

News and Noteworthy

- **David B. Stratton** was elected a fellow of the American College of Bankruptcy.
- **Michael H. Reed** will moderate a program, “Auto Bankruptcies--New Paradigm or Aberration?”, being presented by the American College of Bankruptcy at the Annual Forum of the Eastern District of Pennsylvania Bankruptcy Conference in Philadelphia, PA on January 22, 2010.
- On December 4, **Michael H. Reed** spoke on a panel, “When Things Fall Apart: Workout and Bankruptcy of the Failing Real Estate Project,” presented at the 13th Annual Real Estate Institute of the Pennsylvania Bar Institute in Philadelphia, PA.
- On November 14, **I. William Cohen** spoke on a panel, “Out of Gas? An Analysis of the Chrysler and General Motors Chapter 11 Cases,” at the 6th Circuit Meeting of the American College of Bankruptcy.
- **Michael H. Reed** spoke on a panel, “New Players in Chapter 11--The New Creditor Constituency and the Impact on the Bankruptcy Practice,” presented at the 14th Annual Bankruptcy Institute of the Pennsylvania Bar Institute in Philadelphia, PA on October 29.
- **Kay Standridge Kress** was the chair and moderator for a “Lender Landmines” panel at the Trigild Conference on October 22.

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Proposed Sale of Chicago Cubs – Delaware Bankruptcy Court Approves Expedited Procedures to Sell Assets Before Filing

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On August 31, 2009, a Delaware bankruptcy judge entered an order setting an expedited process for the Tribune Company’s proposed sale of the assets of its non-debtor subsidiary, the Chicago Cubs, before the Cubs had filed a Chapter 11 petition. In what may be a groundbreaking order, Kevin J. Carey, chief judge of the United States Bankruptcy Court for the District of Delaware, authorized Tribune to move forward with its proposed sale of the Cubs to the family of TD Ameritrade founder Joe Ricketts. The proposed deal is valued at \$845 million and includes not only the Cubs, but also Wrigley Field and Tribune’s stake in Comcast SportsNet Chicago.

The Chicago Cubs have been on the market since investor Sam Zell purchased Tribune for \$8.2 billion in 2007. The Cubs are one of Tribune’s most valuable assets. Though Tribune filed for bankruptcy protection on December 8, 2008, the Cubs did not file as part of Tribune’s Chapter 11 case.

The sale of the Cubs contemplates a sale under Section 363 of the Bankruptcy Code even though they are not yet a debtor. Objections to the sale were due by September 17, 2009. The court will hold a hearing on September 24, 2009 to consider Tribune’s motion for court approval of the deal. Judge Carey also approved as much as \$20 million in break-up fees if the parties fail to complete the deal.

The proposed sale, if approved and consummated, would dispose of one of Tribune’s principal assets and represent a substantial step in Tribune’s Chapter 11 reorganization. Notably, both of the signifi-

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THE PARTIES WHO STRUCTURED THE SALE OF THE CUBS AND OBTAINED THE COURT'S APPROVAL OF THE SALE PROCESS SHOWED A GREAT DEAL OF IMAGINATION AND CREATIVITY IN THE PROPOSAL THEY PRESENTED TO THE COURT.

cant organized creditor representative groups in the Tribune bankruptcy, the Official Committee of Unsecured Creditors and a Steering Committee of lenders, fully support the proposed sale, including the deal protections.

The procedures approved by the court in this case are a novel and creative use of the Bankruptcy Code. As noted above, the Cubs have not filed for bankruptcy protection at this time but the proposed sale anticipates a "brief pass through bankruptcy" for the Cubs as a final step in effectuating the transaction. The Cubs will commence their own Chapter 11 case for the limited purpose of consummating the proposed sale and forming the resulting new business combination. The deal will result in Tribune retaining a 5 percent interest in the new entity formed to control the Cubs as part of the sale.

Tribune first announced its intention to sell the Cubs in April of 2007. Therefore, Tribune argued, and the court found, that parties-in-interest had notice that Tribune was seeking to enter into a transaction to divest the Cubs, such as the proposed sale, for nearly two-and-a-half years. The sales process methodically reduced the field of candidates down to the Ricketts family. Tribune argued that the notice provided in the Tribune bankruptcy was sufficient notice for all parties-in-interest, including parties interested in the affairs of the Cubs.

Although the Cubs have not yet filed for bankruptcy protection, the court set October 1, 2009 as the date to consider approval of the sale transaction in the Cubs's anticipated bankruptcy case. Tribune argued that this expedited relief was warranted given the actual notice provided to creditors and parties-in-interest via

the Tribune bankruptcy case and the long pre-bankruptcy sales process discussed above.

The bankruptcy filing by the Cubs would occur after approval of the proposed transaction in Tribune's bankruptcy case and after escrow financing documents are set. The filing by the Cubs will be intended to ensure that the sale proceeds with court approval, that the Cubs's assets are transferred free and clear of all liens and claims, and that contracts can be assumed and assigned to the new entity formed to control the Cubs.

Tribune argued that anything other than a brief pass through bankruptcy would be extremely detrimental to the Cubs. Attorneys for Tribune also argued that the facts and circumstances the court faced "were like none other previously faced by a bankruptcy court." The Cubs's bankruptcy case is proposed to last no longer than two or three business days. Tribune asserted that a longer bankruptcy stay would create lasting harm to the Cubs's brand and make it difficult, if not impossible, for the Cubs baseball team to perform necessary actions both on and off the field.

In the best case, a business planning a Section 363 sale can hope to obtain approval of the sale in 30 to 45 days, and the process often takes longer. In the meantime, there are significant costs associated with preparing for a Chapter 11 filing and operating the business during the Chapter 11 case. There also are significant risks that business relationships may be disrupted and the underlying business, as well as the business's good will, will be damaged. The parties who structured the sale of the Cubs and obtained the court's approval of the sale process showed a great deal of imagination and creativity in the proposal they presented to the court. Creditors and parties-in-interest will get notice of the sale and will have the opportunity to object if they need to, but the Cubs's stay in bankruptcy is anticipated to be exceptionally short.

Double Duty: UCC Definition of Goods Same for §503(b)(9)

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A PREVIOUS VERSION OF THIS ARTICLE WAS PUBLISHED IN *THE LEGAL INTELLIGENCER* ON OCTOBER 16, 2009. IT IS REPUBLISHED HERE WITH PERMISSION.

As most practitioners know, the Bankruptcy Code imposes a specific priority scheme that controls the payment of claims. The higher the priority of a particular claim, the more likely it is to be paid. Generally, secured claims are paid first from the specific collateral backing that claim, followed by administrative priority claims, unsecured priority claims and then general unsecured claims. Equity takes last, assuming there is anything left.

In 2005, Congress amended the Bankruptcy Code to add §503(b)(9), which dramatically changed the payment priorities and, as a result, Chapter 11 itself. Section 503(b)(9) provides for the allowance of an administrative claim for the “value of any goods received by the debtor within 20 days before the date of commencement of a case under [Title 11] in which the goods have been sold to the debtor in the ordinary course of such debtor’s business.” Thus a large body of claims, which were formerly treated as general unsecured, now receive administrative priority. Because a plan (the vehicle for a debtor to successfully exit Chapter 11) must pay administrative claims in full in order to be confirmed, many debtors are now entering Chapter 11, selling their assets and immediately converting to a Chapter 7 liquidation.

However, some debtors, instead of simply giving up, are mounting aggressive challenges against §503(b)(9) claims. For example, the Chapter 11 debtor in the bankruptcy case involving the former consumer electronics giant Circuit City recently sought a ruling that the term “goods,” as used in §503(b)(9), should carry the same definition as set forth in the Uniform Commercial Code. *In re Circuit City Stores, Inc.*, 2009 WL 3032346 (Bankr. E.D.Va. Sept. 22, 2009). The debtor asked the court to rule that in transactions involving both the sale of goods and the provision of services, the “predominant purpose” test should be employed to determine whether the §503(b)(9) priority applies. By doing so, the debtor had hoped to dramatically reduce the overall number of administrative priority claims.

News and Noteworthy

- On October 19, **Michael H. Reed** moderated the panel, “Snake Eyes: Casino Bankruptcies,” presented by the Subcommittee on Chapter 11 of the Business Bankruptcy Committee of the ABA Section of Business Law at the Annual Meeting of the National Conference of Bankruptcy Judges in Las Vegas, NV.
- **Kay Standridge Kress** was a panelist at the Fall ABA Meeting held in conjunction with the National Conference of Bankruptcy Judges. The panel, “Current Developments in Bankruptcy,” took place on October 19.
- On October 19, **Barbara Rom** spoke at the Business Bankruptcy Section of the ABA on Casino Bankruptcies in Las Vegas, NV. Ms. Rom is on the Michigan Gaming Control Board.
- **Michael H. Reed** spoke on a panel, “The New Deal: Transactional Skills for a Changing Environment,” presented at the American Bar Association’s National Conference for the Minority Lawyer in Philadelphia, PA on September 24.

Publications

- **Francis J. Lawall** and **Michael J. Custer** have an article, “Attorneys’ Fees Accruing Post-Petition Under Pre-Petition Indemnity Agreement Represent Pre-Petition Claim,” in an upcoming December issue of *The Legal Intelligencer*.
- “Double Duty: UCC Definition of Goods Same for Section 503(b)(9),” an article written by **Francis J. Lawall** and **Nina M. Varughese**, was featured in the October 16 issue of *The Legal Intelligencer*.
- The September 4 issue of *The Legal Intelligencer* featured an article, “Stay Violation Damages - Not Just a Debtor’s Remedy Any More,” written by **Francis J. Lawall** and **Evelyn C. Meltzer**.

The *Circuit City* court first addressed the definition of “goods” for purposes of §503(b)(9). It noted that the Bankruptcy Code contains no definition of the term and there was no controlling law in the Fourth Circuit. Consistent with the practice in the Fourth Circuit, the bankruptcy court then turned to state law and concluded that the UCC should be employed to fashion a definition for the same term in §503(b)(9). The court noted that using the UCC definition would give a consistent, uniform approach, since 49 states had already adopted some version of the UCC.

UCC §2-105(1) defines goods as “all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid . . .” The bankruptcy court noted that this is consistent with the definition in *Black’s Law Dictionary* and with the term’s ordinary and common usage—it is the “well-known meaning” of goods.

The court also found support for using the UCC definition from the fact that §503(b)(9) is itself part of a section titled “Reclamation” in the 2005 amendments to the Bankruptcy Code. According to the Seventh Circuit, reclamation, which allows sellers to take back goods delivered to buyers under certain circumstances, “arises under §2-702 of the UCC.” See *In the Matter of Adventist Living Centers, Inc.*, 52 F.3d 159, 162 n.1 (7th Cir. 1995). Given that reclamation has its origins in the UCC, which defines “goods,” and that Congress did not choose to provide a different definition in the Bankruptcy Code, the court reasoned that the UCC definition was likely intended to apply to the Bankruptcy Code as well.

As to the second issue under §503(b)(9), the *Circuit City* court concluded that the “predominate purpose test,” developed and applied by the majority of courts to determine whether the UCC is applicable to hybrid contracts calling for the delivery of both goods and services, should be used to determine whether a claim is entitled to administrative priority under §503(b)(9). Under this test, the court must determine whether “the sale of the goods predominates.” See *BMC Indus, Inc. v. Barth Indus, Inc.*, 160 F.3d 1322, 1329-30 (11th Cir. 1998). In so ruling, the court looked with favor upon the formulation of the predominant purpose test set forth in *Princess Cruises, Inc. v. General Electric Co.*, 143 F.3d 828, 833 (4th Cir. 1998) (quoting *Bonebreak v. Cox*, 499 F.2d 951 (8th Cir. 1974)), which held that “[T]he test for inclusion or exclusion is not whether they are mixed but, granting that they are mixed, whether their predominant factor, their thrust, their purpose, reasonably stated, is the rendition of service, with goods

incidentally involved (e.g., contract with artist for painting) or is a transaction of sale, with labor incidentally involved.”

In an October 7, 2009 memorandum ruling arising out of the *SemCrude* Chapter 11 case pending in Wilmington, Delaware, the bankruptcy court addressed, among a number of issues, the measurement of “value” under §503(b)(9). In *re SemCrude*, Case No. 08-11525 (Bankr.D.Del. October 7, 2009). In *SemCrude*, it was argued by the bank agent opposing the §503(b)(9) claims that the term “value” for purposes of measuring the size of a 20-day claim should be “the resale price of goods, or if the goods were not resold, the current market value of the goods on the Effective Date of the Plan.” Not surprisingly, many of the vendors argued that the “value” of the goods was established by the invoice or contract price. Judge Shannon, while recognizing that the term “value” is not defined in the Bankruptcy Code, found that “there is ample and convincing authority to support the proposition that the invoice or purchase price is presumptively the best determinant of value.” The court went on to note, however, that such price could be rebutted under the particular facts and circumstances of a given transaction.

Until the circuit courts (and possibly the Supreme Court) rule on these and many other issues arising under §503(b)(9), this Bankruptcy Code provision will remain a flash point, given the enormous effect it will have on a debtor’s ability to reorganize. For now, we can expect many more creative arguments to be advanced by debtors seeking to successfully emerge from Chapter 11.

Assumption and Assignment of Executory Contracts: Lessons from Chrysler and GM

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The recent bankruptcies of Chrysler, LLC (Chrysler) and GM Corporation (GM) have raised many novel legal questions and issues, including unusual procedures for the assumption and assignment of executory contracts. The Chrysler and GM bankruptcies also are a reminder of the pitfalls facing contract counterparties. The Bankruptcy Code, 11 U.S.C. §365, permits a debtor to reject or assume, and, after assumption, assign executory contracts and unexpired leases. The Bankruptcy Code also provides protections for contract counterparties that require the debtor to: (1) cure all outstanding defaults at the time of assumption, (2) compensate the counterparty for actual pecuniary loss resulting from the default or provide adequate assurance of such compensation and (3) provide adequate assurance of future performance. The Bankruptcy Code does not set forth the procedures that a debtor must follow to assume and assign contracts. However, debtors routinely establish procedures, approved by court order, for the assumption and assignment of executory contracts when selling all or substantially all of their assets in bankruptcy.

Chrysler and GM both proposed procedures for the assumption and assignment of executory contracts, and these procedures were approved by the court. The breakneck speed at which both cases are moving through the court also has significantly affected contract counterparties. Chrysler filed for bankruptcy on April 30, 2009, and on May 3, 2009 Chrysler filed its motion to approve bidding procedures, including procedures for assumption and assignment of executory contracts. Similarly, GM filed for bankruptcy on June 1, 2009 and filed its bidding procedures motion, including assumption and assignment procedures, that same day. Bidding procedures and assumption and assignment procedures are not traditionally sought in “first-day motions.”

Unlike assumption and assignment procedures encountered in most bankruptcy cases, Chrysler’s procedures provided for two notices. The first notice advised the counterparty of the expected assumption and assignment of the contract and included Chrysler’s version of the cure amount. Two noteworthy issues regarding the first notice warrant further discussion. First, the

SUPPLIERS MUST BE VIGILANT AND WATCH FOR IMPORTANT NOTICES FROM BANKRUPT COMPANIES. IN THESE DIFFICULT ECONOMIC TIMES, SUPPLIERS MUST BE CAUTIOUS WITH REGARD TO ASSUMPTION AND ASSIGNMENT OF THEIR CONTRACTS WITH DEBTORS.

cure amounts were calculated as of April 30, 2009, the petition date. Calculating the cure amounts as of the petition date is not in compliance with the Bankruptcy Code, which requires that all existing defaults be cured as of the date of the *assumption* of the contract. This problem was exacerbated by a provision in the notice that payment of the designated cure amount would be in full satisfaction of all obligations arising before the assumption and assignment. Second, the notices were sent to the highest corporate parent level entity instead of to the actual parties to the contract.

As a result of the inaccurate calculation of cure amounts, numerous contract counterparties, who did not otherwise oppose the assumption and assignment of their contracts to the purchaser, were required to file objections. The pace of these cases and the provision of notice only to the parent, combined with the requirement that objections to cure amounts be filed within ten days of service, further complicated the assumption and assignment of contracts that were otherwise uncontested. In fact, many suppliers were required to scramble and file a last-minute objection to the cure amount to preserve their rights.

Unlike traditional assumption and assignment procedures, the Chrysler contracts were not assumed at the expiration of the ten-day period even when no objections were filed. Instead, contracts were assumed when the supplier received a second

notice, which informed the supplier that the contract had been assumed and assigned. Until receipt of the second notice, but before a deadline established by Chrysler, up to 90 days after the closing of the Fiat sale, Fiat could exclude contracts for which the counterparty received the first notice. Also unusual was the provision permitting the *purchaser* to exclude a contract for which the counterparty received the first notice but had not yet received the second notice. If the contract counterparty did not receive the second notice, or the purchaser deemed the contract not assumed, Chrysler was permitted to assume or reject the contract at a later date.

GM's bidding procedures motion included assumption and assignment procedures similar to those in Chrysler's bankruptcy case, in addition to some other unusual procedures. GM's procedures, like Chrysler's, require that counterparties file objections, if any, within ten days of the date of the notice. A notable difference between GM's and Chrysler's procedures is that GM uses a secure Web site that enables the counterparty to view information for only their individual contract. In Chrysler's case, the expected assumed contracts were made public by filing schedules with the court. GM also established a call center for the attempted resolution of cure amount objections. As only some contract counterparties have received notice of their password for the Web site, and contract counterparties have not yet received notice that their contract has been assumed, we are still waiting to see if the assumption and assignment procedures in GM's bankruptcy case will work better than those used in Chrysler's.

Chrysler's and GM's assumption and assignment procedures are an important reminder for suppliers to these and other debtors. Suppliers must be vigilant and watch for important notices from bankrupt companies. These notices should be forwarded to counsel as soon as possible to avoid missing the short deadlines provided for in the procedures and outlined in the notices. Further, suppliers should avoid being lulled into a sense of security by assuming the debtor will treat them fairly regarding the assumption and assignment of their executory contract, especially when the supplier supports the assumption of their contract. Instead, suppliers must confirm that the cure amount has been calculated correctly and conforms to the requirements of the Bankruptcy Code. In these difficult economic times, suppliers must be cautious with regard to assumption and assignment of their contracts with debtors.

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