these proceedings, (ii) the cost of the freight is an administratively solvent estate, and (iii) all administrative expense claims must be treated equally for distribution purposes.

WHEREFORE, the Committee respectfully requests the entry of an Order directing that (i) the funds held in reserve for payment of section 503(b)(9) claims be released, (ii) requiring the Debtors use such funds to pay section 503(b)(9) claims at the same time, and in the same manner as the other administrative expense claims that are being paid in connection with the sale

of the F3 Brands' Assets, and (iii) granting the Committee such other and further relief as the Court deems just and appropriate.

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Respectfully submitted,

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