

University of Texas 2007 Bankruptcy Litigation: Pretrial Practice and Procedure Workshop

First Day Pleadings Presentation

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I. First Day Pleadings Form Requirements:

- A. Application/Motion/Exhibits.**
- B. Master Affidavit in Support of First Day Pleadings.**
- C. Order.**
- D. Petition/Exhibit “A”.**

II. First Day Pleadings Preparation:

A. Organizing for the First Day Hearings and Dealing with Case Specific Factors:

- 1. Administrative Issues.
- 2. Operational Needs of the Business.
- 3. Substantive Issues.

B. Drafting Suggestions:

- 1. Common Fact Pleadings.
- 2. Consistency.
- 3. Accuracy.

C. Tell the Case Story.

D. Disclosure Obligations.

- 1. Debtor.
- 2. Debtor’s Counsel/Engagement.
- 3. Other Parties?

E. Due Process Concerns and Preservation of Rights of Parties Not Present.

- 1. Committee.
- 2. Other Creditors.
- 3. Timeframes.

III. Administrative First Day Pleadings:

A. Joint Administration. Applicable authority: F.R.B.P. 1015; L.B.R. 1015. The typical request for relief contemplates joint administration (i.e., procedural consolidation, in contrast to substantive consolidation) of the cases of affiliated debtors, for administrative convenience. Among other things, all pleadings will be filed in only one designated case (i.e., under the case number that the court designates for all the cases to be jointly administered); one docket will be maintained for the consolidated debtors; and there will be one meeting of creditors. Separate Schedules and SOFAs are usually still required to be prepared, and separate Proofs of Claim Registers need to be maintained.

1. **Example Pleading:**

a. Calpine Corporation—Case No. 05-60200; Southern District of New York; Docket No. 3.

B. Notice/Case Management. Applicable authority: 11 U.S.C. § 105(a); F.R.B.P. 2002 and 9007; L.B.R. 2002.1 and 9007.1. The typical request for relief contemplates seeking approval for a form of service list to be used for most motions/applications in the case (designating parties-in-interest who must be served and possibly clarifying that certain groups of parties-in-interest such as customers or employees, who may assert claims, will not need to be served with routine motions) and may ask for regular case settings (e.g., bi-weekly hearings) and clarification of procedures for expedited setting requests.

1. **Example Pleading:**

a. Brook Mays Music Company—Case No. 06-32816-11; Northern District of Texas; Docket Nos. 3 & 4.

C. Extensions of Time (Schedules, SOFAs, Assumption/Rejection Leases/Executory Contracts, Removal, and Exclusivity). Applicable authority for Schedules and SOFAs: 11 U.S.C. § 105(a); F.R.B.P. 1007(a)(4), 1007(c), and 9006(b); L.B.R. 1007.1(a). Additional applicable authority for Assumption/Rejection of Leases/Executory Contracts: 11 U.S.C. § 365 and F.R.B.P. 6006. Additional applicable authority for Removal: 28 U.S.C. § 1452 and F.R.B.P. 9027. Additional applicable authority for extending exclusivity: 11 U.S.C. § 1121. The typical form of relief contemplates asking for more time for a complex, large debtor to undertake such tasks as filing Schedules/SOFAs and making decisions as to what leases and contracts to assume, what lawsuits to remove to the bankruptcy court and for formulating and filing a plan, since, presumably, these decisions require more evaluation and/or negotiation with a large, complex company.

1. **Example Pleading:**

- a. Brook Mays Music Company—Case No. 06-32816-11; Northern District of Texas; Docket No. 5 (schedules & SOFAs)

D. Bar Date. Applicable authority: F.R.B.P. 3003 and 9006. The typical request for relief contemplates debtor asking for the court to set a deadline for the filing of proofs of claim (and for approval of a form of notice regarding same).

E. Employment of Professionals/Fee Procedures. Applicable authority: 11 U.S.C. §§ 105(a), 327, 330, and 331; F.R.B.P. 2014 and 2016; L.B.R. 2016.1. The typical request for relief contemplates getting court approval for the employment of professionals and also the procedures for interim payment procedures. Often the request is for a monthly reimbursement procedure whereby professionals are paid 80% of their fees and 100% of their expenses, and then submit periodic fee applications wherein the professionals seek retroactive approval for the amounts already paid and permission for the debtor to pay the 20% “holdbacks.”

1. **Example Pleading:**

- a. Brook Mays Music Company—Case No. 06-32816-11; Northern District of Texas; Docket No. 22.

F. Committee Information Access Protocols. Applicable authority: 11 U.S.C. §§ 105(a), 1102(b)(3), and 1103. This is a new protocol that has developed post-BAPCPA. Section 1102(b)(3) now requires Creditors Committees to provide access to information regarding the case to the Committee’s constituency and to solicit input from the constituency during the case. The typical request for relief contemplates getting approval for a protocol to provide information to and solicit input from the constituency (usually with confidentiality provisions to insure that confidential information should not and need not to be provided to creditors who do not sign confidentiality agreements). Usually includes establishing a website, publicly accessible and non-publicly accessible electronic case updates, and a process for persons to request other information.

1. **Example Pleading:**

- a. Brook Mays Music Company—Case No. 06-32816-11; Northern District of Texas; Docket No. 16.

G. Filing of Documents Under Seal. Applicable authority: 11 U.S.C. §§ 105 and 107(b); F.R.B.P. 9018; L.D.R. 79.4; L.B.R. 9029(3). The typical request for relief comes into play when there is certain information that perhaps needs to be put in a pleading in the bankruptcy case, as part of a request for substantive relief, but is perceived by the debtor to be confidential, commercial and proprietary and may harm the estate if it is publicly filed with the court and is accessible to anyone and

becomes widely disseminated. The cited authority collectively give the court the ability to issue any order, such as authorizing/requiring pleadings to be filed and kept under seal, in order to protect the estate with respect to trade secrets, commercial information where there could be direct and adverse impairment of the debtor's interests, or where competitors, for example, might be able to get an unfair advantage through access to information.

1. **Example Pleading:**

- a. Northwest Airlines Corporation—Case No. 05-17930; Southern District of New York; Docket No. 33.

IV. Operational First Day Pleadings:

INTRODUCTION

A company generally files for chapter 11 to reorganize its debts and fix its problems. A successful reorganization hinges on a seamless transition into bankruptcy for the (now) debtor-in-possession. “Operational” first-day pleadings are designed to provide this seamless transition by enabling the debtor-in-possession to continue its operations as usual, thus minimizing the disruption caused by the bankruptcy and thereby giving the debtor-in-possession time to address immediate needs and plan for long-term solutions. As such, operational first-day motions are not intended to be controversial. The following are common operational first-day motions:

A. Cash-Management / Investment-Guidelines Motion

1. **What is the relief requested in a cash-management/investment-guidelines motion?**

- a. Cash Management. A cash management motion (“Cash Management Motion”) generally asks for court permission to maintain an existing cash management system without interruption and technical compliance with certain guidelines promulgated by the United States Trustee.
- b. Investment Guidelines. An investment guidelines motion (“Investment Guidelines Motion”) generally asks for court permission to excuse or ignore strict compliance with 11 U.S.C. § 345 and to approve the investment accounts already established by the debtor-in-possession.

2. **Why is a Cash Management/Investment Guideline Motion filed?**

- a. Cash Management. Guidelines from the United States Trustee generally require that, among other things, debtors-in-possession close their prepetition accounts, establish (new) debtor-in-possession (postpetition) accounts, and account separately for cash

collateral. These guidelines also require that the debtor's business forms indicate that it is a debtor-in-possession and that the checks drawn on the debtor-in-possession accounts bear the exact full name of the debtor-in-possession (as shown on the voluntary petition), the case number, and clearly denote that such checks are written on debtor-in-possession accounts. Moreover, because the priority scheme under the Bankruptcy Code precludes a debtor-in-possession from paying prepetition debts without permission from the court, compliance with these guidelines would arguably help debtors-in-possession and their financial institutions ensure that prepetition claims are not paid after the petition date.

- b. Investment Guidelines. 11 U.S.C. § 345(a) of the Bankruptcy Code allows a debtor-in-possession to deposit or investment money in a way that “will yield the maximum reasonable net return on such money, taking into account the safety of such deposit or investment.” 11 U.S.C. § 345(b) requires that, unless the court orders otherwise, a debtor-in-possession must require all financial institutions to post a bond or pledge a security to ensure the safe return of estate funds if estate deposits exceed federally insured limits.

3. **When is a Cash Management/Investment Guideline Motion filed?**

- a. Cash Management. A Cash Management Motion³ is generally filed when large companies enter bankruptcy with myriad interconnected accounts as part of a complex cash management system. In such cases, forcing a company to comply with these guidelines by closing all of its accounts and establishing a new cash management system would likely disrupt the company's cash-receipts and disbursements cycle. The conclusion reached by the debtor-in-possession in such cases is that the costs to be incurred by strict compliance would outweigh the benefits to be achieved by such compliance. Put differently, a business-as-usual approach provides more value to the estate than technical compliance with the guidelines provides to the estate.
- b. Investment Guideline. An Investment Guideline Motion is generally filed when the terms of the debtor-in-possession's investment accounts do not strictly comply with or adhere to those requirements imposed by 11 U.S.C. § 345(b) and such strict compliance would be inconsistent with 11 U.S.C. § 345(a). In such instances, and when their own investment accounts are

³ Debtors-in-possession often combine requests for relief generally requested in a Cash Management Motion and an Investment Guideline Motion in one pleading.

themselves conservative and sufficiently ensure the safe return of estate funds, debtors-in-possession often ask the court to excuse the requirements imposed by 11 U.S.C. § 345(b).

4. **What is included in a Cash Management/Investment Guideline Motion?**

- a. Cash Management. A Cash Management Motion should generally describe (with words and pictures) the company's cash management system. This description should list all accounts by number and location. This description should detail how cash receipts and cash disbursements are traced through the system. If multiple debtors are involved, this description should detail how cash is moved between debtors and how those transfers are described or recorded on the books of each debtor or non-debtor.
- b. Investment Guidelines. An Investment Guideline Motion should generally describe the terms covering the debtors-in-possession's investment accounts and explain why those terms are conservative enough to justify the waiver of 11 U.S.C. § 345(b). To justify the waiver, this motion should show the court how the debtor-in-possession's current investment accounts preserve capital, provide liquidity, and generate returns to the estate that are consistent with returns otherwise available in the market.

5. **What are the bases for the relief requested in a Cash Management / Investment Guideline Motion?**

- a. Cash Management. 11 U.S.C. §§ 105, 363, and 364.
- b. Investment Guidelines. 11 U.S.C. §§ 105, 345, and 363.

6. **Example Pleadings:**

- a. Global DocuGraphix USA, Inc.—Case No. 06-32888-11; Northern District of Texas; Docket No. 9.
- b. Brook Mays Music Company—Case No. 06-32816-11; Northern District of Texas; Docket No. 8.
- c. Dura Automotive Systems, Inc.—Case No. 06-11020; District of Delaware; Docket No. 6.
- d. Refco Inc.—Case No. 05-60006 (RDD); Southern District of New York; Docket Nos. 111 and 1050.
- e. Delphi Corporation – Case No. 05-44481; Southern District of New York; Docket Nos. 24 and 25.

- f. Musicland Holding Corp.—Case No. 06-10064; Southern District of New York; Docket No. 18.

B. Critical-Vendor Motion

1. **What is the relief requested in a critical-vendor motion?** A critical vendor motion (“Critical Vendor Motion”) generally asks for court permission to pay the prepetition claim of certain vendors whose postpetition business with the debtor-in-possession is “critical” or “necessary” to the debtor-in-possession’s ability to navigate the choppy waters of chapter 11. Please note that Critical Vendor Motions have been criticized in many jurisdictions; accordingly, please review the relevant law in your district before filing a Critical Vendor Motion.
2. **Why is a Critical Vendor Motion filed?** A Critical Vendor Motion is filed because some “critical” vendors often refuse to do business with (and ship product or provide service to) the debtor-in-possession. In exchange for this vendor providing postpetition product or service to the debtor-in-possession on “favorable” terms, subject to court approval, the debtor-in-possession agrees to pay that vendor for its prepetition claim. This requested relief is arguably justified when, because the debtor-in-possession is unable to find replacement goods or services for equal or better terms, the “critical” vendor’s refusal to deal with the debtor-in-possession after the bankruptcy filing would devastate or severely hamper the reorganization. The requested relief is necessary because the priority scheme under the Bankruptcy Code prohibits the payment of prepetition claims without court approval.
3. **When is the Critical Vendor Motion filed?** Critical Vendor Motions are filed when successful reorganizations depend on the debtor-in-possession’s continued receipt of “critical” goods and services from certain vendors after the bankruptcy filing and those “critical” vendors refuse to provide the debtor-in-possession with such goods or services. The breadth of the relief requested in a Critical Vendor Motion is likely narrowed slightly by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”)—11 U.S.C. § 503(b)(9). The BAPCPA gives administrative-expense priority to goods (not services) provided to debtors-in-possession in the ordinary course of business within 20 days before the bankruptcy filing. Given the administrative-expense tag, a debtor-in-possession is presumably authorized to pay the value of these charges without approval from this court. For services, goods not provided to the debtor-in-possession in the ordinary course of business, and goods not provided to the debtor-in-possession within that 20-day window, critical-vendor relief must be obtained by relying on other predicates, some of which are noted below.

4. **What is included in a Critical Vendor Motion?** A Critical Vendor Motion should specifically list or categorize the parties designated by the debtor-in-possession as “critical” and the amounts to be paid to each party. A Critical Vendor Motion should then justify why those vendors are, in fact, “critical” and state that these “critical” vendors have refused to ship to the debtor-in-possession after the petition date. Debtors-in-possession should also attempt to gain approval for payment to “critical” vendors up to an amount in their sole discretion and without court approval. This would give the debtor some control (or leverage) in negotiating with that critical vendor on terms and conditions. Critical Vendor Motions also generally include the terms and conditions that will govern the postpetition dealings between the debtor-in-possession and the critical vendors.
5. **What are the bases for the relief requested in a Critical Vendor Motion?** The doctrine of necessity and 11 U.S.C. §§ 105, 363, and 364(b). Moreover, at least one court has suggested that, if a debtor-in-possession offers to pay for postpetition goods in cash, the vendors refusal to ship those goods may under certain circumstances be construed as a violation of the automatic stay imposed by 11 U.S.C. § 362. *In re CoServ, LLC*, 273 BR 487 (Bankr. N.D. 2002) (“The goal of equal treatment in liquidation or under a plan suggests Congress would not countenance use by a general unsecured prepetition creditor of a ‘critical’ position to force payment of a prepetition debt. Section 362(a)(6) on its face appears to prohibit such ‘economic blackmail.’”) (citations omitted).
6. **Example Pleadings:**
 - a. Dura Automotive Systems, Inc.—Case No. 06-11020; District of Delaware; Docket No. 9.
 - b. Delphi Corporation—Case No. 05-44481; Southern District of New York; Docket No. 17.
 - c. Musicland Holding Corp.—Case No. 06-10064; Southern District of New York; Docket No. 13.

C. Prepetition Employee Wages, Benefits,⁴ Etc.

1. **What is the relief requested in an employee-benefits motion?** An employee benefits motion (“Employee Benefits Motion”) generally asks for court permission to pay the prepetition claims of necessary employees related to prepetition wages, benefits, etc. and employee-reimbursed expenses in the ordinary course of the debtor-in-possession’s business.

⁴ Typical benefits include all general welfare benefits like medical, dental, vision, life and disability insurance, sick time, personal time off, jury-duty pay, other paid leave, severance (non-insider), 401(k) and 403(b) Savings Plans, and other similar benefits.

The following are common benefits provided to employees: (a) medical, dental, vision, life, and disability insurance, (b) holiday pay, personal time off, sick time, (non-insider) severance, jury-duty pay, and other paid leave, and (c) 401(k) and other similar savings or retirement programs.

2. **Why is an Employee Benefits Motion filed?** An Employee Benefits Motion is filed because employees are often times the linchpin of a company's successful reorganization. Companies often times pay their employees in arrears and reimburse expenses after they are actually incurred and paid by the employee. Depending on how far in arrears a company pays its employees for wages, benefits, etc., many employees may hold a rather large prepetition claim when the company files for bankruptcy. Once a bankruptcy is filed, these prepetition claims may not be paid by the debtor-in-possession without court approval. Accordingly, to prevent a mass exodus upon the bankruptcy filing, which would seriously jeopardize the debtor-in-possession's reorganization efforts, the employees must be assured that their pay and benefits will be honored by the debtors-in-possession. This assurance is provided through an Employee Benefits Motion.
3. **When is an Employee Benefits Motion filed?** Employee Benefits Motions are filed when critical employees hold prepetition claims against the estate that must be paid to protect employee morale and the ongoing operations of the debtor-in-possession and to preserve the Debtor's work force.
4. **What is included in an Employee Benefits Motion?** An Employee Benefits Motion should categorize the employee benefits subject to the motion. It should also specifically describe each category so that the court has a working knowledge of the benefits in question. For example, an Employee Benefits Motion should carefully describe the debtor-in-possession's payroll cycle and how much in arrears each payroll cycle is at the petition date, as well as the other benefit programs provided by the debtor-in-possession to its employees. The court needs to understand the relief requested on the first day of the case to avoid misunderstandings later down the road. An Employee Benefits Motion should also generally cover all "employee benefits" so that the debtor-in-possession may continue payments to employee for wages and benefits without interruption up to and through the bankruptcy filing. Unless otherwise justified under the doctrine of necessity, an Employee Benefits Motion should also contain a statement that the debtor-in-possession intends to pay all wages, benefits, etc. in accordance with the priority caps imposed by 11 U.S.C. §§ 507(a)(4) and (5), which would not upset the priority scheme imposed by the Bankruptcy Code.

5. **What are the bases for the relief requested in an Employee Benefits Motion?** The doctrine of necessity and 11 U.S.C. §§ 105, 363, 364(b), 507(a)(4), 507(a)(5), and 541(d).
6. **Example Pleadings:**
 - a. Global Docugraphix USA, Inc.—Case No. 06-32888-11; Northern District of Texas; Docket No. 8.
 - b. Brook Mays Music Company—Case No. 06-32816-11; Northern District of Texas; Docket No. 7.
 - c. Dura Automotive Systems, Inc.—Case No. 06-11020; District of Delaware; Docket No. 4.
 - d. Refco Inc.—Case No. 05-60006 (RDD); Southern District of New York; Docket No. 12.
 - e. Delphi Corporation—Case No. 05-44481; Southern District of New York; Docket No. 12.
 - f. Musicland Holding Corp.—Case No. 06-10064; Southern District of New York; Docket No. 34.

D. Sales and Use Taxes Motion

1. **What is the relief requested in a sales-and-use-tax motion?** A sales and use tax motion (“Sales and Use Tax Motion”) generally asks for court permission to pay the prepetition sales, use, franchise, business, and other similar taxes in the ordinary course of the debtor-in-possession’s business.
2. **Why is a Sales and Use Tax Motion filed?** A Sales and Use Tax Motion is filed because actions taken by taxing authorities to collect their taxes may interfere with the reorganization. Accordingly, payment of these taxes is often in the best interest of the estate because the reorganization may be jeopardized by a taxing authority’s attempt to collect these taxes. This is especially true when the tax is a trust-fund tax for which the directors and officers may be personally liable because they may be more focused on defending or defeating their personal liability than on the company’s reorganization. Because sales, use, and similar taxes are subject to priority treatment under the Bankruptcy Code, early payment of these is justified when it is clear that the debtor-in-possession will reorganize and otherwise be obligated to pay such taxes at a later date anyway.
3. **When is a Sales and Use Tax Motion filed?** A Sales and Use Tax Motion is filed when a debtor-in-possession has incurred various sales, use, franchise, business, and other similar taxes for which payment to the

taxing authority is due and owing on the bankruptcy filing date. Given that tax payments of this kind are made on a periodic basis, it is common for companies to owe a tax liability on the bankruptcy filing date. And, where these taxes are trust fund in nature, officers and directors may be subject to personal liability for any underpayments on the same. This threat (or cloud) of potential personal liability may interfere with or jeopardize the focus of the directors and officers on the debtor-in-possession's reorganization.

4. **What is included in a Sales and Use Tax Motion?** A Sales and Use Tax Motion should describe the types of taxes subject thereto and quantify, historically speaking, the debtor-in-possession's monthly obligation for such taxes. A Sales and Use Tax Motion should also generally describe the payment procedures used by the debtor-in-possession with each taxing authority, whether the tax is a trust-fund tax, and the facts supporting the debtor-in-possession's likelihood of reorganization. It is now common for taxing authorities to require estimated tax payments on a monthly basis with a "true-up" mechanism when the taxes are actually due. It is also common for many taxing authorities to draft tax payments from a debtor-in-possession's account.
5. **What are the bases for the relief requested in a Sales and Use Tax Motion?** The doctrine of necessity and 11 U.S.C. §§ 105, 507(a)(8), and 541(d).
6. **Example Pleadings:**
 - a. Brook Mays Music Company—Case No. 06-32816-11; Northern District of Texas; Docket No. 9.
 - b. Dura Automotive Systems, Inc.—Case No. 06-11020; District of Delaware; Docket No. 8.
 - c. Delphi Corporation—Case No. 05-44481; Southern District of New York; Docket No. 27.
 - d. Musicland Holding Corp.—Case No. 06-10064; Southern District of New York; Docket No. 6.

E. GOB Sales

1. **What is the relief requested in a going-out-of-business motion?** A going-out-of-business motion ("GOB Motion") generally asks for court permission to close its business or to conduct going-out-of-business sales of estate assets. And, given the business-closure issue, a "GOB Motion" usually asks for other things, including, permission for the court to immediately reject certain burdensome executory contracts and unexpired

leases and abandon property that is burdensome and of inconsequential value to the estate.

2. **Why is a GOB Motion filed?** A “GOB Motion” is filed for several reasons. First, debtors-in-possession file a GOB Motion because nonresidential real property leases typically prohibit going-out-of-business sales. Second, many state and local laws prohibit or attempt to regulate such going-out-of-business sales. Third, given that a GOB Motion is often filed in connection with an asset sale, debtors-in-possession file this motion to provide notice of the proposed sale to satisfy bulk-sale concerns. Objections to GOB Motions have centered on, among other things, public policy. The argument is that even bankruptcy debtors must comply with state and local laws designed to protect the public and that laws prohibiting going-out-of-business sales are laws designed to protect the public. Some courts have uniformly rejected that argument on 28 U.S.C. § 959 grounds, which only requires a debtor-in-possession to comply with state and local laws that are designed to protect the public health and safety, by finding that going-out-of-business sales were not designed to protect the public health and safety. Other courts have refused to exempt debtors-in-possession from complying with the going-out-of-business bans. As such, the practical result may be a compromise such that the debtor-in-possession is permitted to conduct the going-out-of-business sales but not permitted to augment inventory, raise prices just before the sale, sell gift cards and later fail to redeem those gift cards, etc.
3. **When is a GOB Motion filed?** A GOB Motion is filed when a debtor-in-possession has determined that certain (or all) locations cannot be operated at a profit. As such, the continued operation of the location(s) will generate additional (and some times substantial) administrative-expense claims against the estate that outweigh the associated benefit to the same. A GOB Motion is often filed when the subject inventory is seasonal in nature, and the value to be realized for that inventory will be greater through a going-out-of-business sale than otherwise.
4. **What is included in a GOB Motion?** The request for GOB relief is often times embedded in a § 363 motion asking the court for permission to conduct going-out-of-business sales at the debtor-in-possession’s retail locations. These going-out-of-business sales are usually structured where the debtor-in-possession receives a fixed price up front from the liquidator, and over time the liquidator conducts going-out-of-business sales at the debtor-in-possession’s locations and reimburses the debtor-in-possession for normal occupancy and operating expenses. This structure allows the liquidator to conduct the sales and to use the debtor-in-possession’s intellectual property during and in furtherance of those sales.
5. **What are the bases for the relief requested in a GOB Motion?** 11 U.S.C. §§ 363(b)(1), 365(a), 554 and 28 U.S.C. § 959(b).

6. **Example Pleadings:**

- a. Brook Mays Music Company—Case No. 06-32816; Northern District of Texas; Docket No. 87.
- b. Musicland Holding Corp.—Case No. 06-10064; Southern District of New York; Docket Nos. 29 and 35.

F. Reclamation Procedures/Return of Goods

1. **What is the relief requested in a reclamation-procedures motion?** A reclamation procedures motion (“Reclamation Procedures Motion”) generally asks the court to establish certain reclamation procedures to govern the attempted reclamation of goods by certain vendors.
2. **Why is a Reclamation Procedures Motion filed?** Historically, a Reclamation Procedures Motion was filed to prevent vendors from reclaiming goods by granting them an administrative claim equal to the value of their valid reclamation claims and to establish procedures under which the validity of all reclamation claims would be determined. Since BAPCPA deleted a provision of § 546 that allowed a bankruptcy court to deny reclamation of goods if the creditor were granted an administrative-expense claim or a lien on other property, the utility of a “reclamation motion” is now arguably limited to establishing procedures for the handling of reclamation claims. These procedures should be designed to allow debtors-in-possession to retain goods subject to reclamation and to minimize the business disruption associated with handling myriad reclamation demands individually. These procedures should also attempt to streamline the reclamation process early in the case, which may encourage these “reclamation” vendors to continue doing business with the debtor-in-possession.

BAPCPA now arguably grants vendors a federal right to reclaim goods. Former 11 U.S.C. § 546(c) expressly stated that a vendor was entitled to exercise its state-law rights to reclaim goods. New 11 U.S.C. § 546(c) makes no reference to state law and provides simply that a vendor may reclaim goods sold to the debtor in the ordinary course of the seller’s business within forty-five days before the filing date. As seen, new 11 U.S.C. § 546(c) now allows a vendor until forty-five days after receipt of those goods by the debtor to make its reclamation demand.

New 11 U.S.C. § 546(c) also expressly makes reclamation rights subject to the prior rights of a secured creditor with a security interests in goods or their proceeds. Other changes to reclamation rights by BAPCPA include 11 U.S.C. § 503(b)(9), which gives vendors an administrative-priority claim for the value of any goods received by the debtor-in-possession within 20 days before the filing date if the goods were sold in the ordinary

course of the debtor's business. This gift of an (increased) administrative-priority claim creates at least one problem when a marginally solvent debtor has hopes of confirming a plan: Confirmation may not be possible because the debtor-in-possession cannot pay all of its administrative claims in full. Since administrative-expense claims are not subject to a claims-filing bar date prior to confirmation of a plan, it is advisable to request the court to establish a bar date in a Reclamation Procedures Motion. This bar date will allow a marginally solvent debtor to assess its ability to pay administrative claims early in the case and to avoid expense and delay in converting to chapter 7, if appropriate.

3. **When is a Reclamation Procedures Motion filed?** A Reclamation Procedures Motion is filed when a company regularly receives a large number of goods that are necessary for its operations within 45 days of the bankruptcy filing. Without such a motion, attempts by vendors to reclaim their goods may cause significant disruption to the debtor-in-possession's daily operation.
4. **What is included in a Reclamation Procedures Motion?** A Reclamation Procedures Motion should (a) require reclamation vendors to submit additional documents supporting each element of their reclamation claim—e.g., dates of delivery, identity of goods delivered, location, etc., (b) establish a timeline within which reclaiming vendors must furnish the requisite documentation of their claim, debtors-in-possession will first reconcile and then report on the reclamation demands, and the parties will seek determination from the court of a reclamation dispute, (c) establish a reclamation-claims bar date, (d) bar reclamation vendors who do not timely comply with the proposed procedures; and (e) prohibit the filing of complaints against the debtor-in-possession to establish reclamation rights pending compliance with the procedures.
5. **What are the bases for the relief requested in a Reclamation Procedures Motion?** U.C.C. § 2-702 and 11 U.S.C. §§ 105, 503(b)(9), and 546.
6. **Example Pleadings:**
 - a. Delphi Corporation—Case No. 05-44481; Southern District of New York; Docket No. 21.
 - b. Musicland Holding Corp.—Case No. 06-10064; Southern District of New York; Docket No. 11.

G. Customer Programs, Deposits, Refunds

1. **What is the relief requested in a customer-programs motion?** A customer programs motion (“Customer Programs Motion”) generally asks

the court for permission but not the directive to continue prepetition customer-service programs, including, without limitation, layaways, gift cards, gift certificates, deposits, and warranty service.

2. **Why is a Customer Programs Motion filed?** A Customer Programs Motion is filed to preserve and to engender customer loyalty, which is necessary to maximize a debtor-in-possession's going-concern value. To file this motion, a debtor-in-possession must determine that the short-term drain of paying these arguably prepetition claims is outweighed by the long-term boon to the estate because of customer satisfaction and appreciation.
3. **When is a Customer Programs Motion filed?** A Customer Programs Motion is filed when a debtor-in-possession's successful reorganization hinges on customer loyalty and satisfaction and the costs of obtaining new customers is outweighed by the costs of retaining old ones.
4. **What is included in a Customer Programs Motion?** A Customer Programs Motion should describe the customer programs offered by the debtor-in-possession and explain (or justify) explain how those programs relate to the debtor-in-possession's ongoing business and successful reorganization. Unless otherwise justified under the doctrine of necessity, a Customer Programs Motion should also state that the debtor-in-possession will not pay any amount for customer programs that exceeds the priority cap imposed by 11 U.S.C. § 507(a)(7). This statement will help neutralize objections from the debtor-in-possession lender, the statutory committees, and the U.S. Trustee. A Customer Programs Motion should also ask the court to allow but not require the debtor-in-possession to honor these prepetition customer programs and quantify the amount outstanding under these programs on the petition date.
5. **What are the bases for the relief requested in a Customer Programs Motion?** The doctrine of necessity and 11 U.S.C. §§ 105, 363(c)(1), 507(a)(7), 1107(a), and 1108.
6. **Example Pleadings:**
 - a. Brook Mays Music Company—Case No. 06-32816-11; Northern District of Texas; Docket No. 10.
 - b. Dura Automotive Systems, Inc.—Case No. 06-11020; District of Delaware; Docket No. 5.
 - c. Delphi Corporation—Case No. 05-44481; Southern District of New York; Docket No. 20.

- d. Musicland Holding Corp.—Case No. 06-10064; Southern District of New York; Docket No. 7

H. Adequate Assurance of Utilities

1. **What is the relief requested in a utility motion?** A utility motion (“Utility Motion”) should ask the court to prohibit “utilities” from altering, refusing, or disconnecting services to the debtor-in-possession on account of pre-petition debts and to approve the amount and method by which the debtor-in-possession will provide adequate assurance of payment for post-petition services provided by the utility company.
2. **Why is a Utility Motion filed?** A Utility Motion is filed because uninterrupted “utility” service is typically essential to a successful reorganization. 11 U.S.C. § 366(b) provides a narrow exception to the general rule that a utility cannot discriminate against a debtor for filing bankruptcy by authorizing a “utility” to terminate services if adequate assurance of future payment is not provided by the debtor-in-possession within 20 days after the case was filed.⁵ Read completely, 11 U.S.C. § 366 provides the debtor-in-possession with the right to receive uninterrupted utility service for, at least, the first 20 days of the case. Thereafter, a utility provider may “alter, refuse, or discontinue if neither the trustee nor the debtor” has provided adequate assurance of future payment and, irrespective of the 20 or 30-day window, a utility may recover or offset against prepetition security deposits without need for relief from stay. Accordingly, a Utility Motion is a way for a debtor-in-possession to define and permissibly reduce or eliminate the need for providing additional security to utility providers by establishing certain procedural protections before a utility can terminate service. These protections are especially helpful when dealing with various utility providers throughout the country.

11 U.S.C. § 366 was changed by BAPCPA in a number of ways. First, adequate assurance is now defined in the Bankruptcy Code. In the past, a debtor could pay adequate assurance to a utility in any form approved by a court. With that in mind, courts would routinely find “adequate assurance” by granting the utility an administrative-expense claim for the amount due after the petition date. Now “adequate assurance” is defined to mean cash or cash equivalent. This change requires the debtor-in-possession to spend money quickly after the petition date.

Second, “adequate assurance” paid by a debtor must now be “satisfactory” to the utility. In the past, a utility could only discontinue service if it was

⁵ See the discrepancy noted below between subsections (b) and (c) regarding a 20 or 30-day during which a debtor has to provide the utility with adequate assurance.

not provided adequate assurance approved by the court. This change gives a utility some say in the form and amount of the proposed adequate-assurance payment.

Third, utilities are now allowed to recover or offset against prepetition security deposits without the need for relief from the automatic stay. In the past, a utility would need to seek permission from the court to offset a prepetition security deposit against a prepetition arrearage.

Finally, there is now a discrepancy between subsections (b) and (c) of 11 U.S.C. § 366 because they contain two different time periods during which a utility is prohibited from discontinuing utility service. Subsection (b) allows a utility to discontinue services if “adequate assurance” is not provided within 20 days after the order of relief, while subsection (c) allows a utility to discontinue service if in a chapter 11 it is not provided “adequate assurance” within 30 days after the order of relief.

In sum, under BAPCPA utilities now have more protection; thus, debtors-in-possession must be more proactive than they used to be when dealing with utilities. Debtors-in-possession can no longer essentially ignore utilities by providing administrative-expense protection to all utilities.

3. **When is a Utility Motion filed?** A Utility Motion is filed when a debtor-in-possession could not function without utility service and the refusal of such service would seriously hamper or cripple the desired reorganization. Additionally, when the debtor-in-possession relies on multiple facilities, a Utility Motion will help minimize time and expense dealing with each utility separately.
4. **What is included in a Utility Motion?** A Utility Motion should ask the court to prohibit a utility from discontinuing service until a determination of adequate assurance is made, to approve the offer of adequate assurance unless the utility asks for more, and to establish certain procedures if the adequate-assurance offer is not accepted by the utility. A Utility Motion should attach a list that identifies: (a) the name and address of the Utility; (b) to the extent known, the account number for which the utility provides services to the debtor-in-possession, (c) the type of utility service provided by the utility to the debtor-in-possession; and (d) the proposed adequate assurance deposit.
5. **What are the bases for the relief requested in a Utility Motion?** 11 U.S.C. §§ 105 and 366.
6. **Example Pleadings:**
 - a. Global Docugraphix USA, Inc.—Case No. 06-32888-11; Northern District of Texas; Docket No. 7.

- b. Brook Mays Music Company—Case No. 06-32816-11; Northern District of Texas; Docket No. 6.
- c. Dura Automotive Systems, Inc.—Case No. 06-11020; District of Delaware; Docket No. 11.
- d. Refco Inc.—Case No. 05-60006 (RDD); Southern District of New York; Docket No. 273.
- e. Delphi Corporation—Case No. 05-44481; Southern District of New York; Docket No. 41.
- f. Musicland Holding Corp.—Case No. 06-10064; Southern District of New York; Docket No. 21.

I. Payment of Certain Prepetition Claims of Shippers, Freight Handlers, and Warehousemen

1. **What is the relief requested in a shippers, freight-handlers, and warehousemen motion?** A shippers, freight handlers, and warehousemen motion (“Shippers, Freight Handlers, and Warehousemen Motion”) should ask the court for permission to pay the prepetition claims of shippers, freight handlers, warehousemen, etc. and other expenses incidental to these claims.
2. **Why is a Shippers, Freight Handlers, and Warehousemen Motion filed?** A Shippers, Freight Handlers, and Warehousemen Motion is filed because the failure to pay to these claims would often times give rise to a lien (possessory or otherwise) under state law in the specific estate property and preclude the delivery of those goods, and the perfection of such liens or interests—under 11 U.S.C. § 362(b)(3)—is excluded from the automatic stay. (Note that BAPCPA added 11 U.S.C. § 546(i), which bars a trustee’s or debtor-in-possession’s use of 11 U.S.C. § 545(2) and (3) to avoid a warehouseman’s lien for storage or handling of goods. By its terms, § 546(i) is intended to conform with applicable state law similar to § 7-209 of the Uniform Commercial Code.) The rationale is that such (secured) creditors would ultimately be paid in full anyway at the end of the case, and the maintenance of a solid supply of these materials (or goods) without interruption would preserve customer loyalty. Moreover, if these (secured) creditors were paid in full at the end of the case, then payment to them on the “first day” would save the estate interest and other costs on those claims in certain circumstances.
3. **When is a Shippers, Freight Handlers, and Warehousemen Motion filed?** A Shippers, Freight Handlers, and Warehousemen Motion is filed when a debtor-in-possession has valuable goods stored or in transit on the petition date, and the failure to pay claims associated with that transit or

storage would likely cause the shippers, haulers, and warehousemen to retain possession of estate property that would otherwise provide value to the estate. To justify the filing of a Shippers, Freight Handlers, and Warehousemen Motion, the value of that good must exceed the prepetition cost of that good, and the failure to debtor-in-possession's failure to possess those goods would irreparably harm the goodwill and reorganization.

4. **What is included in a Shippers, Freight Handlers, and Warehousemen Motion?** A number of these motions are filed with different names. But there is generally one theme with all of these motions: Court permission is sought to pay for prepetition claims that may give rise to a lien if such payment is not made. A Shippers, Freight Handlers, and Warehousemen Motion should identify the types of goods subject to the motion, the amount of the prepetition claims of the shippers, freight handlers, etc., and the types of liens that may be asserted if payment is not otherwise made.
5. **What are the bases for the relief requested in a Shippers, Freight Handlers, and Warehousemen Motion?** The doctrine of necessity and 11 U.S.C. §§ 105, 363, and 503(b)(1).
6. **Example Pleadings:**
 - a. Global DocuGraphix USA, Inc.—Case No. 06-32888-11; Northern District of Texas; Docket No. 10.
 - b. Dura Automotive Systems, Inc.—Case No. 06-11020; District of Delaware; Docket No. 7.
 - c. Delphi Corporation—Case No. 05-44481; Southern District of New York; Docket No. 22.
 - d. Musicland Holding Corp.—Case No. 06-10064; Southern District of New York; Docket No. 8

J. Equity Transfers

1. **What is the relief requested in an equity-trading protocol motion?** An equity-trading protocol motion (“Equity Trading Motion”) generally asks the court to establish certain notice and hearing procedures before certain transfers of equity securities in the debtor-in-possession are deemed effective.
2. **Why is an Equity Trading Motion filed?** An Equity Trading Motion is filed to preserve valuable tax attributes, including, without limitation, net-operating-loss carryforwards as allowed under the Internal Revenue

Code.⁶ If the trading of these tax attributes is left unrestricted, and without notice to the debtor-in-possession, then the debtor-in-possession's ability to use these valuable assets could be severely limited, which could adversely affect the estate and the creditors thereof. Court-approved procedures to monitor the trading of equity securities would allow the debtor-in-possession to be in position to expeditiously act to prevent transfers that would jeopardize the value of certain tax attributes.

3. **When is an Equity Trading Motion filed?** An Equity Trading Motion is generally filed as a first-day motion. This is done because of the severe consequences to the value of the estate if the debtor-in-possession and others are not able to effectively monitor the trading of equity securities from the start of the case.
4. **What is included in an Equity Trading Motion?** An Equity Trading Motion should include well-established procedures⁷ to be followed when one is trading equity securities in the debtor-in-possession. For example, such procedures should define a "substantial shareholder" and require that all such shareholders notify the debtor-in-possession of their existence. Such procedures should also require a substantial shareholder to notify the court, the debtor-in-possession, counsel for the debtor-in-possession, and counsel for the creditors' committee before effectuating a transfer of his or her equity securities in the debtor-in-possession.

Such procedures should also require notification to the debtor-in-possession, counsel for the debtor-in-possession, and counsel for the creditors' committee before a transfer that would result in one becoming or ceasing to be a substantial shareholder is effectuated.

The procedures should set a deadline by which all parties in interest have to object to the proposed transfer of equity securities and a scheduling order by which the court will decide the merits of any such objection.

5. **What are the bases for the relief requested in an Equity Trading Motion?** 11 U.S.C. §§ 105, 362(a)(3), and 541.

⁶ Section 382 of the Internal Revenue Code allows a company to use net operating losses to offset taxable income earned in future years. A company's ability to use net operating losses is, however, restricted if that company undergoes a "change in ownership." Under Section 382, a "change of ownership" occurs when the percentage of a company's equity held by one or more 5% shareholders increases by more than 50 percentage points over the lowest percentage of stock owned by shareholders at any time during a three-year testing period. For example, an individual ("U") owns 50.1 of the stock of corporation XYZ ("X"). U sells her 50.1% interest to another individual ("B"), who owns 5% of X's stock. Under Section 382, a change in ownership has occurred because B's interest in X has increased more than 50 percentage points—5% to 55.1%—during the testing period.

⁷ The number of outstanding shares of common stock in the debtor-in-possession on the filing date should also be noted in the equity-trading protocol motion.

6. **Example Pleadings (transfers of equity):**

- a. Dura Automotive Systems, Inc.—Case No. 06-11020; District of Delaware; Docket No. 13.
- b. Refco Inc.—Case No. 05-60006 (RDD); Southern District of New York; Docket No. 111.
- c. Delphi Corporation—Case No. 05-44481; Southern District of New York; Docket No. 29

V. **Substantive First Day Pleadings:**

A. **Post-Petition Financing.**

- 1. **Use of Cash Collateral.** Applicable authority: 11 U.S.C. §§ 361, 363; F.R.B.P. 4001(b). Cash collateral is broadly defined in 11 U.S.C. § 363(a). The trustee (or debtor-in-possession) may not use, sell or lease cash collateral unless the entity that has an interest in the cash collateral consents or if the court authorizes the use, sale, or lease of cash collateral after hearing in which the trustee must show that such entity is adequately protected for such use. The court may commence a final hearing on a motion for authorization to use, sale, or lease cash collateral no earlier than 15 days after service of the motion. The typical motion will request that the court authorize the use, sale, or lease of only that amount of cash collateral as is necessary to avoid immediate and irreparable harm to the estate pending a final hearing. In the case of a contested preliminary cash collateral hearing, the court may authorize the use, sale, or lease of cash collateral only if there is a reasonable likelihood that the trustee will prevail at a final hearing.
- 2. **Example Pleadings:**
 - a. Brook Mays Music Company—Case No. 06-32816-11; Northern District of Texas; Docket No. 15 (obtain credit and use cash collateral).
- 3. **Obtaining Credit.** Applicable authority: 11 U.S.C. § 364; F.R.B.P. 4001(c). The trustee (or debtor-in-possession) may need to obtain credit to operate the bankruptcy estate. Credit may be obtained in the ordinary course of business as an administrative expense. The trustee may seek court authority to obtain credit other than in the ordinary course. If a trustee is unable to obtain credit, the court may authorize the obtaining of such credit with priority over all administrative expenses, secured by a lien on unencumbered property of the estate, or secured by a junior lien on encumbered property of the estate. Also, the court may authorize the obtaining of credit secured by a senior or equal lien on encumbered

property of the estate only if the trustee is unable to obtain such credit otherwise and the existing lienholder is adequately protected. A motion for authority to obtain credit must be accompanied by a copy of the credit agreement. The court may commence a final hearing on a motion for authority to obtain credit no earlier than 15 days after service of the motion. The typical motion will request that the court authorize the obtaining of credit on an interim basis to the extent necessary to avoid immediate and irreparable harm to the estate pending a final hearing.

4. **Example Pleading:**

a. Brook Mays Music Company—Case No. 06-32816-11; Northern District of Texas; Docket No. 15 (obtain credit and use cash collateral).

5. **The Checklist in the N.D. Tex.** The United States Bankruptcy Court for the Northern District of Texas requires attorneys to submit a checklist for motions and orders pertaining to the use of cash collateral and post-petition financing which are in excess of 10 pages. The checklist is online at http://www.txnb.uscourts.gov/forms/cash_collateral_checklist.pdf.

6. **Example Pleading:**

a. Brook Mays Music Company—Case No. 06-32816-11; Northern District of Texas; Docket No. 14.

B. Assumption/Rejection of Leases and Executory Contracts as of Petition Date. Applicable authority: 11 U.S.C. § 365; F.R.B.P. 6006. Although executory contracts and unexpired leases are separately addressed in the Bankruptcy Code, neither term is defined in the Bankruptcy Code. Unexpired leases are split into leases of real property and personal property. Executory contracts are contracts with obligations by both parties to the contract such that the failure to perform would result in a material breach of the contract. Executory contracts and unexpired leases may be assumed or rejected in bankruptcy. If assumed, they will be afforded administrative claim status and performance should be completed as if bankruptcy had not been filed. If rejected, the holder of the claim under an executory contract or unexpired lease will hold an unsecured claim for damages. The Bankruptcy Code has limitations on such claims for leases of real property and employment contracts. Claimants are also subject to damages mitigation requirements. The automatic stay enjoins a creditor from terminating an executory contract or unexpired lease, and, pending the debtor's decision to assume or reject the executory contract, the counterparty to such contract must continue to perform. Typically, a trustee (or debtor-in-possession) will bring a motion to reject an executory contract or unexpired lease as a first-day motion in order to protect the estate from accumulating unnecessary administrative expense claims. The trustee will usually request that the rejection be effective as of the date the bankruptcy case commenced.

1. **Example Pleadings:**

- a. Brook Mays Music Company—Case No. 06-32816-11; Northern District of Texas; Docket Nos. 11 & 12.
- b. Calpine Corporation—Case No. 05-60200; Southern District of New York; Docket No. 8.
- c. Premium Papers Holdco—Case No. 06-10269; District of Delaware; Docket No. 18.

C. Key Employee Retention and Incentive Plans. Applicable authority: 11 U.S.C. §§ 363(b), 365, 503(b)(1), and 503(c). 11 U.S.C. § 503(c), addressing so-called “KERP” programs, significantly limits the ability of a debtor to pay key employees (particularly executives and other insiders) retention bonuses and severance pay. This section severely limits debtors in their ability to offer KERPs to officers and directors. Specifically, this section provides that payments to induce insiders of the debtor to continue to work for the debtor are not permitted unless: (1) the payment is essential to retain such person; (2) such person has a bona fide job offer from another business at the same or a greater rate of compensation; and (3) the amount of the payment does not exceed ten times the amount of a similar transfer to a non-management employee during the calendar year of the proposed transfer, or if no such transfer has been made, then it may not exceed 25 times the amount of any similar transfer to an insider in the calendar year preceding the case. Severance pay is similarly limited to an amount not to exceed 10 times the amount of the mean severance pay given to nonmanagement employees during the calendar year in which the payment is made.

1. **Example Pleading:**

- a. Brook Mays Music Company—Case No. 06-32816-11; Northern District of Texas; Docket No. 13 (non-insiders).
- b. Calpine Corporation—Case No. 05-60200; Southern District of New York; Docket No. 1174.

D. Abandonment. Applicable authority: 11 U.S.C. § 554; F.R.B.P. 6007. A trustee may abandon property of the bankruptcy estate that is burdensome to the estate or that is of inconsequential value to the estate. If the trustee will not abandon property, a creditor may move the bankruptcy court to order the trustee to abandon property that is burdensome to the estate or that is of inconsequential value and benefit to the estate. Abandonment of property from the estate has the legal effect of revesting the property in the debtor. It does not provide a creditor with relief from the automatic stay.