

University of Tennessee College of Law

## Legal Scholarship Repository: A Service of the Joel A. Katz Law Library

---

Chapter 11 Bankruptcy Case Studies

Student Work

---

Spring 2010

### Active Ride Shop : Chapter 11 Bankruptcy

Matt Fink

Philip Meyer

Follow this and additional works at: [https://ir.law.utk.edu/utk\\_studlawbankruptcy](https://ir.law.utk.edu/utk_studlawbankruptcy)



Part of the [Bankruptcy Law Commons](#)

---

#### Recommended Citation

Fink, Matt and Meyer, Philip, "Active Ride Shop : Chapter 11 Bankruptcy" (2010). *Chapter 11 Bankruptcy Case Studies*. 5.

[https://ir.law.utk.edu/utk\\_studlawbankruptcy/5](https://ir.law.utk.edu/utk_studlawbankruptcy/5)

This Article is brought to you for free and open access by the Student Work at Legal Scholarship Repository: A Service of the Joel A. Katz Law Library. It has been accepted for inclusion in Chapter 11 Bankruptcy Case Studies by an authorized administrator of Legal Scholarship Repository: A Service of the Joel A. Katz Law Library. For more information, please contact [eliza.boles@utk.edu](mailto:eliza.boles@utk.edu).

**Active Ride Shop**  
**Chapter 11 Bankruptcy**

Matt Fink & Philip Meyer  
Professor Kuney's Reorganizations & Workouts  
Spring 2010



Table of Contents

I.	Introduction.....	3
II.	Background.....	3
III.	Operations and First-Day Motions.....	8
IV.	Cash Collateral & DIP Loan.....	17
V.	Executory Contracts & Leases.....	22
VI.	Appointment of Professionals & Fees.....	27
VII.	Plan of Sale & Sale.....	35
VIII.	Avoidance Actions.....	85
IX.	Conclusion.....	87

*Personally, I'm bummed anyone bought that piece of trash. It would have been better if they were just done, and the customers that shopped at Active started supporting skateboarding by shopping at true local shops . . . but I can't say I'm not curious to see how these businessmen plan to make it even more corporate and less 'core. - Blogger<sup>1</sup>*

## I. Introduction

In 2008, hundreds of people waited in the rain for the grand opening of Active Ride Shop's new Chico Hills location, its twenty-sixth store and its biggest opening event yet.<sup>2</sup> In the same year, Active was awarded the Surf Industry Men's Retailer of the Year Award,<sup>3</sup> yet less than a year later the company would file for chapter 11 protection. This paper will explore Active's financial downturn and resulting chapter 11 case, inform the reader about the workings of the chapter 11 process, and impart an understanding of how the process works in the context of a non-plan sale of a business.

## II. Background

Based in Mira Loma, California, Active offers a wide range of extreme sports apparel and gear, and touted itself as the largest retailer of its kind in Southern California and the largest



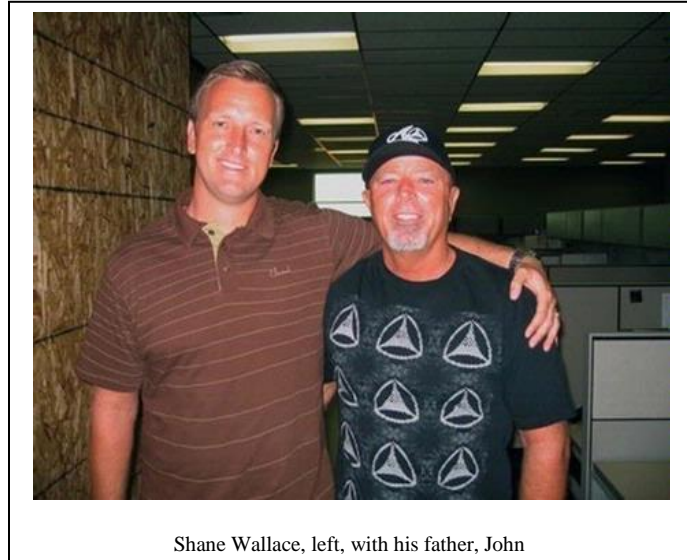
<sup>1</sup> Active Bankruptcy Woes Sold Off to Florida Businessmen, <http://consumemore.wordpress.com/2009/06/18/active-bankruptcy-woes-sold-off-to-florida-businessmen/> (June 18, 2009). The authors think there may be more truth in this comment than its inelegance conveys.

<sup>2</sup> Hang Nguyen, The Shoppes at Chino Hill Debuts With Some Stores Offering Deals, ORANGE COUNTY REG., May 24, 2008, [http://web2.westlaw.com/find/default.wl?rs=WLW10.03&ifm=NotSet&fn=\\_top&sv=Split&cite=2008+WLNR+102+10671&vr=2.0&rp=%2ffind%2fdefault.wl&mt=Westlaw](http://web2.westlaw.com/find/default.wl?rs=WLW10.03&ifm=NotSet&fn=_top&sv=Split&cite=2008+WLNR+102+10671&vr=2.0&rp=%2ffind%2fdefault.wl&mt=Westlaw).

<sup>3</sup> SkateTheory.com, Active Ride Shop Files Chapter 11, <http://www.skatetheory.com/news/active-ride-shop-files-chapter-11/6786> (last visited April 19, 2010)

overall e-commerce and mail order retailer of its class.<sup>4</sup> The core of its business is skating, surfing, and snowboarding apparel and accessories from brands including Billabong, Sole Tech, and Hurley;<sup>5</sup> Active also has an in-house brand.<sup>6</sup>

The Active Wallace Group, owner of Active Ride Shop, was founded in 1989 by John Wallace, a former retail executive, and his son, Shane.<sup>7</sup> In the beginning, John and Shane were the only employees; John worked days, Shane worked nights, and they split the weekends.<sup>8</sup> Active Ride Shop started in a small store in Chino, California and



<sup>4</sup> In re The Active Wallace Group, case no. 09-15370, Voluntary Petition, Dkt. No. 1, filed 3/23/09; Rodd Cayton, *Inland Action-Sports Retailer Expands to Ride Skating Boom*, THE PRESS-ENTERPRISE, June 29, 2007, [http://web2.westlaw.com/find/default.wl?rs=WLW10.03&ifm=NotSet&fn=\\_top&sv=Split&cite=6%2f29%2f07+PR+ES-ENT+&vr=2.0&rp=%2ffind%2fdefault.wl&mt=Westlaw](http://web2.westlaw.com/find/default.wl?rs=WLW10.03&ifm=NotSet&fn=_top&sv=Split&cite=6%2f29%2f07+PR+ES-ENT+&vr=2.0&rp=%2ffind%2fdefault.wl&mt=Westlaw).

<sup>5</sup> Kevin Fung, *Active Wallace to Hold Auction for Assets*, DAILY DEAL, June 9, 2009, [http://web2.westlaw.com/find/default.wl?rs=WLW10.03&ifm=NotSet&fn=\\_top&sv=Split&cite=6%2f9%2f09+DAILYDEAL&vr=2.0&rp=%2ffind%2fdefault.wl&mt=Westlaw](http://web2.westlaw.com/find/default.wl?rs=WLW10.03&ifm=NotSet&fn=_top&sv=Split&cite=6%2f9%2f09+DAILYDEAL&vr=2.0&rp=%2ffind%2fdefault.wl&mt=Westlaw).

<sup>6</sup> Kevin Fung, *Active Wallace to Hold Auction for Assets*, DAILY DEAL, June 9, 2009, [http://web2.westlaw.com/find/default.wl?rs=WLW10.03&ifm=NotSet&fn=\\_top&sv=Split&cite=6%2f9%2f09+DAILYDEAL&vr=2.0&rp=%2ffind%2fdefault.wl&mt=Westlaw](http://web2.westlaw.com/find/default.wl?rs=WLW10.03&ifm=NotSet&fn=_top&sv=Split&cite=6%2f9%2f09+DAILYDEAL&vr=2.0&rp=%2ffind%2fdefault.wl&mt=Westlaw).

<sup>7</sup> Ben Fidler, *Active Wallace to Seek DIP Access*, DAILY DEAL, March 26, 2009, [http://web2.westlaw.com/find/default.wl?rs=WLW10.03&ifm=NotSet&fn=\\_top&sv=Split&cite=3%2f26%2f09+DAILYDEAL&vr=2.0&rp=%2ffind%2fdefault.wl&mt=Westlaw](http://web2.westlaw.com/find/default.wl?rs=WLW10.03&ifm=NotSet&fn=_top&sv=Split&cite=3%2f26%2f09+DAILYDEAL&vr=2.0&rp=%2ffind%2fdefault.wl&mt=Westlaw); Tiffany Montgomery, *Where Active Wants To Be and How it Thrives*, SHOP-EAT-SURF.COM, May 29, 2008, <http://www.shop-eat-surf.com/news-item/494/where-active-wants-to-be>.

<sup>8</sup> Tiffany Montgomery, *Where Active Wants To Be and How it Thrives*, SHOP-EAT-SURF.COM, May 29, 2008, <http://www.shop-eat-surf.com/news-item/494/where-active-wants-to-be>.

expanded throughout Southern California.<sup>9</sup> In 2007, Active Wallace Group began an expansion plan in anticipation of an expected jump in the popularity of snowboarding and skateboarding.<sup>10</sup> The ambitious plan would result in a tripling of its stores. Active's fiscal condition, however, proved unstable. After posting a \$368,356 profit for the fiscal year ending March 31, 2007, Active suffered a \$2.05 million loss for the 2008 fiscal year, and projected a \$7.74 million loss for the 2009 fiscal year.<sup>11</sup> At its apex, Active operated twenty-nine stores; however, before its bankruptcy Active closed eight underperforming stores in an attempt to cut costs.<sup>12</sup>

In hindsight, the company blamed the losses on "rapid overexpansion during a time when its same-store sales were plummeting."<sup>13</sup> During Active's store expansion, which required substantial capital expenditures for accounting, purchasing, inventory, and distribution systems,

---

<sup>9</sup> ActiveRideShop.com, About Active Ride Shop, <http://www.activerideshop.com/c/About.htm> (last visited April 19, 2010).

<sup>10</sup> Rodd Cayton, *Inland Action-Sports Retailer Expands to Ride Skating Boom*, THE PRESS-ENTERPRISE, June 29, 2007.

<sup>11</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order (1) Approving Overbid Procedures and Break-Up Fee In Connection with Proposed Sale of Substantially All Assets of the Estate, and (2) Setting Hearing on Motion for Sale of Substantially All Assets of Estate, Dkt. No. 129, p. 15, filed 5/15/09. Total revenues for 2007 and 2008 were \$58.9 million and \$61.8 million, respectively, and projected income for 2009 was \$59.9 million. *Id.*

<sup>12</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Approving Stipulation for Post-Petition Secured Financing and Use of Cash Collateral, Dkt. No. 2, filed 3/23/09; Kevin Fung, *Active Wallace to Hold Auction for Assets*, DAILY DEAL, June 9, 2009, [http://web2.westlaw.com/find/default.wl?rs=WLW10.03&ifm=NotSet&fn=\\_top&sv=Split&cite=6%2f9%2f09+DAILYDEAL&vr=2.0&rp=%2ffind%2fdefault.wl&mt=Westlaw](http://web2.westlaw.com/find/default.wl?rs=WLW10.03&ifm=NotSet&fn=_top&sv=Split&cite=6%2f9%2f09+DAILYDEAL&vr=2.0&rp=%2ffind%2fdefault.wl&mt=Westlaw).

<sup>13</sup> Ben Fidler, *Active Wallace to Seek DIP Access*, DAILY DEAL, March 26, 2009, [http://web2.westlaw.com/find/default.wl?rs=WLW10.03&ifm=NotSet&fn=\\_top&sv=Split&cite=3%2f26%2f09+DAILYDEAL&vr=2.0&rp=%2ffind%2fdefault.wl&mt=Westlaw](http://web2.westlaw.com/find/default.wl?rs=WLW10.03&ifm=NotSet&fn=_top&sv=Split&cite=3%2f26%2f09+DAILYDEAL&vr=2.0&rp=%2ffind%2fdefault.wl&mt=Westlaw). Same store sales for the fiscal year ending March 2009 were down 46% from the prior year. In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order (1) Approving Overbid Procedures and Break-Up Fee In Connection with Proposed Sale of Substantially All Assets of the Estate, and (2) Setting Hearing on Motion for Sale of Substantially All Assets of Estate, Dkt. No. 129, p. 24, filed 5/15/09.

its total sales stayed flat.<sup>14</sup> Additionally, Active incurred significant costs associated with the implementation of a centralized 103,000 square foot distribution center in Mira Loma.<sup>15</sup>

On Monday, March 23, 2009 Active filed for chapter 11<sup>16</sup> protection in the United States Bankruptcy Court, Central District, in Riverside, California.<sup>17</sup> Active retained the legal services of the Newport Beach, California law firm of Winthrop Couchot, P.C.<sup>18</sup> and the financial advisory services of



Active's Mira Loma distribution center

The Phoenix Group LLC ("Phoenix").<sup>19</sup> The case was presided over by Judge Richard Neiter.<sup>20</sup>

---

<sup>14</sup> Ben Fidler, *Active Wallace to Seek DIP Access*, DAILY DEAL, March 26, 2009, [http://web2.westlaw.com/find/default.wl?rs=WLW10.03&ifm=NotSet&fn=\\_top&sv=Split&cite=3%2f26%2f09+DAILYDEAL&vr=2.0&rp=%2ffind%2fdefault.wl&mt=Westlaw](http://web2.westlaw.com/find/default.wl?rs=WLW10.03&ifm=NotSet&fn=_top&sv=Split&cite=3%2f26%2f09+DAILYDEAL&vr=2.0&rp=%2ffind%2fdefault.wl&mt=Westlaw).

<sup>15</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order (1) Approving Overbid Procedures and Break-Up Fee In Connection with Proposed Sale of Substantially All Assets of the Estate, and (2) Setting Hearing on Motion for Sale of Substantially All Assets of Estate, Dkt. No. 129, p. 16, filed 5/15/09.

<sup>16</sup> Unless otherwise noted, all references are to Title 11 of the United States Code -- the Bankruptcy Code.

<sup>17</sup> In re The Active Wallace Group, case no. 09-15370, Voluntary Petition, Dkt. No. 1, filed 3/23/09.

<sup>18</sup> Ben Fidler, *Active Wallace to Seek DIP Access*, DAILY DEAL, March 26, 2009, [http://web2.westlaw.com/find/default.wl?rs=WLW10.03&ifm=NotSet&fn=\\_top&sv=Split&cite=3%2f26%2f09+DAILYDEAL&vr=2.0&rp=%2ffind%2fdefault.wl&mt=Westlaw](http://web2.westlaw.com/find/default.wl?rs=WLW10.03&ifm=NotSet&fn=_top&sv=Split&cite=3%2f26%2f09+DAILYDEAL&vr=2.0&rp=%2ffind%2fdefault.wl&mt=Westlaw); see discussion of Winthrop Couchot, *infra* section VI.

<sup>19</sup> Ben Fidler, *Active Wallace to Seek DIP Access*, DAILY DEAL, March 26, 2009, [http://web2.westlaw.com/find/default.wl?rs=WLW10.03&ifm=NotSet&fn=\\_top&sv=Split&cite=3%2f26%2f09+DAILYDEAL&vr=2.0&rp=%2ffind%2fdefault.wl&mt=Westlaw](http://web2.westlaw.com/find/default.wl?rs=WLW10.03&ifm=NotSet&fn=_top&sv=Split&cite=3%2f26%2f09+DAILYDEAL&vr=2.0&rp=%2ffind%2fdefault.wl&mt=Westlaw); see discussion of Phoenix, *infra* section VI.

<sup>20</sup> Judge Neiter was appointed to a 14-year term in 2006 after practicing bankruptcy law for over 40 years with the Los Angeles firm of Stutman, Treister & Glatt. He had also served on the panel of mediators for the Central District of California Bankruptcy Court, as chairman of the Debtor/Creditor Relations and Bankruptcy Committee for the State Bar of California, and as a member of the Executive Committee for the Commercial Law and Bankruptcy Section of the Los Angeles County Bar Association. United States Courts for the Ninth Circuit Public Information Office, *Court of Appeals Appoints New Bankruptcy Judges for Central District of California*, Jan. 31, 2006, [http://www.cacb.uscourts.gov/cacb/Notices.nsf/New%20Appointments%20Reappointments/E598F50D9C669BBD8825714F005CE5BE/\\$FILE/Neiter\\_Kaufman.pdf](http://www.cacb.uscourts.gov/cacb/Notices.nsf/New%20Appointments%20Reappointments/E598F50D9C669BBD8825714F005CE5BE/$FILE/Neiter_Kaufman.pdf).

Active's creditors	
Industry companies are 18 of the top 20 unsecured creditors listed in Active's Chapter 11 bankruptcy filing.	
Company	Amount owed
Nike	\$1,494,757
Advantage Construction	\$891,000
Sole Technology	\$682,625
Hurley International	\$615,590
DC Shoe Co.	\$549,557
Quiksilver	\$515,316
One Distribution	\$477,251
Ezekiel	\$432,947
Matix Clothing Co.	\$388,889
Syndrome Dist.	\$355,536
Vans	\$347,998
Girl Skateboard Co.	\$344,857
Stussy Inc.	\$295,074
T&K Print Management	\$236,281
Earth Products	\$231,251
Black Box	\$223,933
Ambiguous Clothing	\$215,258
Element	\$204,925
Independent Trading Co.	\$200,750
Lakai	\$191,952
Total Top 20 owed	\$8,895,747

SOURCE: Active's U.S. Bankruptcy Court filing.

Active's CEO, John Wallace, stated: "The swift and dramatic downturn in the local economy had a major impact on our business in the [last half] of 2008. In combination with the robust growth and expansion we experienced during the previous 24 months, this perfect storm of economic retraction left us with no other option."<sup>21</sup>

Active's court filings listed assets of \$27.7 million and liabilities of \$22 million.<sup>22</sup> Its major unsecured creditors included Nike USA Inc., Advantage Construction, Sole Technology, Hurley International, DC Shoe Co., and Quiksilver, Inc.<sup>23</sup> Active's major secured creditor was Merrill Lynch Business Financial Services ("Merrill"),<sup>24</sup> which had extended a \$3.5 million line of credit and a \$1.5

million revolver loan to Active in July 2006.<sup>25</sup> The related security agreements granted Merrill a senior security interest in substantially all of Active's assets.<sup>26</sup> As of the petition date, Active

<sup>21</sup> SkateTheory.com, *Active Ride Shop Files Chapter 11*, <http://www.skatetheory.com/news/active-ride-shop-files-chapter-11/6786> (last visited April 19, 2010).

<sup>22</sup> In re The Active Wallace Group, case no. 09-15370, Summary of Schedules, Dkt. No. 77, p. 1, filed 4/17/09. Active's assets consisted of personal property and the largest categories were "leasehold and store improvements" (\$12.7 million), inventory (\$5.4 million), and "machinery & equipment" (\$4.9 million). In re The Active Wallace Group, case no. 09-15370, Schedules A-D, Dkt. No. 77-1, p. 4, filed 4/17/09. Its liabilities consisted of \$4.6 million of secured debt, \$2.1 million of unsecured priority claims, and \$15.2 million of unsecured non-priority claims. In re The Active Wallace Group, case no. 09-15370, Summary of Schedules, Dkt. No. 77, p. 1, filed 4/17/09.

<sup>23</sup> In re The Active Wallace Group, case no. 09-15370, Voluntary Petition, Dkt. No. 1, filed 3/23/09.

<sup>24</sup> Merrill Lynch Business Financial Services assigned its interests in its claims against Active to Merrill Lynch Commercial Finance Corp., and these two related entities will be referred to collectively as "Merrill." In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Approving Stipulation for Post-Petition Secured Financing and Use of Cash Collateral, Dkt. No. 2, p. 5, filed 3/23/09.

<sup>25</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Authorizing Retention of Cash Management System, Dkt. No. 3, p. 5, filed 3/23/09.



owed approximately \$4.2 million in principal under these loans, exclusive of interest and other charges.<sup>27</sup> The debt was personally guaranteed by both John and Shane Wallace.<sup>28</sup>

### III. Operations and First-Day Motions

Active, as debtor-in-possession (“DIP”),<sup>29</sup> filed several emergency first day motions<sup>30</sup> involving financing, employee obligations, cash management, merchant services, contract rejection, customer obligations, utility service, establishment of a § 503(b)(9) claims bar date, and limitation of notice requirements.<sup>31</sup>

#### A. Cash Management and Merchant Services

One of Active’s first day motions was an emergency motion for authorization to retain its cash management system, subject to a “Blocked Control Agreement” it had entered into with its lender prepetition.<sup>32</sup> Active also moved for authorization to keep open and retain its various

---

<sup>26</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Emergency Motion for Order Authorizing Retention of Cash Management System, Dkt. No. 3, p. 5, filed 3/23/09.

<sup>27</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Emergency Motion for Order Authorizing Retention of Cash Management System, Dkt. No. 3, p. 5, filed 3/23/09.

<sup>28</sup> In re The Active Wallace Group, case no. 09-15370, Exhibits Part 2 of 3 to Declaration of John Wallace, Dkt. No. 11-2, p. 29-30, filed 3/23/09.

<sup>29</sup> Upon filing a bankruptcy petition, a company becomes a “debtor” and its management will “continue in place as the DIP until the debtor’s plan of reorganization is confirmed, the debtor’s case is dismissed or converted to a chapter 7, or a chapter 11 trustee is appointed.” JONATHAN P. FRIEDLAND, MICHAEL L. BERNSTEIN, PROF. GEORGE W. KUNEY & PROF. JOHN D. AYER, CHAPTER 11 – “101” THE NUTS AND BOLTS OF CHAPTER 11 PRACTICE 19 (2007). Under §§ 1107(a) and 1108, a DIP: (1) generally has the same rights and powers as a bankruptcy trustee; (2) may operate the debtor’s business; and (3) may employ the debtor’s prepetition employees.

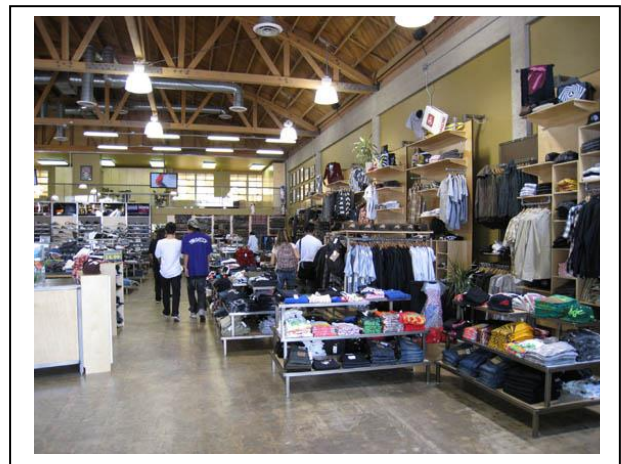
<sup>30</sup> “First-day motions” are usually filed along with the bankruptcy petition. Some are “true emergencies,” others are not; some are actually heard on the first day, others are heard within the first few days. JONATHAN P. FRIEDLAND, MICHAEL L. BERNSTEIN, PROF. GEORGE W. KUNEY & PROF. JOHN D. AYER, CHAPTER 11 – “101” THE NUTS AND BOLTS OF CHAPTER 11 PRACTICE 19 (2007).

<sup>31</sup> In re The Active Wallace Group, case no. 09-15370, Declaration of John Wallace, Dkt. No. 11, p. 1, filed 3/23/09.

<sup>32</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Emergency Motion for Order Authorizing Retention of Cash Management System, Dkt. No. 3, p. 2, filed 3/23/09.

bank accounts, thereby excusing it from the normal § 345(b) requirement to close all existing bank accounts.<sup>33</sup> This relief would allow Active to continue business operations efficiently and avoid the disruption to operations that would result if its cash management system was terminated.<sup>34</sup>

Due to the nature of its chain retail store business, Active utilized centralized accounting systems, including its cash management system, to maximize efficiency, reduce costs, and generate timely and effective financial reports.<sup>35</sup> Active asserted that preserving this system was necessary to continue its day-to-day operations in the most cost-effective manner and that emergency authorization to continue to employ the system was critical to its ability to continue operations.<sup>36</sup> Its motion argued that post-petition use of cash management systems and existing bank accounts in the ordinary course of a debtor's business is routinely granted by bankruptcy courts.<sup>37</sup>



<sup>33</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Authorizing Retention of Cash Management System, Dkt. No. 3, p. 2, filed 3/23/09.

<sup>34</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Authorizing Retention of Cash Management System, Dkt. No. 3, p. 2, filed 3/23/09.

<sup>35</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Authorizing Retention of Cash Management System, Dkt. No. 3, p. 4, filed 3/23/09.

<sup>36</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Authorizing Retention of Cash Management System, Dkt. No. 3, p. 5, filed 3/23/09.

<sup>37</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Authorizing Retention of Cash Management System, Dkt. No. 3, p. 6, filed 3/23/09 (citing Order Approving Continued Post-Petition Use of Debtor's Existing Bank Accounts, *In re CSC Indus., Inc.* and *In re Copperweld Steel Co.*, Nos. 93-41898 and 93-41899 (Bankr. N.D. Ohio 1993)).



Active also asked the court to waive the §345(b) requirement that banks at which its funds are deposited provide a bond or deposit of securities to back the deposits to the extent they are not insured by the United States, on the grounds that those banks would likely charge Active for that service.<sup>38</sup> The United States Trustee (the “UST”) objected to this motion because of the banking crisis that was then taking place across the country.<sup>39</sup> Its concern was that Active had not addressed what would happen to the bankruptcy estate’s funds if Active’s bank was declared insolvent and seized by the FDIC.<sup>40</sup> The UST noted that while Active sought to maintain a “business as usual” atmosphere to minimize disruptions, that particular concern “pales in comparison to an institutional bank failure.”<sup>41</sup> In sum, the UST “vehemently” opposed any deviation from the §345 requirements and desired Active to close all accounts and open DIP accounts.<sup>42</sup> On April 7, 2009 the court continued the hearing on this motion to April 23,<sup>43</sup> but never formally ruled on its merits.

---

<sup>38</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Emergency Motion for Order Authorizing Retention of Cash Management System, Dkt. No. 3, p. 8, filed 3/23/09. Under § 345, the United States Trustee must approve any corporate sureties securing bonds.

<sup>39</sup> In re The Active Wallace Group, case no. 09-15370, United States Trustee’s Objection to Debtor’s Emergency Motion for Order Authorizing Retention of Cash Management System, Dkt. No. 17, p. 1, filed 3/25/09.

<sup>40</sup> In re The Active Wallace Group, case no. 09-15370, United States Trustee’s Objection to Debtor’s Emergency Motion for Order Authorizing Retention of Cash Management System, Dkt. No. 17, p. 1-2, filed 3/25/09.

<sup>41</sup> In re The Active Wallace Group, case no. 09-15370, United States Trustee’s Objection to Debtor’s Emergency Motion for Order Authorizing Retention of Cash Management System, Dkt. No. 17, p. 5, filed 3/25/09.

<sup>42</sup> In re The Active Wallace Group, case no. 09-15370, United States Trustee’s Objection to Debtor’s Emergency Motion for Order Authorizing Retention of Cash Management System, Dkt. No. 17, p. 5, filed 3/25/09.

Another of Active's first-day motions was an emergency motion to authorize it to maintain prepetition merchant service accounts and for a related order compelling banks to continue providing merchant services to Active.<sup>44</sup> This relief was requested to maintain credit card payment processing, the source of approximately 80% of Active's revenue.<sup>45</sup> Although Active asserted that credit card payment processing was within the ordinary course of business under § 363(c)(1), and thus did not need court approval, it argued that even if the court viewed it as outside the ordinary course, it should approve it as a reasonable exercise of Active's business judgment.<sup>46</sup> As the bank agreements were property of the estate, Active asserted that they should be subject to the § 362 automatic stay and thus the banks should be required to continue providing merchant services to Active under the agreements.<sup>47</sup> The motion was withdrawn without explanation on April 2.<sup>48</sup>

---

<sup>43</sup> In re The Active Wallace Group, case no. 09-15370, Order Continuing Hearing on Emergency Motions Re: (1) Financing; (2) Cash Management; (3) Merchant Services; (4) Utility, Dkt. No. 48, p. 2, filed 4/7/09.

<sup>44</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order: (1) Authorizing the Debtor to Maintain Pre-petition Merchant Services Accounts; and (2) Compelling Banks to Continue Merchant Services, Dkt. No. 4, p. 1, filed 3/23/09.

<sup>45</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order: (1) Authorizing the Debtor to Maintain Pre-petition Merchant Services Accounts; and (2) Compelling Banks to Continue Merchant Services, Dkt. No. 4, p. 3, filed 3/23/09. Active had agreements with American Express, Discover, Wells Fargo, JPMorgan Chase, PayPal, and Amazon which allowed it to accept American Express, Discover, MasterCard, and Visa credit cards and PayPal payments. *Id.* at 5.

<sup>46</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order: (1) Authorizing the Debtor to Maintain Pre-petition Merchant Services Accounts; and (2) Compelling Banks to Continue Merchant Services, Dkt. No. 4, p. 7-8, filed 3/23/09.

<sup>47</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order: (1) Authorizing the Debtor to Maintain Pre-petition Merchant Services Accounts; and (2) Compelling Banks to Continue Merchant Services, Dkt. No. 4, p. 9-10, filed 3/23/09.

<sup>48</sup> In re The Active Wallace Group, case no. 09-15370, Withdrawal of Debtor's Emergency Motion for Order: (1) Authorizing the Debtor to Maintain Pre-petition Merchant Services Accounts; and (2) Compelling Banks to Continue Merchant Services, Dkt. No. 34, p. 2, filed 4/2/09.

## B. Customer Obligations

Active also filed an emergency first-day motion for court authorization to honor and comply with customer obligations, namely gift cards.<sup>49</sup> Failure to honor the gift cards would result in negative publicity and loss of customer confidence and support.<sup>50</sup> Active only sought authorization to honor \$500,000 of gift cards. While the total gift card liability on Active's books was approximately \$1.4 million on the petition date, it expected that only one-third of that amount would be redeemed post-petition.<sup>51</sup> Moreover, Active asserted that its pre- and postpetition lender would not provide DIP financing if a greater amount were authorized to be honored.<sup>52</sup> Active invoked the court's inherent equitable powers under § 105(a) to allow debtors to pay prepetition claims of particular creditors under the "necessity of payment doctrine."<sup>53</sup> This motion was granted on April 3, 2009.<sup>54</sup>

---

<sup>49</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Authorizing Debtor to Honor and Comply With Customer Obligations, Dkt. No. 6, p. 2, filed 3/23/09.

<sup>50</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Authorizing Debtor to Honor and Comply With Customer Obligations, Dkt. No. 6, p. 5, filed 3/23/09.

<sup>51</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Authorizing Debtor to Honor and Comply With Customer Obligations, Dkt. No. 6, p. 4, filed 3/23/09. Over \$400,000 of the gift cards were purchased over three years before the petition date. *Id.*

<sup>52</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Authorizing Debtor to Honor and Comply With Customer Obligations, Dkt. No. 6, p. 4, filed 3/23/09.

<sup>53</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Authorizing Debtor to Honor and Comply With Customer Obligations, Dkt. No. 6, p. 5, filed 3/23/09. The "necessity of payment," enables the bankruptcy court to authorize a debtor's payment of prepetition claims essential to continued operations. *In re Ionosphere Clubs, Inc.*, 98 B.R. 174, 175-76 (Bankr. S.D.N.Y. 1989) (citation omitted).

<sup>54</sup> In re The Active Wallace Group, case no. 09-15370, Order Authorizing Debtor to Honor and Comply With Customer Obligations, Dkt. No. 36, p. 2, filed 4/3/09.

### C. Utility Service

Another of Active's first-day motions was an emergency order pursuant to §§ 105(a) and 366 related to its utility providers.<sup>55</sup> Active moved the court to prohibit the utilities companies from altering, refusing, or discontinuing service.<sup>56</sup> Any interruption in gas, water, electric, telecommunications, and other services would disrupt Active's operations and impair its reorganization.<sup>57</sup> Active also moved the court to deem the utilities adequately assured of future performance and to establish procedures for determining adequate assurance of future payment to the utilities.<sup>58</sup> It proposed to protect the utilities via a procedure allowing any utility to request adequate assurance if it believed the facts and circumstances related to providing post-petition services merited greater protection.<sup>59</sup> On April 2, Active amended the motion, proposing to deposit 50% of its estimated monthly utility costs into an interest-bearing account to provide

---

<sup>55</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order (A) Prohibiting Utility Providers From Altering, Refusing or Discontinuing Service, (B) Deeming Utilities Adequately Assured of Future Performance, and (C) Establishing Procedures for Determining Adequate Assurance of Payment, Dkt. No. 7, p. 1, filed 3/23/09. Section 366(a) protects debtors against the immediate termination of utility services after it files for bankruptcy. A utility may not alter, refuse, or discontinue services to a debtor during the first twenty days of the case solely because of unpaid prepetition amounts. A utility may, however, subsequently do so unless the debtor furnishes adequate assurance of payment for post-petition services within thirty days of the petition date.

<sup>56</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order (A) Prohibiting Utility Providers From Altering, Refusing or Discontinuing Service, (B) Deeming Utilities Adequately Assured of Future Performance, and (C) Establishing Procedures for Determining Adequate Assurance of Payment, Dkt. No. 7, p. 2, filed 3/23/09.

<sup>57</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order (A) Prohibiting Utility Providers From Altering, Refusing or Discontinuing Service, (B) Deeming Utilities Adequately Assured of Future Performance, and (C) Establishing Procedures for Determining Adequate Assurance of Payment, Dkt. No. 7, p. 2, filed 3/23/09.

<sup>58</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order (A) Prohibiting Utility Providers From Altering, Refusing or Discontinuing Service, (B) Deeming Utilities Adequately Assured of Future Performance, and (C) Establishing Procedures for Determining Adequate Assurance of Payment, Dkt. No. 7, p. 1, filed 3/23/09.

<sup>59</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order (A) Prohibiting Utility Providers From Altering, Refusing or Discontinuing Service, (B) Deeming Utilities Adequately Assured of Future Performance, and (C) Establishing Procedures for Determining Adequate Assurance of Payment, Dkt. No. 7, p. 9, filed 3/23/09.

adequate assurance of payment to its providers.<sup>60</sup> The account would be held in escrow pending further order of the court, and the amendment contemplated allowing providers to request additional assurances if they believed the escrow account was inadequate.<sup>61</sup> On April 7, the court continued the hearing on the motion;<sup>62</sup> Active, however, withdrew the motion without explanation on May 1.<sup>63</sup>

#### D. Employee Obligations

Active also sought emergency court authorization to pay its prepetition wage-related obligations and honor its employee-related prepetition benefits.<sup>64</sup> Active moved for authorization to: (1) pay wage and salary obligations up to the § 507(a)<sup>65</sup> priority limit; (2) reimburse ordinary course prepetition business expenses;<sup>66</sup> (3) pay benefit obligations such as 401(k) and insurance contributions; and (4) honor all prepetition vacation, sick, holiday, and

---

<sup>60</sup> In re The Active Wallace Group, case no. 09-15370, Amendment to Debtor's Emergency Motion for Order (A) Prohibiting Utility Providers From Altering, Refusing or Discontinuing Service, (B) Deeming Utilities Adequately Assured of Future Performance, and (C) Establishing Procedures for Determining Adequate Assurance of Payment, Dkt. No. 35, p. 2, filed 4/2/09. Active's estimated this amount at \$38,710. *Id.*

<sup>61</sup> In re The Active Wallace Group, case no. 09-15370, Amendment to Debtor's Emergency Motion for Order (A) Prohibiting Utility Providers From Altering, Refusing or Discontinuing Service, (B) Deeming Utilities Adequately Assured of Future Performance, and (C) Establishing Procedures for Determining Adequate Assurance of Payment, Dkt. No. 35, p. 2, filed 4/2/09.

<sup>62</sup> In re The Active Wallace Group, case no. 09-15370, Order Continuing Hearing on Emergency Motions Re: (1) Financing; (2) Cash Management; (3) Merchant Services; (4) Utility, Dkt. No. 48, p. 2, filed 4/7/09.

<sup>63</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Withdrawal of Emergency Motion for Order (A) Prohibiting Utility Providers From Altering, Refusing or Discontinuing Service, (B) Deeming Utilities Adequately Assured of Future Performance, and (C) Establishing Procedures for Determining Adequate Assurance of Payment, Dkt. No. 110, p. 2, filed 5/1/09.

<sup>64</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Authorizing Payment and Honoring of Prepetition Payroll Obligations, Dkt. No. 8, p. 1, 6, filed 3/23/09.

<sup>65</sup> Section 507(a)(4) gives priority status to allowed unsecured claims for wages, salaries, or commissions, including vacation, severance, and sick leave pay earned by an individual within 180 days of the petition date, up to \$10,950 per individual. Active owed prepetition wages of approximately \$130,000. In re The Active Wallace Group, case no. 09-15370, Declaration of John Wallace, Dkt. No. 11, p. 5, filed 3/23/09.

<sup>66</sup> Active estimated its prepetition employee expense reimbursement to be \$4,000. In re The Active Wallace Group, case no. 09-15370, Declaration of John Wallace, Dkt. No. 11, p. 5, filed 3/23/09.

related paid leave claims. Active cited its need to retain its employees and their support to maintain its ongoing business obligations as grounds for the requested emergency relief.<sup>67</sup> Obtaining the requested relief would allow Active to continue its business operations in the ordinary course, meet customer needs, and preserve going-concern value.<sup>68</sup> Active asserted that all of the payments at issue constituted priority claims under § 507(a)(4) and (a)(5) and were therefore likely to be paid in any event; thus, the court, it argued, should permit payment of the prepetition wages so it could maintain an effective workforce.<sup>69</sup> The court granted the motion on April 14, 2009 finding that immediate and irreparable harm would occur if the relief was not granted.<sup>70</sup> The order provided that Active could not make payments to its insiders until authorized pursuant to the UST guidelines.<sup>71</sup>

#### E. Claims Bar Date

Another of Active's emergency first-day motions sought establishment of a bar date for creditors' requests for payment of §§ 105 and 503(b)(9) administrative claims.<sup>72</sup> Affected creditors would have to file and serve their proofs of claim within thirty days of service of the

---

<sup>67</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Authorizing Payment and Honoring of Prepetition Payroll Obligations, Dkt. No. 8, p. 2, filed 3/23/09.

<sup>68</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Authorizing Payment and Honoring of Prepetition Payroll Obligations, Dkt. No. 8, p. 7, filed 3/23/09.

<sup>69</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Authorizing Payment and Honoring of Prepetition Payroll Obligations, Dkt. No. 8, p. 10, filed 3/23/09.

<sup>70</sup> In re The Active Wallace Group, case no. 09-15370, Order Authorizing Payment and Honoring of Prepetition Payroll Obligations, Dkt. No. 65, p. 2, filed 4/14/09.

<sup>71</sup> In re The Active Wallace Group, case no. 09-15370, Order Authorizing Payment and Honoring of Prepetition Payroll Obligations, Dkt. No. 65, p. 2, filed 4/14/09.

<sup>72</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Establishing Bar Date for Filing Requests for Payment of Administrative Expense Claims Under Sections 105 and 503(b)(9) of the Bankruptcy Code and Approving Form, Manner and Sufficiency of Notice of the Bar Date Pursuant to Bankruptcy Rule 9007, Dkt. No. 9, p. 1, filed 3/23/09.



notice of the requested claims bar date.<sup>73</sup> This motion related to Active's status as a retailer of goods. Sellers of goods may make an administrative expense claim for the value of goods delivered to a debtor in the ordinary course of business within twenty days of the petition date under § 503(b)(9). Active had received goods in the ordinary course of its business prior to the petition date and believed that § 503(b)(9) claimants would seek allowances of administrative expense claims.<sup>74</sup> As § 509(b)(9) does not set any date by which applicable claims must be asserted, Active sought to establish the bar date to permit a timely determination of the 503(b)(9) claims.<sup>75</sup> The court granted the motion on April 3 and ordered the 503(b)(9) claimants holding administrative expense claims and the creditors with reclamation claims to file and serve all proofs of claim within sixty days.<sup>76</sup>

#### F. Limitation of Notice Requirements

Active also moved to limit its notice requirements and obligations.<sup>77</sup> With over 375 creditors, serving notice of all proceedings to all creditors would be administratively burdensome

---

<sup>73</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Establishing Bar Date for Filing Requests for Payment of Administrative Expense Claims Under Sections 105 and 503(b)(9) of the Bankruptcy Code and Approving Form, Manner and Sufficiency of Notice of the Bar Date Pursuant to Bankruptcy Rule 9007, Dkt. No. 9, p. 2, filed 3/23/09.

<sup>74</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Establishing Bar Date for Filing Requests for Payment of Administrative Expense Claims Under Sections 105 and 503(b)(9) of the Bankruptcy Code and Approving Form, Manner and Sufficiency of Notice of the Bar Date Pursuant to Bankruptcy Rule 9007, Dkt. No. 9, p. 7, filed 3/23/09.

<sup>75</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Establishing Bar Date for Filing Requests for Payment of Administrative Expense Claims Under Sections 105 and 503(b)(9) of the Bankruptcy Code and Approving Form, Manner and Sufficiency of Notice of the Bar Date Pursuant to Bankruptcy Rule 9007, Dkt. No. 9, p. 7, filed 3/23/09.

<sup>76</sup> In re The Active Wallace Group, case no. 09-15370, Order Establishing Bar Date for Filing Requests for Payment of Administrative Expense Claims Under Sections 105 and 503(b)(9) of the Bankruptcy Code and Reclamation Claim Under Section 546(c), and Approving Form, Manner and Sufficiency of Notice of the Bar Date Pursuant to Bankruptcy Rule 9007, Dkt. No. 37, p. 2-3, filed 4/3/09.

<sup>77</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion to Limit Notice of Certain Matters Requiring Notice to Creditors, Dkt. No. 10, p. 1, filed 3/23/09.

and expensive.<sup>78</sup> Thus, Active proposed limiting notice to the UST, the secured and 20 largest unsecured creditors, investors, all parties who requested special notice, and to any party whose interest would be impacted directly by a particular action or proceeding.<sup>79</sup> It would still provide notice pertaining to major issues in the case to all creditors.<sup>80</sup> This motion was granted on April 3, 2009.<sup>81</sup>

#### IV. Cash Collateral & DIP Loan<sup>82</sup>

One of Active's first-day motions was an emergency request for the court to approve: (1) the use of cash collateral; and (2) a DIP loan from Merrill.<sup>83</sup> Active requested that the court allow a § 364(c)(1) superiority administrative claim in favor of Merrill, as well as a first priority lien on property of the estate not otherwise subject to a § 364(c)(2) lien (postpetition collateral) and a junior lien on property of the estate subject to a § 354(c)(3) lien (prepetition collateral).<sup>84</sup>

---

<sup>78</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion to Limit Notice of Certain Matters Requiring Notice to Creditors, Dkt. No. 10, p. 5, filed 3/23/09.

<sup>79</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion to Limit Notice of Certain Matters Requiring Notice to Creditors, Dkt. No. 10, p. 6, filed 3/23/09.

<sup>80</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion to Limit Notice of Certain Matters Requiring Notice to Creditors, Dkt. No. 10, p. 6, filed 3/23/09.

<sup>81</sup> In re The Active Wallace Group, case no. 09-15370, Order Limiting Notice of Certain Matters Requiring Notice to Creditors, Dkt. No. 38, p. 2, filed 4/3/09.

<sup>82</sup> DIP loans, also known as "post-petition financing" are covered in § 364, which authorizes the DIP to obtain credit and "outlines four paths whereby a lender may achieve priority for money advanced to a debtor after the petition date." JONATHAN P. FRIEDLAND, MICHAEL L. BERNSTEIN, PROF. GEORGE W. KUNEY & PROF. JOHN D. AYER, CHAPTER 11 – "101" THE NUTS AND BOLTS OF CHAPTER 11 PRACTICE 164 (2007). The four paths generally involve achieving superpriority administrative expense status, receiving post-petition liens, and receiving "priming liens" with priority senior or equal to existing liens. *Id.* at 164-65.

<sup>83</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Approving Stipulation for Post-Petition Secured Financing and Use of Cash Collateral, Dkt. No. 2, filed 3/23/09. Often prepetition lenders are also the DIP lender in chapter 11 cases; thus, as here, a single motion combining a request to use cash collateral and a request to incur DIP financing is common. JONATHAN P. FRIEDLAND, MICHAEL L. BERNSTEIN, PROF. GEORGE W. KUNEY & PROF. JOHN D. AYER, CHAPTER 11 – "101" THE NUTS AND BOLTS OF CHAPTER 11 PRACTICE 166 (2007).

<sup>84</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Approving Stipulation for Post-Petition Secured Financing and Use of Cash Collateral, Dkt. No. 2, p. 2, filed 3/23/09. Under

The loan would be personally guaranteed by John and Shane Wallace.<sup>85</sup> Without the financing, Active faced the possibility of shutting down before it could complete a sale of its assets.<sup>86</sup> Active asserted that its lack of sufficient cash to meet ongoing operating expenses constituted good cause for the court to hear its motion on an emergency basis.<sup>87</sup>

Active owed Merrill, a prepetition creditor, \$4.2 million on a revolver and term loan as of the petition date, secured by substantially all of Active's assets.<sup>88</sup> Active's cash constituted proceeds of that prepetition collateral and was, therefore, Merrill's cash collateral within the meaning of § 363(a).<sup>89</sup> Merrill had already agreed to Active's use of cash collateral.<sup>90</sup> Active

---

the prepetition indebtedness agreements, Merrill had senior security interests in substantially all of Active's assets and related proceeds, including accounts, chattel paper, contract rights, inventory, equipment, fixtures, general intangibles, deposit accounts, documents, instruments, investment property and financial assets, and books and records. In re The Active Wallace Group, case no. 09-15370, Exhibits Part 1 of 3 to Declaration of John Wallace, Dkt. No. 11-1, p. 6-7, filed 3/23/09. Section 364(c) provides:

If the trustee is unable to obtain unsecured credit allowable under section 503(b)(1) of this title as an administrative expense, the court . . . may authorize the obtaining of credit or incurring of debt (1) with priority over any or all administrative expense of the kind specified in Section 503(b) or 507(b) of this title; (2) secured by a lien on property of the estate that is not otherwise subject to a lien; or (3) secured by a junior lien on property of the estate that is subject to a lien.

<sup>85</sup> In re The Active Wallace Group, case no. 09-15370, Exhibits Part 1 of 3 to Declaration of John Wallace, Dkt. No. 11-1, p. 6, filed 3/23/09.

<sup>86</sup> Ben Fidler, *Active Wallace to Seek DIP Access*, DAILY DEAL, March 26, 2009, [http://web2.westlaw.com/find/default.wl?rs=WLW10.03&ifm=NotSet&fn=\\_top&sv=Split&cite=3%2f26%2f09+DAILYDEAL&vr=2.0&rp=%2ffind%2fdefault.wl&mt=Westlaw](http://web2.westlaw.com/find/default.wl?rs=WLW10.03&ifm=NotSet&fn=_top&sv=Split&cite=3%2f26%2f09+DAILYDEAL&vr=2.0&rp=%2ffind%2fdefault.wl&mt=Westlaw).

<sup>87</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Approving Stipulation for Post-Petition Secured Financing and Use of Cash Collateral, Dkt. No. 2, filed 3/23/09.

<sup>88</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Approving Stipulation for Post-Petition Secured Financing and Use of Cash Collateral, Dkt. No. 2, filed 3/23/09.

<sup>89</sup> In re The Active Wallace Group, case no. 09-15370, Order (A) Authorizing Interim Use of Cash Collateral, (B) Granting Adequate Protection, and (C) Continuing the Interim Hearing, Dkt. No. 28, p. 5, filed 3/30/09. "Cash collateral" Under 363(a) means "cash . . . or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest and includes the proceeds . . . or profits of property . . . subject to a security interest . . . whether existing before or after the commencement of a case under this title."

<sup>90</sup> In re The Active Wallace Group, case no. 09-15370, Order (A) Authorizing Interim Use of Cash Collateral, (B) Granting Adequate Protection, and (C) Continuing the Interim Hearing, Dkt. No. 28, p. 4, filed 3/30/09. A secured creditor like Merrill can acquire substantial control of a chapter 11 case by also serving as the DIP lender, and "may

cited its lack of sufficient operating cash, the related danger of having to close its doors, and the fact it was “worth more alive than dead” as justifications for emergency relief.<sup>91</sup> Active asserted that it had attempted but failed to obtain post-petition financing, secured or unsecured, from any other source.<sup>92</sup> The proposed post-petition financing was a working capital line of credit priced at LIBOR plus 2.25% and would mature in less than a month.<sup>93</sup>

The court authorized the use of cash collateral on March 30, pursuant to a budget and under a plan where the DIP would submit weekly “variance reports” to reconcile differences between the pro-forma budget figures and the actual financial results.<sup>94</sup> Under §§ 361 and 363(e), a lender is entitled to adequate protection of its interest in prepetition collateral, including the use of cash collateral. The court granted the following adequate protections to Merrill: (a) Active was ordered to pay Merrill all interest, fees, and charges owed under its prepetition loans when due; (b) replacement liens in prepetition collateral, all post-petition property of the estate, and in all related proceeds; (c) automatic perfection of the replacement liens as of the petition date not subject to subordination as to the replacement value; and (d) super-priority administrative expense claim status, limited to replacement value, pursuant to §507(b).<sup>95</sup> By its

---

secure preferential treatment of both their prepetition and postpetition debts.” George W. Kunej, *Hijacking Chapter 11*, 21 EMORY BANKR. DEV. J. 19, 46 (2004).

<sup>91</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Emergency Motion for Order Approving Stipulation for Post-Petition Secured Financing and Use of Cash Collateral, Dkt. No. 2, filed 3/23/09.

<sup>92</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Emergency Motion for Order Approving Stipulation for Post-Petition Secured Financing and Use of Cash Collateral, Dkt. No. 2, filed 3/23/09.

<sup>93</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Emergency Motion for Order Approving Stipulation for Post-Petition Secured Financing and Use of Cash Collateral, Dkt. No. 2, filed 3/23/09.

<sup>94</sup> In re The Active Wallace Group, case no. 09-15370, Order (A) Authorizing Interim Use of Cash Collateral, (B) Granting Adequate Protection, and (C) Continuing the Interim Hearing, Dkt. No. 28, p. 5, filed 3/30/09.

<sup>95</sup> In re The Active Wallace Group, case no. 09-15370, Order (A) Authorizing Interim Use of Cash Collateral, (B) Granting Adequate Protection, and (C) Continuing the Interim Hearing, Dkt. No. 28, p. 5-7, filed 3/30/09.

terms, the order would expire on April 7, 2009.<sup>96</sup> Thus, on April 8, the court entered a second order authorizing the use of cash collateral and granting adequate protection on the same terms, which by its terms would expire on April 23.<sup>97</sup> Also, a continued hearing on an order approving DIP financing and use of cash collateral was scheduled for April 23.<sup>98</sup>

On April 13, Active, the Official Committee of Unsecured Creditors (the “OCC”) and Merrill filed a stipulation with the court concerning DIP financing and the use of cash collateral.<sup>99</sup> The parties stressed the importance of increasing inventory shipments to Active and explained that the OCC had been negotiating the DIP financing with Merrill to obtain this goal.<sup>100</sup> The parties asked that the court continue the hearing on DIP financing and use cash collateral to April 30 so they could finalize negotiations.<sup>101</sup>

On April 22, Winthrop Resources Corporation (“Winthrop”), a lessor of computer equipment to Active, filed a limited objection to Active’s motion for approval of DIP financing

---

<sup>96</sup> In re The Active Wallace Group, case no. 09-15370, Order (A) Authorizing Interim Use of Cash Collateral, (B) Granting Adequate Protection, and (C) Continuing the Interim Hearing, Dkt. No. 28, p. 8, filed 3/30/09.

<sup>97</sup> In re The Active Wallace Group, case no. 09-15370, Second Order (A) Authorizing Interim Use of Cash Collateral, (B) Granting Adequate Protection, and (C) Continuing the Interim Hearing, Dkt. No. 53, filed 4/8/09.

<sup>98</sup> In re The Active Wallace Group, case no. 09-15370, Stipulation to Continue Hearing on Debtor’s Emergency Motion for Order Approving Stipulation for Post-Petition Secured Financing Pursuant to 11 U.S.C. Section 364(C) (1), (2) and (3) and Use of Cash Collateral, Dkt. No. 78, p. 2, filed 4/17/09.

<sup>99</sup> In re The Active Wallace Group, case no. 09-15370, Stipulation to Continue Hearing on Debtor’s Emergency Motion for Order Approving Stipulation for Post-Petition Secured Financing Pursuant to 11 U.S.C. Section 364(C) (1), (2) and (3) and Use of Cash Collateral, Dkt. No. 78, p. 1, filed 4/17/09.

<sup>100</sup> In re The Active Wallace Group, case no. 09-15370, Stipulation to Continue Hearing on Debtor’s Emergency Motion for Order Approving Stipulation for Post-Petition Secured Financing Pursuant to 11 U.S.C. Section 364(C) (1), (2) and (3) and Use of Cash Collateral, Dkt. No. 78, p. 2, filed 4/17/09.

<sup>101</sup> In re The Active Wallace Group, case no. 09-15370, Stipulation to Continue Hearing on Debtor’s Emergency Motion for Order Approving Stipulation for Post-Petition Secured Financing Pursuant to 11 U.S.C. Section 364(C) (1), (2) and (3) and Use of Cash Collateral, Dkt. No. 78, p. 2-3, filed 4/17/09.

and use of cash collateral.<sup>102</sup> Winthrop objected to Active's failure to include a line-item for lease payments due Winthrop in Active's proposed cash collateral budget and argued that this would improperly favor other administrative creditors over Winthrop.<sup>103</sup> Winthrop argued that Active could not satisfy the § 363(e) requirement of adequate protection for the use of Winthrop's computer equipment by failing to reserve amounts in the cash collateral budgeted for lease payments.<sup>104</sup> In essence, Winthrop argued, Active was "forcing Winthrop to fund its post-petition operations in addition to [Active's] use of the [e]quipment in consummating a successful sale of the assets – something Winthrop never agreed to do."<sup>105</sup> Winthrop requested adequate protection payments and argued that, at a minimum, it should be entitled to an administrative claim for lease obligations incurred as of the petition date.<sup>106</sup>

Active asserted that it had satisfied the "adequate protection" burden in § 363 via its budgeted figures that projected "positive earnings from the proposed use of cash collateral

---

<sup>102</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Winthrop Resources Corporation to the Debtor's Emergency Motion for Order Approving Stipulation for Post-petition Secured Financing Pursuant to 11 U.S.C. § 364 (c)(1), (2) and (3) and Use of Cash Collateral, Dkt. No. 87, p. 1, filed 4/22/09.

<sup>103</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Winthrop Resources Corporation to the Debtor's Emergency Motion for Order Approving Stipulation for Post-petition Secured Financing Pursuant to 11 U.S.C. § 364 (c)(1), (2) and (3) and Use of Cash Collateral, Dkt. No. 87, p. 2, filed 4/22/09. Aggregate monthly payments of \$19,986 were owed to Winthrop under the leases, which also required Active to insure and maintain the equipment. *Id.* at 3-4.

<sup>104</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Winthrop Resources Corporation to the Debtor's Emergency Motion for Order Approving Stipulation for Post-petition Secured Financing Pursuant to 11 U.S.C. § 364 (c)(1), (2) and (3) and Use of Cash Collateral, Dkt. No. 87, p. 2, filed 4/22/09. Under § 363(e), on request of an entity that has an interest in property leased by the DIP, the court "shall prohibit or condition such . . . lease as is necessary to provide adequate protection of such interest."

<sup>105</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Winthrop Resources Corporation to the Debtor's Emergency Motion for Order Approving Stipulation for Post-petition Secured Financing Pursuant to 11 U.S.C. § 364 (c)(1), (2) and (3) and Use of Cash Collateral, Dkt. No. 87, p. 5, filed 4/22/09.

<sup>106</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Winthrop Resources Corporation to the Debtor's Emergency Motion for Order Approving Stipulation for Post-petition Secured Financing Pursuant to 11 U.S.C. § 364 (c)(1), (2) and (3) and Use of Cash Collateral, Dkt. No. 87, p. 6-7, filed 4/22/09.

pool.”<sup>107</sup> The court approved the DIP financing on May 15 via an interim order with a final hearing date set for June 9.<sup>108</sup> The terms of the approval also required weekly variance reports.<sup>109</sup> The court granted § 364(c)(1) superpriority administrative expense status on the DIP loan and granted Merrill perfected senior security interests in all property and interests in property acquired by Active from the petition date.<sup>110</sup> The approval order contained acknowledgements by Active and its guarantors that the prepetition indebtedness to Merrill, including the related security interests, was valid and binding without any applicable claims or defenses.<sup>111</sup>

---

<sup>107</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Emergency Motion for Order Approving Stipulation for Post-Petition Secured Financing and Use of Cash Collateral, Dkt. No. 2, filed 3/23/09.

<sup>108</sup> In re The Active Wallace Group, case no. 09-15370, Amended Interim Order (A) Authorizing Post-petition Financing and Use of Cash Collateral, (B) Granting Senior Liens and Priority Administrative Expense Status, (C) Authorizing Debtor to Enter Into Post-petition Amendment with Merrill Lynch Commercial Finance Corp., (D) Scheduling a Final Hearing Pursuant to Bankruptcy Rule 4001(c), and (E) Granting Related Relief, Dkt. No. 131, p. 1, 26, filed 5/15/09.

<sup>109</sup> In re The Active Wallace Group, case no. 09-15370, Amended Interim Order (A) Authorizing Post-petition Financing and Use of Cash Collateral, (B) Granting Senior Liens and Priority Administrative Expense Status, (C) Authorizing Debtor to Enter Into Post-petition Amendment with Merrill Lynch Commercial Finance Corp., (D) Scheduling a Final Hearing Pursuant to Bankruptcy Rule 4001(c), and (E) Granting Related Relief, Dkt. No. 131, p. 10-11, filed 5/15/09.

<sup>110</sup> In re The Active Wallace Group, case no. 09-15370, Amended Interim Order (A) Authorizing Post-petition Financing and Use of Cash Collateral, (B) Granting Senior Liens and Priority Administrative Expense Status, (C) Authorizing Debtor to Enter Into Post-petition Amendment with Merrill Lynch Commercial Finance Corp., (D) Scheduling a Final Hearing Pursuant to Bankruptcy Rule 4001(c), and (E) Granting Related Relief, Dkt. No. 131, p. 11, filed 5/15/09. Merrill’s post-petition collateral included accounts receivable, equipment, inventory and other goods, instruments and documents of title, general intangibles, securities, cash, deposit accounts, books and records, and all proceeds. *Id.*

<sup>111</sup> In re The Active Wallace Group, case no. 09-15370, Amended Interim Order (A) Authorizing Post-petition Financing and Use of Cash Collateral, (B) Granting Senior Liens and Priority Administrative Expense Status, (C) Authorizing Debtor to Enter Into Post-petition Amendment with Merrill Lynch Commercial Finance Corp., (D) Scheduling a Final Hearing Pursuant to Bankruptcy Rule 4001(c), and (E) Granting Related Relief, Dkt. No. 131, p. 14-15, filed 5/15/09.

## V. Executory Contracts & Leases

Active filed an emergency first-day motion seeking court authorization to reject<sup>112</sup> certain real property leases and executory contracts and authorization of an



Shane Wallace pictured at left

expedited procedure for rejecting other leases and executory contracts.<sup>113</sup> Active sought to initially reject leases for eight underperforming stores it had already vacated to avoid post-petition accrual of related rents as administrative priority claims.<sup>114</sup> Moreover, Active asked the court to deem the leases and contracts rejected as of the petition date.<sup>115</sup> Active asserted that downsizing of operations was necessary and, consistent with § 365, rejection of these leases was critically important as part of Active's overall recovery plan.<sup>116</sup> The expedited procedure for

---

<sup>112</sup> Under § 365, the DIP “may assume (elect to retain) or reject (elect to terminate) any unexpired lease” or executory contract. JONATHAN P. FRIEDLAND, MICHAEL L. BERNSTEIN, PROF. GEORGE W. KUNEY & PROF. JOHN D. AYER, CHAPTER 11 – “101” THE NUTS AND BOLTS OF CHAPTER 11 PRACTICE 188 (2007). Although undefined in the Code, many courts have deferred to the “Countryman definition” of the term “executory contract”:

[A] contract under which the obligation of *both* the bankrupt and the other party to the contract is so far clearly unperformed that failure of either to complete performance would constitute a material breach excusing the performance of the other.

*Id.* at 198 (citing Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 469 (1973)).

<sup>113</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Authorizing: (1) Rejection of Certain Executory Contracts, and (2) Lease Rejection Procedures, Dkt. No. 5, p. 1-2, filed 3/23/09.

<sup>114</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Authorizing: (1) Rejection of Certain Executory Contracts, and (2) Lease Rejection Procedures, Dkt. No. 5, p. 4, filed 3/23/09. Active had already turned over its keys and provided notice of its intention to reject the leases to the landlords. *Id.* at 8.

<sup>115</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Authorizing: (1) Rejection of Certain Executory Contracts, and (2) Lease Rejection Procedures, Dkt. No. 5, p. 8, filed 3/23/09.

<sup>116</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Authorizing: (1) Rejection of Certain Executory Contracts, and (2) Lease Rejection Procedures, Dkt. No. 5, p. 7-8, filed 3/23/09.



rejecting other leases and executory contracts would essentially allow Active to reject contracts without a hearing after providing notice, for reasons of efficiency and minimizing expenses and burden on the court.<sup>117</sup>

On May 15, 2009, the court granted a modified version of Active's motion that rejected nine real property leases, an e-commerce partnership operating agreement with ESPN, six vehicle leases, and ten professional skater partnership agreements.<sup>118</sup> The court also approved expedited procedures for the rejection of other leases and executory contracts, whereby Active could send notice of the rejection, and all interested parties could provide responses before a hearing on the issue.<sup>119</sup>

On April 3, Active filed a motion seeking authorization to defer payment of "stub rent"<sup>120</sup> as well as the April 2009 rent owed under its real property leases. It proposed to spread the rent owed over four equal monthly installments beginning on May 1.<sup>121</sup> April's rent obligations totaled \$567,148 and Active did not have these funds. It asserted, however, that based on its "recent efforts to restructure its operations" it would be able to pay future rent as well as the

---

<sup>117</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Emergency Motion for Order Authorizing: (1) Rejection of Certain Executory Contracts, and (2) Lease Rejection Procedures, Dkt. No. 5, p. 9, filed 3/23/09.

<sup>118</sup> In re The Active Wallace Group, case no. 09-15370, Order Authorizing: (1) Rejection of Certain Executory Contracts, and (2) Lease Rejection Procedures, Dkt. No. 127, p. 2-3, filed 5/15/09.

<sup>119</sup> In re The Active Wallace Group, case no. 09-15370, Order Authorizing: (1) Rejection of Certain Executory Contracts, and (2) Lease Rejection Procedures, Dkt. No. 127, p. 3-5, filed 5/15/09.

<sup>120</sup> "Stub rent" is a bankruptcy term of art meaning rent owed for the period from the petition date through the end of that month. Ilana Volkov & Erin E. Wietecha, "*Stub Rent*" Considered Administrative Expense Obligation by Delaware District Court, BANKRUPTCY & RESTRUCTURING LAW MONITOR, May 5, 2009, <http://www.bankruptcyandstructuringlawmonitor.com/2009/05/articles/commercial-landlords-tenants/stub-rent-considered-administrative-expense-obligation-by-delaware-district-court/>.

<sup>121</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order Extending Time for Performance of Lease Obligations, Dkt. No. 39, p. 2, filed 4/3/09.

deferred payments it was requesting.<sup>122</sup> Closing the eight underperforming stores reduced Active's monthly occupancy expenses by \$207,000, and corporate compensation reductions would result in an annual savings of \$900,000.<sup>123</sup> Active cited § 365(d)(3) as authorizing the court to extend performance of its lease obligations.<sup>124</sup> Active was in the process of negotiating lease terms with its landlords and, according to case law, attempts at negotiating the terms of the assumption of a lease constitute "cause" for extending the time for performance.<sup>125</sup> The motion was supported by a declaration from Phoenix's Managing Director.<sup>126</sup>

Several of Active's landlords objected to the motion on April 6, arguing that Active had failed to establish cause for the relief requested and that Active essentially sought to force the landlords to act as involuntary post-petition lenders without any protections.<sup>127</sup> According to the landlords, the "financing" Active sought would be more appropriately borne by its DIP lender.<sup>128</sup>

---

<sup>122</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order Extending Time for Performance of Lease Obligations, Dkt. No. 39, p. 3, filed 4/3/09.

<sup>123</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order Extending Time for Performance of Lease Obligations, Dkt. No. 39, p. 5, filed 4/3/09.

<sup>124</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order Extending Time for Performance of Lease Obligations, Dkt. No. 39, p. 5, filed 4/3/09. Section 365(d)(3) states that the court "may extend, for cause, the time for performance of [obligations under nonresidential real property leases] that arise within 60 days after the date of the order for relief, but the time for performance shall not be extended beyond such 60-day period."

<sup>125</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order Extending Time for Performance of Lease Obligations, Dkt. No. 39, p. 6, filed 4/3/09 (citing *In re DWE Screw Products, Inc.*, 157 B.R. 326, 329 (Bankr. N.D. Ohio 1993)).

<sup>126</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order Extending Time for Performance of Lease Obligations, Dkt. No. 39, p. 7, filed 4/3/09.

<sup>127</sup> In re The Active Wallace Group, case no. 09-15370, Objection of Various Landlord Creditors to Debtor's Motion for an Order Extending Time for Performance of Lease Obligations, Dkt. No. 44, p. 1, filed 4/6/09.

<sup>128</sup> In re The Active Wallace Group, case no. 09-15370, Objection of Various Landlord Creditors to Debtor's Motion for an Order Extending Time for Performance of Lease Obligations, Dkt. No. 44, p. 2, filed 4/6/09.

Citing the “unequivocal” mandate of § 365(d)(3),<sup>129</sup> the landlords argued that they were “not required to perform post-petition services absent current payment,” and that Active should be required to immediately pay the rent owed. Further, the landlords argued that they must receive adequate protection if the court allowed Active to defer rent.<sup>130</sup>

The court denied Active’s April 3 motion on April 7.<sup>131</sup> Active submitted an extension motion on April 9, seeking similar rent deferral relief as requested in its April 3 motion, but under a slightly different deferral schedule.<sup>132</sup> The same objecting landlords then submitted a supplemental objection on April 16, re-asserting the same arguments contained in their April 6 objection.<sup>133</sup> On April 22, Active filed an omnibus reply to the landlords’ objections.<sup>134</sup> Again, it explained that it could not meet its rent obligations in a lump sum, but that the increased revenue and savings from its recovery efforts would allow it to meet its obligations on a deferred schedule.<sup>135</sup> Active asserted that, contrary to the landlords’ arguments, they have no automatic

---

<sup>129</sup> Section 365(d)(3) provides that the DIP “shall timely perform all of the obligations of the debtor . . . arising from and after the order for relief under any unexpired lease nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title.

<sup>130</sup> In re The Active Wallace Group, case no. 09-15370, Objection of Various Landlord Creditors to Debtor’s Motion for an Order Extending Time for Performance of Lease Obligations, Dkt. No. 44, p. 6, filed 4/6/09.

<sup>131</sup> In re The Active Wallace Group, case no. 09-15370, Order Denying Debtor’s Motion for Order Extending Time for Performance of Lease Obligations, Dkt. No. 47, filed 4/7/09.

<sup>132</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Notice of Motion and Motion for Order Extending Time for Performance of Lease Obligations, Dkt. No. 57, filed 4/9/09.

<sup>133</sup> In re The Active Wallace Group, case no. 09-15370, Supplemental Objection of Various Landlord Creditors to Debtor’s Motion for an Order Extending Time for Performance of Lease Obligations, Dkt. No. 70, filed 4/16/09. Also on April 16, another group of landlords submitted an objection to Active’s April 9 extension motion, raising the same arguments that Active had not shown cause for the extension or proposed adequate protection for the landlords. In re The Active Wallace Group, case no. 09-15370, Objection to Debtor’s Motion for Order Extending Time for Performance of Lease Obligations, Dkt. No. 71, filed 4/16/09.

<sup>134</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Omnibus Reply to Objections and Opposition to Motion Order Extending Time for Performance of Lease Obligations, Dkt. No. 86, p. 1, filed 4/22/09.

<sup>135</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Omnibus Reply to Objections and Opposition to Motion Order Extending Time for Performance of Lease Obligations, Dkt. No. 86, p. 1, filed 4/22/09.

right to adequate protection under § 363(e); rather, they must file a noticed motion to seek adequate protection pursuant to Rule 4001(a)(1),<sup>136</sup> which they had not done.<sup>137</sup>

On May 6, the landlords filed another objection to Active's rent deferral motion, requesting that the court order Active to pay the stub rent, April rent, and charges by May 22.<sup>138</sup> On April 15, the court found that Active had demonstrated cause for an extension and ordered Active to pay, by May 22, stub rent, April rent, and charges due under real property leases not rejected prior to May 22.<sup>139</sup>

## VI. Appointment of Professionals & Fees

Prior to filing bankruptcy, Active maintained ongoing business relationships with several professionals, including attorneys, accountants, financial advisors, and investment bankers.<sup>140</sup> These firms were instrumental in marketing the firm to outsiders, negotiating with the secured creditors and landlords, and maintaining accurate business records.<sup>141</sup> After Active filed its

---

<sup>136</sup> Unless otherwise noted, "Rule" refers to the Federal Rules of Bankruptcy Procedure (often referred to as the "Bankruptcy Rules" or "FRBP"). Rule 4001(a)(1) provides that "a motion to prohibit or condition the use, sale, or lease of property pursuant to § 363(e) shall be made . . . and shall be served . . . ."

<sup>137</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Omnibus Reply to Objections and Opposition to Motion Order Extending Time for Performance of Lease Obligations, Dkt. No. 86, p. 3, filed 4/22/09.

<sup>138</sup> In re The Active Wallace Group, case no. 09-15370, Objection of Various Landlords to Debtor's Proposed Form of Order on Motion for an Order Extending Time for Performance of Lease Obligations, Dkt. No. 115, p. 2, filed 5/6/09.

<sup>139</sup> In re The Active Wallace Group, case no. 09-15370, Order Extending Time for Performance of Lease Obligations, Dkt. No. 126, p. 2, filed 5/15/09.

<sup>140</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Application for Authority to Employ Phoenix Group Business Advisors, LLC as its Financial Advisor, Dkt. No. 90, p. 4, filed 4/21/09, ("[Phoenix] was originally retained on March 3, 2009"); In re The Active Wallace Group, case no. 09-15370, Debtor's Application for Authority to Employ Rossi, Daskocil, and Finkelstein, LLP as its Accountants, Dkt. No. 91, p. 3, filed 4/21/09, ("[Accountant] has performed accounting services and/or litigation support services . . . since April 2003"); *see also* In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order Approving Sale and Authorizing Assumption and Assignment, Dkt. No. 168, p. 10, filed 06/08/09.

<sup>141</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order Approving Sale and Authorizing Assumption and Assignment, Dkt. No. 168, p. 10, filed 06/08/09.

bankruptcy petition, these services remained vital to the company's stakeholders as a means of preserving the value of the estate.<sup>142</sup>

Professionals can provide services to a DIP, but the Rules mandate certain disclosures,<sup>143</sup> and under the Code, a bankruptcy judge makes the final determination whether the bankrupt firm may employ the professionals and compensate them for their services.<sup>144</sup> A DIP seeking to retain professional services after the petition date must make a motion to the court for an order of approval.<sup>145</sup> The professional must also satisfy the "disinterested person" requirement of the Code, excluding: (a) creditors, equity holders, and insiders; (b) directors, officers, and employees within two years of filing; and (c) anyone with an interest "materially adverse to the interest of the estate or any class of creditors or equity security holders" for any reason.<sup>146</sup>

Courts also examine the reasonableness of proposed compensation for professionals, and the Code limits compensation to amounts paid for "actual, necessary services."<sup>147</sup> The Code gives factors for the bankruptcy court to consider in setting the compensation, including the difficulty of the assignment, the professional's credentials, and whether the fee "is reasonable

---

<sup>142</sup> *In re The Active Wallace Group*, case no. 09-15370, Debtor's Application for Authority to Employ Rossi, Dorskocil, and Finkelstein, LLP as its Accountants, Dkt. No. 91, p. 3, filed 4/21/09 (claiming employment would result in "substantial cost efficiencies" from "intricate knowledge about and experience with [Active's] business and its tax and financial history").

<sup>143</sup> FRBP 2014. This disclosure information is lengthy, and must state "the specific facts showing the necessity for the employment," the reasons for the selection, "any proposed arrangement for compensation," and all connections of the proposed employee with "any other party in interest" including the UST. *Id.* See *In Re Lotus Properties LP*, 63 F.3d 887, 880-82 (9th Cir. 1995) (stating that the professional is to make a full, candid, and complete disclosure in its application for employment).

<sup>144</sup> Section 327 (stating that the trustee may employ professionals "with the court's approval").

<sup>145</sup> Rule 2014 ("[a]n order approving the employment of attorneys, accountants, appraisers, auctioneers, agents, or other professionals pursuant to § 327, § 1103, or § 1114 of the Code shall be made only on application of the trustee or committee").

<sup>146</sup> Sections 327(a) and 101(14).

<sup>147</sup> Section 330(a)(1)(A).

based on the customary compensation charged by comparably skilled practitioners” in non-bankruptcy contexts.<sup>148</sup> The court, on its own initiative, can lower the compensation from what the professional requested,<sup>149</sup> and restrict compensation for unnecessary duplication of services and services not reasonably likely to benefit the debtor’s estate.<sup>150</sup>

Active retained the legal services of Charles Liu,<sup>151</sup> Marc Winthrop,<sup>152</sup> and Gerrick Hollander<sup>153</sup> of Winthrop Couchot, P.C., via payment of a \$96,783 retainer prior to the filing of the case.<sup>154</sup> Winthrop Couchot’s hourly fees ranged from \$650 for Marc Winthrop to \$450 for Charles Liu.<sup>155</sup> Active applied for formal court authority to employ Winthrop Couchot as general insolvency counsel on April 15, 2009,<sup>156</sup> and the court granted its application on June 9, effective as of the March 23 petition date.<sup>157</sup>

---

<sup>148</sup> Section 330(a)(3)(a)-(f); *See also In re Busy Beaver Blvd. Ctrs.*, 19 F.3d 833, 840 (3d Cir. 1994).

<sup>149</sup> Section 330(a)(2).

<sup>150</sup> Section 330(a)(4)(A).

<sup>151</sup> Charles Liu is no longer with Winthrop Couchot.

<sup>152</sup> Marc Winthrop, a graduate of the UCLA School of Law, has substantial Chapter 11 experience, lectures extensively in California continuing legal education bankruptcy seminars, and has taught university courses on bankruptcy. WinthropCouchot.com, Attorneys, [http://www.winthropcouchot.com/attorneys.php?attorney\\_id=2](http://www.winthropcouchot.com/attorneys.php?attorney_id=2) (last visited April 19, 2010).

<sup>153</sup> Garrick Hollander, a CPA and graduate of Loyola Law School, represents debtors in Chapter 11 cases, creditors, and bankruptcy trustees. WinthropCouchot.com, Attorneys, [http://www.winthropcouchot.com/attorneys.php?attorney\\_id=5](http://www.winthropcouchot.com/attorneys.php?attorney_id=5) (last visited April 19, 2010).

<sup>154</sup> *In re The Active Wallace Group*, case no. 09-15370, Application of Debtor and Debtor-in-Possession for Authority to Employ Winthrop Couchot Professional Corporation as General Insolvency Counsel, Dkt. No. 66, p. 4, filed 4/15/09. Established in 1995, Winthrop Couchot’s practice includes six attorneys and is limited to bankruptcy, insolvency, reorganizations, workouts, and related commercial litigation. WinthropCouchot.com, Firm Overview, <http://www.winthropcouchot.com/index.php> (last visited April 19, 2010); WinthropCouchot.com, Attorneys, <http://www.winthropcouchot.com/attorneys.php> (last visited April 19, 2010).

<sup>155</sup> *In re The Active Wallace Group*, case no. 09-15370, Application of Debtor and Debtor-in-Possession for Authority to Employ Winthrop Couchot Professional Corporation as General Insolvency Counsel, Dkt. No. 66, p. 20, filed 4/15/09.

<sup>156</sup> *In re The Active Wallace Group*, case no. 09-15370, Application of Debtor and Debtor-in-Possession for Authority to Employ Winthrop Couchot Professional Corporation as General Insolvency Counsel, Dkt. No. 66, filed 4/15/09.

Active also sought to retain its prepetition accounting firm, Rossi, Doskocil & Finkelstein (“Rossi”), for post-petition services.<sup>158</sup> Rossi’s hourly rates ranged from \$350 for the named partners to \$105 for a “Staff Accountant.”<sup>159</sup> Active owed the firm over \$55,000 prior to filing, and Rossi was willing to waive any right to recover that sum if the court granted the non-appealable order approving the post-petition employment arrangement.<sup>160</sup> If waiver was not necessary, the prepetition claim would be treated the same as other general unsecured claims.<sup>161</sup> The court granted Active’s application to employ Rossi on June 6, provided that Rossi waived its prepetition claim as the parties had contemplated.<sup>162</sup>

For financial advising services, Active filed a motion on April 21 to retain Phoenix.<sup>163</sup> Active had originally retained Phoenix three weeks prior to filing the petition by means of an engagement letter that contemplated pre- as well as post-petition services.<sup>164</sup> Phoenix’s hourly

---

<sup>157</sup> In re The Active Wallace Group, case no. 09-15370, Order Authorizing Debtor’s Application for Authority to Employ Winthrop Couchot Professional Corporation as General Insolvency Counsel, Dkt. No. 171, filed 6/9/09.

<sup>158</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Application for Authority to Employ Rossi, Doskocil, and Finkelstein, LLP as its Accountants, Dkt. No. 91, p. 1, filed 4/21/09. Founded in 1984, Rossi is registered by the Public Company Accounting Oversight Board and a member of the American Institute of Certified Public Accountants and the Center for Public Audit Firms. *Id.* at 13

<sup>159</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Application for Authority to Employ Rossi, Doskocil, and Finkelstein, LLP as its Accountants, Dkt. No. 91, p. 15, filed 4/21/09.

<sup>160</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Application for Authority to Employ Rossi, Doskocil, and Finkelstein, LLP as its Accountants, Dkt. No. 91, p. 4, filed 4/21/09.

<sup>161</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Application for Authority to Employ Rossi, Doskocil, and Finkelstein, LLP as its Accountants, Dkt. No. 91, p. 4, filed 4/21/09.

<sup>162</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor’s Application for Authority to Employ Rossi, Doskocil, and Finkelstein, LLP as its Accountants, Dkt. No. 175, p. 4, filed 6/10/09.

<sup>163</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Application for Authority to Employ Phoenix Group Business Advisors, LLC as its Financial Advisor, Dkt. No. 90, p. 2, filed 4/21/09. Phoenix advertises itself as a “one of the preeminent ‘botique’ firms on the west coast.” *Id.* at p. 23.

<sup>164</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Application for Authority to Employ Phoenix Group Business Advisors, LLC as its Financial Advisor, Dkt. No. 90, p. 19, filed 4/21/09.

rates ranged from \$395 for its Senior Managing Partner to \$125 for “Para-professionals.”<sup>165</sup> Active retained Phoenix to better understand the company’s “financial condition and prospects,” “[p]rovide restructuring advice and assistance,” and “assist in negotiations with creditors,” among other needs.<sup>166</sup>

In addition to these services, Active filed to retain the services of Phoenix and Partnership Capital Growth, LLC (“PCG”), as co-investment bankers “to assist in the identification of buyers and consummation of a sale transaction.”<sup>167</sup> Both firms were already actively searching for a buyer or investor for Active by the time Active filed their retention application.<sup>168</sup>

As part of Active’s application to retain these two firms as investment bankers, it submitted a retention and compensation plan for each, along with copies of the compensation agreements that the parties had previously executed.<sup>169</sup> The application argued that Phoenix’s services as investment banker would not be duplicative of its services as financial advisor because no time spent by Phoenix as its investment banker would be charged on an hourly basis,

---

<sup>165</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Application for Authority to Employ Phoenix Group Business Advisors, LLC as its Financial Advisor, Dkt. No. 90, p. 19, filed 4/21/09.

<sup>166</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Application for Authority to Employ Phoenix Group Business Advisors, LLC as its Financial Advisor, Dkt. No. 90, p. 2-3, filed 4/21/09.

<sup>167</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Application for Authority to Employ Partnership Capital Growth, LLC and Phoenix Group Advisory Services, LLC as its Co-investment Bankers, Dkt. No. 143, p. 2, filed 5/21/09.

<sup>168</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Application for Authority to Employ Partnership Capital Growth, LLC and Phoenix Group Advisory Services, LLC as its Co-investment Bankers, Dkt. No. 143, p. 4, filed 5/21/09.

<sup>169</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Application for Authority to Employ Partnership Capital Growth, LLC and Phoenix Group Advisory Services, LLC as its Co-investment Bankers, Dkt. No. 143, p. 2, filed 5/21/09.



as was the case for its financial advising services.<sup>170</sup> Instead, the Phoenix, PCG and Active agreed that if either of them found a buyer that would pay enough to allow Merrill to recover all of its principle balance, Active would owe them collectively for the greater of \$500,000 or 5% of the transaction value, plus expenses.<sup>171</sup> If a buyer could not be found that was capable of satisfying the Merrill debt, only the \$500,000 minimum payment would not apply.<sup>172</sup> Under their arrangement, PCG would be entitled to the first \$100,000, and the finder would be entitled to 75% of the remaining fee.<sup>173</sup>

Notice of this application was served on the OCC and Merrill along with the other creditors, giving each party fifteen days to file any opposition to the application.<sup>174</sup> No party had objected by June 5, prompting Active to file a second request that the court authorize the employment of the firms pursuant to the terms of the application.<sup>175</sup> The court did not act on this request prior to the sale on July 3.<sup>176</sup>

---

<sup>170</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Application for Authority to Employ Partnership Capital Growth, LLC and Phoenix Group Advisory Services, LLC as its Co-investment Bankers, Dkt. No. 143, p. 3, filed 5/21/09. Compensation for unnecessarily duplicative services is forbidden by § 330(a)(4)(A)(i).

<sup>171</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Application for Authority to Employ Partnership Capital Growth, LLC and Phoenix Group Advisory Services, LLC as its Co-investment Bankers, Dkt. No. 143, p. 4, filed 5/21/09.

<sup>172</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Application for Authority to Employ Partnership Capital Growth, LLC and Phoenix Group Advisory Services, LLC as its Co-investment Bankers, Dkt. No. 143, p. 4, filed 5/21/09.

<sup>173</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Application for Authority to Employ Partnership Capital Growth, LLC and Phoenix Group Advisory Services, LLC as its Co-investment Bankers, Dkt. No. 143, p. 5, filed 5/21/09. The application hypothesized a \$8.0 million dollar purchase price, but the final sale closed for \$5.2 million. *Id.*

<sup>174</sup> In re The Active Wallace Group, case no. 09-15370, Notice of Filing Application to Retain PCG and Phoenix as Investment Bankers, Dkt. No. 144, p. 3, filed 5/21/09.

<sup>175</sup> In re The Active Wallace Group, case no. 09-15370, Declaration of Garrick A. Hollander Re Non-Receipt of Opposition to Debtor's Application for Authority to Employ PCG and Phoenix, Dkt. No. 186, p. 2-3, filed 6/24/09.

<sup>176</sup> The Court finally approved PCG and Phoenix as co-investment bankers by order on July 24. The order clarified that their fee would be capped at 5%, regardless of the parties previous agreement to a minimum \$500,000 dollars.

As of July 7, the agreement between PGC, Phoenix, and Active had changed slightly.<sup>177</sup> Even though Merrill's debt was satisfied during the sale, the parties had agreed to forego the minimum \$500,000 fee in favor of a 5% fee and to split the fee 70/30 instead of 75/25.<sup>178</sup> Regardless of the fee structure, the court had not yet approved any retention.<sup>179</sup> The OCC and other creditors were challenging both the amount of the fee and Phoenix's billing as both a financial advisor and as an investment banker.<sup>180</sup> Specifically, the OCC was concerned with the "attempt by [Phoenix] to be double paid for any investment banking services that were provided to the estate."<sup>181</sup> Some of the work that was billed hourly as financial consulting services was in furtherance of consummating the sale.<sup>182</sup> The OCC intended to conduct further discovery to determine whether Phoenix and PCG had "provided any services of value to the estate regarding [their] purported investment advisor services."<sup>183</sup> A hearing on this matter was scheduled for August 4.<sup>184</sup>

---

In re The Active Wallace Group, case no. 09-15370, Order Authorizing Employment of PCG and Phoenix, Dkt. No. 243, p. 1-2, filed 07/24/09.

<sup>177</sup> In re The Active Wallace Group, case no. 09-15370, Professional Fee Statement for PCG and Phoenix, Dkt. No. 218, p. 1, filed 7/07/09.

<sup>178</sup> In re The Active Wallace Group, case no. 09-15370, Professional Fee Statement for PCG and Phoenix, Dkt. No. 218, p. 1, filed 7/07/09.

<sup>179</sup> The court did not approve the retention of the investment banking professionals until July 24, 2009. In re The Active Wallace Group, case no. 09-15370, Order Granting Application to Retain PCG and Phoenix, Dkt. No. 243, p. 2, filed 7/24/09.

<sup>180</sup> In re The Active Wallace Group, case no. 09-15370, OCC's Limited Opposition to Professional Fees, Dkt. No. 233, p. 2-3, filed 07/16/09.

<sup>181</sup> In re The Active Wallace Group, case no. 09-15370, OCC's Limited Opposition to Professional Fees, Dkt. No. 233, p. 3, filed 07/16/09.

<sup>182</sup> In re The Active Wallace Group, case no. 09-15370, OCC's Limited Opposition to Professional Fees, Dkt. No. 233, p. 3, filed 07/16/09. See, e.g., In re The Active Wallace Group, case no. 09-15370, Exhibit to Notice of Hearing on OCC's Opposition to Payment of Professional Fees, Dkt. No. 231-2, p. 29-30, filed 7/09/09 (showing many hours spent soliciting buyers).

<sup>183</sup> In re The Active Wallace Group, case no. 09-15370, OCC's Limited Opposition to Professional Fees, Dkt. No. 233, p. 4, filed 07/16/09.

This professional fee dispute was ultimately resolved before the hearing. The OCC had sustained their objection long enough to persuade the co-investment bankers to a settlement.<sup>185</sup> This settlement agreement, allowed by Rule 9019, provided that the estate would pay Phoenix \$45,000 for its financial advising services.<sup>186</sup> For investment banking services, Active would pay \$248,000 to PCG and \$48,000 to Phoenix.<sup>187</sup> Because the court had eventually allowed the retention of the investment bank professionals effective as of the petition date, these payments satisfied administrative claims and were payable pro rata from the professional fee account.<sup>188</sup> If this account was not large enough to satisfy the entire claim, however, the professionals would be paid pro rata from the general estate.<sup>189</sup> The parties also released one another from all claims as part of the settlement.<sup>190</sup>

---

<sup>184</sup> In re The Active Wallace Group, case no. 09-15370, Notice of Hearing Re Professional Compensation, Dkt. No. 231, p. 1-2, filed 07/09/09.

<sup>185</sup> In re The Active Wallace Group, case no. 09-15370, OCC Motion for Order Approving Settlement, Dkt. No. 260, p. 5, filed 08/18/09.

<sup>186</sup> In re The Active Wallace Group, case no. 09-15370, OCC Motion for Order Approving Settlement, Dkt. No. 260, p. 6, filed 08/18/09. Rule 9019 allows the court to approve a compromise under a proper motion after an opportunity for a hearing and notice to all creditors. The standards to be applied include “the probability of success on the litigation on its merits, the difficulties in collection on a judgment, the complexity of the litigation involved, the expense, inconvenience or delay occasioned by the litigation, and the interests of the creditors. In re The Active Wallace Group, case no. 09-15370, OCC Motion for Order Approving Settlement, Dkt. No. 260, p. 6, filed 08/18/09 (citing In re A&C Properties, 784 F.2d 1377, 1380-81 (9th Cir. 1986), cert den. Martin v. Robinson, 479 U.S. 854, 1-7 S.Ct. 189 (1989); In re America West Airlines, Inc., 214 B.R. 382 (Bankr. D. Ariz. 1997).

<sup>187</sup> In re The Active Wallace Group, case no. 09-15370, OCC Motion for Order Approving Settlement, Dkt. No. p. 260, 6, filed 08/18/09.

<sup>188</sup> In re The Active Wallace Group, case no. 09-15370, Final Order Authorizing Post-Petition Financing and Use of Cash Collateral, Dkt. No. 173, p. 16-18, filed 6/10/09, (providing that, as a part of the court’s interim financing order, Active would establish a professional fee reserve whereby funds of the estate were budgeted and deposited into the account for payment to retained professionals).

<sup>189</sup> In re The Active Wallace Group, case no. 09-15370, OCC Motion for Order Approving Settlement, Dkt. No. 260, p. 6, filed 08/18/09.

<sup>190</sup> In re The Active Wallace Group, case no. 09-15370, OCC Motion for Order Approving Settlement, Dkt. No. 260, p. 6, filed 08/18/09.

## VII. Plan of Sale & Sale

### The Hunt for a Buyer

Beginning in the spring of 2008 and continuing through the spring of 2009, Active was in search of a strategic buyer capable of providing the cash infusion necessary to finance the firm's operations and purchase new inventory for its stores.<sup>191</sup> Beginning in March of 2008, a full year before filing the petition, Active consulted with PCG in an effort to find a buyer.<sup>192</sup> PCG, in turn, contacted "approximately 80 potential purchasers, including 14 strategic buyers and 66 private equity firms."<sup>193</sup> While some expressed interest, none committed to a purchase. After the March 23 petition was filed, PCG continued to contact prospects.<sup>194</sup> Phoenix also assisted in the search for a strategic purchaser.<sup>195</sup>

### Enter the Stalking Horse<sup>196</sup>

On May 6, 2009, Zumiez, Inc., notified PCG of its intent to purchase Active's assets and assume its executory contracts and leases.<sup>197</sup> Zumiez proposed a 100% cash offer of \$7.2 million

---

<sup>191</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order (1) Approving Overbid Procedures and Break-Up Fee In Connection with Proposed Sale of Substantially All Assets of the Estate, and (2) Setting Hearing on Motion for Sale of Substantially All Assets of Estate, Dkt. No. 129, p. 5-6, filed 5/15/09.

<sup>192</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order (1) Approving Overbid Procedures and Break-Up Fee In Connection with Proposed Sale of Substantially All Assets of the Estate, and (2) Setting Hearing on Motion for Sale of Substantially All Assets of Estate, Dkt. No. 129, p. 5, filed 5/15/09.

<sup>193</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order (1) Approving Overbid Procedures and Break-Up Fee In Connection with Proposed Sale of Substantially All Assets of the Estate, and (2) Setting Hearing on Motion for Sale of Substantially All Assets of Estate, Dkt. No. 129, p. 6, filed 5/15/09.

<sup>194</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order (1) Approving Overbid Procedures and Break-Up Fee In Connection with Proposed Sale of Substantially All Assets of the Estate, and (2) Setting Hearing on Motion for Sale of Substantially All Assets of Estate, Dkt. No. 129, p. 6, filed 5/15/09 (stating that PCG had contacted a total of 116 potential purchasers).

<sup>195</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order Approving Sale and Authorizing Assumption and Assignment, Dkt. No. 168, p. 10, filed 06/08/09.

<sup>196</sup> In asset sales, the first party to submit a bid is known as a "stalking horse." Stephen Sather, Shakespeare for Lawyers: Stalking Horse, 15 AM. BANKR. INST. J. 37 (1996).

dollars.<sup>198</sup> John Wallace signed a non-binding letter of intent (“LOI”) on May 10, 2009, and the parties proceeded with negotiations according to its terms.<sup>199</sup>

Active filed a motion with the court on May 15 requesting an order approving overbid procedures and break-up fee<sup>200</sup> and setting a

hearing for a motion for approval of the sale of substantially all of their assets to a wholly-owned subsidiary of Zumiez.<sup>201</sup> The Central District of California’s local bankruptcy rules require this



---

<sup>197</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 25-26, filed 5/15/09. These assets included all inventory, all store assets including all assets necessary to operate the stores, all leaseholds, all corporate office assets, all software licenses and agreements, all electronic data, select distribution center equipment, all intellectual property, and all customer lists and other customer information. Id. at 31.

<sup>198</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 26, filed 5/15/09.

<sup>199</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 29, filed 5/15/09.

<sup>199</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 29, filed 5/15/09.

<sup>200</sup> The stalking horse bid is “used to establish a floor for subsequent bidding.” Often the stalking horse will be paid a “break-up fee” for reimbursement of its expenses if it is not the successful bidder. These fees “encourage an initial bidder to spend money developing a bid and conducting due diligence, knowing full well that its bid will be shopped to other prospective purchasers.” Stephen Sather, *Shakespeare for Lawyers: Stalking Horse*, 15 AM. BANKR. INST. J. 37 (1996). The stalking horse’s bid, in the form of an asset purchase agreement, becomes the “template against which other potential buyers bid in an auction, pursuant to a set of court-approved procedures.” Robert E. Steinberg, *The Seven Deadly Sins in § 363 Sales*, 24 AM. BANKR. INST. J. 22 (2005).

<sup>201</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 2, filed 5/15/09.

type of motion for an order establishing sale procedures for sales of estate assets, as well as for actual authorization of any sale.<sup>202</sup>

### Introduction to Non-Plan Sales of a Business Under § 363

In chapter 11, a DIP may sell its business assets in two ways: (1) under a confirmed plan of reorganization; or (2) in a non-plan pre-confirmation sale under § 363.<sup>203</sup> The Code presumes that confirmation of a chapter 11 plan is the normal course, and that sales of substantially all the DIP's assets under § 363 is the exception.<sup>204</sup> In the past fifteen years, however, businesses have increasingly used § 363 sales in lieu of confirming a plan of reorganization,<sup>205</sup> and they have become the “preferred method of monetizing the assets of a debtor company.”<sup>206</sup> The process ordinarily involves a court-approved auction in which potential buyers bid against the stalking horse's offer; once the winner is selected, the transaction “closes with the sale being free and clear of prior liens and most claims, including claims by creditors that have not been paid at the time of the sale.”<sup>207</sup> The stalking horse and seller will typically negotiate bidding procedures that will determine, among other things who can participate in the process and how competing bids

---

<sup>202</sup> United States Bankruptcy Court, Central District of California Local Bankruptcy Rule (“LBR”) 6004-1.

<sup>203</sup> George W. Kuney, *Hijacking Chapter 11*, 21 EMORY BANKR. DEV. J. 19, 106 (2004). Option (1) has been described as “an often lengthy and expensive process.” *Id.*

<sup>204</sup> Daniel J. Bussel & Kenneth N. Klee, *Recalibrating Consent in Bankruptcy*, 83 AM. BANKR L. J. 663, 729 (2009).

<sup>205</sup> Daniel J. Bussel & Kenneth N. Klee, *Recalibrating Consent in Bankruptcy*, 83 AM. BANKR L. J. 663, 729-30 (2009).

<sup>206</sup> Robert E. Steinberg, *The Seven Deadly Sins in § 363 Sales*, 24 AM. BANKR. INST. J. 22 (2005).

<sup>207</sup> Robert E. Steinberg, *The Seven Deadly Sins in § 363 Sales*, 24 AM. BANKR. INST. J. 22 (2005). The process is quick and efficient and can often yield the highest price for the assets because the buyer can assume liabilities selectively. *Id.* It does not require a disclosure statement, and the seller “need not obtain the super-majority consent of each class of creditors and interest holders.” George W. Kuney, *Hijacking Chapter 11*, 21 EMORY BANKR. DEV. J. 19, 108 (2004).

will be analyzed; the procedures are then submitted for court approval.<sup>208</sup> The goal of the procedures is to “establish a process that will both maximize the proceeds of the sale and fairly protect the stalking horse.”<sup>209</sup>

Section 363 sales allow the parties to avoid the lengthy process of “negotiating, proposing, confirming, and consummating a plan of reorganization.”<sup>210</sup> Assets may be sold free and clear of interests and claims, and overall the process can result in the “use of chapter 11 to effect a federal unified foreclosure process.”<sup>211</sup>

The Code authorizes the DIP to sell estate property outside the ordinary course of business.<sup>212</sup> Usually only notice and a hearing are required, and this streamlined procedure involves an “apparent conflict” with the overall safeguards of chapter 11.<sup>213</sup> Accordingly, in often cited *Lionel* case, the Second Circuit held that “there must be some articulated business justification” for selling property outside the ordinary course of business.<sup>214</sup> The *Lionel* court established the following standard for evaluating whether this justification exists:

[The judge] should consider all salient factors pertaining to the proceeding . . . [including] the proportionate value of the asset to the estate as a whole, the amount of elapsed time since the filing, the likelihood that a plan of reorganization will be proposed and confirmed in the near future, the effect of the proposed disposition on future plans of reorganization, the proceeds to be obtained vis-à-vis any appraisals of the property, which of the alternatives of use,

---

<sup>208</sup> Corinne Ball, John K. Kane & Jones Day, *Section 363 Sales: Bidding Procedures and Sale Orders*, 1396 PLI/Corp 891, 897 (2003).

<sup>209</sup> Corinne Ball, John K. Kane & Jones Day, *Section 363 Sales: Bidding Procedures and Sale Orders*, 1396 PLI/Corp 891, 897 (2003).

<sup>210</sup> George W. Kunej, *Hijacking Chapter 11*, 21 EMORY BANKR. DEV. J. 19, 105 (2004).

<sup>211</sup> George W. Kunej, *Hijacking Chapter 11*, 21 EMORY BANKR. DEV. J. 19, 106 (2004).

<sup>212</sup> Section 363(b).

<sup>213</sup> *In re Lionel Corp*, 722 F.2d 1063, 1071 (2d Cir. 1983).

<sup>214</sup> *In re Lionel Corp*, 722 F.2d 1063, 1070 (2d Cir. 1983).

sale or lease the proposal envisions and, most importantly perhaps, whether the asset is increasing or decreasing in value.<sup>215</sup>

Active had several business justifications for its decision to sell. First, it needed “to adequately stock its stores with fresh inventory for the [then] upcoming season.”<sup>216</sup> The combination of sales revenues and external financing were not sufficient to adequately purchase for the new seasonal product lines.<sup>217</sup> This shortfall was made worse by the costs of the bankruptcy and the “stigma associated with operating as a debtor-in-possession.”<sup>218</sup>

Second, Zumiez, as purchaser, would provide an immediate cash infusion that would “maximize value and recovery to creditors.”<sup>219</sup> Third, Zumiez offered to pay a fixed amount per retail location and an uncalculated amount equal to the lower of the cost or market value of the inventory.<sup>220</sup> It was therefore important to Active that the sale close quickly in order to preserve the market value of the inventory and maximize the purchase price.<sup>221</sup> Also, a quick sale would

---

<sup>215</sup> *In re Lionel Corp.*, 722 F.2d 1063, 1071 (2d Cir. 1983).

<sup>216</sup> *In re The Active Wallace Group*, case no. 09-15370, Debtor’s Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 3, filed 5/15/09.

<sup>217</sup> *In re The Active Wallace Group*, case no. 09-15370, Debtor’s Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 3, filed 5/15/09.

<sup>218</sup> *In re The Active Wallace Group*, case no. 09-15370, Debtor’s Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 3, filed 5/15/09.

<sup>219</sup> *In re The Active Wallace Group*, case no. 09-15370, Debtor’s Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 3, filed 5/15/09.

<sup>220</sup> *In re The Active Wallace Group*, case no. 09-15370, Debtor’s Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 3, filed 5/15/09.

<sup>221</sup> *In re The Active Wallace Group*, case no. 09-15370, Debtor’s Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 3, filed 5/15/09.



allow Active's successor to update its inventory with the new styles that its customers demanded.<sup>222</sup>

As of March 30, 34% of Active's inventory was more than six months old, 31% was of indeterminate age, and much of their newer products were Active's less expensive in-house brand.<sup>223</sup> In their trend-driven industry, old items depreciated quickly, and the wasting nature of assets was an important consideration of the *Lionel* court in finding the requisite business justification.<sup>224</sup> Because of the downturn in the economy, suppliers had cut back the amount of inventory they were holding, meaning that even if Active were able to place orders for new inventory, it would take several months before those products would hit the shelves.<sup>225</sup> If Zumiez was to successfully bail out Active, the transaction needed to be completed as soon as possible.



---

<sup>222</sup> See *In re The Active Wallace Group*, case no. 09-15370, Debtor's Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 24-25, filed 5/15/09.

<sup>223</sup> *In re The Active Wallace Group*, case no. 09-15370, Debtor's Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 24, filed 5/15/09.

<sup>224</sup> *In re Lionel Corp.*, 722 F.2d 1063, 1071 (2d Cir. 1983).

<sup>225</sup> *In re The Active Wallace Group*, case no. 09-15370, Debtor's Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 23, filed 5/15/09.

### Breakdown of The Stalking Horse Offer

At the time of the offer, Zumiez was a publicly traded company (ZUMZ:Nasdaq) with more than 350 stores in 31 states featuring a product line similar to Active's.<sup>226</sup> In contrast to Active's financials, Zumiez's sales and net income for 2009 were increasing and the company had more than \$33 million cash on hand.<sup>227</sup> Zumiez had recently completed a successful acquisition of Fast Forward, another sport apparel retailer with nineteen stores.<sup>228</sup> It had relationships with virtually all of Active's suppliers and 30 years experience in the action sports lifestyle retail industry.<sup>229</sup> Zumiez's long-term plan for Active was to develop it "as a stand-alone concept into a national brand."<sup>230</sup>

In exchange for all of Active's assets, Zumiez offered to pay (1) \$100,000 per purchased store; (2) the lower of the cost or market value of inventory, as determined by Zumiez's appraiser; and (3) up to \$1.3 million for assumption of gift card obligations, with total consideration being adjusted if liabilities exceeded that amount.<sup>231</sup> The cost of the inventory

---

<sup>226</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 23, filed 5/15/09.

<sup>227</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 16, filed 5/15/09

<sup>228</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 24, filed 5/15/09.

<sup>229</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 23, filed 5/15/09.

<sup>230</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 24, filed 5/15/09.

<sup>231</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 6, filed 5/15/09.

according to the Active's records was approximately \$5.2 million as of March 30, 2009, but a significant portion of the inventory was aged, and suspected to be valued less by market than by cost.<sup>232</sup> Zumiez expected to have valued the inventory and decided on the number of stores it desired by June 10. Active believed the total amount of gift card liabilities realized would be around \$300,000.<sup>233</sup> Zumiez's bid would also be contingent on negotiating substantial rent reductions with Active's landlords, a process expected to be both time and labor intensive.<sup>234</sup>

Active's motion stipulated that Zumiez, as the stalking horse bidder, would file their final bid by noon on June 22.<sup>235</sup> The sale would be conducted at the offices of Winthrop Couchot on June 26, with only Zumiez and other qualified competing bidders eligible to attend and bid.<sup>236</sup> The sale would then close on or about July 10.<sup>237</sup>

Any competing bidders would have to overcome the stalking horse protections in Zumiez's proposal. First, Zumiez's offer included a provision requiring any over-bidder to pay

---

<sup>232</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 6, filed 5/15/09.

<sup>233</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 7, filed 5/15/09.

<sup>234</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 9, filed 5/15/09.

<sup>235</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 7, filed 5/15/09.

<sup>236</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 8, filed 5/15/09.

<sup>237</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 7, filed 5/15/09.

Zumiez a break-up fee of \$250,000 within fifteen days after a court-finalized sale.<sup>238</sup> Second, Active's motion proposed that bidding be in increments of \$50,000.<sup>239</sup> Combined, a competitor looking to overbid Zumiez would have to be willing to pay a \$300,000 premium. Other requirements for competing bids as stipulated in Active's motion were that they (1) contain terms at least on par with Zumiez; (2) show 'red-lined changes' in the APA where the two differ; (3) be made by a financially-qualified buyer after due diligence review of Active's books; (4) be accompanied by a \$50,000 deposit; and (5) be delivered at least three days prior to the sale date.<sup>240</sup>

These provisions served to protect Zumiez from competition and also to compensate the firm for the expenses related to preparing the stalking-horse bid.<sup>241</sup> Active favored the break-up fee because it encouraged the initial stalking-horse offer, discouraged a protracted bidding strategy, and ensured a high floor bid early in the process that would "create momentum towards the consummation of a sale."<sup>242</sup> Active argued that the initial overbid requirement (\$300,000) was a 4% increase over the original bid, and thus below amounts allowed by bankruptcy courts

---

<sup>238</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 28, filed 5/15/09.

<sup>239</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 8, filed 5/15/09.

<sup>240</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 6-7, filed 5/15/09.

<sup>241</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 12, filed 5/15/09.

<sup>242</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 12, filed 5/15/09.

in other cases.<sup>243</sup> While the court should carefully scrutinize the procedures to ensure that Active's estate would not be unduly burdened and that the rights of all parties would be protected, unless the arrangement was tainted with self-dealing, fraud, or bad faith, the court should accord "substantial deference" to the fiduciary duty of the DIP's board who approved the terms of the break-up fee arrangement.<sup>244</sup> Some experts, on the other hand, have identified the range of two to three percent as appropriate.<sup>245</sup>

The court scheduled a hearing on the sales procedures for June 4; motions opposing the procedure were due by May 22, giving the UST, Merrill, and the other creditors only one week to prepare any objections.<sup>246</sup> On May 20, Zumiez filed for a modification of the overbid procedures that would change the break-up fee to the greater of 3% of the successful bid amount or \$150,000.<sup>247</sup> Thus, if the highest bid was \$7.2 million, as originally estimated by Zumiez, the break-up fee would be \$226,000 rather than \$250,000. No supporting documentation or argument accompanied the modification request. Pressure was apparently placed on Zumiez to reduce the break-up fee, perhaps in an effort to enhance interest in the sale auction.

---

<sup>243</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 9-10, filed 5/15/09. Active demonstrated that one court had approved overbid amount of 22%, Id. at 10, citing *In re Twenver, Inc.*, 149 B.R. 954, 956 (Bankr. D. Colo. 1992).

<sup>244</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 11, filed 5/15/09, citing *In Re Hupp Industries, Inc.*, 140 B.R. 191, 196 (Bankr. N.D. Ohio 1992); Mark F. Hebbeln, *The Economic Case for Judicial Deference to Break-up Fee Agreements in Bankruptcy*, 13 BANKR. DEV. J. 475, 502-505 (1997); Daniel M. Glosband, *Pathology of Section 363 Sales: Not as Simple as They Look*, J. Private Equity, Fall 2004, at 61 (noting two standards: the Southern District of New York's lenient 'business judgment standard' and Delaware's strict 'actual necessity' standard).

<sup>245</sup> Corinne Ball, John K. Kane & Jones Day, *Section 363 Sales: Bidding Procedures and Sale Orders*, 1396 PLI/ Corp 891, 897 (2003).

<sup>246</sup> In re The Active Wallace Group, case no. 09-15370, Notice to Creditors and Parties in Interest of Hearing on Debtor's Motion, Dkt. No. 130, p. 1, filed 5/15/09.

<sup>247</sup> In re The Active Wallace Group, case no. 09-15370, Modification to Overbid Procedures, Dkt. No. 141, p. 1, filed 05/20/09.

### The Creditors of the Estate Seek to Maximize Their Expected Return

On May 22, several of Active's creditors, including Merrill, the OCC, landlords, and various other smaller general unsecured creditors, filed objections to Zumiez's proposed sale procedure.<sup>248</sup> Each of these firms had a stake in netting the largest possible sales price from the auction, and thus wanted to insure that all procedures allowed for the greatest competition among interested purchasers.

Merrill filed a limited objection to the proposal; it supported the sale strategy, and was seeking clarification of its rights under the proposal, rather than a denial of the motion.<sup>249</sup> Under the interim financing order setting forth Merrill's rights as DIP lender it could, pursuant to § 363(k), "credit bid" at any sale of substantially all the assets.<sup>250</sup> First, Merrill's objection sought a declaration that it would not have to meet the requirements of the proposal regarding bidder qualifications.<sup>251</sup>

Second, as Zumiez's proposal stated that Active would determine which bid was the highest and best, Merrill requested that this determination be explicitly subject to a "prior

---

<sup>248</sup> In re The Active Wallace Group, case no. 09-15370, Creditors' Committee's Opposition to Debtor's Motion for Order (1) Approving Overbid Procedures and Break-Up Fee in Connection With Proposed Sale of Substantially All Assets of the Estate, etc., Dkt. No. 148, filed 05/22/09; In re The Active Wallace Group, case no. 09-15370, Limited Objection to Debtor's Motion for Order (1) Approving Overbid Procedures and Break-Up Fee in Connection With Proposed Sale of Substantially All Assets of the Estate, etc., Dkt. No. 149, filed 05/22/09; In re The Active Wallace Group, case no. 09-15370, Limited Objection of Various Landlord Creditors to Debtor's Motion for Order (1) Approving Overbid Procedures and Break-Up Fee in Connection With Proposed Sale of Substantially All Assets of the Estate, etc., Dkt. No. 150, filed 05/22/09

<sup>249</sup> In re The Active Wallace Group, case no. 09-15370, Merrill Lynch Commercial Finance Corp's Limited Objection to the Debtor's Motion, Dkt. No. 147, p. 2, filed 05/22/09.

<sup>250</sup> In re The Active Wallace Group, case no. 09-15370, Merrill Lynch Commercial Finance Corp's Limited Objection to the Debtor's Motion, Dkt. No. 147, p. 4, filed 05/22/09.

<sup>251</sup> In re The Active Wallace Group, case no. 09-15370, Merrill Lynch Commercial Finance Corp's Limited Objection to the Debtor's Motion, Dkt. No. 147, p. 5, filed 05/22/09.

consultation” with itself and the OCC.<sup>252</sup> It also recommended that the “overbid procedures . . . permit the piecemeal sale of the [a]ssets to one or more purchasers so long as the aggregate bid exceeds any competing bids for a purchase of the [a]ssets in bulk” in order to “obtain the highest and best bids.”<sup>253</sup>

Third, Merrill objected that under the proposed bid procedures, Zumiez would have until noon on June 22 to disclose their precise purchase price, based on the investigation of the inventory composition, giving the other bidders less than four days to formulate a competing proposal for the June 26 auction.<sup>254</sup> Merrill claimed this arrangement mitigated the need for the break-up fee, as there would be no time to shop the bid around and attract competing offers.<sup>255</sup>

Fourth, Merrill objected to the reduction in the purchase price in the event that the gift card liabilities amounted to more than \$1.3 million, on the grounds that the liability would likely not be paid in full because not all those holding Active gift cards would actually use them.<sup>256</sup>

Fifth, Merrill objected that while Zumiez’s LOI “contemplated entry into consulting or employment agreements with John and Shane Wallace,” it did not disclose the terms of those

---

<sup>252</sup> In re The Active Wallace Group, case no. 09-15370, Merrill Lynch Commercial Finance Corp.’s Limited Objection to the Debtor’s Motion, Dkt. No. 147, p. 5, filed 05/22/09.

<sup>253</sup> In re The Active Wallace Group, case no. 09-15370, Merrill Lynch Commercial Finance Corp.’s Limited Objection to the Debtor’s Motion, Dkt. No. 147, p. 5, filed 05/22/09.

<sup>254</sup> In re The Active Wallace Group, case no. 09-15370, Merrill Lynch Commercial Finance Corp.’s Limited Objection to the Debtor’s Motion, Dkt. No. 147, p. 6, filed 05/22/09.

<sup>255</sup> In re The Active Wallace Group, case no. 09-15370, Merrill Lynch Commercial Finance Corp.’s Limited Objection to Debtor’s Motion, Dkt. No. 147, p. 6, filed 5/22/09 (quoting *In re Integrated Resources, Inc.*, 135 B.R. 746, 750 (Bankr. S.D.N.Y. 1992).

<sup>256</sup> In re The Active Wallace Group, case no. 09-15370, Merrill Lynch Commercial Finance Corp.’s Limited Objection to Debtor’s Motion, Dkt. No. 147, p. 6, filed 5/22/09. See In re The Active Wallace Group, case no. 09-15370, Debtor’s Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p.25, filed 5/15/09 (letter of intent discussing the gift card liabilities).

agreements, including compensation. Merrill argued that Zumiez and the Wallaces should disclose the amount of compensation.<sup>257</sup>

Sixth, Merrill contended that the terms of the “Transition Services Agreement”<sup>258</sup> mentioned in Zumiez’s LOI should be disclosed so that the court could evaluate whether the Agreement provided a benefit to Active’s estate, or “at the very least, [had] an economically neutral effect on the estate.”<sup>259</sup> Merrill argued that disclosure would be “consistent with the practice in similar cases” but provided no case law supporting the contention.<sup>260</sup>

Finally, Merrill objected that the LOI did not “specify whether cure costs associated with the assumption and assignment of executory contracts and unexpired leases” would be paid by Active’s estate or Zumiez.<sup>261</sup> Merrill argued that “in either case, the parties should be required to specify the terms of payment of any cure costs.” The LOI also failed to specify whether cash and cash equivalents were excluded from the sale.<sup>262</sup>

---

<sup>257</sup> In re The Active Wallace Group, case no. 09-15370, Merrill Lynch Commercial Finance Corp.’s Limited Objection to Debtor’s Motion, Dkt. No. 147, p. 6-7, filed 5/22/09.

<sup>258</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p.27, filed 5/15/09 (discussing a Transition Service Agreement that would “support the business during the ownership transition).

<sup>259</sup> In re The Active Wallace Group, case no. 09-15370, Merrill Lynch Commercial Finance Corp.’s Limited Objection to Debtor’s Motion, Dkt. No. 147, p. 7, filed 5/22/09.

<sup>260</sup> In re The Active Wallace Group, case no. 09-15370, Merrill Lynch Commercial Finance Corp.’s Limited Objection to Debtor’s Motion, Dkt. No. 147, p. 7, filed 5/22/09.

<sup>261</sup> In re The Active Wallace Group, case no. 09-15370, Merrill Lynch Commercial Finance Corp.’s Limited Objection to Debtor’s Motion, Dkt. No. 147, p. 7 filed 5/22/09.

<sup>262</sup> In re The Active Wallace Group, case no. 09-15370, Merrill Lynch Commercial Finance Corp.’s Limited Objection to Debtor’s Motion, Dkt. No. 147, p. 7 filed 5/22/09.



The OCC also filed an opposition to the proposed sale procedures.<sup>263</sup> In the same vein as Merrill, the OCC objected that the expedited procedure was “calculated to squelch competitive bidding” and therefore should not have been approved.<sup>264</sup> The OCC’s motion stated that it had received inquiries from at least three companies that appeared interested in bidding, and argued that the contemplated procedures were aimed at “prevent[ing] any of those potential purchasers from meaningful participation in the sales process.”<sup>265</sup>

The OCC argued that approval of the § 363 sale and accompanying bid procedures is usually based on the courts consideration of “the overall process by which the proposed purchase was selected and that party’s good faith.”<sup>266</sup> The OCC took objection to the proposed break-up fee because none of the recognized functions of bidding protections applied to Active.<sup>267</sup> It argued that a valid break-up fee “served any of three possible useful functions (1) to attract or retain a potentially successful bid, (2) to establish a bid standard or minimum for other bidders to follow, or (3) to attract additional bidders.”<sup>268</sup>

In Active’s case, Zumiez’s proposed fee was arguably not intended to induce others to bid, because the maximum bid (\$7.2 million) was artificially high and the period allowed for

---

<sup>263</sup> In re The Active Wallace Group, case no. 09-15370, Creditors’ Committee’s Opposition to Debtors Motion, Dkt. No. 148 filed 5/22/09.

<sup>264</sup> In re The Active Wallace Group, case no. 09-15370, Creditors’ Committee’s Opposition to Debtors Motion, Dkt. No. 148, p. 1 filed 5/22/09.

<sup>265</sup> In re The Active Wallace Group, case no. 09-15370, Creditors’ Committee’s Opposition to Debtors Motion, Dkt. No. 148, p 3 filed 5/22/09.

<sup>266</sup> In re The Active Wallace Group, case no. 09-15370, Creditors’ Committee’s Opposition to Debtors Motion, Dkt. No. 148, p 3 filed 5/22/09, citing *Licensing by Paolo, Inc. v. Sinatra (In re Gucci)*, 126 F.3d 380, 390-391 (2d Cir. 1997); *In re Abbotts Dairies of Pennsylvania, Inc.*, 788 F.2d 143, 147-150 (3d Cir 1986).

<sup>267</sup> In re The Active Wallace Group, case no. 09-15370, Creditors’ Committee’s Opposition to Debtors Motion, Dkt. No. 148, p 4 filed 5/22/09.

<sup>268</sup> In re The Active Wallace Group, case no. 09-15370, Creditors’ Committee’s Opposition to Debtors Motion, Dkt. No. 148, p 4 filed 5/22/09, quoting *In re Integrated Resources*, 147 B.R. 650, 659 (S.D.N.Y. 1992).

competing bids was so short as to “deter participation by other bidders.”<sup>269</sup> In a rather conclusory fashion, the OCC argued that the fee arrangement did not “further the diverse interests of the debtor, creditors, and equity holders alike.”<sup>270</sup> The OCC obviously had an interest in Active receiving the highest possible bid at the auction, and was pressing for a procedure that would provide more time and less cost to competing bidders. In the end, as an alternative to having the bidding procedures tossed completely, the OCC said they would support a seven-day period between Zumiez’s stalking horse bid and the auction date, and a break-up fee equal to 3% of Zumiez’s initial bid.<sup>271</sup>

Several landlords and an equipment lessor also filed limited objections to the sale procedures.<sup>272</sup> Their general objection was that Active had failed to propose procedures consistent with the requirements for a sale under § 365.<sup>273</sup> Section 365(f) authorizes a debtor to assume and assign nonresidential real property leases, provided that the debtor: (1) assumes the lease in accordance with the provisions of § 365; and (2) demonstrates adequate assurance of future performance by the assignee of the lease, regardless of whether there has been a default under the lease.<sup>274</sup> Adequate assurance of future performance is determined by existing factual

---

<sup>269</sup> In re The Active Wallace Group, case no. 09-15370, Creditors’ Committee’s Opposition to Debtors Motion, Dkt. No. 148, p. 4 filed 5/22/09.

<sup>270</sup> In re The Active Wallace Group, case no. 09-15370, Creditors’ Committee’s Opposition to Debtors Motion, Dkt. No. 148, p. 5 filed 5/22/09.

<sup>271</sup> In re The Active Wallace Group, case no. 09-15370, Creditors’ Committee’s Opposition to Debtors Motion, Dkt. No. 148, p. 5 filed 5/22/09.

<sup>272</sup> See, e.g., In re The Active Wallace Group, case no. 09-15370, Limited Objection to Debtor’s Motion, Dkt. No. 149, filed 05/22/09; Limited Objection of Various Landlord Creditors to Debtor’s Motion, Dkt. No. 150, filed 05/22/09.

<sup>273</sup> See, e.g., In re The Active Wallace Group, case no. 09-15370, Limited Objection to Debtor’s Motion, Dkt. No. 149, filed 05/22/09; Limited Objection of Various Landlord Creditors to Debtor’s Motion, Dkt. No. 150, filed 05/22/09.

<sup>274</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Various Creditors to Debtor’s Sale Procedures Motion, Dkt. No. 150, p. 4, filed 5/22/09. See 11 U.S.C. § 365(f)(2).

conditions, and the court may look to many factors in determining what is necessary to provide adequate assurance of future performance under § 365(b), including sufficient economic backing, economic conditions, certificates, credit reports, escrow deposits, or other similar forms of security or guarantee.<sup>275</sup>

These landlords argued that because their leased properties were shopping centers, the heightened standards of adequate assurance provided for in § 365(b)(3)(A) through (D) applied to them.<sup>276</sup> The extra evidence required includes evidence of the source of rent and that the financial condition and operation performance of the proposed assignee and its guarantors be similar to the lessees at the time of the original lease.<sup>277</sup> Also, the proposed assignee must show that the percentage rent due under the lease will not substantially decline, and that the assumption and assignment will not disrupt the tenant mix or balance in the shopping center.<sup>278</sup>

The landlords argued that the proposed sale motion did not specify what evidence would be provided to the landlords nor when it would be provided.<sup>279</sup> They argued that this evidence is usually “voluminous” and that several days would be necessary for the landlords to determine

---

<sup>275</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Various Creditors to Debtor’s Sale Procedures Motion, Dkt. No. 150, p. 4-5 filed 5/22/09 (citing *In re Lafayette Radio Electronics Corp.*, 9 B.R. 993, 998 (Bankr. E.D.N.Y. 1981); *In re Belize Airways*, 5 B.R. 152 (Bankr. S.D. Fla. 1980)). Courts also look to the operating experience of the proposed assignee. *In re Bygaph, Inc.*, 56 B.R. 596, 605 (Bankr. S.D.N.Y. 1986).

<sup>276</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Various Creditors to Debtor’s Sale Procedures Motion, Dkt. No. 150, p. 4-5 filed 5/22/09.

<sup>277</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Various Creditors to Debtor’s Sale Procedures Motion, Dkt. No. 150, p. 5, filed 5/22/09 (citing Code § 365(b)(3)).

<sup>278</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Various Creditors to Debtor’s Sale Procedures Motion, Dkt. No. 150, p. 5, filed 5/22/09.

<sup>279</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Various Creditors to Debtor’s Sale Procedures Motion, Dkt. No. 150, p. 5, filed 5/22/09.

whether the assurances were indeed adequate.<sup>280</sup> The landlords further argued that the lack of procedures in the motion amounted to a violation of due process.<sup>281</sup> They contended that three specific features were missing from Active's proposed timeline: (1) the date when Active would file the sale motion; (2) an expedited procedure to communicate the auction results; and (3) a deadline for objections to the sale motion.<sup>282</sup>

Another group of landlords objected to the "(i) absence of a timetable or mechanism for delivery of adequate assurance of future performance information to the Landlords (for proposed assignees of the Leases); (ii) absence of a timetable or mechanism for resolution of cure claims under [§ 365] and objections to successful bidders; and (iii) timing of the hearing to approve the successful bidder" scheduled to occur prior to July 1.<sup>283</sup>

They sought information such as the exact name of the bidder and proposed assignee, audited financial statements for the past two years, and financial information for each location on which Zumiez proposed to bid.<sup>284</sup> They further requested that such evidence of adequate assurance be e-mailed to their counsel within one day after Active's counsel received the information.<sup>285</sup> They also sought Active's records regarding the cure amounts under the leases

---

<sup>280</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Various Creditors to Debtor's Sale Procedures Motion, Dkt. No. 150, p. 5-6, filed 5/22/09.

<sup>281</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Various Creditors to Debtor's Sale Procedures Motion, Dkt. No. 150, p. 6, filed 5/22/09.

<sup>282</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection to Debtor's Motion, Dkt. No. 149, p. 4, filed 5/22/09.

<sup>283</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Various Creditors to Debtor's Sale Procedures Motion, Dkt. No. 150, p. 4, filed 5/22/09. Shopping center lessors have additional notice allowances under § 364.

<sup>284</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Various Creditors to Debtor's Sale Procedures Motion, Dkt. No. 150, p. 6, filed 5/22/09.

<sup>285</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Various Creditors to Debtor's Sale Procedures Motion, Dkt. No. 150, p. 6, filed 5/22/09.

because this information was necessary not only to the landlords, but also to competing bidders, for purposes of formulating an accurate bid.<sup>286</sup>

Winthrop, the leasing agency that had supplied much of Active's computer equipment, also filed a limited objection to the proposed sales procedures.<sup>287</sup> In sum, it objected to the proposal's lack of: (1) any procedures for the assumption and assignment or rejection of executory contracts and leases;<sup>288</sup> (2) protection for its leased equipment; and (3) compliance with § 365(d)(5) concerning the continuing performance of lease obligations by the trustee.<sup>289</sup>

Winthrop argued that the sales procedure motion did not provide them with adequate assurance of future performance by Zumiez.<sup>290</sup> Under § 365(f)(2), the debtor may assign a lease only if the debtor has provided assurance of future performance under the terms of the lease, regardless of whether there has been a default.<sup>291</sup> Winthrop wanted the proposal to require Zumiez to either assume the equipment leases or return all of Winthrop's equipment upon

---

<sup>286</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Various Creditors to Debtor's Sale Procedures Motion, Dkt. No. 150, p 6-7 filed 5/22/09.

<sup>287</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Winthrop Resources to the Debtor's Motion, Dkt. No. 146, p. 1, filed 05/22/09.

<sup>288</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Winthrop Resources to the Debtor's Motion, Dkt. No. 146, p. 2, filed 05/22/09.

<sup>289</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Winthrop Resources to the Debtor's Motion, Dkt. No. 146, p. 2, filed 05/22/09.

<sup>290</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Winthrop Resources to the Debtor's Motion, Dkt. No. 146, p. 4, filed 05/22/09.

<sup>291</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Winthrop Resources to the Debtor's Motion, Dkt. No. 146, p. 4, filed 05/22/09.

rejection.<sup>292</sup> Winthrop also made clear that in the event of any post-petition breach of the lease, all related late charges and attorney fees would be administrative expense claims.<sup>293</sup>

On May 28, Active responded to these creditor objections by proposing to incorporate additional terms into the sales motion.<sup>294</sup> These additions provided that the landlords would receive immediate notification of the winning bidder by “electronic transmission or other expedited method” and that each would have five business days to respond and object to the lease assignments.<sup>295</sup> An additional change moved the auction to June 19, rather than June 26, supposedly giving the creditors more time to overlook the buyer’s credentials.<sup>296</sup> Their final bid would be filed on June 15 and would include the precise amount of the purchase price.<sup>297</sup>

Zumiez also submitted a response to the creditors’ objections. Zumiez pointed out that Active was in “a very precarious position” where vendors could stop shipments “without assurance that the Debtor will be able to pay them,” that Active’s inventory was “aging and dangerously low,” and that 250 full time employees were at risk of losing their jobs.<sup>298</sup> Zumiez,

---

<sup>292</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Winthrop Resources to the Debtor’s Motion, Dkt. No. 146, p. 4, filed 05/22/09.

<sup>293</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Winthrop Resources to the Debtor’s Motion, Dkt. No. 146, p. 6, filed 05/22/09, citing *In Re Muma Services, Inc.*, 279 B.R. 478 (Bankr. D. Del. 2002).

<sup>294</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Response to Limited Objection of Various Landlord Creditors, Dkt. No. 155, p. 2, filed 5/28/09.

<sup>295</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Response to Limited Objection of Various Landlord Creditors, Dkt. No. 155, p. 2, filed 5/28/09.

<sup>296</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Response to Limited Objection of Various Landlord Creditors, Dkt. No. 155, p. 2, filed 5/28/09.

<sup>297</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Response to Limited Objection of Various Landlord Creditors, Dkt. No. 155, p. 2, filed 5/28/09.

<sup>298</sup> In re The Active Wallace Group, case no. 09-15370, Zumiez Inc.’s Reply to Opposition to Debtor’s Sales Procedures Motion, Dkt. No. 156, p. 2, filed 5/28/09.

if the successful bidder, would provide capital to retain most of these jobs and continue store operations “with a proven management team backed by substantial capitalization.”<sup>299</sup>

In response to the contention that the bid was illusory due to its vagueness, Zumiez argued that the substantial portion of the bid was based on stores and inventory.<sup>300</sup> Zumiez argued that inventory is customarily valued at closing, that it had already contacted a firm to perform the valuation, and all data would have to be received before an exact price could be announced.<sup>301</sup> As for the leases, Zumiez was interested in acquiring 20 of the 21 Active stores.<sup>302</sup> Many of these leases had option periods beyond the existing terms, and Zumiez was in negotiations to ensure that the options would be fully enforceable notwithstanding the bankruptcy status.<sup>303</sup>

Active had allegedly required that Zumiez not negotiate independently with the landlords concerning the restructuring of the leases.<sup>304</sup> Instead, Zumiez was instructed to inform Phoenix what terms it was seeking, and Phoenix would then negotiate the lease revision with the landlords.<sup>305</sup> Based on Zumiez’s experience in negotiating over 350 leases for its other locations,

---

<sup>299</sup> In re The Active Wallace Group, case no. 09-15370, Zumiez Inc.’s Reply to Opposition to Debtor’s Sales Procedures Motion, Dkt. No. 156, p 2, filed 5/28/09.

<sup>300</sup> In re The Active Wallace Group, case no. 09-15370, Zumiez Inc.’s Reply to Opposition to Debtor’s Sales Procedures Motion, Dkt. No. 156, p 2, filed 5/28/09.

<sup>301</sup> In re The Active Wallace Group, case no. 09-15370, Zumiez Inc.’s Reply to Opposition to Debtor’s Sales Procedures Motion, Dkt. No. 156, p. 2-3, filed 5/28/09.

<sup>302</sup> In re The Active Wallace Group, case no. 09-15370, Zumiez Inc.’s Reply to Opposition to Debtor’s Sales Procedures Motion, Dkt. No. 156, p. 3, filed 5/28/09.

<sup>303</sup> In re The Active Wallace Group, case no. 09-15370, Zumiez Inc.’s Reply to Opposition to Debtor’s Sales Procedures Motion, Dkt. No. 156, p. 3, filed 5/28/09.

<sup>304</sup> In re The Active Wallace Group, case no. 09-15370, Zumiez Inc.’s Reply to Opposition to Debtor’s Sales Procedures Motion, Dkt. No. 156, p. 3, filed 5/28/09.

<sup>305</sup> In re The Active Wallace Group, case no. 09-15370, Zumiez Inc.’s Reply to Opposition to Debtor’s Sales Procedures Motion, Dkt. No. 156, p. 3, filed 5/28/09.

it believed that these negotiations would take weeks and that it was unlikely that any buyer would be willing to assume the leases without modification.<sup>306</sup> Also, Active had sent notice of intent to reject six of the 20 leases that Zumiez was considering assuming.<sup>307</sup> Without knowing whether Active would in fact reject these leases, Zumiez was unable to offer exact information as to which leases it would assume.<sup>308</sup>

Zumiez also expressed its intention to have all lease modifications fully negotiated before the auction, but if the landlords were unwilling to negotiate in a timely fashion, this goal would be unattainable.<sup>309</sup> Zumiez understood the landlords' concern for adequate assurance and even suggested that all potential bidders prove they had "cash or capacity under a credit facility of at least \$15 million as a condition to assumption and assignment."<sup>310</sup> This amount was derived by multiplying the \$7.2 million purchase price by two to support working capital and capital improvements, and additional money for operating liquidities.<sup>311</sup>

Next, the response addressed the expedited auction procedure.<sup>312</sup> Expediency was needed because back-to-school inventory would have typically been ordered and delivered by

---

<sup>306</sup> In re The Active Wallace Group, case no. 09-15370, Zumiez Inc.'s Reply to Opposition to Debtor's Sales Procedures Motion, Dkt. No. 156, p. 4, filed 5/28/09.

<sup>307</sup> In re The Active Wallace Group, case no. 09-15370, Zumiez Inc.'s Reply to Opposition to Debtor's Sales Procedures Motion, Dkt. No. 156, p. 4, filed 5/28/09.

<sup>308</sup> In re The Active Wallace Group, case no. 09-15370, Zumiez Inc.'s Reply to Opposition to Debtor's Sales Procedures Motion, Dkt. No. 156, p. 4, filed 5/28/09.

<sup>309</sup> In re The Active Wallace Group, case no. 09-15370, Zumiez Inc.'s Reply to Opposition to Debtor's Sales Procedures Motion, Dkt. No. 156, p. 4, filed 5/28/09.

<sup>310</sup> In re The Active Wallace Group, case no. 09-15370, Zumiez Inc.'s Reply to Opposition to Debtor's Sales Procedures Motion, Dkt. No. 156, p. 4-5, filed 5/28/09.

<sup>311</sup> In re The Active Wallace Group, case no. 09-15370, Zumiez Inc.'s Reply to Opposition to Debtor's Sales Procedures Motion, Dkt. No. 156, p. 4-5, filed 5/28/09.

<sup>312</sup> In re The Active Wallace Group, case no. 09-15370, Zumiez Inc.'s Reply to Opposition to Debtor's Sales Procedures Motion, Dkt. No. 156, p. 5, filed 5/28/09.



June, and holiday orders would be due to vendors over the next month or two.<sup>313</sup> These two seasons were the major revenue generating periods, producing roughly 60% to 80% of the sales, and without a new owner capable of rapid restocking, further underperformance could be expected, which would greatly reduce the value to potential buyers.<sup>314</sup> The need for inventory information before the auction, and the seasonal timing of inventory demand required that the auction and sale be conducted with all allowable haste.<sup>315</sup>

These recurring inventory concerns were not unique. Inventory valuation disputes can confound the sale process and their related delays can “radically devalue assets because time is the enemy of the seller in a §363 sale.”<sup>316</sup> One expert has noted that some inventory valuation problems can be avoided by placing limits on related purchase price adjustments in the APA, something Active and Zumiez did not do.<sup>317</sup>

Zumiez agreed to reduce its breakup fee to the greater of 3% or \$150,000.<sup>318</sup> It objected to any contention that the bid procedures were designed to chill bidding; rather, Zumiez argued, its efforts and negotiations with landlords would benefit any winning bidder. The costs associating with forming an opening bid were substantial; Zumiez argued they would exceed

---

<sup>313</sup> In re The Active Wallace Group, case no. 09-15370, Zumiez Inc.’s Reply to Opposition to Debtor’s Sales Procedures Motion, Dkt. No. 156, p. 5, filed 5/28/09.

<sup>314</sup> In re The Active Wallace Group, case no. 09-15370, Zumiez Inc.’s Reply to Opposition to Debtor’s Sales Procedures Motion, Dkt. No. 156, p. 5, filed 5/28/09.

<sup>315</sup> In re The Active Wallace Group, case no. 09-15370, Zumiez Inc.’s Reply to Opposition to Debtor’s Sales Procedures Motion, Dkt. No. 156, p. 5, filed 5/28/09.

<sup>316</sup> Robert E. Steinberg, *The Seven Deadly Sins in § 363 Sales*, 24 AM. BANKR. INST. J. 22, 22 (2005).

<sup>317</sup> Robert E. Steinberg, *The Seven Deadly Sins in § 363 Sales*, 24 AM. BANKR. INST. J. 22, 22 (2005).

<sup>318</sup> In re The Active Wallace Group, case no. 09-15370, Zumiez Inc.’s Reply to Opposition to Debtor’s Sales Procedures Motion, Dkt. No. 156, p. 6, filed 5/28/09.

\$150,000 because it had ten employees working on the deal and would incur inventory valuation fees to its appraiser.<sup>319</sup>

Zumiez had no objection to allowing Merrill automatic qualified bidder status, nor did it object to bidders acquiring only a portion of the assets.<sup>320</sup> Concerning assumption of the gift card liabilities, Zumiez claimed that although the objecting parties may not realize it, Zumiez may become liable to the state for any unclaimed gift cards under California's unclaimed property law.<sup>321</sup> Thus, even though the expected liability may have been much less, liability for the full amount was a possibility for Zumiez.<sup>322</sup>

Zumiez clarified that no arrangement had been made with either of the Wallace brothers concerning employment or future compensation, but allowed that if and when such arrangements were made, the substance would be disclosed to all interested parties.<sup>323</sup> The final stipulation of the response stated that all costs of cure regarding the leases would be paid by Active, and the proposed sale did not contemplate acquiring the cash or cash equivalents of the debtor, except that the till, or standard amount kept physically in each store for daily operations, would be transferred as necessary assets.<sup>324</sup>

---

<sup>319</sup> In re The Active Wallace Group, case no. 09-15370, Zumiez Inc.'s Reply to Opposition to Debtor's Sales Procedures Motion, Dkt. No. 156, p. 6, filed 5/28/09.

<sup>320</sup> In re The Active Wallace Group, case no. 09-15370, Zumiez Inc.'s Reply to Opposition to Debtor's Sales Procedures Motion, Dkt. No. 156, p. 7, filed 5/28/09.

<sup>321</sup> In re The Active Wallace Group, case no. 09-15370, Zumiez Inc.'s Reply to Opposition to Debtor's Sales Procedures Motion, Dkt. No. 156, p. 7, filed 5/28/09. *See* California Civil Code §§ 1749.45, 1749.5; California Code of Civil Procedure §§ 1520, 1520.5 (suggesting that unclaimed gift cards with expiration dates escheat to the state after three years, and the state may have a claim at that point).

<sup>322</sup> In re The Active Wallace Group, case no. 09-15370, Zumiez Inc.'s Reply to Opposition to Debtor's Sales Procedures Motion, Dkt. No. 156, p. 7, filed 5/28/09.

<sup>323</sup> In re The Active Wallace Group, case no. 09-15370, Zumiez Inc.'s Reply to Opposition to Debtor's Sales Procedures Motion, Dkt. No. 156, p. 7, filed 5/28/09.

<sup>324</sup> In re The Active Wallace Group, case no. 09-15370, Zumiez Inc.'s Reply to Opposition to Debtor's Sales Procedures Motion, Dkt. No. 156, p. 8, filed 5/28/09.

### The Court Sets the Stage for the Sales Auction

On June 4, the Court held a hearing to clarify bidding procedures after finding the notice of the hearing to be adequate.<sup>325</sup> Four days later, Active filed their motion for an order approving the sale of the assets free and clear of liens, claims, and interests pursuant to § 363(b) and (f), and authorizing the assumption and assignment of certain unexpired leases and executory contracts.<sup>326</sup> This motion stipulated that if qualified bids were received, the auction would take place at Winthrop Couchot's offices in Newport Beach on June 15, four days ahead of the previously slated date.<sup>327</sup> The motion provided that any prospective bidders must contact PCG for non-public due-diligence information.<sup>328</sup>

Active supplemented this motion with a memorandum of points and authorities that presented the background facts, the procedural posture, and argued that: (1) the motion should be approved pursuant to § 363(b) and 363(f);<sup>329</sup> (2) the purchase price realized at the auction would be fair and reasonable under the circumstances;<sup>330</sup> (3) the anticipated purchase price compared

---

<sup>325</sup> In re The Active Wallace Group, case no. 09-15370, Order Approving Overbid Procedures in Connection with Proposed Sale, Dkt. No. 179, p. 1-2, filed 06/11/09.

<sup>326</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order Approving Sale and Authorizing Assumption and Assignment, Dkt. No. 168, p. 1, filed 06/08/09.

<sup>327</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order Approving Sale and Authorizing Assumption and Assignment, Dkt. No. 168, p. 5, filed 06/08/09.

<sup>328</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order Approving Sale and Authorizing Assumption and Assignment, Dkt. No. 168, p. 5, filed 06/08/09.

<sup>329</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order Approving Sale and Authorizing Assumption and Assignment, Dkt. No. 168, p. 14-15, filed 06/08/09 (stating that "a sound and in fact compelling basis exists for court approval of the sale."); *In re Lionel Corp.*, 722 F.2d 1063, 1071 (2d Cir. 1983) (which stated that "the touchstone for proper exercise of debtor discretion is a good business reason.")

<sup>330</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order Approving Sale and Authorizing Assumption and Assignment, Dkt. No. 168, p. 13-14 filed 06/08/09 (stating that the "Debtor's management believes a sale of the asset represents a value that is consistent with the fair market value of the assets on a going concern basis").

favorably with the value of Active's assets;<sup>331</sup> and (4) the assets were decreasing in value and continuing the case would cause them to depreciate even more.<sup>332</sup> Active's motion also asked that it be authorized to assume and assign certain contracts to the buyer.<sup>333</sup>

According to the resulting order filed June 11, interested bidders were required to serve their bids on Active, Merrill, and the OCC by noon on June 15.<sup>334</sup> The order also required bidders to pay a \$50,000 refundable deposit before bidding.<sup>335</sup> Bids had to provide that the sale would close within ten days after entry of a sale order.<sup>336</sup> The auction was to be conducted on June 16 at Winthrop Couchot's offices.<sup>337</sup> Active, "in consultation with" Merrill and the OCC,

---

<sup>331</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order Approving Sale and Authorizing Assumption and Assignment, Dkt. No. 168, p. 16, filed 06/08/09 (citing *In Re Deleware & Hudson Railway Co.*, 124 B.R. 169, 179 (D. Del. 191) (arguing that fair and reasonable price for the sale of assets is evidenced by extensive solicitation of bids, negotiations with prospective bidders, and testimony that proposed offer is best available)).

<sup>332</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order Approving Sale and Authorizing Assumption and Assignment, Dkt. No. 168, p. 16, filed 06/08/09.

<sup>333</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order Approving Sale and Authorizing Assumption and Assignment, Dkt. No. 168, p. 18-19, filed 06/08/09 (arguing that a bankruptcy court may so authorize when it is within the sound business judgment of the debtor) (citing § 365(a); *Phar-mor, Inc. v. Strouss Building Associates*, 204 B. R. 948, 951-952 (N. D. Ohio 1997)). See also Daniel M. Glosband, *Pathology of Section 363 Sales: Not as Simple as They Look*, J. Private Equity, Fall 2004, at 62, (stating that "[c]ertain contracts may not be transferable to a buyer. To assign a contract to a buyer, the seller must first "assume" the contract, making it a viable postbankruptcy obligation of the seller").

<sup>334</sup> In re The Active Wallace Group, case no. 09-15370, Order Approving Overbid Procedures in Connection with Proposed Sale, Dkt. No. 179, p. 2, filed 06/11/09. *But see* Daniel M. Glosband, *Pathology of Section 363 Sales: Not as Simple as They Look*, J. Private Equity, Fall 2004, at 60 (stating that "[b]idders who dutifully comply with the rules find themselves in competition with others who do not. The debtor may accept late or non-conforming bids, may overlook the absence of an APA or evidence of financing, or may entertain bids that are for a modified package of assets").

<sup>335</sup> In re The Active Wallace Group, case no. 09-15370, Order Approving Overbid Procedures in Connection with Proposed Sale, Dkt. No. 179, p. 2, filed 06/11/09.

<sup>336</sup> In re The Active Wallace Group, case no. 09-15370, Order Approving Overbid Procedures in Connection with Proposed Sale, Dkt. No. 179, p. 3, filed 06/11/09.

<sup>337</sup> In re The Active Wallace Group, case no. 09-15370, Order Approving Overbid Procedures in Connection with Proposed Sale, Dkt. No. 179, p. 3, filed 06/11/09.

would determine the highest and best bidder.<sup>338</sup> The winning bidder would then increase their deposit to \$250,000, and Active would seek court confirmation of the Sale by June 30.<sup>339</sup> Auction results were to be transmitted by noon the next day to be available on PACER by the following business day.<sup>340</sup> All landlords and counterparties to the executory contracts would have until June 25 to object to the proposed assignments and Active would then have until June 26 to file any reply.<sup>341</sup>

As previously stated, Active's motion argued that the sale of substantially all the assets of the estate was authorized under § 363(b) and supported by related case law.<sup>342</sup> The motion argued that the proposed sale satisfied the *Lionel* criteria for a proper business justification.<sup>343</sup>

#### The Auction is Held and Lifestyle is the Highest Bidder

The auction took place as ordered on June 16, 2009 at 10:00 AM at Winthrop Couchot's office.<sup>344</sup> The bidders in attendance were Zumiez, Inc., Active Sports Lifestyle USA, LLC

---

<sup>338</sup> In re The Active Wallace Group, case no. 09-15370, Order Approving Overbid Procedures in Connection with Proposed Sale, Dkt. No. 179, p. 3, filed 06/11/09.

<sup>339</sup> In re The Active Wallace Group, case no. 09-15370, Order Approving Overbid Procedures in Connection with Proposed Sale, Dkt. No. 179, p. 3, filed 06/11/09.

<sup>340</sup> In re The Active Wallace Group, case no. 09-15370, Order Approving Overbid Procedures in Connection with Proposed Sale, Dkt. No. 179, p. 3-4, filed 06/11/09.

<sup>341</sup> In re The Active Wallace Group, case no. 09-15370, Order Approving Overbid Procedures in Connection with Proposed Sale, Dkt. No. 179, p. 4, filed 06/11/09.

<sup>342</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order Approving Sale and Authorizing Assumption and Assignment, Dkt. No. 168, p. 12, filed 06/08/09 (citing *Otto Preminger Films, Ltd. v. Qintex Entertainment, Inc.*, 950 F.2d 1492, 1495 (9th Cir. 1991)).

<sup>343</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Order Approving Sale and Authorizing Assumption and Assignment, Dkt. No. 168, p. 12, filed 06/08/09 (citing *In re Lionel Corp.*, 722 F.2d 1063, 1071 (2d Cir. 1983)).

<sup>344</sup> In re The Active Wallace Group, case no. 09-15370, Results of Auction for Sale of Substantially All Assets, Dkt. No. 182, p. 2, filed 06/17/09.

(“Lifestyle”), Nine Star Corporation, Surf Associates, Inc., and Meleen and Company.<sup>345</sup> After the bidding concluded, Active consulted with Merrill and the OCC and determined that the highest and best offer was received not from the stalking horse, Zumiez, but from Lifestyle.<sup>346</sup> Lifestyle’s consideration was \$5.2 million,<sup>347</sup> \$2 million less than had been estimated by Zumiez when executing their original LOI.<sup>348</sup> This disparity might be explained by Zumiez’s overvaluation of the inventory and earnings potential of the firm, but the court filings are silent on why exactly Zumiez decided to offer far less than they had originally proposed. One expert has noted that the stalking horse can have a major impact on the sale process and a poor choice can inadvertently chill the bidding;<sup>349</sup> it is difficult to speculate what would have happened had Active not chosen Zumiez.

Active filed the auction results the next day, along with a draft copy of the proposed Asset Purchase Agreement (“APA”) with Lifestyle, and adequate assurance statements from Lifestyle’s controlling shareholder, Issa Ladha.<sup>350</sup> The APA was dated June 12,<sup>351</sup> indicating that

---

<sup>345</sup> In re The Active Wallace Group, case no. 09-15370, Results of Auction for Sale of Substantially All Assets, Dkt. No. 182, p. 2, filed 06/17/09.

<sup>346</sup> In re The Active Wallace Group, case no. 09-15370, Results of Auction for Sale of Substantially All Assets, Dkt. No. 182, p. 2, filed 06/17/09.

<sup>347</sup> In re The Active Wallace Group, case no. 09-15370, Results of Auction for Sale of Substantially All Assets, Dkt. No. 182, p. 2, filed 06/17/09.

<sup>348</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Motion for order (1) Approving Overbid Procedures and Break-up Fee in Connection with Sale (2) Setting Hearing on Motion for Sale, Dkt. No. 129, p. 26, filed 5/15/09.

<sup>349</sup> Robert E. Steinberg, *The Seven Deadly Sins in § 363 Sales*, 24 AM. BANKR. INST. J. 22, 22 (2005).

<sup>350</sup> In re The Active Wallace Group, case no. 09-15370, Results of Auction for Sale of Substantially All Assets, Dkt. No. 182, p. 2, filed 06/17/09. This filing was required by the Court’s June 11 order requiring that the results and evidence of adequate assurance be “transmitted electronically or by other expedited means by noon on the business day following the conclusion of the auction.” to the various creditors.” In re The Active Wallace Group, case no. 09-15370, Order Approving Overbid Procedures in Connection with Proposed Sale, Dkt. No. 179, p. 4, filed 06/11/09.

<sup>351</sup> In re The Active Wallace Group, case no. 09-15370, Results of Auction for Sale of Substantially All Assets, Dkt. No. 182, p. 4, filed 06/17/09.

Active and Lifestyle may have been in negotiations prior to the auction. The APA included a cash payment of \$1 million at closing and assumption of both the Merrill DIP loan and some of the other liabilities, such as leases and executory contracts.<sup>352</sup> Crossed out of the original APA before filing was the assumption of the gift card liabilities estimated at \$1.2 million.<sup>353</sup> Also omitted from the assumed liabilities were “all rights, demands, claims, actions and causes of action arising under Chapter 5 of the Bankruptcy Code,”<sup>354</sup> a section that discusses creditor’s rights to file claims against the estate of the debtor. This exclusion allowed the assets to pass to the purchaser free and clear of liability.<sup>355</sup> Because Active was a DIP and still subject to court oversight, the parties acknowledged that the APA was “subject to higher and better offers presented at the hearing on the Sale Order” and contingent on Bankruptcy Court approval.<sup>356</sup> As part of the agreement, Lifestyle would assume 21 real estate leases,<sup>357</sup> and roughly fifteen other executory contracts and leases, including leases of office equipment, a note payable on a Mercedes Benz, and three truck leases.<sup>358</sup>

---

<sup>352</sup> In re The Active Wallace Group, case no. 09-15370, Results of Auction for Sale of Substantially All Assets, Dkt. No. 182, p. 11, filed 06/17/09.

<sup>353</sup> In re The Active Wallace Group, case no. 09-15370, Results of Auction for Sale of Substantially All Assets, Dkt. No. 182, p. 10, filed 06/17/09. Both parties initialed this key change in terms.

<sup>354</sup> In re The Active Wallace Group, case no. 09-15370, Results of Auction for Sale of Substantially All Assets, Dkt. No. 182, p. 2, filed 06/17/09.

<sup>355</sup> See George W. Kuney, *Selling a Business in Bankruptcy Without a Plan of Reorganization*, CAL. BUS. L. PRAC., Spring 2003 at 57 at 58-59 (discussing the law of sales free and clear under Code § 363(f)).

<sup>356</sup> In re The Active Wallace Group, case no. 09-15370, Results of Auction for Sale of Substantially All Assets, Dkt. No. 182, p. 22, filed 06/17/09.

<sup>357</sup> In re The Active Wallace Group, case no. 09-15370, Results of Auction for Sale of Substantially All Assets, Dkt. No. 182, p. 32, filed 06/17/09.

<sup>358</sup> In re The Active Wallace Group, case no. 09-15370, Results of Auction for Sale of Substantially All Assets, Dkt. No. 182, p. 33, filed 06/17/09.

Also filed with the auction results was evidence of Lifestyle's financial ability to consummate the APA.<sup>359</sup> Lifestyle's controlling shareholder and manager, Ladha, certified that he had sufficient readily-available funds to close on the sale and "adequately support the ongoing operations of the business post closing" and offered a letter of reference from his bank in support of this claim.<sup>360</sup> He also stated that he had provided Merrill and the OCC with his personal financial statement "under strict confidentiality."<sup>361</sup>

The letter of reference from Ladha's bank showed that Ladha was "a very successful hotel owner/operator with properties in Florida, Pennsylvania, and Costa Rica," and that he had "expertise in acquiring under valued [sic] and 'distressed' properties and making them profitable."<sup>362</sup> The letter also stated that the bank had extended up to \$90 million to Ladha in the past.<sup>363</sup> Ladha's personal financial statement showed a net worth of nearly \$30 million as of December 15, 2008, including \$3.8 million cash on hand.<sup>364</sup> He had annual income of \$1.1 million and also owned real estate in Florida worth \$3.5 million.<sup>365</sup>

---

<sup>359</sup> In re The Active Wallace Group, case no. 09-15370, Results of Auction for Sale of Substantially All Assets, Dkt. No. 182, p. 35, filed 06/17/09.

<sup>360</sup> In re The Active Wallace Group, case no. 09-15370, Results of Auction for Sale of Substantially All Assets, Dkt. No. 182, p. 35, filed 06/17/09.

<sup>361</sup> In re The Active Wallace Group, case no. 09-15370, Results of Auction for Sale of Substantially All Assets, Dkt. No. 182, p. 35, filed 06/17/09.

<sup>362</sup> In re The Active Wallace Group, case no. 09-15370, Results of Auction for Sale of Substantially All Assets, Dkt. No. 182, p. 36, filed 06/17/09.

<sup>363</sup> In re The Active Wallace Group, case no. 09-15370, Results of Auction for Sale of Substantially All Assets, Dkt. No. 182, p. 36, filed 06/17/09.

<sup>364</sup> In re The Active Wallace Group, case no. 09-15370, Results of Auction for Sale of Substantially All Assets, Dkt. No. 182, p. 39, filed 06/17/09.

<sup>365</sup> In re The Active Wallace Group, case no. 09-15370, Results of Auction for Sale of Substantially All Assets, Dkt. No. 182, p. 40, filed 06/17/09.



Further assurance was provided in the form of a statement by Ladha himself. According to this statement, Ladha had begun a ready-made garment business in 1970 and operated retail businesses in Florida since 1971 before selling the operations to his nephew in 1987.<sup>366</sup> He had contacts in the garment industry throughout Asia.<sup>367</sup> Esmail Mawjee, who worked alongside Ladha in these endeavors, would be “moving to California to manage the new Active company.”<sup>368</sup>

#### Active’s Creditors Are Concerned With Issa Ladha’s Credentials

After the creditors were notified of the auction results and Ladha’s financial condition, many filed objections seeking further assurance that Active would be paying them in full from the proceeds of the sale and that their new lessee, in the case of assumption and assignment, would be capable of fulfilling obligations under the existing leases.<sup>369</sup> The Code provides that the DIP may assign an unexpired lease only if adequate assurance of future performance by the assignee of such contract or lease is provided, whether or not there has been a default in such contract or lease.<sup>370</sup>

---

<sup>366</sup> In re The Active Wallace Group, case no. 09-15370, Results of Auction for Sale of Substantially All Assets, Dkt. No. 182, p. 37, filed 06/17/09.

<sup>367</sup> In re The Active Wallace Group, case no. 09-15370, Results of Auction for Sale of Substantially All Assets, Dkt. No. 182, p. 37, filed 06/17/09.

<sup>368</sup> In re The Active Wallace Group, case no. 09-15370, Results of Auction for Sale of Substantially All Assets, Dkt. No. 182, p. 38, filed 06/17/09.

<sup>369</sup> See, e.g., In re The Active Wallace Group, case no. 09-15370, Various Landlord’s Objection to Debtor’s Sales Order Motion, Dkt. No.1 94, p. 5-6, filed 6/25/09 (claiming that the information provided from Lifestyle did not satisfy “fundamental concepts of due process”).

<sup>370</sup> § 365(f)(2)(b)

The Camp Project, LLC (Camp), landlord of Active’s Costa Mesa location and creditor of the estate, was one such objector.<sup>371</sup> This shopping center featured upscale tenant mix.<sup>372</sup> While Active and Zumiez had been negotiating a sale of the assets, Camp was in



negotiations with Active to amend their lease.<sup>373</sup> Camp argued in its objection that Active had “secretly” negotiated “a hidden agenda” with Zumiez “behind the scenes,” and claimed that its offered concessions were based on the premise that Active would continue to occupy and manage the location.<sup>374</sup> Camp also argued that the “crux of [their] objection” was that Active had never accepted any amendment, and instead it had returned the offer unsigned one day after the acceptance period had expired.<sup>375</sup> Therefore, the negotiated amendment never became effective. Under the original lease, Camp’s cure claim was \$61,000, not the \$38,000 amount based on the amendment that Active used in the sales motion.<sup>376</sup>

---

<sup>371</sup> In re The Active Wallace Group, case no. 09-15370, Objection of The Camp Project, LLC, Dkt. No. 191, p. 1-2, filed 06/25/09. (stating that the Camp is a “custom-designed shopping center . . . with a specialty emphasis on outdoor, healthy, and environmentally ‘green’ oriented tenants and complimentary food services and clothing shops”).

<sup>372</sup> In re The Active Wallace Group, case no. 09-15370, Objection of The Camp Project, LLC, Dkt. No. 191, p. 1, filed 06/25/09.

<sup>373</sup> In re The Active Wallace Group, case no. 09-15370, Objection of The Camp Project, LLC, Dkt. No. 191, p. 1-2, filed 06/25/09. These concessions, according to Camp’s filing, amounted to a grant of two months free rent (July and August), forgiveness of May’s rent (\$20,000), and a 50% base rent concession for 4.5 years if Active accepted by June 4, 2009.

<sup>374</sup> In re The Active Wallace Group, case no. 09-15370, Objection of The Camp Project, LLC, Dkt. No. 191, p. 1-2, filed 06/25/09.

<sup>375</sup> In re The Active Wallace Group, case no. 09-15370, Objection of The Camp Project, LLC, Dkt. No. 191, p. 2, filed 06/25/09.

<sup>376</sup> In re The Active Wallace Group, case no. 09-15370, Debtor’s Motion for Order Approving Sale and Authorizing Assumption and Assignment, Dkt. No. 168, p. 27, filed 06/08/09.

Camp also was concerned with the proposed buyer's capitalization in light of the 20 leases it intended to assume.<sup>377</sup> Unlike the financial status of Ladha, Lifestyle's capitalization remained undisclosed. Camp requested that the court deny assumption of their lease because "Lifestyle" had not shown the financial ability to assume the lease and assure it can both service the lease/purchase merchandise on an extended basis.<sup>378</sup>

Active responded that Camp's argument concerning the validity of the lease was an "outrageously disingenuous and transparent effort to extract more from the Debtor's estate than it [was] entitled to" according to the lease.<sup>379</sup> The issue was primarily whether Camp had restricted acceptance of the lease. Active argued that the deadline was a "target" meant to speed negotiations, and that it could not be accepted by John Wallace until June 4, and that the pressures and demands of other parts of the litigation on June 4 caused the acceptance to be faxed on June 5.<sup>380</sup> Active may have known that this was a sticky issue of contract formation, and therefore ended their response by saying "[i]f however, the Court were inclined to deny the Debtor of the benefit of its bargain and not enforce the Amendment, then the Debtor hereby

---

<sup>377</sup> In re The Active Wallace Group, case no. 09-15370, Objection of The Camp Project, LLC, Dkt. No. 191, p. 2, filed 06/25/09.

<sup>378</sup> In re The Active Wallace Group, case no. 09-15370, Objection of The Camp Project, LLC, Dkt. No. 191, p. 2, filed 06/25/09.

<sup>379</sup> In re The Active Wallace Group, case no. 09-15370, Omnibus Reply to Oppositions to the Debtor's Motion, Dkt. No. 201, p. 6, filed 06/26/09.

<sup>380</sup> In re The Active Wallace Group, case no. 09-15370, Omnibus Reply to Oppositions to the Debtor's Motion, Dkt. No. 201, p. 6-7, filed 06/26/09.

rejects its interest in the lease with Camp.”<sup>381</sup> Camp eventually withdrew its objection on June 29 after reaching an agreement with Lifestyle.<sup>382</sup>

Winthrop, as a lessor of computers and other equipment, filed an objection to both Active’s proposed cure amount within the sale order and to the lack of adequate assurance provided by the Debtor.<sup>383</sup> Winthrop admitted that Active had provided adequate assurance in the form of Ladha’s personal statement and bank reference letter.<sup>384</sup> Winthrop argued, however, that Lifestyle, not Ladha, was the purchaser, and that without a guarantee from him, records of his personal financial condition were largely irrelevant.<sup>385</sup> Moreover, Lifestyle was incorporated by Ladha less than a week prior to the auction, so no financial information was available to assess the financial stability of the new entity.<sup>386</sup> Winthrop argued that, “[a]t a minimum, the [p]urchaser should provide Winthrop with an opening balance sheet, information on the initial capitalization, available letters of credit, and any other financial documentation specific to Lifestyle and any guarantors.”<sup>387</sup>

---

<sup>381</sup> In re The Active Wallace Group, case no. 09-15370, Omnibus Reply to Oppositions to the Debtor’s Motion, Dkt. No. 201, p. 7, filed 06/26/09.

<sup>382</sup> In re The Active Wallace Group, case no. 09-15370, The Camp Project’s Withdrawal of Its Objection, Dkt. No. 202, p. 2, filed 06/26/09.

<sup>383</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Winthrop Resources Corp. to the Debtor’s Motion, Dkt. No. 189, p. 2, filed 6/25/09.

<sup>384</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Winthrop Resources Corp. to the Debtor’s Motion, Dkt. No. 189, p. 4-5, filed 6/25/09.

<sup>385</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Winthrop Resources Corp. to the Debtor’s Motion, Dkt. No. 189, p. 5, filed 6/25/09.

<sup>386</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Winthrop Resources Corp. to the Debtor’s Motion, Dkt. No. 189, p. 5, filed 6/25/09.

<sup>387</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Winthrop Resources Corp. to the Debtor’s Motion, Dkt. No. 189, p. 6, filed 6/25/09.

Winthrop supported their argument that a guarantee was necessary with case law holding that (1) the “lack of financial guarantee by [a] responsible officer provides a basis to withhold consent of assignment because no adequate assurance of future performance has been provided”<sup>388</sup> and (2) that “[c]ourts often determine whether adequate assurance of future performance has been offered by considering ‘whether the debtors financial data indicated its ability to generate an income stream sufficient to meet its obligations, the general economic outlook in the debtor’s industry, and the presence of a guarantee.’”<sup>389</sup>

Winthrop also sought an amendment to the cure amount to compensate for late fees of roughly \$9,000 and attorney fees of roughly \$17,000, due under certain lease provisions, in addition to unpaid rents on their equipment of \$38,000.<sup>390</sup> Furthermore, it specified that these cure amounts be paid by the debtor upon or prior to closing on the sale.<sup>391</sup> In support of their recovery of the late fees and attorney fees, Winthrop referred to the Code’s mandate that prior to assignment of the leases, the debtor is required to cure all outstanding defaults under the lease.<sup>392</sup>

Several other landlords filed objections based on Active’s inaccurate statement of proposed cure amounts under the shopping mall leases.<sup>393</sup> They argued that “[t]he determination

---

<sup>388</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Winthrop Resources Corp. to the Debtor’s Motion, Dkt. No. 189, p. 6, filed 6/25/09 (citing *Magoon Estate, Ltd. v. Grudoski (In re Grudoski)*, 33 B.R. 154, 156 (Bankr. D. Haw. 1983)).

<sup>389</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Winthrop Resources Corp. to the Debtor’s Motion, Dkt. No. 189, p. 6, filed 6/25/09 (citing *Richmond Leasing Co. v. Capital Bank, N.A.*, 762 F. 2d. 1303, 1310 (5th Cir. 1985)).

<sup>390</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Winthrop Resources Corp. to the Debtor’s Motion, Dkt. No. 189, p. 6-7, filed 6/25/09.

<sup>391</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Winthrop Resources Corp. to the Debtor’s Motion, Dkt. No. 189, p. 6-7, filed 6/25/09.

<sup>392</sup> In re The Active Wallace Group, case no. 09-15370, Limited Objection of Winthrop Resources Corp. to the Debtor’s Motion, Dkt. No. 189, p. 6, filed 6/25/09 (citing § 365(b)(2)).

<sup>393</sup> See, e.g., In re The Active Wallace Group, case no. 09-15370, Objection by Premier Centers to Debtor’s Motion, Dkt. No. 192, p. 2, filed 6/25/09 (claiming \$15,000 in unrecognized late fees).

owed by Active under § 365(b) must take several issues into consideration, including year-end adjustments and reconciliations, attorney’s fees, costs, and interest.<sup>394</sup> The leases contained “provisions for the recovery of attorney fees, costs, and interest in the event the Landlords are required to take legal action to protect their interests.”<sup>395</sup> The landlords sought to protect the “full benefit of the bargain” contained in the original prepetition leases.<sup>396</sup>

Active argued that the right to attorney fees incurred as a result of the bankruptcy fees provided by contract was limited by the California Civil Code to

fees incurred in an action on a contract.<sup>397</sup> California case law held that bankruptcy litigation, such as a relief from the automatic stay, was not an action on a contract, but an action based on

**Active Sports & Lifestyle USA, LLC  
Proforma Balance Sheet**

<i>\$\$ (in Millions)</i>	Amount
Cash & AR	\$ 2.3
Deposits	0.3
Inventory - net	4.2
<b>Total Current Assets</b>	<b>6.8</b>
Equipment - stores	0.3
Leasehold Improvements	0.4
Furniture & Fixtures	0.1
Store Improvements	0.1
<b>Total Assets</b>	<b>\$ 7.6</b>
Merrill Lynch Debt (current portion)	1.0
Merrill Lynch Debt	3.3
LT Debt	0.4
Capital Leases	0.5
Deferred Revenue	0.4
Balance of Purchase Price	1.0
Shareholder's Equity	1.0
<b>Total Liabilities &amp; Shareholder's Equity</b>	<b>\$ 7.6</b>

<sup>394</sup> In re The Active Wallace Group, case no. 09-15370, Objection of Various Landlord Creditors to Debtor’s Proposed Cure Payments, Dkt. No. 193, p. 3, filed 6/25/09.

<sup>395</sup> In re The Active Wallace Group, case no. 09-15370, Objection of Various Landlord Creditors to Debtor’s Proposed Cure Payments, Dkt. No. 193, p. 4, filed 6/25/09.

<sup>396</sup> In re The Active Wallace Group, case no. 09-15370, Objection of Various Landlord Creditors to Debtor’s Proposed Cure Payments, Dkt. No. 193, p. 4, filed 6/25/09. (stating “[t]he Debtor cannot on the one hand assume the favorable portions of the Leases and on the other hand reject the unfavorable aspects of the same Leases. *In re Washington Capital Aviation & Leasing*, 156 B.R. 167, 172 (Bankr. E.D. Va. 1993). If forced to continue the performance of the Leases, the Landlords are entitled to the full benefit of its bargain under the Leases. See *Matter of Superior Toy and Mfg. Co., Inc.*, 78 F.3d 1169 (7th Cir. 1996)”).

<sup>397</sup> In re The Active Wallace Group, case no. 09-15370, Omnibus Reply to Oppositions to the Debtor’s Motion, Dkt. No. 201, p. 2, filed 06/26/09. See Cal. Civ. Code §1717(a).

statute.<sup>398</sup> Furthermore, Active cited to several cases where bankruptcy courts had denied attorney fees related to a creditor's monitoring of the bankruptcy case.<sup>399</sup>

The landlords also objected to the lack of adequate assurance provided up to that point. In determining whether there has been adequate assurance of future performance under § 365(b), courts have looked to sufficient economic backing, economic conditions, certificates, credit reports, escrow deposits or other similar forms of security or guarantee.<sup>400</sup> Courts also look to the operating experience of the proposed assignee.<sup>401</sup> No such evidence about Active Sports had been produced here and no competent admissible evidence had been produced by Active to demonstrate its own financial condition when the leases were executed. As such, there was no "benchmark" against which Active Sports' financial condition could be measured.<sup>402</sup>

Active's Irvine, California landlord similarly objected that Active and Lifestyle had not provided adequate assurance.<sup>403</sup> Its reasoning, similar to that of Camp and other landlords was that Lifestyle was a Florida LLC with no financial history and, although Mr. Lahda was the sole shareholder, he had signed no formal guaranty in favor of the company.<sup>404</sup> Even if he had

---

<sup>398</sup> *In re The Active Wallace Group*, case no. 09-15370, Omnibus Reply to Oppositions to the Debtor's Motion, Dkt. No. 201, p. 3, filed 06/26/09.

<sup>399</sup> *In re The Active Wallace Group*, case no. 09-15370, Omnibus Reply to Oppositions to the Debtor's Motion, Dkt. No. 201, p. 4, filed 06/26/09.

<sup>400</sup> *In re Belize Airways*, 5 B.R. 152 (Bankr. S.D. Fla. 1980); *In re Lafayette Radio Electronics Corp.*, 9 B.R. 993 (Bankr. E.D.N.Y. 1981).

<sup>401</sup> *In re Bygaph, Inc.*, 56 B.R. 596 (Bankr. S.D.N.Y. 1986).

<sup>402</sup> *In re The Active Wallace Group*, case no. 09-15370, Various Landlord's Objection to Debtor's Sales Order Motion, Dkt. No.1 94, p. 4, filed 6/25/09.

<sup>403</sup> *In re The Active Wallace Group*, case no. 09-15370, Irvine's Objection to Debtor's Sales Order Motion, Dkt. No. 200, p. 2, filed 6/25/09.

<sup>404</sup> *In re The Active Wallace Group*, case no. 09-15370, Irvine's Objection to Debtor's Sales Order Motion, Dkt. No. 200, p. 2-3, filed 6/25/09.

provided such a guaranty, the credit would be shaky because Mr. Ladha's assets included off-shore accounts, unidentified stock holdings, and a life insurance policy with a cash value much lower than its face value.<sup>405</sup>

Active addressed the adequate assurance issue by responding that Lifestyle would be operating the same Active stores with the same management team that had "successfully led [Active] in its operations over the last 20 years."<sup>406</sup> Active had reduced its overhead since the financial difficulties, and with the \$1.6 million cash infusion and \$4.2 million of existing inventory, it believed that "the financial condition of the new company going forward" would be strong. It also referenced two exhibits that showed adequate assurance. The first was a June 25 letter from US Bank that stated Ladha kept both deposit and loan accounts with the bank and that those relationships had "been handled in an exemplary manner."<sup>407</sup> The letter stated that Ladha had opened a deposit account in the name of Lifestyle, with a \$2.25 million balance.<sup>408</sup> The second assurance was a letter from the desk of Issa Ladha and an attached projected balance sheet (See Above) that showed shareholder's equity of \$2 million and current assets of \$6.8

---

<sup>405</sup> In re The Active Wallace Group, case no. 09-15370, Irvine's Objection to Debtor's Sales Order Motion, Dkt. No. 200, p. 3, filed 6/25/09.

<sup>406</sup> In re The Active Wallace Group, case no. 09-15370, Omnibus Reply to Oppositions to the Debtor's Motion, Dkt. No. 201, p. 5, filed 06/26/09.

<sup>407</sup> In re The Active Wallace Group, case no. 09-15370, Omnibus Reply to Oppositions to the Debtor's Motion, Dkt. No. 201, p. 12, filed 06/26/09.

<sup>408</sup> In re The Active Wallace Group, case no. 09-15370, Omnibus Reply to Oppositions to the Debtor's Motion, Dkt. No. 201, p. 12, filed 06/26/09.



million.<sup>409</sup> His letter requested that the creditors “withdraw [their] objection immediately and support the transaction today.”<sup>410</sup>

The landlords also argued that “the use clauses in all of the Leases are properly characterized as restrictive use provisions. That is, the use provisions limit the type of business the Debtor may conduct at the Centers, as opposed to an exclusive use provision, which would guarantee to the Debtor the exclusive right to sell certain products at the Centers.”<sup>411</sup> The use provisions are important because Active Sports as the proposed assignee is legally bound to take the Leases subject to their existing use provisions.<sup>412</sup> Their argument proceeded that “[w]hile it appears that Active Sports does not contemplate a change in use, that has yet to be definitively confirmed, and the Landlords object to any change in the use clauses of the Leases.”<sup>413</sup> Active did not respond to this use-clause objection.

Concerned in part that the sale would limit its rights to pursue actions against Merrill, the OCC also filed an objection to the sales order motion.<sup>414</sup> The OCC referred to the challenge period provided for in the Amended Interim Order of May 15 that allowed a period to “contest the extent, validity, perfection, priority and enforceability of [Merrill’s] prepetition lien and

---

<sup>409</sup> In re The Active Wallace Group, case no. 09-15370, Omnibus Reply to Oppositions to the Debtor’s Motion, Dkt. No. 201, p. 13, filed 06/26/09.

<sup>410</sup> In re The Active Wallace Group, case no. 09-15370, Omnibus Reply to Oppositions to the Debtor’s Motion, Dkt. No. 201, p. 13, filed 06/26/09.

<sup>411</sup> In re The Active Wallace Group, case no. 09-15370, Various Landlord’s Objection to Debtor’s Sales Order Motion, Dkt. No.1 94, p. 5, filed 6/25/09.

<sup>412</sup> See § 365(b)(3)(C).

<sup>413</sup> In re The Active Wallace Group, case no. 09-15370, Various Landlord’s Objection to Debtor’s Sales Order Motion, Dkt. No.1 94, p. 5, filed 6/25/09.

<sup>414</sup> In re The Active Wallace Group, case no. 09-15370, Creditor Committee’s Limited Opposition to Debtor’s Sales Order Motion, Dkt. No. 195, p. 1, filed 6/25/09.

claims.”<sup>415</sup> The OCC also opposed the assumption and assignment of leases under which landlords objected to the proposed cure amounts, seeking penalties or interest.<sup>416</sup>

A losing bidder, Nine Star, also filed an objection to the sales order motion.<sup>417</sup> Nine Star objected to the proposed order on the grounds that the auction order provided only for cash-only offers and that the APA left the door open for competing offers until the court acted on the sale motion.<sup>418</sup> Nine Star was still pursuing its own purchase strategy and submitted an offer which it felt was better than Lifestyle’s.<sup>419</sup> It argued that Lifestyle’s proposed assumption of debt was not in keeping with the cash-only requirement of the auction, and that if it had known, it would have presented a similar bid at the auction.<sup>420</sup>

In response to Nine Star’s objection as a losing competing bidder, Active claimed they had no standing to object because it was neither a creditor nor a party-in-interest.<sup>421</sup> Unlike Nine Star, Lifestyle had obtained Merrill’s consent to assume Active’s liabilities under the DIP loan. This consent fulfilled the bidding requirement that any offered bid have no financing contingencies.<sup>422</sup> Nine Star’s offer proposed the assumption of the DIP loan liability, but lacked

---

<sup>415</sup> In re The Active Wallace Group, case no. 09-15370, Creditor Committee’s Limited Opposition to Debtor’s Sales Order Motion, Dkt. No. 195, p. 2, filed 6/25/09.

<sup>416</sup> In re The Active Wallace Group, case no. 09-15370, Creditor Committee’s Limited Opposition to Debtor’s Sales Order Motion, Dkt. No. 195, p. 2, filed 6/25/09.

<sup>417</sup> In re The Active Wallace Group, case no. 09-15370, Comments of Nine Star, Dkt. No. 199, p. 1, filed 6/25/09.

<sup>418</sup> In re The Active Wallace Group, case no. 09-15370, Comments of Nine Star, Dkt. No. 199, p. 2-3, filed 6/25/09.

<sup>419</sup> In re The Active Wallace Group, case no. 09-15370, Comments of Nine Star, Dkt. No. 199, p. 3, filed 6/25/09.

<sup>420</sup> In re The Active Wallace Group, case no. 09-15370, Comments of Nine Star, Dkt. No. 199, p. 3, filed 6/25/09.

<sup>421</sup> In re The Active Wallace Group, case no. 09-15370, Omnibus Reply to Oppositions to the Debtor’s Motion, Dkt. No. 201, p. 5, filed 06/26/09.

<sup>422</sup> In re The Active Wallace Group, case no. 09-15370, Omnibus Reply to Oppositions to the Debtor’s Motion, Dkt. No. 201, p. 5, filed 06/26/09. A hearing is required before the debtor may sell property of the estate other than in the ordinary course of business. Code § 363(b)(1).

any evidence of Merrill's consent to such assumption.<sup>423</sup> Active further argued that even if Nine Star could prove standing and absence of a financial contingency, it had failed to show that its bid was higher or better than Lifestyle's bid.<sup>424</sup> Unlike Lifestyle's lump sum offer, Nine Star proposed payments over time, which would not meet Active's need for immediate cash to update inventories.<sup>425</sup>

#### Consummation of the Sale to Lifestyle

On the morning of June 30, 2009, the Bankruptcy Court held the hearing on Active's sale motion.<sup>426</sup> At this hearing, Active's counsel "sought authority to consummate" the asset sale and contract assumption and assignment to Lifestyle pursuant the APA.<sup>427</sup> Next, Meleen and Company and Nine Star each separately "propounded oral, but not written, proposals" to purchase some or all of the assets and assume some or all of the leases.<sup>428</sup> Over the objection of Lifestyle, the court allowed each competitor to present its proposal to Active, the OCC, and other parties in interest.<sup>429</sup>

---

<sup>423</sup> In re The Active Wallace Group, case no. 09-15370, Omnibus Reply to Oppositions to the Debtor's Motion, Dkt. No. 201, p. 6, filed 06/26/09.

<sup>424</sup> In re The Active Wallace Group, case no. 09-15370, Omnibus Reply to Oppositions to the Debtor's Motion, Dkt. No. 201, p. 6, filed 06/26/09.

<sup>425</sup> In re The Active Wallace Group, case no. 09-15370, Omnibus Reply to Oppositions to the Debtor's Motion, Dkt. No. 201, p. 6, filed 06/26/09.

<sup>426</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor's Motion to Approve Sale, Dkt. No. 211, p. 2, filed 7/02/09.

<sup>427</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor's Motion to Approve Sale, Dkt. No. 211, p. 2, filed 7/02/09.

<sup>428</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor's Motion to Approve Sale, Dkt. No. 211, p. 2, filed 7/02/09.

<sup>429</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor's Motion to Approve Sale, Dkt. No. 211, p. 3, filed 7/02/09.

Another issue resolved at the hearing was the amount of cash Lifestyle would pay should the amount of liability assumed under Merrill's DIP loan differ from the \$4.2 million projection.<sup>430</sup> Lifestyle agreed at the hearing that to the extent that the amount owing to Merrill was less than \$4.2 million, the cash payment to Active at closing would be increased accordingly.<sup>431</sup>

### The Court Approves the Sale

On July 2, 2009, the Court issued its order granting Active's motion and approving the sale and assumption and assignment to Lifestyle,<sup>432</sup> clearing the way for the deal to close.<sup>433</sup> The order first listed all the evidence the court had reviewed in reaching its findings and directives. This evidence broadly included all of "the record and pleadings in [the] chapter 11 case," including all of the filed documents, the oral proposals at the hearing, and the "representations, arguments, and stipulations of counsel."<sup>434</sup>

Based on this evidence, the court reached an important set of findings.<sup>435</sup> It first found that it was procedurally proper for the court to rule on the motion.<sup>436</sup> After stating that Active

---

<sup>430</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor's Motion to Approve Sale, Dkt. No. 211, p. 5, filed 7/02/09.

<sup>431</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor's Motion to Approve Sale, Dkt. No. 211, p. 5, filed 7/02/09.

<sup>432</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor's Motion to Approve Sale, Dkt. No. 211, p. 1, filed 7/02/09.

<sup>433</sup> Section 363(b) (requiring notice and a hearing before the debtor may sell other than in the ordinary course).

<sup>434</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor's Motion to Approve Sale, Dkt. No. 211, p. 3, filed 7/02/09.

<sup>435</sup> Bankruptcy courts typically enter lengthy findings of fact and conclusions of law supporting § 363 sale orders that "contain detailed provisions insulating the seller, the purchaser, their insiders and professionals from liability." JONATHAN P. FRIEDLAND, MICHAEL L. BERNSTEIN, PROF. GEORGE W. KUNEY & PROF. JOHN D. AYER, CHAPTER 11 – "101" THE NUTS AND BOLTS OF CHAPTER 11 PRACTICE 223 (2007). These findings are often drafted by the DIP's and purchaser's counsel. *Id.*

had followed proper procedure in conducting the auction, the court determined that Lifestyle “provided the highest, best and most certain offer for the assets and [was] the successful bidder.”<sup>437</sup> The Court also found, in the spirit of *Lionel*, that (1) Active had “exercised sound and proper business judgment in determining to sell,”<sup>438</sup> (2) no other consents or approvals other than those contained in the sales order motion were required to close the deal,<sup>439</sup> (3) Active had good and marketable title to all the assets being sold and that the transfer would be legal, valid, and effective,<sup>440</sup> (4) Merrill and other holders of liens and encumbrances had consented to the sale,<sup>441</sup> (5) all of the actions by Active and Lifestyle were conducted at arm’s length and in good faith, so that Lifestyle met the good faith purchaser requirements of 363(m),<sup>442</sup> (6) Active had provided sufficient evidence of its ability to cure its §365(b)(1) defaults under the assumed contracts,<sup>443</sup> (7) Lifestyle had provided sufficient evidence of its “ability and willingness to

---

<sup>436</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor’s Motion to Approve Sale, Dkt. No. 211, p. 3-4, filed 7/02/09.

<sup>437</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor’s Motion to Approve Sale, Dkt. No. 211, p. 4-5, filed 7/02/09.

<sup>438</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor’s Motion to Approve Sale, Dkt. No. 211, p. 5, filed 7/02/09.

<sup>439</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor’s Motion to Approve Sale, Dkt. No. 211, p. 5, filed 7/02/09.

<sup>440</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor’s Motion to Approve Sale, Dkt. No. 211, p. 5, filed 7/02/09.

<sup>441</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor’s Motion to Approve Sale, Dkt. No. 211, p. 6, filed 7/02/09.

<sup>442</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor’s Motion to Approve Sale, Dkt. No. 211, p. 6, filed 7/02/09. A court finding that a sale is to a good faith purchaser within the meaning of § 363(m) essentially cuts off the right to appeal the sale once the closing has taken place, providing speed and finality to the process. Corinne Ball, John K. Kane & Jones Day, *Section 363 Sales: Bidding Procedures and Sale Orders*, 1396 PLI/Corp 891, 910 (2003).

<sup>443</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor’s Motion to Approve Sale, Dkt. No. 211, p. 7, filed 7/02/09.

provide adequate assurance of future performance.” regarding the assumed contracts,<sup>444</sup> but notwithstanding this finding, a dispute remained regarding whether the Riverside landlord had received adequate assurance.<sup>445</sup>

After making these findings and granting Active’s motion to approve the sale to Lifestyle, the court jumped to action.<sup>446</sup> Aside from the continued disputes over cure amounts and the dispute with the Riverside landlord regarding adequate assurance, the court overruled all landlord objections that had not been resolved.<sup>447</sup> The court rejected both competing proposals presented at the hearing.<sup>448</sup> The assets would pass to Lifestyle encumbered only by Merrill’s blanket lien; any other liens and encumbrances would attach to the net sale proceeds according to their priority.<sup>449</sup> The court authorized Active to assume and assign the unexpired leases and executory contracts.<sup>450</sup> All undisputed amounts needed to cure the contractual defaults would be paid out of the proceeds within three business days after closing.<sup>451</sup> The disputed cure amounts

---

<sup>444</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor’s Motion to Approve Sale, Dkt. No. 211, p. 7, filed 7/02/09.

<sup>445</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor’s Motion to Approve Sale, Dkt. No. 211, p. 8, filed 7/02/09.

<sup>446</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor’s Motion to Approve Sale, Dkt. No. 211, p. 8, filed 7/02/09.

<sup>447</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor’s Motion to Approve Sale, Dkt. No. 211, p. 8, filed 7/02/09.

<sup>448</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor’s Motion to Approve Sale, Dkt. No. 211, p. 8, filed 7/02/09.

<sup>449</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor’s Motion to Approve Sale, Dkt. No. 211, p. 8-9, filed 7/02/09.

<sup>450</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor’s Motion to Approve Sale, Dkt. No. 211, p. 9, filed 7/02/09.

<sup>451</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor’s Motion to Approve Sale, Dkt. No. 211, p. 9, filed 7/02/09.

would be resolved after another round of pleadings and a hearing on August 12.<sup>452</sup> Any landlord indemnification claims against Active and the bankruptcy estate would be limited to “the proceeds of [Active’s] insurance coverage.”<sup>453</sup>

The court waived the ten-day stay of the order provided for in Rules 6004(h) and 6006(d), meaning the sale could close immediately.<sup>454</sup> After the sale, the court would retain jurisdiction to “(i) enforce and implement the terms and provisions of the APA, (ii) resolve any disputes arising under or relating to the APA, (iii) resolve any disputes relating to the [c]ure [a]mounts and adequate assurance of future performance regarding the lease of the Riverside Store; and (iv) interpret, implement and enforce the provisions of this Order.”<sup>455</sup> Any subsequent order in the case, whether pursuant to a plan of reorganization or to liquidation, would be deemed not to conflict with the court’s sale order, the terms of the sale order would survive.<sup>456</sup>

The court made slight changes or clarifications to the APA as well. For example, although section 1.3(a) of the APA read that Lifestyle would assume obligations under the assigned contracts only “*to the extent relating to or arising from the period commencing after the closing date,*”<sup>457</sup> the court ordered that Lifestyle would also be responsible for all accrued and

---

<sup>452</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor’s Motion to Approve Sale, Dkt. No. 211, p. 10, filed 7/02/09.

<sup>453</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor’s Motion to Approve Sale, Dkt. No. 211, p. 10, filed 7/02/09.

<sup>454</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor’s Motion to Approve Sale, Dkt. No. 211, p. 10, filed 7/02/09.

<sup>455</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor’s Motion to Approve Sale, Dkt. No. 211, p. 11, filed 7/02/09.

<sup>456</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor’s Motion to Approve Sale, Dkt. No. 211, p. 12, filed 7/02/09.

<sup>457</sup> In re The Active Wallace Group, case no. 09-15370, Results of Auction for Sale of Substantially All Assets, Dkt. No. 182, p. 10, filed 6/17/09 (emphasis added).

unbilled obligations such as common area and tax expenses, even though a portion of the liability may have accrued before closing.<sup>458</sup>

Throughout negotiations, Lifestyle and Active did not intend that Lifestyle would assume all of Active's unexpired leases or executory contracts.<sup>459</sup> Before Active could make an informed decision whether to assume or reject any of these executory contracts, it probably wanted to see which of the contracts Lifestyle was interested in assuming. Under the Code, the debtor may assume or reject executory contracts with court approval,<sup>460</sup> but in the case of an unexpired lease of non-residential real property (all of Active's store leases), if the debtor has not made the decision within 120 days after the order for relief and has not applied for an extension, the lease is deemed rejected.<sup>461</sup> In Active's case, these decisions had to be made by July 20, and as a safety measure, Active filed for a 90 day extension on June 19.<sup>462</sup> The motion was filed "in order to preserve options and avoid the rejection of [the leases]" because Active did not know "with absolute certainty whether the sale transaction [would] close or when it [would] close."<sup>463</sup>

---

<sup>458</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor's Motion to Approve Sale, Dkt. No. 211, p. 10, filed 7/02/09.

<sup>459</sup> See In re The Active Wallace Group, case no. 09-15370, Asset Purchase Agreement, Dkt. No. 208, p. 9, filed 7/02/09 (showing separate provisions for Assumption of Liabilities and Excluded Liabilities).

<sup>460</sup> Section 365(a).

<sup>461</sup> Section 365(d)(4)(A).

<sup>462</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Extension of Time to Assume or Reject Unexpired Leases of Nonresidential Real Property, Dkt. No. 183, p. 2, filed 06/19/09.

<sup>463</sup> In re The Active Wallace Group, case no. 09-15370, Debtor's Motion for Extension of Time to Assume or Reject Unexpired Leases of Nonresidential Real Property, Dkt. No. 183, p. 3, filed 06/19/09. The application for extension must be "for cause." Code § 365(d)(4). The motion argued that relevant factors included, *inter alia*, whether the lease is a primary asset of the debtor, whether the debtor has had time to intelligently appraise its financial situation and potential value of its assets in terms of the formulation of a plan, whether the lessor continues to receive rental payments, and whether the case is exceptionally complex and involves a large number of leases. *Id.* at p. 4-5 (citing *In Re Wedtech Corp.*, 72 B.R. 464, 471-472 (Bankr. S.D.N.Y. 1987)).



On July 1, 2009, Active's counsel delivered nine rejection notices to various contractual counterparties, including five employees.<sup>464</sup> The procedure for communicating contract rejection was established by court order on May 15.<sup>465</sup> The notice provided that the contracts would be rejected effective "not earlier than five (5) business days after July 1,"<sup>466</sup> which would have been July 8. If one of the counterparties objected to the lease rejection, they would have been allowed to serve an objection upon Active's counsel within five days after the rejection date.<sup>467</sup> If this were to happen, the court would set a hearing date, Active's motion would be due no later than ten days prior to that scheduled hearing, the objecting counterparty's response would be due no later than five days before that hearing, and Active could reply to the response no later than two days before the hearing.<sup>468</sup> If after the hearing, the court ultimately granted the rejection motion under § 365(a), the rejection would be effective as of the July 8 rejection date.<sup>469</sup>

---

<sup>464</sup> In re The Active Wallace Group, case no. 09-15370, Notice of Rejection of Debtor's Interests in Certain Executory Contracts Pursuant to Court Approved Rejection Procedures, Dkt. No. 206, p. 2, filed 07/02/09. These nine executory contracts correspond to leases listed in Notice of Purchaser's Election to Decline Assumption of Certain Unexpired Leases and Executory Contracts, Dkt. No. 205, p. 1-2, filed 06/29/09. This notice was filed with the court on July 2. Notice of Rejection of Debtor's Interests in Certain Executory Contracts Pursuant to Court Approved Rejection Procedures, Dkt. No. 206, p. 1, filed 07/02/09.

<sup>465</sup> In re The Active Wallace Group, case no. 09-15370, Order Authorizing: (1) Rejection of Certain Executory Contracts, and (2) Lease Rejection Procedures, Dkt. No. 127, p. 3-5, filed 5/15/09.

<sup>466</sup> In re The Active Wallace Group, case no. 09-15370, Notice of Rejection of Debtor's Interests in Certain Executory Contracts Pursuant to Court Approved Rejection Procedures, Dkt. No. 206, p. 2, filed 07/02/09.

<sup>467</sup> In re The Active Wallace Group, case no. 09-15370, Notice of Rejection of Debtor's Interests in Certain Executory Contracts Pursuant to Court Approved Rejection Procedures, Dkt. No. 206, p. 2, filed 07/02/09.

<sup>468</sup> In re The Active Wallace Group, case no. 09-15370, Notice of Rejection of Debtor's Interests in Certain Executory Contracts Pursuant to Court Approved Rejection Procedures, Dkt. No. 206, p. 2-3, filed 07/02/09.

<sup>469</sup> In re The Active Wallace Group, case no. 09-15370, Notice of Rejection of Debtor's Interests in Certain Executory Contracts Pursuant to Court Approved Rejection Procedures, Dkt. No. 206, p. 2, filed 07/02/09.

The order approving the sale required that the closing could not take place “until the closing of the transactions contemplated in the Merrill Documents.”<sup>470</sup> While these documents were not a part of the record available for review,<sup>471</sup> it can be assumed that these documents contemplated the terms of the assumption by Lifestyle of the roughly \$4.2 million liability in favor of Merrill secured by the transferred assets. The APA was also conditioned on the validity of the buyer’s representations, one of which involved the executed term sheet.<sup>472</sup>

Active and Lifestyle closed the sale on July 3, 2009, one day after court approval.<sup>473</sup> Even after the sale, the estate was still faced with several lingering issues. A month after the sale, Active filed a status report with the court as was mandated by the sales order.<sup>474</sup> According to this report, the only outstanding adjudicatory issues after the sale were “related to the assumption and assignment of certain unexpired real property leases,”<sup>475</sup> and a fee dispute between Active, Phoenix, and PCG. Regarding the dispute over professional fees, the status report said all parties had been working diligently in efforts to resolve the matter, and all hoped that there would be no need



---

<sup>470</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor’s Motion to Approve Sale, Dkt. No. 211, p. 9, filed 7/02/09.

<sup>471</sup> The APA references a “Term Sheet already agreed to in writing by and between [Lifestyle USA and Merill].” In re The Active Wallace Group, case no. 09-15370, Asset Purchase Agreement, Dkt. No. 208, p. 9, filed 7/02/09.

<sup>472</sup> In re The Active Wallace Group, case no. 09-15370, Asset Purchase Agreement, Dkt. No. 208, p. 19, filed 7/02/09.

<sup>473</sup> In re The Active Wallace Group, case no. 09-15370, Declaration of Issa Ladha in Support of Adequate Assurance of Future Performance, Dkt. No. 213, p. 2, filed 7/06/09.

<sup>474</sup> In re The Active Wallace Group, case no. 09-15370, Post-Sale Status Report, Dkt. No. 252, p. 1, filed 07/31/09. The order stated that the status report should be filed by 7/29/09, but Active was not reprimanded in the record for missing this deadline. In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor’s Motion to Approve Sale, Dkt. No. 211, p. 12, filed 7/02/09.

<sup>475</sup> In re The Active Wallace Group, case no. 09-15370, Post-Sale Status Report, Dkt. No. 252, p. 2, filed 07/31/09.

for Court intervention.<sup>476</sup>

The landlord of Active's Riverside, CA, store had objected prior to the sale that Lifestyle had not provided adequate assurance of future performance.<sup>477</sup> While many of the shopping center lessors had reached private, negotiated agreements with Lifestyle whereby they accepted the assumption and assignment of the Active leases,<sup>478</sup> Riverside continued its objections to both the assumption and assignment and the proposed cure amounts after the sale.<sup>479</sup> Because of this ongoing disagreement, Lifestyle was authorized by the court order "at its sole cost and expense . . . to take possession of and manage the Riverside Store . . . [u]ntil further order of [the] Court."<sup>480</sup>

As a result of the objections, Ladha provided further assurance in the form of a two-year projection that demonstrated and expected timely payment of rent at the Riverside location and at Lifestyle's other stores.<sup>481</sup> Ladha also produced a post-closing balance sheet that reflected proper capitalization and a \$1.1 million cash balance.<sup>482</sup> Finally, Ladha also agreed "to

---

<sup>476</sup> In re The Active Wallace Group, case no. 09-15370, Post-Sale Status Report, Dkt. No. 252, p. 3, filed 07/31/09.

<sup>477</sup> In re The Active Wallace Group, case no. 09-15370, Various Landlord's Objection to Debtor's Sales Order Motion, Dkt. No. 194, p. 4, filed 6/25/09. The landlord was Westminster Central, LLC, but is referred to throughout as 'landlord' and 'Riverside.'

<sup>478</sup> See, e.g. In re The Active Wallace Group, case no. 09-15370, The Camp Project, LLC's Withdrawal of its Objection, Dkt. No. 202, p. 2, filed 6/29/09.

<sup>479</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor's Motion to Approve Sale, Dkt. No. 211, p. 10-11, filed 7/02/09.

<sup>480</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor's Motion to Approve Sale, Dkt. No. 211, p. 11, filed 7/02/09.

<sup>481</sup> In re The Active Wallace Group, case no. 09-15370, Declaration of Issa Ladha in Support of Adequate Assurance of Future Performance, Dkt. No. 213, p. 2, filed 7/06/09.

<sup>482</sup> In re The Active Wallace Group, case no. 09-15370, Declaration of Issa Ladha in Support of Adequate Assurance of Future Performance, Dkt. No. 213, p. 2, filed 7/06/09.

personally guarantee the post-closing obligations for the first six months under the Riverside Lease.”<sup>483</sup>

Ladha’s further assurances on behalf of Lifestyle were not adequate by Riverside’s standards. Riverside’s response noted that the documents Ladha had filed amounted to “only four documents” and Ladha’s personal guarantee was “limited.”<sup>484</sup> Ultimately, Lifestyle bore the burden of persuasion on the matter.<sup>485</sup> Despite production of these documents, Riverside contended that Lifestyle had not provided any “competent admissible evidence of adequate assurance.”<sup>486</sup> The documents were not admissible as evidence because “it appear[ed] that Mr. Ladha lack[ed] the requisite personal knowledge to establish [a] proper foundation” for their admission.<sup>487</sup>

---

<sup>483</sup> In re The Active Wallace Group, case no. 09-15370, Declaration of Issa Ladha in Support of Adequate Assurance of Future Performance, Dkt. No. 213, p. 3, filed 7/06/09. Ladha filed these financial documents with the clerk and included a separate *ex parte* motion that they be filed under seal. In re The Active Wallace Group, case no. 09-15370, *Ex Parte* Application to File Under Seal Exhibits to Declaration of Issa Ladha, Dkt. No. 219, p. 1, filed 7/07/09. LBR 5005-1(c)(3) states that:

“Requests to file documents under seal pursuant to 11 U.S.C. §107 (b) and (c) and FRBP 9018 shall be filed as paper documents. A paper copy of the order sealing documents shall be attached to the documents under seal and be delivered to the Clerk's Office. The Clerk shall maintain sealed documents in paper form.”

Rule 9018 states that a bankruptcy court may make any order which justice requires to protect the purchaser in respect of confidential commercial information. See also § 107(b).

<sup>484</sup> In re The Active Wallace Group, case no. 09-15370, Response of the Westminster Funds to Adequate Assurance of Future Performance Offered by Lifestyle, Dkt. No. 221, p. 2, filed 7/10/09 (bold and underline in original).

<sup>485</sup> In re The Active Wallace Group, case no. 09-15370, Response of the Westminster Funds to Adequate Assurance of Future Performance Offered by Lifestyle, Dkt. No. 221, p. 4, filed 7/10/09 (citing *In re Rachels Industries, Inc.*, 109 B.R. 797, 802 (Bankr. W.D. Tenn. 1990); *Richmond Leasing Co. v. Capital Bank, N.A.*, 762 F.2d 1303, 1309 (5th Cir. 1985).

<sup>486</sup> In re The Active Wallace Group, case no. 09-15370, Response of the Westminster Funds to Adequate Assurance of Future Performance Offered by Lifestyle, Dkt. No. 221, p. 3, filed 7/10/09.

<sup>487</sup> In re The Active Wallace Group, case no. 09-15370, Response of the Westminster Funds to Adequate Assurance of Future Performance Offered by Lifestyle, Dkt. No. 221, p. i, filed 7/10/09 (citing Fed. R. Evid. 602 and 901).

Riverside further argued that a shopping center lessor is afforded extra protection on assumption and assignment under the Code.<sup>488</sup> It wanted more information such as Active's historical sales volume for the store, Active's financial condition and operating performance at the time it entered the lease, along with evidence that the tenant mix and balance would not be disrupted, and that the assignment would be subject to the all the provisions of the existing lease, including radius and use provisions.<sup>489</sup>

Alternatively, Riverside argued that even using the information Ladha had provided, Lifestyle's "position is nothing short of precarious," noting that the profit and loss projections show a net operating loss of "more than \$750,000 in a declining market."<sup>490</sup> Lifestyle's financial condition was "materially inferior" to Active's when it signed the lease in 2003.<sup>491</sup> Apparently this dispute was resolved by Ladha agreeing to guarantee Lifestyle's performance under the lease for its full term.<sup>492</sup> This agreement was not reached until a hearing on July 17.<sup>493</sup>

---

<sup>488</sup> In re The Active Wallace Group, case no. 09-15370, Response of the Westminster Funds to Adequate Assurance of Future Performance Offered by Lifestyle, Dkt. No. 221, p. 4, filed 7/10/09, citing Code § 365(b)(3) and *L.R.S.C. Co. v. Rickel Home Centers, Inc. (In re Rickel Home Centers, Inc.)*, 209 F.3d 291, 299 (3rd Cir. 2000).

<sup>489</sup> In re The Active Wallace Group, case no. 09-15370, Response of the Westminster Funds to Adequate Assurance of Future Performance Offered by Lifestyle, Dkt. No. 221, p. 6-7, filed 7/10/09.

<sup>490</sup> In re The Active Wallace Group, case no. 09-15370, Response of the Westminster Funds to Adequate Assurance of Future Performance Offered by Lifestyle, Dkt. No. 221, p. 8, filed 7/10/09. The response also said the projection expected a "roughly \$2 million loss over the next 24 months." *Id.* at p. 3.

<sup>491</sup> In re The Active Wallace Group, case no. 09-15370, Response of the Westminster Funds to Adequate Assurance of Future Performance Offered by Lifestyle, Dkt. No. 221, p. 8, filed 7/10/09.

<sup>492</sup> In re The Active Wallace Group, case no. 09-15370, Order Approving Assignment of Riverside Lease, Dkt. No. 241, p. 2, filed 7/23/09.

<sup>493</sup> In re The Active Wallace Group, case no. 09-15370, Order Approving Assignment of Riverside Lease, Dkt. No. 241, p. 2, filed 7/23/09.

After the hearing the court ordered that Lifestyle had given adequate assurance, but not until after Ladha had fully guaranteed performance.<sup>494</sup>

The other dispute involved settling the cure amounts owed and payable out of the proceeds of the sale.<sup>495</sup> Naturally, the landlords were attempting to recover the maximum amount possible. By the time Active filed the month-end status report on July 31, all of these cost-to-cure disputes were resolved except for the one between Active and Riverside.<sup>496</sup> At that point, Active and the OCC were still investigating the merits of Riverside's asserted cure amount.<sup>497</sup>

The status report closed with a post-sale strategy for the estate. The report noted that while the sale had saved more than 100 jobs and generated \$1 million for the estate, the cure payments, which totaled roughly \$800,000, had "rendered the estate administratively insolvent." At this point, Active and the OCC believed that the insolvent condition could be reversed by addressing "potential claims and causes of action . . . against third parties."<sup>498</sup>

### VIII. Avoidance Actions

Active and its attorneys identified millions of dollars of potential avoidance actions that it planned to pursue.<sup>499</sup> To cap the estate's administrative expense exposure, on December 31,

---

<sup>494</sup> In re The Active Wallace Group, case no. 09-15370, Order Approving Assignment of Riverside Lease, Dkt. No. 241, p. 3, filed 7/23/09.

<sup>495</sup> In re The Active Wallace Group, case no. 09-15370, Post-Sale Status Report, Dkt. No. 252, p. 2, filed 07/31/09.

<sup>496</sup> In re The Active Wallace Group, case no. 09-15370, Post-Sale Status Report, Dkt. No. 252, p. 2, filed 07/31/09.

<sup>497</sup> In re The Active Wallace Group, case no. 09-15370, Post-Sale Status Report, Dkt. No. 252, p. 2, filed 07/31/09.

<sup>498</sup> In re The Active Wallace Group, case no. 09-15370, Post-Sale Status Report, Dkt. No. 252, p. 3, filed 07/31/09.

<sup>499</sup> In re The Active Wallace Group, case no. 09-15370, Application of Debtor and Debtor-in-Possession for Authority to Amend Terms of Employment and Compensation of Winthrop Couchot Professional Corporation, Dkt. No. 276, filed 12/31/09. The Code gives a DIP several "avoiding powers," codified in chapter 5, that allow the DIP to "set aside, unravel, treat as a nullity – or in the jargon of bankruptcy law 'avoid' certain transactions that the

2009 Active and Winthrop Couchot sought authority to pursue the actions on a contingency fee basis;<sup>500</sup> the court granted that authority on March 5, 2010.<sup>501</sup> Then, between March 25 and April 15, 2010, Active filed approximately 54 adversary proceedings,<sup>502</sup> in the nature of avoidance actions, styled as “Complaint[s] to Avoid and Recover Transfers of Property and for Disallowance of Claim[s].”<sup>503</sup> These complaints were filed against, among others, media, marketing, health insurance, design, investment services, packaging, and transport companies, as well as vendors.

A typical complaint’s first claim was to avoid preferential transfers pursuant to § 547,<sup>504</sup> and alleged that Active had made “one or more transfers by check, wire transfer, or its equivalent, of an interest . . . in property” during the preference period. The complaints included the aggregate amount of the alleged preferential transfer and a line-item chart. The complaints recited that the transfers were made on account of antecedent debts, and that because of the transfers, the defendants received more than they would have in a case under Chapter 7 of the

---

debtor engaged in before bankruptcy.” JONATHAN P. FRIEDLAND, MICHAEL L. BERNSTEIN, PROF. GEORGE W. KUNEY & PROF. JOHN D. AYER, CHAPTER 11 – “101” THE NUTS AND BOLTS OF CHAPTER 11 PRACTICE 97 (2007).

<sup>500</sup> In re The Active Wallace Group, case no. 09-15370, Application of Debtor and Debtor-in-Possession for Authority to Amend Terms of Employment and Compensation of Winthrop Couchot Professional Corporation, Dkt. No. 276, filed 12/31/09.

<sup>501</sup> In re The Active Wallace Group, case no. 09-15370, Order Granting Debtor’s Application for Authority to Amend Terms of Employment and Compensation of Winthrop Couchot Professional Corporation, Dkt. No. 283, filed 3/5/10.

<sup>502</sup> An “adversary proceeding” is a lawsuit filed in a bankruptcy case. JONATHAN P. FRIEDLAND, MICHAEL L. BERNSTEIN, PROF. GEORGE W. KUNEY & PROF. JOHN D. AYER, CHAPTER 11 – “101” THE NUTS AND BOLTS OF CHAPTER 11 PRACTICE 70 (2007).

<sup>503</sup> An example, filed against Electric Visual Evolution, LLC, is: In re The Active Wallace Group, case no. 09-15370, Complaint to Avoid and Recover Transfers of Property and For Disallowance of Claim, Dkt. No. 295, filed 3/25/10.

<sup>504</sup> Under § 547, the DIP has the power to avoid preferences. A preference is essentially a transfer “to a creditor for an antecedent debt . . . made while the debtor was insolvent and within 90 days before bankruptcy (or 1 year if the recipient is an insider) if it permits the creditor to get more than it would get in Chapter 7. JONATHAN P. FRIEDLAND, MICHAEL L. BERNSTEIN, PROF. GEORGE W. KUNEY & PROF. JOHN D. AYER, CHAPTER 11 – “101” THE NUTS AND BOLTS OF CHAPTER 11 PRACTICE 100 (2007) (citing § 547(b)) (internal punctuation omitted).

Code.<sup>505</sup> The typical complaint's second claim was to recover the avoided transfers for the benefit of the estate pursuant to § 550,<sup>506</sup> and the usual third claim was for disallowance of the defendant's claim pursuant to § 502(d).<sup>507</sup>

## IX. Conclusion (Sort of)

Contemporaneous with this period of adversary proceeding filings, Active's entire case was transferred, without explanation, to the Los Angeles Division of the Central District of California on March 29, 2010.<sup>508</sup> A new case number was assigned and an order closing the case in the Riverside Division was filed on March 29, 2010.<sup>509</sup> As of April 27, 2010, the case remains open. Debtors, like Active, that liquidate in a Chapter 11 case do not receive a discharge.<sup>510</sup> Because of this, and in keeping with the modern trend, Active's likely exit strategy will be to voluntarily convert to a Chapter 7 case.<sup>511</sup>



<sup>505</sup> Even if a payment meets the elements of a preference, the creditor may prevail under one of the defenses set forth in § 547(c), the most common being the self-explanatory “ordinary course of business defense.” JONATHAN P. FRIEDLAND, MICHAEL L. BERNSTEIN, PROF. GEORGE W. KUNEY & PROF. JOHN D. AYER, CHAPTER 11 – “101” THE NUTS AND BOLTS OF CHAPTER 11 PRACTICE 101 (2007).

<sup>506</sup> Section 550 provides that “to the extent that a transfer is avoided,” the DIP may recover the property for the benefit of the estate. Recovery may be from the initial transferee or any immediate or mediate transferee of that initial transferee. *Id.*

<sup>507</sup> Section 502(d) provides that the “claim of any entity from which property is recoverable” as an avoidable preference shall be disallowed.

<sup>508</sup> *In re The Active Wallace Group*, case no. 10-21670, Notice of Transfer of Case, Dkt. No. 334, filed 3/31/10.

<sup>509</sup> *In re The Active Wallace Group*, case no. 09-15370, Order Closing Case, Dkt. No. 333, filed 3/29/10.

<sup>510</sup> JONATHAN P. FRIEDLAND, MICHAEL L. BERNSTEIN, PROF. GEORGE W. KUNEY & PROF. JOHN D. AYER, CHAPTER 11 – “101” THE NUTS AND BOLTS OF CHAPTER 11 PRACTICE 332 (2007).

<sup>511</sup> Daniel J. Bussel & Kenneth N. Klee, *Recalibrating Consent in Bankruptcy*, 83 AM. BANKR. L. J. 663, 729-30 (2009); George W. Kuney, *Misinterpreting the Bankruptcy Code Section 363(f) and Undermining the Chapter 11 Process*, 76 AM. BANKR. L. J. 235, n.30 (2002). 87