



904: Litigation Aspects of Bankruptcy: Protecting Your Client's Assets & Preserving Their Rights

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Faculty Biographies

Bruce D. Becker

Bruce D. Becker is president and CEO of GST Telecommunications in Portland, Oregon. Mr. Becker was GST's senior vice president of law and regulatory affairs before he became the company's chief executive officer.

Before joining GST, Mr. Becker held a number of in-house positions at Ameritech Corporation in Chicago, serving as general counsel of Ameritech Long Distance Industry Services.

Mr. Becker has been active in ACCA affairs for a number of years. He is a former member of the ACCA board of directors and former president of the Chicago chapter. Mr. Becker also was president and a board member of the Chicago Bar Foundation, the philanthropic arm of the Chicago Bar Association, and currently serves on the board of trustees of the Trillium Family Services Foundation in Portland.

Mr. Becker received his undergraduate degree from Yale University and his law degree from Harvard Law School.

Matthew C. Joly

Matthew C. Joly is a senior counsel with Sears, Roebuck and Co., in charge of managing Sears' exposure to vendor and commercial customer bankruptcy proceedings. His responsibilities include managing litigation related to commercial bankruptcies, administering Sears' claims in commercial bankruptcy matters, educating Sears' associates on working with and avoiding vendors in bankruptcy, and monitoring advances in commercial bankruptcy law.

Prior to coming to Sears, Mr. Joly worked for several Chicago area law firms and as a sole practitioner, concentrating in commercial bankruptcy, litigation, and transactions for closely held corporations, small partnerships, and professionals.

Mr. Joly is a founding member of Sears' law department committee. He concentrates his pro-bono efforts in advising not for profit corporations and assisting qualified participants in the CHAC, Inc. Choose To Own Program, a charitable organization established to assist low-income working people buy their first homes.

Mr. Joly received his BA from the University of Illinois and is a graduate of the Illinois Institute of Technology, Chicago-Kent College of Law.

Maita D. Prout

Maita D. Prout is a partner in the Los Angeles office of Holland & Knight LLP, where she is head of that office's creditor's rights and bankruptcy group. She has extensive experience in bankruptcy, bankruptcy litigation, asset based finance, and out-of-court workouts. Parties she represents include lenders, landlords, trade creditors, licensors of intellectual property, creditors' committees, equity

committees, purchasers of assets from bankruptcy estates, bankruptcy trustees, and others. Representative engagements include avoidance action defense, claims litigation, negotiation and documentation of cash collateral stipulations, negotiation and documentation of debtor-in-possession financing, negotiation of terms of plans of reorganization, true sale and non-consolidation options, and negotiation and documentation of bankruptcy transactions.

Ms. Prout is the immediate past chair of the commercial law and bankruptcy section of the Los Angeles County Bar Association. Other professional affiliations include Financial Lawyers Conference, Los Angeles Bankruptcy Forum, Commercial Real Estate Women LA, and NNCREW. She is a founder of an ongoing series of complimentary educational programs for judges sponsored by the commercial law committee of the Los Angeles County Bar Association. Ms. Prout has written articles and spoken on bankruptcy and commercial law topics for numerous organizations, including California Continuing Education of the Bar, the Los Angeles County Bar Association, Financial Executives International, National Network of Commercial Real Estate Women, National Licensors' Credit Association, and the USC Entertainment Law Symposium.

Ms. Prout received her BA, *cum laude*, from the University of California at Los Angeles and her JD from UCLA School of Law.

ACCA 2003 ANNUAL MEETING

PROTECTING YOUR CLIENT'S RIGHTS IN BANKRUPTCY

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ACCA 2003 ANNUAL MEETING

PROTECTING YOUR CLIENT'S RIGHTS IN BANKRUPTCY

1. Introduction to Chapter 11 of the Bankruptcy Code
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2. The Automatic Stay
 - a. What is the automatic stay and what does it cover?
 - b. Actions not prohibited by the automatic stay –
 - Merchandise returns – post-petition returns by the debtor credited against pre-petition debt
 - Both parties must agree
 - Must be in the best interest of the bankruptcy estate
 - Strategy considerations

Set-off of creditor's pre-petition debt to debtor against debtor's pre-petition debt to creditor

Recoupment – allows set-off of pre-petition against post-petition claims

Reclamation of goods provided to debtor

- State law right to reclaim goods shipped may be exercised
- Must be written demand
- Very short time to make written demand (see 11 U.S.C. Section 546(c)(1) -- demand must be made timely
- Goods must have been sold to the debtor in the ordinary course of business
- Debtor must have been insolvent when the goods were received
- If court denies reclamation creditor is entitled to either an administrative claim or a lien

Non-dischargeability for certain types of debts (e.g., fraud, embezzlement)

- c. Perfection of liens against the debtor – generally prohibited by automatic stay, but there are exceptions (e.g., mechanics' liens in certain states)

3. The claims process

a. Types of claims in a Chapter 11 proceeding

Secured

Unsecured

Administrative

Priority

Contingent

b. Filing a claim

Notice of filing of bankruptcy from the court

Has the claim been scheduled by the debtor?
If so, is it scheduled as contingent, disputed or
unliquidated? Is the scheduled amount
correct?

Gathering the information for the claim form

Identifying the proper person on the claim
form to receive notices (e.g., the claims
administrator)

Watch for the debtor's claims deadlines/
bar dates

Tracking your claims

c. Litigating disputes over the validity and amount of claims

Pre-existing litigation may be removed to Bankruptcy Court, or stay may be lifted to allow litigation to continue in order to liquidate (but not enforce) the claim

The debtor files an objection to creditor's claim; the debtor may commence an adversary proceeding to pursue cross-claims

Creditor claims for rejection damages (damages arising out of the debtor's rejection of an executory contract – see below)

Litigation over extent and validity of secured claim may also arise in other contexts

Tactical issues – the consequences of payment as an unsecured claim (i.e., “bankruptcy dollars” v. real dollars)

d. The debtor also may commence an adversary proceeding to pursue an independent claim against a creditor

4. Preferences

a. What is a preference, and what is the rationale?

b. Asserted by complaint

c. Most common defenses

Payments were made in the ordinary course of business of the debtor and non-debtor, according to ordinary business terms

Offsets in the amount of new value given by the non-debtor to the debtor after receipt of payment

Payments represented contemporaneous exchange for new value

d. Preference-proofing your receipt of payments

COD terms

Applying debtor's payments to latest invoices may preserve ordinary course of business defense

Working with the debtor so as not to precipitate a bankruptcy filing within 90-days of receipt of payment

Immediate deposit of checks to minimize likelihood of coming within the 90-day preference period

5. Dealing with companies that might be approaching bankruptcy

a. Signs of impending bankruptcy

Nonpayment or delinquent payment

Unexpected and significant personnel changes

Unexplained changes in quality of product and service

Requests for changes in terms

Negative news in publications and on the grapevine

Late filing of SEC reports

- b. Minimizing financial exposure to a company about to file bankruptcy (subject to the preference rules discussed above)

Get cash upfront

Change payment terms (e.g., obtain a deposit)

Obtain a letter of credit

Obtain collateral (note: taking collateral may be a preference, in which case it would be subject to avoidance)

Delay payments to the debtor if a set-off or recoupment claim might be available in bankruptcy

If the contract permits, end the relationship

6. Doing business with the debtor after bankruptcy has been filed
 - a. Continuation of a debtor's business under "First Day" orders
 - b. Debtor is entitled to the benefit of its contracts unless it rejects or post-petition breach by debtor excuses performance (see below), but sums owing for post-petition goods and services are entitled to administrative priority
 - c. If there is no binding contract, the creditor may terminate the relationship or alter payment terms (e.g., cash up front, deposits)
 - d. The creditor receives an administrative claim against the debtor if the debtor breaches a post-petition commitment to the creditor
 - e. Separate rules for utilities, which may require "adequate assurance" of the debtor's performance in return for continuing to provide service
 - f. "Extraordinary" transactions (e.g., sales of the debtor's assets) require court approval
 - g. Monitor the bankruptcy docket to see if the debtor is proposing actions that might have an impact on your relationship, such as a sale of a part of the business

7. Assumption and assignment of contracts between creditor and debtor, and commercial leases where the debtor is the lessee
 - a. Definition of an executory contract
 - b. Purpose of allowing the debtor to decide whether to assume a pre-petition contract or lease
 - c. Entire contract or lease must be assumed and assigned – no cherry picking
 - d. Prerequisites to allowing the debtor to assume a contract – curing defaults and providing adequate assurance of future performance
 - e. *ipso facto* clauses unenforceable
 - f. Assignment of assumed contracts (contractual anti-assignment clauses may be unenforceable)
 - g. Rejection of a contract or lease by the debtor –

General unsecured claim - Gives rise to a claim for breach of contract but the breach is considered pre-petition and rejection damages therefore are general unsecured claims

Administrative priority claim - Creditor may have an administrative claim based on post-petition performance under the rejected contract or lease

h. Special rules for real property leases

Landlord of assigned lease entitled to a security deposit from assignee

Assignment of shopping center leases – debtor cannot assume and assign a lease if the tenant mix will be disrupted

Cap on landlord's damage claim for rejection of lease

i. A special issue – assumption and assignment of intellectual property rights

Debtor/licensor rejects license agreement – Licensee may elect to treat license as terminated, or retain rights under the contract and make royalty payments

When licensee elects to retain rights –

- licensee waives right of setoff with respect to royalty payments
- no administrative claim allowed
- debtor may not interfere with licensee's rights
- debtor required to provide the licensee with the intellectual property to the extent provided in the license agreement

PROTECTING YOUR CLIENT'S RIGHTS IN BANKRUPTCY

Relevant Bankruptcy Code Provisions

(The Bankruptcy Code is Title 11 of the United States Code, so the following provisions are cited as 11 U.S.C.101 – 1330)

Sec. 362 – Automatic Stay

Sec. 365 – Executory contracts and unexpired leases

Sec. 366 – Utility service

Sec. 502 – Allowance of claims or interests

Sec. 503 – Allowance of administrative expenses

Sec. 506 – Determination of secured status

Sec. 507 – Priorities

Sec. 521 – Debtor's duties

Sec. 546 – Preferences

Sec. 553 – Setoff

UNITED STATES BANKRUPTCY COURT
FOR THE _____ DISTRICT OF _____

In Re:

[name]

Honorable _____

Debtor

_____ /

Case No. _____

(Chapter 11)

MOTION OF SEARS, ROEBUCK AND CO. FOR PERMISSION
TO EXERCISE RECOUPMENT RIGHTS OR
TO MODIFY THE AUTOMATIC STAY

Sears, Roebuck and Co. ("Sears"), by and through its undersigned counsel, for its Motion for the entry of an order by this Court permitting Sears to exercise its recoupment rights, or in the alternative, to modify the automatic stay effective in this bankruptcy case, states as follows:

- 1. The Chapter 11 debtor, herein [entity name] ("Debtor"), [commenced this voluntary case] on [date].
2. Debtor is engaged in the business of [describe nature of business]. Debtor is operating its business as a debtor-in-possession.
3. Prior to the commencement of this bankruptcy case, Sears purchased goods from the Debtor on credit terms from time to time.
4. On or about [date], Sears and Debtor executed Sears' Universal Terms and Conditions (the "UTC"). A copy of the executed UTC is attached hereto as Exhibit A. Pursuant to Section 2.2 of the UTC, its provisions are incorporated into all "Vendor Agreements" between Debtor and Sears, including all "Purchase Orders" issued by Sears to Debtor.

5. After executing the UTC, Sears ordered goods/services from Debtor under various Purchase Orders issued by Sears to Debtor. As of the date of this Motion, Sears is indebted to Debtor for the purchase of goods in the [aggregate] [estimated] sum of \$_____.
6. The UTC, all Purchase Orders, the Vendor Guide, and other Vendor Agreements with respect to any particular line of merchandise have been deemed by Sears and the Debtor to be "a series of installments in one and the same transaction and deemed to constitute a single contract" between Sears and the Debtor. UTC §2.2.
7. Under applicable Illinois law and the UTC, Sears holds rights to recoup any and all sums due Sears by the Debtor from any and all sums payable by Sears to the Debtor.
8. The Debtor has acknowledged these recoupment rights in the UTC as follows:
 - A. Section 13 of the UTC provides in relevant part as follows:

"SEARS REMEDIES. In addition to all other remedies available to Sears under the UCC or otherwise, any Merchandise may be rejected by Sears and abandoned, returned or held at Seller's expense and risk, when such Merchandise: (a) is not produced, sold, shipped and/or delivered in compliance with the terms of the applicable Vendor Agreement, or otherwise does not conform to the applicable Vendor Agreement; (b) is delivered in excess of the quantities ordered, in broken packs or partial shipments, or in packages or assortments other than as specified; (c) allegedly violates any applicable federal, state or local laws, regulations issued pursuant to such laws, or any governmental administrative orders, rules or regulations, of the United States, its territories or any other country in which Merchandise is produced or delivered; or (d) allegedly infringes any patent, trademark, service mark, trade name, trade dress, copyright, trade secret, domain name, right of publicity or other intellectual property right in any way related to or affecting Merchandise, or involves any unfair competition. Sears' right to reject and return or hold Merchandise at Seller's expense shall, without limiting such right, extend to Merchandise sold to Sears hereunder which was returned by a Sears customer for any reason entitling Sears to reject or revoke acceptance of such Merchandise. Sears may, at its option, require Seller to replace any nonconforming Merchandise or grant Sears a full refund or full credit (collectively, "Refund Credit"). At its election, Sears may accept nonconforming Merchandise, and Seller shall be liable for any reduced value of such Merchandise or the cost incurred by Sears to repair the same. Acceptance of Merchandise by Sears shall not relieve Seller of any of its warranty or other obligations hereunder. Sears may also charge to Seller all direct and indirect costs incurred by Sears as a result of any nonconforming Merchandise or delivery, or an administrative fee in an amount reasonably related to such costs whether or not Merchandise is rejected by Sears (collectively, "Return Costs"). Acceptance by Sears of replacement Merchandise, a full or partial credit or refund,

or Return Costs, shall not relieve Seller of liability for other damages sustained by Sears as a result of Seller's failure to deliver conforming Merchandise in a timely manner or arising as a result of any other breach by Seller.”

B. Section 15 of the UTC provides in relevant part as follows:

“RECOUPMENT AND SET-OFF. Sears and Seller acknowledge and agree that Sears’ monetary obligations to Seller under the Vendor Agreements shall at all times be net of all Refund Credits, Return Costs, Defense Obligations, Indemnity and Contribution Obligations and other monetary obligations owing by Seller to Sears under any Vendor Agreement or otherwise (collectively, "Seller's Monetary Obligations") and any installment payment or advance made by Sears to Seller in respect of any Vendor Agreement while any Seller's Monetary Obligations are outstanding shall be deemed to be an overpayment to Seller to the extent of such outstanding Seller's Monetary Obligations and shall be subject to recoupment and or set-off by Sears. Without limiting the foregoing, Sears shall have the right, at all times, to deduct any Seller's Monetary Obligations from any amounts owed to Seller by Sears, and to pay only the net sum due, if any. Any Seller's Monetary Obligations that remain outstanding after any exercise by Sears of its recoupment and/or set-off rights shall be paid by Seller promptly upon demand by Sears. For the purpose of Sears’ exercise of the right of recoupment and/or set-off only, any raw materials, components and parts sold by Seller to Sears for use in Merchandise, if applicable, shall be deemed to be sold to Sears pursuant to a Purchase Order.

9. At present, "Seller's Monetary Obligations" that are the subject of Sears recoupment rights are described in nature and estimated amount as follows:

A. [insert description and amount]

B. [insert description and amount]

10. In addition to the foregoing, there are or may be arising in the future additional Seller's Monetary Obligations that also form the basis of Sears recoupment rights against the Debtor. Sears does not waive and expressly reserves those rights herein.

11. In the event that this Court determines that Sears rights vis a vis the Debtor do not constitute recoupment rights but are rights of setoff subject to the automatic stay provisions of the Bankruptcy Code, then Sears requests that this Court enter an order modifying the stay to permit Sears to exercise its setoff rights.

12. In the event that this Court determines that relief from the automatic stay is necessary in order for Sears to exercise its rights as described herein, Sears requests that this Court enter an order modifying the automatic stay effective in this bankruptcy case to permit Sears to exercise these rights. This Court should so modify the automatic stay for the following reasons:

A. Sufficient "cause" exists to lift the automatic stay, including the inability or refusal to adequately protect any recoupment (or other) rights held by Sears;

B. The Debtor lacks equity in Seller's Monetary Obligations subject to Sears recoupment (or other) rights and those obligations are not necessary to an effective reorganization of the Debtor.

WHEREFORE, Movant, Sears, Roebuck and Co., respectfully requests that this Court enter an order:

- i) authorizing Sears to fully exercise its present and future recoupment rights against the Seller's Monetary Obligations or, in the alternative, modify the automatic stay to permit Sears to exercise any present or future recoupment or other rights, including rights of set-off, that it holds against those obligations; and
- ii) granting such other and further relief as may be just and proper under the circumstances.

[ATTORNEY NAME]
[FIRM NAME]

Attorneys for _____

UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA

In re: _____)
)
)
 Debtor.)
)
)
)
)
)
 _____)

Case No:

NOTICE OF PERFECTION OF
PURCHASE MONEY SECURITY
INTEREST

NOTICE IS HEREBY GIVEN that pursuant to 11 U.S.C. § 546(b), in lieu of filing a
UCC Financing Statement, _____ ("Creditor") hereby perfects its
purchase money security interest in and to the following described property: _____
_____ (the "Collateral").

Dated: [LAWFIRM]

By: _____
_____, Attorneys
for _____

[ATTORNEY NAME]
[FIRM NAME]

Attorneys for _____

UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA

In re:)	Case No:
)	
)	
Debtor.)	NOTICE OF PERFECTION OF
)	MECHANICS' LIEN
)	
_____)	

NOTICE IS HEREBY GIVEN that pursuant to 11 U.S.C. § 546(b), in lieu of filing suit, by this notice _____ ("Subcontractor") hereby perfects its mechanics' liens on [certain real property commonly known as/located at _____ or that certain development or project known as or located in _____], in the original sum of _____ (\$_____) for labor, services, and/or materials furnished by Subcontractor. True and correct copies of Subcontractor's mechanics' liens are attached hereto, marked as Exhibit A and incorporated herein.

Dated: [LAWFIRM]

By: _____, Attorneys
for _____

UNITED STATES BANKRUPTCY COURT

District of New Jersey

Notice of Chapter 11 Bankruptcy Case, Meeting of Creditors, & Deadlines

A Chapter 11 bankruptcy case concerning the debtor corporation listed below was filed on 07/01/02.

You may be a creditor of the debtor. **This notice lists important deadlines.** You may want to consult an attorney to protect your rights. All documents filed in the case may be inspected at the bankruptcy clerk's office at the address listed below.

NOTE: The staff of the bankruptcy clerk's office cannot give legal advice.

See Reverse Side For Important Explanations.

Debtor (name(s) and address):

--

Social Security Number(s)/Taxpayer ID(s):

--

United States Bankruptcy Judge:
Honorable Novalyn L. Winfield

Attorney for Debtor (name and address):

--

Attorney for Debtor(s)
Telephone number: 973-228-1616

Meeting of Creditors:

Date: 12/04/02 Time: 09:00 AM

Location: Office of the US Trustee, Suite 1401, One Newark Center, 14th Floor, Newark, NJ 07102-5504

Deadlines to File a Proof of Claim:

Proof of Claim must be received by the bankruptcy clerk's office by the following deadline:

For all creditors (except a governmental unit): 03/07/03

For a governmental unit: 180 days from date of order for relief. 11 U.S.C. § 502(b)(9)

Creditors May Not Take Certain Actions:

The filing of the bankruptcy case automatically stays certain collection and other actions against the debtor and the debtor's property. If you attempt to collect a debt or take other action in violation of the Bankruptcy Code, you may be penalized.

Address of the Bankruptcy Clerk's Office:

U.S. Bankruptcy Court
MLK Jr Federal Building
50 Walnut Street
Newark, NJ 07102

For the Court:

Clerk of the Bankruptcy Court:
James J. Waldron

Business Hours:

8:30 a.m. - 4:00 p.m., Monday - Friday (except holidays)

Date:

11/04/02

FORM 110 (Official Form 10/4/01)

UNITED STATES BANKRUPTCY COURT DISTRICT OF NEW JERSEY		PROOF OF CLAIM
Name of Debtor <div style="border: 1px solid black; height: 20px; width: 100%;"></div>	Case Number 02-37185 (NLW)	 <small>02-37185</small>
<p>NOTE: This form should not be used to make a claim for an administrative expense arising after the commencement of the case. A "request" for payment of an administrative expense may be filed pursuant to 11 U.S.C. § 503</p>		
Name of Creditor (The person or other entity to whom the debtor owes money or property): Name and Address where notices should be sent: Telephone Number:	<input type="checkbox"/> Check box if you are aware that anyone else has filed a proof of claim relating to your claim. Attach copy of statement giving particulars. <input type="checkbox"/> Check box if you have never received any notices from the bankruptcy court in this case. <input type="checkbox"/> Check box if the address differs from the address on the envelope sent to you by the court.	Mail Claim To: Clerk, U.S. Bankruptcy Court U.S. Bankruptcy Court MLK Jr Federal Building 50 Walnut Street Newark, NJ 07102 Chapter: 11 Creditor ID:
Account or other number by which creditor identifies debtor:	Check here if <input type="checkbox"/> replaces this claim <input type="checkbox"/> amends a previously filed claim, dated: _____	
1. Basis for Claim <input type="checkbox"/> Goods sold <input type="checkbox"/> Services performed <input type="checkbox"/> Money loaned <input type="checkbox"/> Personal injury/wrongful death <input type="checkbox"/> Taxes <input type="checkbox"/> Other _____	<input type="checkbox"/> Retiree benefits as defined in 11 U.S.C. § 1114(a) <input type="checkbox"/> Wages, salaries, and compensation (fill out below) Your SS #: _____ Unpaid compensation for services performed from _____ to _____ (date) (date)	
2. Date debt was incurred:	3. If court judgment, date obtained:	
4. Total Amount of Claim at Time Case Filed: \$ _____	If all or part of your claim is secured or entitled to priority, also complete Item 5 or 6 below. <input type="checkbox"/> Check this box if claim includes interest or other charges in addition to the principal amount of the claim. Attach itemized statement of all interest or additional charges.	
5. Secured Claim. <input type="checkbox"/> Check this box if your claim is secured by collateral (including a right of setoff). Brief Description of Collateral: <input type="checkbox"/> Real Estate <input type="checkbox"/> Motor Vehicle <input type="checkbox"/> Other _____ Value of Collateral: \$ _____ Amount of arrearage and other charges <u>at time case filed</u> included in secured claim, if any: \$ _____	6. Unsecured Priority Claim. <input type="checkbox"/> Check this box if you have an unsecured priority claim Amount entitled to priority \$ _____ Specify the priority of the claim: <input type="checkbox"/> Wages, salaries, or commissions (up to \$4,650)* earned within 90 days before filing of the bankruptcy petition or cessation of the debtor's business, whichever is earlier - 11 U.S.C. § 507(a)(3). <input type="checkbox"/> Contributions to an employee benefit plan - 11 U.S.C. § 507(a)(4). <input type="checkbox"/> Up to \$ 2,100* of deposits toward purchase, lease, or rental of property or services for personal, family, or household use - 11 U.S.C. § 507(a)(6). <input type="checkbox"/> Alimony, maintenance, or support owed to a spouse, former spouse, or child - 11 U.S.C. § 507(a)(7). <input type="checkbox"/> Taxes or penalties owed to governmental units - 11 U.S.C. § 507(a)(8). <input type="checkbox"/> Other - Specify applicable paragraph of 11 U.S.C. § 507(a)(____). *Amounts are subject to adjustment on April 1, 2004 and every 3 years thereafter with respect to cases commenced on or after the date of adjustment.	
7. Credits: The amount of all payments on this claim has been credited and deducted for the purpose of making this proof of claim. 8. Supporting Documents: Attach copies of supporting documents, such as promissory notes, purchase orders, invoices, itemized statements of running accounts, contracts, court judgments, mortgages, security agreements, and evidence of perfection of lien. DO NOT SEND ORIGINAL DOCUMENTS. If the documents are not available, explain. If the documents are voluminous, attach a summary. 9. Date-Stamped Copy: To receive an acknowledgment of the filing of your claim, enclose a stamped, self-addressed envelope and the number of copies indicated below. For Chapters 12 and 13: send original and two copies. For Chapters 7 and 11: send original and one copy.	THIS SPACE IS FOR COURT USE ONLY	
Date	Sign and print the name and title, if any, of the creditor or other person authorized to file this claim (attach copy of power of attorney, if any):	
Penalty for presenting fraudulent claim: Fine of up to \$500,000 or imprisonment for up to 5 years, or both. 18 U.S.C. §§ 152 and 357L.		

EXPLANATIONS

FORM B9F
(Alt.)(9/97)

Proof of Identification and Social Security Number	Important notice to individual debtors: Effective March 1, 2002, all individual debtors must provide picture identification and proof of social security number to the trustee at the meeting of creditors. Failure to do so may result in your case being dismissed.
Filing of Chapter 11 Bankruptcy Case	A bankruptcy case under Chapter 11 of the Bankruptcy Code (Title 11, United States Code) has been filed in this court by or against the debtor listed on the front side, and an order for relief has been entered. Chapter 11 allows a debtor to reorganize or liquidate pursuant to a plan. A plan is not effective unless confirmed by the court. You may be sent a copy of the plan and a disclosure statement telling you about the plan, and you might have the opportunity to vote on the plan. You will be sent notice of the date of the confirmation hearing, and you may object to confirmation of the plan and attend the confirmation hearing. Unless a trustee is serving, the debtor will remain in possession of the debtor's property and may continue to operate any business.
Creditors May Not Take Certain Actions	Prohibited collection actions are listed in Bankruptcy Code § 362. Common examples of prohibited actions include contacting the debtor by telephone, mail or otherwise to demand repayment; taking actions to collect money or obtain property from the debtor; repossessing the debtor's property; and starting or continuing lawsuits or foreclosures.
Meeting of Creditors	A meeting of creditors is scheduled for the date, time and location listed on the front side. <i>The debtor's representative must be present at the meeting to be questioned under oath by the trustee and by creditors.</i> Creditors are welcome to attend, but are not required to do so. The meeting may be continued and concluded at a later date without further notice.
Claims	A Proof of Claim is a signed statement describing a creditor's claim. If a Proof of Claim form is not included with this notice, you can obtain one at any bankruptcy clerk's office. You may look at the schedules that have been or will be filed at the bankruptcy clerk's office. If your claim is scheduled and is <i>not</i> listed as disputed, contingent, or unliquidated, it will be allowed in the amount scheduled unless you file a Proof of Claim or you are sent further notice about the claim. Whether or not your claim is scheduled, you are permitted to file a Proof of Claim. If your claim is not listed at all or if your claim is listed as disputed, contingent, or unliquidated, then you must file a Proof of Claim by the "Deadline to File a Proof of Claim" listed on the front side, or you might not be paid any money on your claim against the debtor in the bankruptcy case.
Discharge of Debts	Confirmation of a Chapter 11 plan may result in a discharge of debts, which may include all or part of your debt. See Bankruptcy Code § 1141(d). A discharge means that you may never try to collect the debt from the debtor, except as provided in the plan.
Bankruptcy Clerk's Office	Any paper that you file in this bankruptcy case should be filed at the bankruptcy clerk's office at the address listed on the front side. You may inspect all papers filed, including the list of the debtor's property and debts, at the bankruptcy clerk's office.
Legal Advice	The staff of the bankruptcy clerk's office cannot give legal advice. You may want to consult an attorney to protect your rights.
---Refer to Other Side For Important Deadlines and Notices---	
<u>Undeliverable Notices.</u> Undeliverable notices will be sent by return mail to the debtor. It is the debtor's responsibility to obtain the party's correct address, resend the returned notice, and notify this office of the party's change of address. Failure to provide all parties with a copy of this notice may adversely affect the debtor as provided by the Bankruptcy Code.	
<u>Case information - telephone access.</u> Case summary information can be obtained from any touch tone telephone by calling the automated Voice Case Information System (VCIS) at the toll free number: 1-877-239-2547. This service is free of charge and is available 24 hours a day.	
<u>Case information - electronic access.</u> Case summary and docket information can be obtained from the Public Access to Court Electronic Records (Pacer) system. To register or for more information, please call the Pacer Billing Center at 1-800-676-6856 or visit the Pacer Web Site: http://pacer.pac.uscourts.gov .	
<u>Internet access.</u> Additional information may be available at the Court's Web Site: http://www.nj.uscourts.gov	

INSTRUCTIONS FOR PROOF OF CLAIM FORM

The instructions and definitions below are general explanations of the law. In particular types of cases or circumstances, such as bankruptcy cases that are not filed voluntarily by a debtor, there may be exceptions to these general rules.

DEFINITIONS

Debtor

The person, corporation, or other entity that has filed a bankruptcy case is called the debtor.

Creditor

A creditor is any person, corporation, or other entity to whom the debtor owed a debt on the date that the bankruptcy case was filed.

Proof of Claim

A form telling the bankruptcy court how much the debtor owed a creditor at the time the bankruptcy case was filed (the amount of the creditor's claim). This form must be filed with the clerk of the bankruptcy court where the bankruptcy case was filed.

Secured Claim

A claim is a secured claim to the extent that the creditor has a lien on property of the debtor (collateral) that gives the creditor the right to be paid from that property before creditors who do not have liens on the property.

Examples of liens are a mortgage on real estate and a security interest in a car, truck, boat, television set, or other item of property. A lien may have been obtained through a court proceeding before the bankruptcy case began; in some states a court judgment is a lien. In addition, to the extent a creditor also owes money to the debtor (has a right of setoff), the creditor's claim may be a secured claim. (See also *Unsecured Claim*.)

Unsecured Claim

If a claim is not a secured claim it is an unsecured claim. A claim may be partly secured and partly unsecured if the property on which a creditor has a lien is not worth enough to pay the creditor in full.

Unsecured Priority Claim

Certain types of unsecured claims are given priority, so they are to be paid in bankruptcy cases before most other unsecured claims (if there is sufficient money or property available to pay these claims). The most common types of priority claims are listed on the proof of claim form. Unsecured claims that are not specifically given priority status by the bankruptcy laws are classified as *Unsecured Nonpriority Claims*.

Items to be completed in Proof of Claim form (if not already filed in)

Court, Name of Debtor, and Case Number:

Fill in the name of the federal judicial district where the bankruptcy case was filed (for example, Central District of California), the name of the debtor in the bankruptcy case, and the bankruptcy case number. If you received a notice of the case from the court, all of this information is near the top of the notice.

Information about Creditor:

Complete the section giving the name, address, and telephone number of the creditor to whom the debtor owes money or property, and the debtor's account number, if any. If anyone else has already filed a proof of claim relating to this debt, if you never received notices from the bankruptcy court about this case, if your address differs from that to which the court sent notice, or if this proof of claim replaces or changes a proof of claim that was already filed, check the appropriate box on the form.

1. Basis for Claim:

Check the type of debt for which the proof of claim is being filed. If the type of debt is not listed, check "Other" and briefly describe the type of debt. If you were an employee of the debtor, fill in your social security number and the dates of work for which you were not paid.

2. Date Debt Incurred:

Fill in the date when the debt first was owed by the debtor.

3. Court Judgments:

If you have a court judgment for this debt, state the date the court entered the judgment.

4. Total Amount of Claim at Time Case Filed:

Fill in the total amount of the entire claim. If interest or other charges in addition to the principal amount of the claim are included, check the appropriate place on the form and attach an itemization of the interest and charges.

5. Secured Claim:

Check the appropriate place if the claim is a secured claim. You must state the type and value of property that is collateral for the claim, attach copies of the documentation of your lien, and state the amount past due on the claim as of the date the bankruptcy case was filed. A claim may be partly secured and partly unsecured. (See DEFINITIONS, above.)

6. Unsecured Priority Claim:

Check the appropriate place if you have an unsecured priority claim, and state the amount entitled to priority. (See DEFINITIONS, above.) A claim may be partly priority and partly nonpriority if, for example, the claim is for more than the amount given priority by the law. Check the appropriate place to specify the type of priority claim.

7. Credits:

By signing this proof of claim, you are stating under oath that in calculating the amount of your claim you have given the debtor credit for all payments received from the debtor.

8. Supporting Documents:

You must attach to this proof of claim form copies of documents that show the debtor owes the debt claimed or, if the documents are too lengthy, a summary of those documents. If documents are not available, you must attach an explanation of why they are not available.

For additional information

Case information - telephone access. Case summary information can be obtained from any touch tone telephone by calling the automated Voice Case Information System (VCIS) at the toll free number: 1-877-239-2547. This service is free of charge and is available 24 hours a day.

Case information - electronic access. Case summary and docket information can be obtained from the Public Access to Court Electronic Records (Pacer) system. To register or for more information, please call the Pacer Billing Center at 1-800-676-6856 or visit the Pacer Web Site: <http://pacer.psc.uscourts.gov>.

Internet access. Additional information may be available at the Court's Web Site: <http://www.njb.uscourts.gov>

SUPPORT FOR SEARS, ROEBUCK AND CO. PROOF OF CLAIM

In Re: Debtor, Inc.

Case No.: 03-10361

On, 1997, Sears, Roebuck and Company and Debtor, Inc., (the 'Debtor') agreed to Universal Terms and Conditions for the Debtor's sale of merchandise to Sears for resale to the general public (the 'Agreement'). Attached as Exhibit A.

Pursuant to the Agreement, Sears ordered merchandise from the Debtor to resell to the public. Sears duly paid for these purchases under the terms of the Agreement.

Under Section 8.1 of the Agreement, the Debtor makes various representations and warranties for all merchandise sold to Sears. From time to time, the Debtor sent Sears merchandise that was not fit for use in the ordinary course of business. From time to time, the Debtor charged Sears for merchandise that it did not ship Sears. Sears outstanding Claims for Returned Goods and Shortage Quantity Clams are attached chronologically as Exhibit B. The Debtor failed to reimburse Sears \$XXXX for returned goods and short goods.

Under Section 2.2 of the Agreement, the Debtor agrees sales to Sears can be modified to incorporate Sears expense for promoting its merchandise. The Debtor subsequently agreed to fund various merchandise promotional efforts undertaken by Sears tied to sales of its products. These promotional agreements are documented by the Promotional Subsidy and Advertising Co-op agreements attached chronologically as Exhibit B. The Debtor owes Sears \$XXXX under the promotional agreements.

Under Section 5.1 of the Agreement, the Debtor agrees to ship its merchandise to Sears packaged and labeled in a manner consistent with standards set by Sears. The Debtor further agrees Sears may recover its costs for curing any breach of the Agreement. The Debtor shipped goods not in compliance with the agreed standards, incurring an additional \$XXXX debt to Sears which has not been paid.

Sears reserves its right to amend this Proof of Claim to the extent any additional matter may reasonably become known to Sears.

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE**

In re:

Advanced Glassfiber Yarns LLC, et al.,
Debtors.

(Chapter 11)

Case Nos. 02-13615
and 02-13616 (JKF)

Jointly Administered

**MOTION FOR AN ORDER AUTHORIZING THE DEBTORS
TO HONOR CERTAIN PRE-PETITION OBLIGATIONS TO CUSTOMERS AND
TO OTHERWISE CONTINUE CUSTOMER PROGRAMS AND PRACTICES**

This motion (the "Motion") of Advanced Glassfiber Yarns LLC ("AGY LLC") and AGY Capital Corp., debtors and debtors-in-possession (the "Debtors"), respectfully represents:

SUMMARY OF RELIEF REQUESTED HEREIN

1. Like most companies in the glass yarns and materials business, the Debtors offer warranties, rebates, returns, credits, concessions, and other similar programs, practices and commitments (collectively, the "Customer Practices") directed to develop and sustain goodwill in the marketplace for their products and services. The Customer Practices are also designed to allow the Debtors to not only match their competitors' pricing, payment terms and special offer programs, but also to distinguish the Debtors from their competitors, ensure customer satisfaction and generate goodwill -- thereby retaining current customers, attracting new ones and ultimately enhancing net revenue. Absent authorization from the Court, the Debtors will be unable to honor or perform obligations respecting their Customer Practices that arose or accrued prior to the commencement of these Chapter 11 cases. The Debtors believe that

their inability to continue their Customer Practices without interruption will harm their customer relationships and significantly erode the Debtors' competitive standing in the marketplace. Any such harm to the Debtors' customer relationships could result in a material reduction in sales and revenues and jeopardize the Debtors' ability to effectuate a successful reorganization.

2. Accordingly, by this Motion, the Debtors seek entry of an order, substantially in the form annexed hereto as Exhibit A (the "Proposed Order"), pursuant to Sections 105 and 363 of Title 11, United States Code, 11 U.S.C. §§ 101 et seq. (the "Bankruptcy Code"), authorizing the Debtors to (a) honor and perform, in their sole discretion, pre-petition obligations related to the Customer Practices, and (b) continue, renew, replace, implement new or terminate such of the Customer Practices as they see fit, in the ordinary course of business, without further order of the Court.¹

JURISDICTION

3. The Court has jurisdiction over this Motion under 28 U.S.C. § 1334, which is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2). Venue of this proceeding is proper pursuant to 28 U.S.C. §§ 1408 and 1409.

BACKGROUND

A. Commencement of the Chapter 11 Cases

4. On December 10, 2002 (the "Petition Date"), each of the Debtors filed a voluntary petition for relief under Chapter 11 the Bankruptcy Code. Pursuant to Sections 1107 and 1108 of the Bankruptcy Code, the Debtors are continuing to operate their businesses and

manage their affairs as debtors-in-possession. The Debtors are jointly administering their estates solely for procedural purposes.

5. On December 20, 2002, the Office of the United States Trustee appointed an official committee of unsecured creditors in these Chapter 11 cases.

B. Background of the Debtors

6. The Debtors are one of the largest manufacturers and global suppliers of glass yarns. The Debtors currently supply glass yarns to customers in Latin America, Asia, Canada, Europe and the United States. The Debtors operate primarily through AGY LLC, a Delaware limited liability company headquartered in Aiken, South Carolina.

7. AGY LLC was formed on or about July 1, 1998, when Owens Corning (“OC”) contributed substantially all of the assets and liabilities comprising its glass yarns and specialty materials business to AGY LLC. Thereafter, OC sold a fifty-one percent (51%) ownership interest in AGY LLC to AGY Holdings, Inc., a wholly-owned subsidiary of Porcher Industries Group. The remaining forty-nine percent (49%) ownership interest in AGY LLC was retained by OC through a wholly-owned subsidiary, Jefferson Holdings, Inc.²

8. The Debtors sell their products primarily to glass yarn weavers who weave glass yarn into fabric that is used in a variety of end-user applications. Markets for glass yarns include the electronics, industrial and construction, and specialty markets. The Debtors’ products fall into two general categories: (i) heavy yarns and (ii) fine yarns. Glass yarns are used

¹ The Debtors intend to honor their pre-petition Customer Practices only with respect to those customers who continue to purchase materials from the Debtors on customary terms.

² OC, Jefferson Holdings, Inc. and certain other affiliates thereof, are presently the subject of separate Chapter 11 cases pending in this judicial district.

for a wide range of applications such as printed circuit boards, roofing materials, filtration equipment, building reinforcement, window screening, aerospace materials and reinforced tapes. Fine yarns require a significant level of technical engineering, and generally command higher prices than non-specialty heavy yarns and are primarily used to construct laminates in multi-layer printed circuit boards.

9. The Debtors employ approximately 1205 individuals (of which approximately 350 individuals are presently furloughed), and operate three manufacturing facilities located in Aiken, South Carolina; South Hill, Virginia; and Huntingdon, Pennsylvania. As of October 31, 2002, the Debtors, on a consolidated book-value basis, had aggregate assets and liabilities of \$194.1 million and \$409.0 million, respectively.

C. Circumstances Surrounding the Chapter 11 Filings

10. Due in large part to a significant global economic downturn and inventory correction primarily in the electronics market, and a substantial increase in direct foreign competition resulting in part from a global underutilization of production capacity, the Debtors experienced a substantial decline in sales and operating income during its 2001 fiscal year. For example, sales and operating income decreased approximately twenty-six percent (26%) and forty-four percent (44%), respectively, between fiscal years 2000 and 2001.

11. As a result of this sharp decline, the Debtors found themselves significantly overleveraged, with current and projected income insufficient to support the Debtors' present level of debt. To combat these negative effects, during 2001 the Debtors began implementing a series of cost reduction measures. These measures included an approximately forty-four percent (44%) reduction in the Debtors' salaried and wage workforce, substantial

reductions in production schedules and capital expenditures, elimination of certain benefit programs for salaried employees and other measures.

12. Notwithstanding these efforts, the Debtors' liquidity difficulties continued. During 2001 and 2002, the Debtors experienced certain financial covenant defaults with respect to approximately \$180 million of indebtedness owed under a senior secured revolving credit and term loan facility (the "Credit Facility"). In addition, AGY LLC was unable to make a July 15, 2002 interest payment in respect of its \$150 million of 9⁷/₈% senior subordinated notes due 2009 (the "Notes"), resulting in the formation of an *ad hoc* committee of certain holders of the Notes (the "Informal Note Committee"). Subsequently, AGY LLC was unable to make a scheduled principal payment due under the Credit Facility on September 30, 2002, and a scheduled interest payment due at the end of November, 2002. As a result of such covenant and payment defaults, the Debtors and their pre-petition secured lenders (the "Pre-Petition Lenders") entered into various waiver, amendment and forbearance agreements. Pursuant to such agreements, among other things, the Pre-Petition Lenders agreed to forbear from exercising rights and remedies under the Credit Facility under certain terms and conditions, in consideration of certain concessions by the Debtors including, increases in the Debtors' cost of borrowing and reductions in the Debtors' borrowing availability and capacity.

13. In light of their financial difficulties, prior to the Petition Date, the Debtors engaged in extensive negotiations with representatives of the Pre-Petition Lenders, the Informal Note Committee and other parties in an effort to achieve an agreement respecting a consensual restructuring of the Debtors' indebtedness and liabilities. In connection with such negotiations, and in light of the previously scheduled retirement of AGY LLC's then-president, in October, 2002 the Debtors engaged the Carl Marks Consulting Group LLC ("Carl Marks") as turnaround

and management consultants. Marc Pfefferle and Gary Bernhardt of Carl Marks were appointed as Chief Restructuring Officer and Chief Operating Officer, respectively, of the Debtors.

14. Under the guidance of Messrs. Pfefferle and Bernhardt, the Debtors undertook a comprehensive bottoms-up analysis of their operations and finances, and in or around mid-November, 2002, formulated a revised business plan for the Debtors that served as the basis for continued pre-petition restructuring negotiations. Although the Debtors believe that substantial progress was made during such pre-petition negotiations, the parties were unable to reach an agreement prior the expiration on December 6, 2002 of the Debtors' forbearance agreement with their Pre-Petition Lenders.

15. Accordingly, the Debtors commenced the instant Chapter 11 cases to further stabilize their day-to-day operations and finances, and to obtain a moratorium of their indebtedness while continuing to pursue strategic restructuring negotiations with their major creditor and other constituencies. The Debtors believe that, under the protection of this Court, they will be able to restructure their indebtedness and propose a plan of reorganization consistent with the provisions of Chapter 11.

**AUTHORIZATION TO HONOR PRE-PETITION OBLIGATIONS
RESPECTING CUSTOMER PRACTICES AND TO CONTINUE
TO ADMINISTER SUCH PRACTICES**

A. Overview of Customer Practices

16. The Debtors offer their customers various types of warranties, return and credit policies and other commitments concerning the delivery, performance, and durability of their products. For example, the Debtors offer their customers a warranty on the materials sold

for a period of one year from the date of shipment of the material. If a customer makes a timely and valid warranty claim, depending on the circumstances, the Debtors will replace the material or provide the customer with a credit.

17. Further, as a way to provide a mechanism to adequately respond to competitors' price decreases, certain of the Debtors' customer supply arrangements call for a quarterly or annual rebate to the customer based on the volume of materials purchased or a discount based on timely payment of invoices. The Debtors also credit customers for material returned that does not meet the customers' specifications, was not the correct type or quantity of material ordered by the customers or was incorrectly priced by the Debtors. Finally, the Debtors also credit customers with an allowance when they pick up material directly from the Debtors' manufacturing facilities.

18. While it is difficult to accurately gauge the cost to the Debtors of maintaining the Customer Practices, honoring warranty claims, returns, discounts and other credit policies has historically averaged approximately \$700,000 per month, and approximately \$550,000 per month after taking into account the Debtors' ability to reuse or resell certain returned materials. Based on known returns and outstanding credits as of the Petition Date, the Debtors estimate that the cost of honoring and performing obligations respecting their Customer Practices that arose or accrued prior to the Petition Date is approximately \$1.3 million after taking into account the reuse or resale of certain returned materials (which equates to approximately two months of returns, credits and discounts).

B. The Critical Need to Honor and Maintain the Customer Practices

19. The Debtors seek authorization to honor and perform any pre-Petition Date obligations that arose or accrued in connection with their Customer Practices in order to maintain their competitive standing in the glassfiber yarns industry and to preserve their goodwill with their customers during the pendency of these Chapter 11 cases. As set forth below, absent such relief, the Debtors' customer relations may be severely and irreparably harmed at a time when customer loyalty and patronage is critical to the Debtors' reorganization efforts.

20. The success and viability of the Debtors' businesses are dependent upon the loyalty of their customers. The glassfiber yarns and materials industry is highly competitive, with the Debtors facing stiff competition from manufacturers in Europe and more recently, direct competition from Mexico, Asia and the Pacific Rim. Such competition, coupled with the continuing general economic downturn and inventory correction in the electronics industry has put even greater pressure on the Debtors to maintain the loyalty and support of their customers. Accordingly, to maintain and enhance their position in the marketplace, it is critical and essential that the Debtors be able to demonstrate a "business as usual" atmosphere to the marketplace despite their Chapter 11 filings. Without authorization to honor the Customer Practices, the Debtors' customers may perceive that the Debtors are unable or unwilling to fulfill the pre-petition promises they have made through the Customer Practices and may shift business to the Debtors' competitors resulting in lower sales, revenue and EBITDA.

21. In addition to honoring their pre-petition Customer Practices, the Debtors seek to continue and maintain such Customer Practices post-petition. The Customer Practices

have been successful business strategies in the past and have generated valuable goodwill and repeat business and increasing the Debtors' net revenue. The Debtors believe that maintaining these benefits throughout these bankruptcy cases is essential to the continued vitality of their businesses -- and ultimately to their prospects for a successful reorganization. If the Debtors' customers perceive that the Debtors will no longer be offering the full package of services their customers require or have come to expect, it will erode their goodwill and ongoing business relationships. In addition, the Debtors' failure to honor such obligations could significantly limit their ability to attract new customers.

LEGAL AUTHORITY

22. The Debtors respectfully submit that this Court can authorize the relief requested herein pursuant to Sections 105 and 363 of the Bankruptcy Code. Section 105(a) of the Bankruptcy Code authorizes the Court to issue "any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." 11 U.S.C. § 105(a). The purpose of Section 105(a) is to ensure a bankruptcy court's power to take whatever action "is appropriate or necessary in aid of the exercise of its jurisdiction." 2 Collier on Bankruptcy, § 1105.01 at 105-2 (15th ed. 1993).

23. Section 363(b) provides, in relevant part, that "the trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate." 11 U.S.C. § 363(b). A court can authorize a debtor to use property of the estate outside of the ordinary course pursuant to Section 363(b)(1) of the Bankruptcy Code when there is a "sound business purpose" that justifies such use. See In re Lionel Corp., 722 F.2d 1063, 1071 (2d Cir. 1983); In re Delaware & Hudson R.R. Co., 124 BR. 169, 176 (D. Del. 1991) (explaining

that the Third Circuit has adopted the "sound business purpose" test to evaluate motions brought pursuant to Section 363(b)); see also Stephens Indus., Inc. v. McClung, 789 F.2d 386, 390 (6th Cir. 1986) (adopting the "sound business purpose" standard for sales proposed pursuant to section 363(b)); In re Montgomery Ward Holding Corp., 242 B.R. 147, 153 (D. Del. 1999) (approving employee Retention Plan under sound business purpose test as discussed in Lionel). For the reasons set forth above, the Debtors have determined, in the exercise of their sound business judgment, that it is necessary to honor and perform pre-petition obligations that arose or accrued in connection with the Customer Practices to maintain the goodwill that the Debtors have developed over the years and to preserve and enhance their competitive standing in the marketplace.

24. Additionally, the relief requested is supported by the "necessity of payment" doctrine. That doctrine provides for payment of pre-petition claims or honoring of pre-petition programs as necessary to maintain the continuity of a debtor's business. See In re Lehigh & New England Ry. Co., 657 F.2d 570, 581 (3d Cir. 1981) (payment of creditors' claims authorized under "necessity of payment doctrine"); In re Ionosphere Clubs, Inc., 98 B.R. 174, 176 (Bankr. S.D.N.Y. 1989) (necessity of payment rule applies to chapter 11 Debtors) (citing Dudley v. Mealey, 147 F.2d 268 (2d Cir.), cert. denied, 315 U.S. 873 (1945)).

25. As described above, the Debtors need to retain their current customer base and attract new customers in order to effectuate a successful reorganization. The loyalty and continued patronage of each customer, therefore, is critical to the Debtors' financial health and reorganization prospects. Where retaining loyalty and patronage of customers is critical to a successful reorganization, Bankruptcy Courts in this and other Districts have routinely granted relief similar to that requested herein. See e.g., In re Owens Corning, et al., Case No. 00-03837

(MFW) (Bankr. D. Del. October 6, 2000) (authorizing debtors to honor pre-petition obligations to customers under various warranty and other customer programs); In re MMH Holdings, Inc., Case No. 00-02027 (SLR) (Bankr. D. Del. May 21, 2000) (authorizing debtors to continue pre-petition customer programs and practices); In re Harnischfeger Industries, Inc. et al., Case No. 99-2171 (PJW) (Bankr. D. Del. June 7, 1999) (authorizing debtors to continue pre-petition customer programs and practices); In re Acme Metals Incorporated, et al., Case No. 98-2179 (MAW) (Bankr. D. Del. Order dated Sept. 29, 1998) (authorizing debtors to continue performance under warranty, refund and customer credit policies); In re Montgomery Ward Holding Corp., Case No. 97-1409 (PAW) (Bankr. D. Del. order dated July 7, 1997) (authorizing debtors to continue pre-petition customer programs and practices); In re Braun's Fashions Corporation, et al., Case No. 96-1030 (HSB) (Bankr. D. Del. order dated July 2, 1996) (authorizing debtors to honor pre-petition obligations to customers); In re The Icing, Inc., Case No. 95-512 (PAW) (Bankr. D. Del. order dated May 4, 1995) (authorizing debtor to continue performance under programs necessary to maintain customer relations); In re Simmons Upholstered Furniture, Inc., Case No. 94-635 (HSB) (Order dated June 29, 1994) (authorizing debtor to continue performance under warranties and other programs necessary to maintain customer relations); In re Bills' Dollar Stores, Inc., Case No. 93-808 (PAW) (Bankr. D. Del. order dated July 12, 1993) (authorizing debtor to honor pre-petition obligations to customers); In re Memorex Telex Corp., et al., Case No. 92-8 (HSB) (Bankr. D. Del. order dated January 6, 1992) (authorizing debtors to honor warranty and service agreements); In re Federated Department Stores, Inc., 1990 Bankr. Lexis 102, 102 (Bankr. S.D. Ohio 1990) (authorizing debtor to treat deposits or pre-petition payments on goods and services "in the same manner as debtor treated deposits prior to the commencement of these cases").

26. The Debtors' estates and creditors also will benefit from the relief sought herein because it will allow the Debtors to continue their ordinary course operations with minimal disruption. If the Debtors are prohibited from honoring and maintaining their Customer Practices consistent with past business practices, then customers' lost confidence in the Debtors will damage the Debtors' businesses to an extent that far exceeds the cost associated with honoring and continuing such practices. The relief requested herein will protect the Debtors' goodwill during this critical time, enhance the Debtors' ability to generate revenue, and preserve and enhance the Debtors' standing in the highly competitive glassfiber yarns and materials industry.

RESERVATION OF RIGHTS

27. Nothing contained herein is intended or should be construed as an admission as to the validity of any claim against the Debtors, a waiver of the Debtors' rights to dispute any claim, or an approval or assumption of any agreement, contract or lease under Section 365 of the Bankruptcy Code. Likewise, if this Court grants the relief sought herein, any payment made pursuant to the Court's order is not intended and should not be construed as an admission as to the validity of any claim or a waiver of the Debtors' rights to subsequently dispute such claim.

NOTICE

28. Notice of this Motion has been given to the (i) Office of the United States Trustee; (ii) counsel to the Official Committee of Unsecured Creditors; (iii) counsel to the Debtors' pre-petition and post-petition secured lenders; and (iv) all parties on the Master Service

List. The Debtors respectfully submit that such notice is sufficient, and request that this Court find that no further notice of the relief requested herein is required.

29. No previous motion for the relief sought herein has been made to this or any other Court.

WHEREFORE, the Debtors respectfully request that the Court enter the Proposed Order authorizing the Debtors to (a) honor and perform, in their sole discretion, pre-petition obligations related to the Customer Practices, (b) continue, renew, replace, implement new or terminate such of the Customer Practices as they see fit, in the ordinary course of business, without further application to the Court, and (c) grant such further relief as is just and proper.

Dated: Wilmington, Delaware
December 23, 2002

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Proposed Co-Counsel to the Debtors and
Debtors-in-Possession

**BANKRUPTCY AND
THE INTELLECTUAL PROPERTY LICENSE
ISSUE OUTLINE**

MAITA DEAL PROUT
HOLLAND & KNIGHT LLP

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I. THE LICENSOR'S BANKRUPTCY CLAIM

A. General Unsecured Claims

Amounts owing under the license agreement at the time the bankruptcy is filed, plus any additional breach damages are generally unsecured claims that will be paid pro rata with other general, unsecured claims. Rarely are unsecured claims paid in full, and payment generally is made months or years after the bankruptcy is filed.

General, unsecured claims are asserted by the creditor filing a Proof of Claim with the clerk of the court on or before the bar date established as the last date for filing claims. There is an Official Form of Proof of Claim that is completed and to which is attached a copy of the contract or other writings on which the claim is based. See Rule 3001 Federal Rules of Bankruptcy Procedure.

B. Administrative Claims

Administrative claims are expenses and other obligations incurred by the debtor after filing the bankruptcy. Administrative claims are entitled to priority of payment, ahead of pre-bankruptcy claims. Allowed administrative claims must be paid in full before payments to general, unsecured creditors.

If the licensee continues to utilize and benefit from the license after filing bankruptcy, royalties accruing under the license agreement after the bankruptcy is filed may be entitled to administrative claim status. A licensor may have both a general, unsecured claim and an administrative claim. An administrative claim is asserted by filing a request for payment or, if provided in a plan or other proceeding, by filing a proof of administrative claim, on or before the bar date established for asserting such claims.

II. POST-PETITION PERFORMANCE UNDER THE LICENSE AGREEMENT

A. The Licensing Agreement as an Executory Contract

Under Section 365 of the Bankruptcy Code, a debtor or trustee may assume or reject a contract that is "executory." Under the widely accepted Countryman definition, an executory contract is one "on which performance is due to some extent on both sides . . . and which the obligations of both parties are so far unperformed that the failure of either party to complete performance would constitute a material breach and thus excuse the performance of the other." *Everex Systems, Inc. v. Cadtrak Corp. (In re CFLC, Inc.)*, 89 F.3d 673, 677 (9th Cir. 1996) (internal quotes omitted).

License agreements generally are executory contracts, typically because each party remains obligated to perform. The licensor agrees to forbear from suing for

infringement and the licensee agrees to use the license only as agreed and to pay royalties. See, e.g., *In re Superior Toy & Mfg. Co.*, 78 F.3d 1169 (7th Cir. 1996); *In re Patient Educ. Media, Inc.*, 210 B.R. 237 (Bankr. S.D.N.Y. 1997).

B. Assumption vs. Rejection

1. ***Debtor's Election.*** Section 365(a) of the Bankruptcy Code authorizes a Chapter 11 debtor in possession or a bankruptcy trustee to assume or reject any executory contract of the debtor.

2. ***Rejection.*** The debtor may reject any executory license agreement provided reasonable business judgment was exercised in reaching the decision. When the debtor is the licensor and rejects a license agreement, Section 365(n) of the Bankruptcy Code protects the licensee. These protective provisions do not apply when the debtor is the licensee.

3. ***Assumption.*** Under Section 365(b) of the Bankruptcy Code, in order to be allowed to assume a contract that is in default, the debtor or trustee must demonstrate the ability to cure past defaults and meet future obligations. More precisely, the prerequisites of assumption are for the debtor or trustee to (i) cure or provide adequate assurance of a prompt cure, (ii) compensate, or provide adequate assurance of prompt compensation, for "actual pecuniary loss" resulting from default, and (iii) provide "adequate assurance of future performance."

C. Limitations on Debtor's Right to Assume.

1. ***Effect of Prohibitions Against Assignment.*** If non-bankruptcy law prohibits assignment without consent of licensor in some jurisdictions the debtor may be prohibited from assuming.

2. ***Assumability of Patent and Copyright Licenses.*** Under the Copyright Act, the owner of a copyright has the *exclusive* right to exploit or authorize others to exploit the copyrighted work. Accordingly, a non-exclusive copyright license is personal to the licensee, meaning the licensor cannot be forced to accept performance by anyone other than the licensee, and the license cannot be assigned without the consent of the licensor. Some jurisdictions consider the pre-bankruptcy debtor and the post-bankruptcy debtor in possession to be different legal entities for purposes of this analysis. Because the licensor cannot be forced to accept performance from a party other than the pre-bankruptcy debtor, these jurisdictions may not permit assumption without the consent of the licensor. See, *Perlman v. Catapult Entertainment Inc. (In re Catapult Entertainment Inc.)*, 165 F.3d 747 (9th Cir. 1999) (non-exclusive patent license non-assignable). Other jurisdictions consider this a fiction, and will allow assumption by the debtor. E.g., *Institut Pasteur v. Cambridge Biotech Corp.*, 104 F.3d 489 (1st Cir. 1997).

Note: If the license is exclusive, it may be treated as a sale of the rights that are the subject of the transaction, rather than a license, and the result may be different.

3. *Assumability of Trademark Licenses.* Under trademark law, the owner of the trademark cannot necessarily prohibit someone else from using the trademark. Whether a use is prohibited turns on whether there is a likelihood of confusion or deceive the consumer. Therefore, the holder of trademark cannot necessarily bar assignment, in which case the debtor can assume the license, regardless of the consent of the licensor.

D. After Rejection or Assumption

1. *Consequences of Rejection.* Under Section 365(g) of the Bankruptcy Code, if a debtor rejects an executory contract, the rejection is deemed to be a breach of the contract by the debtor. Notwithstanding the rejection happens after the bankruptcy is filed, the breach is deemed to have occurred as of the date the bankruptcy was filed. The non-debtor party to the contract will have a pre-petition damage claim for breach. The licensor may also be entitled to a priority administrative claim if the debtor/licensee continued to use the license for a period of time after filing the bankruptcy and before rejecting the agreement, and failed to compensate the licensor for such use.

2. *Post-Assumption.* If a debtor or trustee assumes a contract, the entire contract must be assumed -- both burdensome and beneficial provisions. The debtor cannot accept only the benefits and reject the burdens. The debtor or trustee is required to perform under the contract after assumption. If there is a breach after assumption, the licensor's claim is a priority administrative claim.

III. ASSIGNMENT OF THE LICENSE AGREEMENT BY THE DEBTOR

A. Context

The transfer of a license agreement may arise in a discrete transaction whereby the licensee seeks to assign its interest in the license agreement, or it may arise in the context of a larger transaction such as the sale of the business as a going concern or the sale of assets, such as inventory, that are subject to the licensed copyright or trademark. However, if the licensor's consent is required for the licensee to assign its interest in the license agreement, that right is not abrogated just because it is imbedded in a larger transaction.

B. Limitations on Debtor's Right to Assign

1. *Non-Assignable Contracts.* If the licensor cannot be compelled to accept performance from a third party under applicable state or federal law, the debtor or

trustee may not assign unless the licensor consents. Bankruptcy Code Section 365(c).

2. **Copyright Licenses.** Non-exclusive copyright licenses are personal to the licensee and generally not assignable by their nature. (The debtor therefore may not be allowed to assign them unless the licensor consents.)

Note: If the license is non-exclusive there may be a different result.

3. **Trademark Licenses.** Trademark licenses may or may not be assignable under applicable state or federal law. If trademark law would not force the licensor to accept performance from a third party, the debtor or trustee cannot assign the license without the licensor's consent. If trademark law would not excuse the licensor from accepting performance from a third party, the debtor or trustee may be able to assign over the objection of the licensor. The licensor can protect itself through the terms of the license agreement by drawing the license as narrowly as possible and by including quality control provisions, mechanisms for enforcing such standards, change of control provisions, and an anti-assignment clause.

IV. PROTECTING AGAINST THE PREFERENCE

A. Spotting a Preference

A preference is defined by Section 547 of the Bankruptcy Code as a payment (or transfer of other property) by a debtor made to or for the benefit of a creditor on account of antecedent debt, made while the debtor was insolvent, made on or within 90 days before the filing of the bankruptcy petition (or, if the payment is to an insider, made within one year), that enables the creditor to receive more than it would in a Chapter 7 liquidation. The Bankruptcy Code allows a trustee or the debtor to recover or void a payment or transfer that is preferential.

B. Protecting Payments Received from Being Characterized as Preferences

1. **Payments to Secured Creditors.** Payments made by a debtor to fully secured creditors are not preferences. If the licensor has an adequate security interest in assets of the debtor/licensee to secure royalty payments owed under the license agreement, the payments received will be safe from attack as preferences. 11 U.S.C. § 547(b)

2. **Payments by Check.** When the debtor makes a payment by check, the issue is how to determine the date the payment was made for purposes of counting the 90-day (or one year, for insiders) preference period. Is it the date the check was delivered? The date the check cleared? The date the check was mailed? The Supreme Court has determined that for purposes of determining whether the payment falls within preference period payment is made on the date the drawee

bank honors the check. *Barnhill v. Johnson*, 503 U.S. 393, 112 S.Ct. 1386, 118 L.Ed.2d 39 (1992). The licensor should deposit checks received from problem licensees immediately upon receipt so as to start the time running on the preference period.

3. ***Ordinary Course of Business/Ordinary Business Terms.*** Payments made by the debtor in the ordinary course of business *and* according to ordinary business terms, on debts incurred in the ordinary course of business are excepted from preference avoidance. 11 U.S.C. § Section 547(c). Ordinary course of business means what is ordinary as between the parties. The recipient of payments may be able to protect against a claim of preference by applying payments received to newer invoices, or in a manner consistent with the course of dealing between the parties.

V. STRUCTURING THE TRANSACTION TO PROVIDE PROTECTION

A. Guarantees

Obtain a guarantee of the obligations of the licensee. The bankruptcy of the licensee does not stay pursuit of the guarantor.

B. Security Interests

Security interests may be sought in a variety of transactions. For example a film producer may seek to retain a security interest in the rights licensed to a distributor, to secure the distributors performance under the distribution agreement. Care must be taken to properly create and perfect any security interest.

C. Letters of Credit

The licensor may obtain a letter of credit that may be drawn in the event of default in royalty payments. The bankruptcy of the licensee will not prevent a draw on the letter of credit.