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Robby Lockett

Scott Lochridge

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Drug Fair Group, Inc.

Chapter 11 Bankruptcy

Robby Lockett, Scott Lochridge, and Jessica Manning
5/4/2011

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Introduction

On Wednesday, March 18, 2009, the Drug Fair Debtors filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. The Debtors are comprised of two entities, CDI, Inc. (“CDI”) and Drug Fair Group, Inc. (“Drug Fair”) collectively, “the Debtors.” All the activities and operations of the Debtors occur through Drug Fair. CDI is a holding company that owns all of the outstanding stock of Drug Fair and has no independent operations.

Corporate History

Drug Fair was founded in 1954 under the name Community Distributors, Inc. In 2005, CDI acquired one hundred percent of the stock of Community Distributors, Inc. CDI is owned by CDI Holding Corp. Sun CDI, LLC owns substantially all of the stock of CDI Holding Corp., and Sun Capital Partners owns Sun CDI, LLC. In 2006, Community Distributors, Inc. changed its name to Drug Fair Group, Inc.¹

The Debtors were the largest regional drug store chain focused primarily on the market in northern and central New Jersey and were the twenty-second largest drug store chain in the United States. The Debtors were headquartered in Somerset, New Jersey, with a warehouse on the premises. All of the Debtors’ facilities, including stores, were leased. The Debtors employed about 1,475 people, and, according to various employees, the employees were not told in advance that the Debtors would be closing its stores during its chapter 11 case.² None of the employees were subject to a collective bargaining agreement.

¹ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Declaration of Timothy D. Boates in Support of Debtors’ Chapter 11 Petitions and First Day Motions (Dkt. 16)(March 18, 2009).

² “Drug Fair lays off nearly 50 corporate employees, closes four pharmacies,” *available at* http://www.nj.com/news/index.ssf/2009/03/drug_fair_lays_off_nearly_50_c.html last visited April 1, 2011.

The Debtors operated in two ways. First, they operated a forty-six store chain of traditional drug stores under the name “Drug Fair”. Second, they operated a twelve store chain of general merchandise stores under the name “Cost Cutters.” Four of the Cost Cutters stores had Drug Fair pharmacies in the store.³ In the 2000s, the Debtors introduced a savings card called “We Care.” “We Care” also functioned as the company’s slogan and customers could use the “We Care” card at either Drug Fair or Cost Cutters stores.⁴

Pre-Petition Economic Storm

In 2007 and 2008, competition from other chain drugstores began to jeopardize the company. For the years 2007 and 2008 the Debtors reported a net loss of \$8,352,000 and \$22,868,000, respectively. The Debtors’ major pre-petition debt included a loan and security agreement with Bank of America, a secured loan agreement with Fortress Credit Group, unsecured obligations to Cardinal Health, and unsecured promissory notes. The Debtors began to see reduced revenue in 2008 and focused on revamping operating processes and decreasing costs, including reducing inventory. However, the efforts failed and the Debtors fell behind on their credit obligations.⁵

In March 2009, before the Debtors filed their bankruptcy petition, two Drug Fair locations in Raritan and Rockaway, New Jersey closed without notice, signaling trouble. Reports quickly

³ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Debtor’s Motion for an Order (A) Authorizing and Approving Agreements; (B) Approving Sale and Assignment of Certain of the Debtors’ Assets Pursuant to Section 363 of the Bankruptcy Code Free and Clear of All Liens, Claims and Encumbrances; (C) Authorizing the Debtors to Consummate Transactions Related to the Above; and (D) Granting Other Relief (Dkt. 286)(June 8, 2009).

⁴ “Walgreens plans to buy N.J.’s Drug Fair, close 11 stores,” *available at* http://www.nj.com/news/index.ssf/2009/03/walgreens_plans_to_buy_njs_dru.html last visited April 20, 2011.

⁵ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Declaration of Timothy D. Boates in Support of Debtors’ Chapter 11 Petitions and First Day Motions (Dkt. 16)(March 18, 2009).

surfaced saying that Drug Fair was behind on rent and supplier payments.⁶ Prior to its Chapter 11 filing, the Debtors arranged for Walgreens⁷ to purchase the majority of its store locations and its prescription files from eleven of its stores.⁸ Customers who had prescriptions on file at one of the eleven stores could go to any Walgreens store to access their prescriptions and prescription records.

The Filing

The Debtors hired RAS Management Advisors, LLC⁹ (“RAS”) in January 2009 to assist them in developing and evaluating financial strategies.¹⁰ The Debtors appointed Tim Boates, RAS President, as Chief Restructuring Officer in February 2009.

In a letter to company employees who were terminated as a result of the filing, Mr. Boates said, “[t]he company has been seeking financing that would have enabled it to continue operations. However, it has been unsuccessful due in part to the worsening economic conditions and

⁶ “Walgreens plans to buy N.J.’s Drug Fair, close 11 stores,” *available at* http://www.nj.com/news/index.ssf/2009/03/walgreens_plans_to_buy_njs_dru.html last visited April 20, 2011.

⁷ Walgreens is the nation's largest drugstore chain with fiscal 2008 sales of \$59 billion. The company operates 6,679 drugstores in 49 states, the District of Columbia and Puerto Rico. Walgreens provides the most convenient access to consumer goods and services and cost-effective pharmacy, health and wellness services in America through its retail drugstores, Walgreens Health Services division and Walgreens Health and Wellness division. Walgreens Health Services assists pharmacy patients and prescription drug and medical plans through Walgreens Health Initiatives Inc. (a pharmacy benefit manager), Walgreens Mail Service Inc., Walgreens Home Care Inc., Walgreens Specialty Pharmacy LLC and SeniorMed LLC (a pharmacy provider to long-term care facilities). Walgreens Health and Wellness division includes Take Care Health Systems, the largest and most comprehensive manager of worksite health and wellness centers and in-store convenient care clinics, with more than 700 locations throughout the country. “Drug Fair Group Files for Chapter 11 Bankruptcy Protection and Obtains ‘Stalking Horse’ Bid from Walgreens for 32 Pharmacy Locations”, *available at*: <http://www.businesswire.com/news/home/20090318006073/en/Drug-Fair-Group-Files-Chapter-11-Bankruptcy>

⁸ Memo of Tim LaBeau, Drug Fair CEO, March 17, 2009 *available here*.

⁹ RAS Management Advisors was founded in 1989. They pride themselves on understanding the unique challenges businesses can face. They also claim to have numerous contacts in the banking industry, allowing them to offer a variety of alternatives to their clients. RAS Management Advisors, LLC corporate website, <http://www.rasmanagement.com/index.html> last visited April 20, 2011.

¹⁰ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Declaration of Timothy D. Boates in Support of Debtors’ Chapter 11 Petitions and First Days Motions (Dkt. 16).

unforeseeable tightening credit markets, which constitute a national emergency.”¹¹ In a memo to employees, Chief Executive Officer Tim LaBeau stated:

These challenging economic times have affected all of our families, our friends and our patients in some manner. As you have been well aware, our company too has been struggling to maintain its viability. To this end, rather than close our doors like others, we decided to initiate a process to find a buyer who is in a better position to continue the Drug Fair legacy.¹²

Mr. Boates explained that while many options were considered, it was decided that a sale of Drug Fair’s assets through Chapter 11 would be the best way to maximize value for the Debtors’ stakeholders and that the filing was in the best interest of all involved.¹³ Drug Fair was one of three of Sun Capital’s businesses to file for bankruptcy within a span of thirteen months.¹⁴

Judges

After the filing of the petition, Judge Walrath was assigned the Debtor’s case.¹⁵ Judge Walrath graduated from Princeton University with a degree in history. While at Princeton, she was captain of the women’s basketball team. She then went to law school at Villanova University where she served on the Villanova Law Review for two years and graduated cum laude. After law school, she clerked for Chief Judge of the U.S. Bankruptcy Court for the Eastern District of Pennsylvania,

¹¹ “Drug files for bankruptcy,” *available at*: http://www.nj.com/news/index.ssf/2009/03/drug_fair_files_for_bankruptcy.html last visited April 20, 2011.

¹² Memo of Tim LaBeau, Drug Fair CEO, March 17, 2009 *available here*.

¹³ “Drug Fair Group Files for Chapter 11 Bankruptcy Protection and Obtains ‘Stalking Horse’ Bid from Walgreens for 32 Pharmacy Locations,” *available at*: <http://www.businesswire.com/news/home/20090318006073/en/Drug-Fair-Group-Files-Chapter-11-Bankruptcy>

¹⁴ Wickes Furniture was the first. “Furniture retailer Wickes files for bankruptcy,” *available at* <http://www.reuters.com/article/2008/02/04/wickes-bankruptcy-idUSN0459624820080204> last visited April 20, 2011. Mervyns was the second. “Mervyns files for bankruptcy, will stay open,” *available at* http://www.msnbc.msn.com/id/25918757/ns/business-consumer_news/ last visited April 20, 2011.

¹⁵ Docket Report.

Honorable Emil F. Goldhaber.¹⁶ She began her career as an associate at Clark Ladner Fortenbaugh and Young in 1982. She became a partner of the firm in 1987 and continued her work there until 1996, when the firm dissolved.¹⁷ She then became a partner of Walrath and Coolidge, located in Wellsboro, Pennsylvania.¹⁸ Her practice as an attorney was focused on debtor-creditor rights and commercial litigation. Only a few years after starting her own firm, she was appointed United States Bankruptcy Court Judge for the District of Delaware. In 2003, she was appointed as Chief Bankruptcy Judge.¹⁹

On March 18, 2009, Judge Shannon was added to the Debtors' case.²⁰ Like Judge Walrath, Judge Shannon also graduated from Princeton. He attended law school at Marshall-Wythe School of Law at the College of William and Mary in Williamsburg, Virginia. Judge Shannon worked as a partner with Young Conaway Stargatt and Taylor, LLP in Wilmington, Delaware where he represented corporate debtors and official committees in Chapter 11 cases. In 2006, he was appointed United States Bankruptcy Court Judge for the District of Delaware.²¹

It is unclear why two judges presided over this case. Although Judge Shannon was added to the case at the beginning, he did not enter any of the orders until the later parts of the case. Perhaps Judge Walrath had a sailing trip planned and knew she would not be able to preside over the entire

¹⁶ <http://www.ruttergroup.com/bknataut.htm>

¹⁷ http://www.abiworld.org/Content/NavigationMenu/MeetingsEvents/DistanceLearning/BestofABI/Bestof2005/AnnualSpringMeeting/Best_of_2005_Annual1.htm

¹⁸ <http://walrathcoolidge.com/>

¹⁹ <http://www.ruttergroup.com/bknataut.htm>

²⁰ Docket Report.

²¹ <http://www.legalspan.com/catalog2/faculty.asp?UserID=20090208207240134858%20%20%20%20%20%20%20&OwnerColor=%23003366&recID=20090208-207240-133713>

case so she arranged for Judge Shannon to serve as her back up.²² “Over the past ten years, [Judge Walrath and her husband have] taken sailing trips to Mallorca, the British Virgin Islands, islands north of the Netherlands, and the Baltic.”

Official Committee of Unsecured Creditors

Patrick Reilley of Cole, Schotz, Meisel, Forman and Leonard represented the Official Committee of Unsecured Creditors. Reilley graduated law school from Boston University School of Law in 2002. Reilly focuses his practice on corporate reorganizations, creditors’ rights issues, and litigation arising in Chapter 11 bankruptcy cases.²³ The firm was founded in 1928 and now has 120 attorneys. One of its primary areas of practice is Bankruptcy & Corporate Restructuring.²⁴

Debtor’s Attorneys

Klehr Harrison Harvey Branzburg, LLP represented the Debtors. The firm has offices in Pennsylvania, New Jersey and Delaware.²⁵ It represents clientele ranging from the individual to multi-national corporations. One of its major practice areas is Bankruptcy and Corporate Restructuring.²⁶ The firm claims to “achieve . . . clients’ objectives in an environment of total quality, professionalism, and cost effectiveness.”²⁷

²² <http://beneschwomen.wordpress.com/2011/03/31/judge-mary-f-walrath-a-passion-for-bankruptcy-and-sailing/> “Over the past ten years, [Judge Walrath and her husband have] taken sailing trips to Mallorca, the British Virgin Islands, islands north of the Netherlands, and the Baltic.”

²³ <http://www.coleschotz.com/attorneys-154.html>

²⁴ <http://www.coleschotz.com/about.html>

²⁵ <http://klehr.com/>

²⁶ <http://www.klehr.com/?p=1120>

²⁷ <http://www.klehr.com/?p=1171>

The attorney assigned to the Drug Fair case was Domenic Pacitti. He works out of the firm's Delaware office, which specializes in Bankruptcy and Corporate Litigation.²⁸ Pacitti “concentrates his practice on bankruptcy, restructuring and workouts, representing debtors, creditors, creditors’ committees, secured creditors, unsecured creditors and acquirers of distressed assets and companies.”²⁹

First Day Orders

Motion for Joint Administration

On the date of filing, Drug Fair and CDI moved for joint administration of their Chapter 11 bankruptcy cases.³⁰ Bankruptcy Rule 1015(b) provides that “[i]f . . . two or more petitions are pending in the same court by or against . . . a debtor and an affiliate, the court may order a joint administration of the estates.”³¹ Further, Bankruptcy Rule 105(a) provides that a bankruptcy court “may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of the [Bankruptcy Code].”³² Joint administration provides administrative convenience as many of the motions, hearings, and orders that arise affect the Debtors and would have to be separately conducted in each case absent joint administration. Because of the cost reduction associated with the joint administration in the Debtors case, jointly administering the two cases cut the paperwork and proceeding in half. Significant cost savings are realized and parties in interest

²⁸ <http://klehr.com/?t=10&L=18&format=xml>

²⁹ <http://klehr.com/?t=3&A=823&format=xml&Domenic%20E.%20Pacitti>

³⁰ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Debtor’s Motion for an Order Directing Joint Administration of their Chapter 11 Cases (Dkt. 3)(March 18, 2009).

³¹ 11 U.S.C. § 1015(b). Joint administration is merely a matter of convenience and cost savings and works no substantive changes upon the debtors’ estates, which remain separate. In this it is different from “substantive consolidation” which works a combination or merger of the estates into one resulting estate, which works substantive changes upon the rights and remedies available to creditors and parties in interest. [cite].

³² 11 U.S.C. § 105(a).

benefit. In addition to the cost savings, joint administration would allow parties in interest to monitor the case more efficiently.³³

Bankruptcy Judge Walrath granted the motion for joint administration of the Debtors' cases in accordance with Bankruptcy Rule 1015(b).³⁴ Granting joint administration is routine in cases like the Debtors' and is generally non-controversial.³⁵

Motion to Maintain Bank Accounts

The Debtors also moved for authorization to use existing bank accounts and business forms, and use their existing cash management system. They also requested an additional sixty days for the Debtors to comply with Bankruptcy Rule 345(b) for the investment money or to file a motion to waive the requirements of the rule.³⁶

The Office of the United States Trustee has established operating guidelines for debtors in possession relating to cash management systems (the "UST Guidelines").³⁷ The UST Guidelines require that a debtor (a) establish one debtor in possession account for all estate funds required for the payment of taxes, (b) close all existing bank accounts and open new debtor in possession

³³ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Debtor's Motion for an Order Directing Joint Administration of their Chapter 11 Cases (Dkt. 3)(March 18, 2009).

³⁴ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Debtor's Motion for an Order Directing Joint Administration of their Chapter 11 Cases (Dkt. 37)(March 20, 2009).

³⁵ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Debtor's Motion for an Order Directing Joint Administration of their Chapter 11 Cases (Dkt. 3)(March 18, 2009).

³⁶ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Motion of Debtors for an Order (a) Authorizing Maintenance and Use of Existing Bank Accounts and Existing Business Forms, (b) Authorizing Maintenance of the Debtors' Existing Cash Management System, and (c) Modifying Guidelines for Investment of Money of the Estate Under 11 U.S.C. §345(B) (Dkt. 5)(March 18, 2009).

³⁷ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Motion of Debtors for an Order (a) Authorizing Maintenance and Use of Existing Bank Accounts and Existing Business Forms, (b) Authorizing Maintenance of the Debtors' Existing Cash Management System, and (c) Modifying Guidelines for Investment of Money of the Estate Under 11 U.S.C. §345(B) (Dkt. 5)(March 18, 2009).

accounts; (c) maintain a separate debtor in possession account for cash collateral and obtain checks that bear the designation “debtor in possession;” and (d) reference the bankruptcy case number and type of account on such checks.³⁸

At the time the petition was filed, the Debtors maintained several bank accounts. They had a depository account which was used to deposit cash and checks from each store on a daily basis. The Debtors also had a bank account for each store in connection with its sale of lottery tickets, of which the state of New Jersey had direct access so that it could withdraw the proceeds. They had disbursement accounts into which advances under its prepetition loans were deposited to pay accounts payable. Presumably, this cash management system most efficiently met the obligations of the Debtors, and developing an entirely new cash management system would have been difficult and disruptive. Therefore, the Debtors sought relief from the UST Guidelines. Also, in order to avoid the expense and delay of ordering new business forms that appropriately reflected the status of the Debtors, as debtors-in-possession, the Debtors requested that the court authorize the use of all correspondence and business forms until the current stock was depleted.³⁹

Bankruptcy Code 345(b) provides that the estates must require the entity with which the money is deposited or invested to obtain a bond in favor of the United States that is secured by the undertaking of an adequate corporate surety unless the court for cause orders otherwise.⁴⁰ The Debtors believed that because they did not expect to have significant sums of cash to invest and

³⁸ 28 U.S.C. § 586 (2009).

³⁹ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Motion of Debtors for an Order (a) Authorizing Maintenance and Use of Existing Bank Accounts and Existing Business Forms, (b) Authorizing Maintenance of the Debtors’ Existing Cash Management System, and (c) Modifying Guidelines for Investment of Money of the Estate Under 11 U.S.C. §345(B) (Dkt. 5)(March 18, 2009).

⁴⁰ 11 U.S.C. 345(b).

because default would only occur if they were unable to transfer such funds to post-petition lenders, the guidelines of § 345 would not protect their creditors or estates.⁴¹

Judge Walrath granted the motion authorizing the Debtors to continue the use of their cash management system, as well as use of all correspondence and business forms without reference to their status as debtors in possession. She also granted additional time for the Debtors to come into compliance with § 345 of the Bankruptcy Code.⁴²

Motion Prohibiting Utilities from Discontinuing Service

On March 18, 2009, the Debtors filed a motion for an order determining adequate assurance of payment for future utility services.⁴³ Pursuant to Bankruptcy Rule 366(c)(2), utility providers may discontinue its services if the debtor has not furnished adequate assurance of payment within thirty days after the petition date.⁴⁴ Also, Bankruptcy Rule 105(a) provides that a bankruptcy court “may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of the [Bankruptcy Code].”⁴⁵

The Debtors obtained their gas, water, and electric utilities from approximately thirty-eight different providers, spending approximately \$341,000 each month for these utilities. These services were necessary for them to continue with the everyday operations of the business. The Debtors

⁴¹ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Motion of Debtors for an Order (a) Authorizing Maintenance and Use of Existing Bank Accounts and Existing Business Forms, (b) Authorizing Maintenance of the Debtors’ Existing Cash Management System, and (c) Modifying Guidelines for Investment of Money of the Estate Under 11 U.S.C. §345(B) (Dkt. 5)(March 18, 2009).

⁴² *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Motion of Debtors for an Order (a) Authorizing Maintenance and Use of Existing Bank Accounts and Existing Business Forms, (b) Authorizing Maintenance of the Debtors’ Existing Cash Management System, and (c) Modifying Guidelines for Investment of Money of the Estate Under 11 U.S.C. §345(B) (Dkt. 39)(March 20, 2009).

⁴³ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Motion of the Debtors for Entry of Interim and Final Orders Determining Adequate Assurance of Payment for Future Utility Services (Dkt. 6)(March 18, 2009).

⁴⁴ 11 U.S.C. § 366(c)(2).

⁴⁵ 11 U.S.C. § 105(a).

stated in their motion that the courts should “focus upon the need of the utility for assurance and to require that the debtor supply no more than that, since the debtor . . . has a conflicting need to conserve scarce financial resources.”⁴⁶ With continued operation, the Debtors believed that they would have adequate cash flow to pay the utility providers for post-petition obligations. The Debtors also proposed to provide additional adequate assurance by funding a security deposit account with \$170,500, which represented enough money to pay for two weeks of utilities.⁴⁷

Judge Walrath granted the motion in an interim hearing that prohibited any utility providers from refusing or discontinuing service on account of any unpaid prepetition charges. The order required the Debtors to deposit \$170,500 into an account representing the adequate assurance for the utility services. She also set April 15, 2009 as the date for the final hearing on the motion.⁴⁸

On April 8, seven days prior to the date set for the final hearing, three of the utility providers objected to the motion claiming that the Debtors had failed to identify who would hold the account in which the adequate assurance money would be placed, how the utility providers would access the account, and what would happen to the money in the event of a default by the Debtors. Furthermore, these utility providers urged that only two weeks of utility charges could not represent

⁴⁶ *Virginai Elec. & Power Co.*, 117 F.2d at 650.

⁴⁷ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Motion of the Debtors for Entry of Interim and Final Orders Determining Adequate Assurance of Payment for Future Utility Services (Dkt. 6)(March 18, 2009).

⁴⁸ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Interim Order Determining Adequate Assurance of Payment for Future Utility Services (Dkt. 40)(March 20, 2009).

adequate assurance of payment.⁴⁹ A week later, these utility providers withdrew their objections pursuant to a settlement.⁵⁰ The exact terms of the agreement are unclear.

Having no outstanding objections to the interim order, Judge Shannon granted the motion in the final order, prohibiting any utility providers from refusing or discontinuing services on account of any unpaid prepetition charges. His order required the Debtors to deposit only \$47,495 into an account representing the adequate assurance for the utility providers of future performance. The order stated that all the objections filed had been resolved and the terms of their resolution would control the obligation between the Debtors and those utility providers.⁵¹ The tactic of filing a motion to obtain relief to jump start negotiations with the opposing party against the back drop of the potential for judicial resolution of the matter, resulting in withdrawal of any objections filed and entry of an agreed order is common in Chapter 11 cases, especially with regard to the initial or first-day motions.

Motion to Continue Customer Programs

The Debtors filed a motion seeking authorization to maintain and administer their customer programs and honor prepetition obligations related to their customer programs.⁵² Under Bankruptcy Rule 363(b)(1), “[t]he [debtor], after notice and a hearing, may use, sell, or lease, other

⁴⁹ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Objection of Certain Utility Companies to the Motion of the Debtors for Entry of Interim and Final Orders Determining Adequate Assurance of Payment for Future Utility Services (Dkt. 113)(April 8, 2009).

⁵⁰ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Notice of Withdrawal of Objection of Certain Utility Companies to the Motion of the Debtors for Entry of Interim and Final Orders Determining Adequate Assurance of Payment for Future Utility Services (Dkt. 130)(April 15, 2009).

⁵¹ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Final Order Determining Adequate Assurance of Payment for Future Utility Services (Dkt. 133)(April 16, 2009).

⁵² *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Motion of the Debtors for Entry of an Order Authorizing, but Not Directing, the Debtors to Maintain and Administer customer Programs and Honor Prepetition Obligations Related Thereto (Dkt. 7)(March 18, 2009).

than in the ordinary course of business, property of the estate.”⁵³ According to *In re Ionosphere Clubs, Inc.*, “a debtor may be authorized to pay certain prepetition claims if they can articulate some business justification, other than mere appeasement of major creditors.”⁵⁴ In addition to § 363, Bankruptcy Rule 105(a) provides that a bankruptcy court “may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of the [Bankruptcy Code].”⁵⁵

In order to maintain the value of the company, the Debtors believed it was important to maintain positive customer relations by honoring their previous commitments. Under their customer programs, the Debtors estimated that they owed a total of approximately \$20,000 in prepetition obligations, most of which were in the form of discounts or store credit. The Debtors estimated that approximately \$1,000 of the obligations from the customer programs represented cash payments. They believed the relief requested was necessary to preserve customer loyalty and the value of the estate.⁵⁶

The Debtors argued that the application of Bankruptcy Rule 105(a) was appropriate here because the relief requested was consistent with the rehabilitative policy of Chapter 11. Not honoring their customer programs would put them at a disadvantage compared with their competitors, which could adversely affect a successful reorganization.⁵⁷

⁵³ 11 U.S.C. §363(b)(1).

⁵⁴ *In re Ionosphere Clubs, Inc.*, 98 B.R. 174, 175 (Bankr. S.D.N.Y. 1989).

⁵⁵ 11 U.S.C. § 105(a).

⁵⁶ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Motion of the Debtors for Entry of an Order Authorizing, but Not Directing, the Debtors to Maintain and Administer customer Programs and Honor Prepetition Obligations Related Thereto (Dkt. 7)(March 18, 2009).

⁵⁷ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Motion of the Debtors for Entry of an Order Authorizing, but Not Directing, the Debtors to Maintain and Administer customer Programs and Honor Prepetition Obligations Related Thereto (Dkt. 7)(March 18, 2009).

On March 24, 2009, Judge Walrath granted a motion authorizing, but not requiring, the Debtors to maintain and administer the customer programs. They were also authorized to pay any prepetition amounts outstanding up to a maximum of \$20,000.⁵⁸

Motion for Authority to Obtain Credit for Insurance Coverage

The Debtors also filed a motion for an order authorizing them to continue their prepetition insurance policies and enter into new insurance policies, change insurance coverage as needed, keep their premium financing agreement, and make changes to their premium financing agreement. The Debtors urged that this relief should be granted pursuant to Bankruptcy Rules 105(a), 363, 364 and 1112.⁵⁹

Bankruptcy Rule 105(a) provides that a bankruptcy court “may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of the [Bankruptcy Code].”⁶⁰ The Debtors believed that granting this motion would preserve the value of the estates, thus benefit the parties in interest because it would allow the Debtors to continue their business operations without interruption.

Bankruptcy Rule 363(b)(1) provides that “[t]he [debtor], after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate.”⁶¹ According to *In re Ionosphere Clubs, Inc.*, “a debtor may be authorized to pay certain prepetition claims if they can

⁵⁸ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Order for Authorizing, but Not Directing, the Debtors to Maintain and Administer customer Programs and Honor Prepetition Obligations Related Thereto (Dkt. 54)(March 24, 2009).

⁵⁹ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Motion of the Debtors for Entry of an Order (A) Authorizing, but Not Directing, the Debtors to (i) Continue Prepetition Insurance Coverage and Enter into New Insurance Policies and (ii) maintain Prepetition Financing of Insurance Premiums and Enter Into New Postpetition Premium Financing Agreements and (B) Authorizing and Directing Financial Institutions to Honor Related Checks and Electronic Payment Requests (Dkt. 8)(March 18, 2009).

⁶⁰ 11 U.S.C. § 105(a).

⁶¹ 11 U.S.C. §363(b)(1).

articulate some business justification, other than mere appeasement of major creditors.”⁶² The Debtors owed a total of \$282,000 on account of prepetition insurance policies and related broker fees. The insurance provides coverage for things such as property, workers compensation, and general liability among other things. The Debtors urged that paying the outstanding prepetition premium amounts would benefit their estate by allowing business operations to continue without interruption.⁶³

Bankruptcy Rule 364(c) authorizes a debtor that is unable to obtain unsecured credit to exercise its business judgment to incur secured debt if it is in the best interest of the estate.⁶⁴ Because lenders are typically unwilling to finance insurance premiums on an unsecured basis, the Debtors argued they should be authorized to renew their premium finance agreements or obtain new ones without further approval. As stated previously, paying the outstanding premium obligations would have allowed business operations to continue without interruption.

Finally, Bankruptcy Rule 1112(b)(1) states “...the court shall convert a [chapter 11] case to a case under chapter 7 or dismiss a case under [Chapter 11]...” if cause is established.⁶⁵ “[T]he term ‘cause’ includes failure to maintain appropriate insurance that poses a risk to the estate or the public.”⁶⁶ The Debtors claimed that all of their insurance policies were required by law. Therefore,

⁶² *In re Ionosphere Clubs, Inc.*, 98 B.R. 174, 175 (Bankr. S.D.N.Y. 1989).

⁶³ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Motion of the Debtors for Entry of an Order (A) Authorizing, but Not Dircting, the Debtors to (i) Continue Prepetition Insurance Coverage and Enter into New Insurance Policies and (ii) maintain Prepetition Financing of Insurance Premiums and Enter Into New Postpetion Premium Financing Agreements and (B) Authorizing and Dircting Financial Institutions to Honor Related Checks and Electronic Payment Requests (Dkt. 8)(March 18, 2009).

⁶⁴ 11 U.S.C. §364(c).

⁶⁵ 11 U.S.C. §1112(b)(1).

⁶⁶ 11 U.S.C. §1112(b)(4)(C).

not maintaining these policies would force the court to convert the case into a Chapter 7 bankruptcy, eliminating the possibility of a successful reorganization.⁶⁷

Judge Walrath approved an order granting the motion authorizing the Debtors to pay any prepetition amounts to continue insurance policies up to a total of \$303,000. The order also authorized the Debtors to continue to honor the terms of their premium financing agreements.⁶⁸ A ruling like this one is routine in cases such as this where a debtor deals with the public, who could be injured in the ordinary course of business. If the Debtors were without insurance, injured parties could very likely be left uncompensated.

Motion to Pay Sales and Use Taxes

The Debtors also filed a first day motion to pay taxes and fees that accrued or arose before the petition date in the ordinary course of business pursuant to Bankruptcy Rules 105(a), 363(b), 507(a)(8), and 541.⁶⁹

Under Bankruptcy Rule 363(b)(1), “[t]he [debtor], after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate.”⁷⁰ According to *In re Ionosphere Clubs, Inc.*, “a debtor may be authorized to pay certain prepetition claims if they can

⁶⁷ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Motion of the Debtors for Entry of an Order (A) Authorizing, but Not Directing, the Debtors to (i) Continue Prepetition Insurance Coverage and Enter into New Insurance Policies and (ii) maintain Prepetition Financing of Insurance Premiums and Enter Into New Post-petition Premium Financing Agreements and (B) Authorizing and Directing Financial Institutions to Honor Related Checks and Electronic Payment Requests (Dkt. 8)(March 18, 2009).

⁶⁸ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Order (A) Authorizing, but Not Directing, the Debtors to (i) Continue Prepetition Insurance Coverage and Enter into New Insurance Policies and (ii) maintain Prepetition Financing of Insurance Premiums and Enter Into New Post-petition Premium Financing Agreements and (B) Authorizing and Directing Financial Institutions to Honor Related Checks and Electronic Payment Requests (Dkt. 41) (March 20, 2009).

⁶⁹ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Motion of the Debtors for Entry of an Order Authorizing the Debtors to Pay Certain Prepetition Taxes and Fees (Dkt. 9)(March 18, 2009).

⁷⁰ 11 U.S.C. § 363(b)(1).

articulate some business justification, other than mere appeasement of major creditors.”⁷¹ The Debtors estimated the total amount of prepetition taxes and fees owed was approximately \$553,000 and that such payment was appropriate to preserve the value of the estates because unpaid taxes and fees may result in penalties and the accrual of interest. Another business justification the Debtors claimed was that payment of the prepetition tax obligations would allow operation to continue without interruption and reduce the amount and priority of claims that would be asserted against the estate.⁷²

Under § 507(a)(8), a penalty related to a claim can be granted eighth priority status making them paid in full before any unsecured creditors would be satisfied.⁷³ Therefore, relief to pay taxes would only affect the timing of the payment and Drug Fair would save potential interest expense and penalties. Also, if payments were not made on time, the directors and officers of Drug Fair may have been subjected to personal liability for such taxes and fees, which would obviously have been an unwanted distraction.⁷⁴

Bankruptcy Rule 541(d) provides that only legal title and not an equitable interest of the property that a debtor holds as of the commencement of the case becomes property of the estate.⁷⁵ Some of the tax obligations of the Debtors were on account of “trust fund” taxes of which they may

⁷¹ *In re Ionosphere Clubs, Inc.*, 98 B.R. 174, 175 (Bankr. S.D.N.Y. 1989).

⁷² *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Motion of the Debtors for Entry of an Order Authorizing the Debtors to Pay Certain Prepetition Taxes and Fees (Dkt. 9)(March 18, 2009).

⁷³ 11 U.S.C. § 507(a)(8).

⁷⁴ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Motion of the Debtors for Entry of an Order Authorizing the Debtors to Pay Certain Prepetition Taxes and Fees (Dkt. 9)(March 18, 2009).

⁷⁵ 11 U.S.C. § 541(d).

not have had a legal interest. Therefore, pursuant to Rule 541(d) the Debtors felt like they should be granted the relief requested.⁷⁶

Judge Walrath entered an order approving the motion to pay sales and use taxes. The total amount of the taxes and fees paid were not to exceed \$553,000.⁷⁷

Motion to Pay Employee Wages

The Debtors moved for entry of an order authorizing payment of prepetition wages, salaries, benefits, and employee expense reimbursements and to authorize financial institutions to process payments of prepetition wages pursuant to Bankruptcy Rules 105(a).⁷⁸ Bankruptcy Rule 105(a) provides that a bankruptcy court “may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of the [Bankruptcy Code].”⁷⁹ A court may authorize the immediate payment of prepetition claims where the payments are essential to a debtor’s continued business operations.⁸⁰ The Debtors believed that if the employees were not paid many would chose to leave and seek employment elsewhere which would decrease the value of the estate and therefore not benefit the parties in interest.

⁷⁶ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Motion of the Debtors for Entry of an Order Authorizing the Debtors to Pay Certain Prepetition Taxes and Fees (Dkt. 9)(March 18, 2009).

⁷⁷ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Order Authorizing Debtors to Pay Certain Prepetition Taxes and Fees (Dkt. 42)(March 18, 2009).

⁷⁸ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Motion of Debtors for an Order (I) Authorizing Debtors to (a) Pay Prepetition Employee Wages, (b) Make Payments for which Payroll Deduction where Made, and (c) Pay All Costs Incident to the Foregoing Payments and Contributions and (II) Authorizing Applicable Banks and Other Financial Institutions to Receive, Process, Honor and Pay Any and All Checks Drawn on Debtors’ Accounts for Such Purposes (Dkt. 10)(March 18, 2009).

⁷⁹ 11 U.S.C. § 105(a).

⁸⁰ *In re Lehigh & New England Ry. Co.*, 657 F.2d 570, 581 (3d Cir. 1981).

The Debtors then claimed this relief would not harm the Debtors' estates or creditors because the payment requested would be given priority status under Rule 507(a)(4).⁸¹ Under Rule 507(a)(4) each employee may be granted a priority claim for "wages, salaries, or commissions, including vacation, severance and sick leave pay earned by an individual" up to \$10,950.⁸² Most of the employees had claims less than \$10,950 so the Debtors stated that granting the relief requested would essentially be no different than waiting to pay the employees.⁸³ This argument would only be true if the debtors would liquidate enough cash to pay all priority claims in full upon liquidation.

At the interim hearing, on March 24, 2009, Judge Walrath approved an order granting the motion to pay prepetition wages that become due and payable prior to the final hearing up to a maximum amount of \$10,950 for each employee.⁸⁴ In the final hearing, Judge Shannon approved an order granting the motion to pay wages that become due and payable up to a maximum amount of \$10,950 for each employee. Furthermore, the order authorized the Debtors to issue post-petition

⁸¹ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Motion of Debtors for an Order (I) Authorizing Debtors to (a) Pay Prepetition Employee Wages, (b) Make Payments for which Payroll Deduction where Made, and (c) Pay All Costs Incident to the Foregoing Payments and Contributions and (II) Authorizing Applicable Banks and Other Financial Institutions to Receive, Process, Honor and Pay Any and All Checks Drawn on Debtors' Accounts for Such Purposes (Dkt. 10)(March 18, 2009).

⁸² 11 U.S.C. § 507(a)(4).

⁸³ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Motion of Debtors for an Order (I) Authorizing Debtors to (a) Pay Prepetition Employee Wages, (b) Make Payments for which Payroll Deduction where Made, and (c) Pay All Costs Incident to the Foregoing Payments and Contributions and (II) Authorizing Applicable Banks and Other Financial Institutions to Receive, Process, Honor and Pay Any and All Checks Drawn on Debtors' Accounts for Such Purposes (Dkt. 10)(March 18, 2009).

⁸⁴ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del, Interim Order (I) Authorizing Debtors to (a) Pay Prepetition Employee Wages, (b) Make Payments for which Payroll Deduction where Made, and (c) Pay All Costs Incident to the Foregoing Payments and Contributions and (II) Authorizing Applicable Banks and Other Financial Institutions to Receive, Process, Honor and Pay Any and All Checks Drawn on Debtors' Accounts for Such Purposes (Dkt. 55)(March 24, 2009).

checks related to prepetition wage obligations that had been dishonored or rejected by banks who were honoring the automatic stay of section 362 after the petition was filed.⁸⁵

Motion to Approve Debtor-in-Possession Financing

The Debtors filed a motion for interim and final orders authorizing them to obtain post-petition financing pursuant to Bankruptcy Rules 105, 361, 363, 364(c) and 364(d). They sought and order authorizing them to borrow funds on an interim basis up to \$20 million and on a final basis up to \$40 million. The Debtors major pre-petition debts included a loan and security agreement with Bank of America which provided for revolving credit loans of up to \$60 million, a loan agreement with Fortress Credit Corp with a balance of \$20 million, unsecured obligations to Cardinal Health of approximately \$17.9 million, approximately \$22.1 million in additional trade debt, and approximately \$2.9 million in unsecured obligations under promissory notes.⁸⁶

As of the petition date, the Debtors were indebted to the pre-petition first lien secured parties approximately \$44 million. To secure the pre-petition first lien liabilities, the Debtors granted security interests and encumbrances to the pre-petition secured parties upon substantially all of the Debtors' assets and personal property. As of the petition date, the Debtors were indebted to the pre-petition second lien secured parties approximately \$20.5 million. To secure the pre-petition second lien obligations, the Debtors granted subordinated second interests and liens to the pre-

⁸⁵ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del, Final Order (I) Authorizing Debtors to (a) Pay Prepetition Employee Wages, (b) Make Payments for which Payroll Deduction where Made, and (c) Pay All Costs Incident to the Foregoing Payments and Contributions and (II) Authorizing Applicable Banks and Other Financial Institutions to Receive, Process, Honor and Pay Any and All Checks Drawn on Debtors' Accounts for Such Purposes (Dkt. 139)(April 16, 2009).

⁸⁶ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Motion for Interim and Final Orders (I) Authorizing Debtors-in-Possession to Enter into Senior Debtor-in-Possession Credit Agreement and Obtain Post-petition Financing Pursuant to Section 363 and 364 of the Bankruptcy Code; (II) Granting Liens, Security Interests and Superpriority Claims; (III) Authorizing the Use of Cash Collateral; (IV) Affording Adequate Protection to Prepetition Lenders; and (V) Providing for the Payment of Secured Prepetition Indebtedness (Dkt. 11)(March 18, 2009).

petition second lien secured parties upon substantially all of the Debtors' assets and personal property. The pre-petition first liens were senior to the pre-petition second liens.⁸⁷

The Debtors needed to obtain funds in order to continue its operations and to preserve the value of the estate. Under the debtor-in-possession credit agreement, the Debtors would be entitled to borrow up to \$40 million on a final basis and \$20 million on an interim basis. The proceeds of the debtor-in-possession credit facility were to be used for working capital and general corporate purposes, and payment of costs of administration. The proceeds were to be applied first to reduce the Debtor's obligations to the prepetition agent and the prepetition lenders until paid in full and then to reduce the senior debtor-in-possession debt. The loans would accrue interest at a rate equal to the highest of the Federal Funds Rate plus ½ of 1%, the adjusted LIBOR Rate, or the Prime Rate set by Bank of America. Additionally, they loans would be subject to a margin rate depending on the type loan. A failure to pay the interest, principal, or fees when due constituted a default.⁸⁸

On March 20, 2009, Judge Walrath approved the order granting the motion on an interim basis authorizing the Debtors to obtain credit and incur debt up to a maximum of \$20 million. She also scheduled the final hearing to consider granting the relief requested by the Debtors, which would allow them to obtain credit and incur debt up to a maximum of \$40 million.⁸⁹

⁸⁷ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Motion for Interim and Final Orders (I) Authorizing Debtors-in-Possession to Enter into Senior Debtor-in-Possession Credit Agreement and Obtain Post-petition Financing Pursuant to Section 363 and 364 of the Bankruptcy Code; (II) Granting Liens, Security Interests and Superpriority Claims; (III) Authorizing the Use of Cash Collateral; (IV) Affording Adequate Protection to Prepetition Lenders; and (V) Providing for the Payment of Secured Prepetition Indebtedness (Dkt. 11)(March 18, 2009).

⁸⁸ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Motion for Interim and Final Orders (I) Authorizing Debtors-in-Possession to Enter into Senior Debtor-in-Possession Credit Agreement and Obtain Postpetition Financing Pursuant to Section 363 and 364 of the Bankruptcy Code; (II) Granting Liens, Security Interests and Superpriority Claims; (III) Authorizing the Use of Cash Collateral; (IV) Affording Adequate Protection to Prepetition Lenders; and (V) Providing for the Payment of Secured Prepetition Indebtedness (Dkt. 11)(March 18, 2009).

⁸⁹ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Interim Order Pursuant to 11 U.S.C. Sections 105, 361, 362, 363 and 364 and Rules 2002, 4001 and 9014 of the Federal Rules of Bankruptcy Procedure (1) Authorizing Incurrence by the Debtors of Post-petition Secured Indebtedness with Priority Over All Secured Indebtedness and with

The Unsecured Creditors Committee filed an objection to the Debtors' debtor-in-possession financing motion. According to a cash flow analysis conducted by the Committee's financial advisors, the Debtors did not need additional post-petition financing, as they had sufficient cash flow to meet all expenses throughout the entire debtor-in-possession period.⁹⁰

Upon the final hearing, Judge Shannon overruled all objections to the motion granted the debtor-in-possession financing motion in its entirety authorizing the Debtor's to borrow up to \$40 million, which accordingly enabled the Debtors to continue to operate their businesses.⁹¹

Pre-liquidation Activities

Going out of Business Sales

In trying to prepare for liquidation, the Debtors sought to conduct store closing sales at twenty-three locations, free and clear of liens. This was a liquidation style sale and was supervised by experienced liquidators. The going out of business sale assets were finished assets, including display merchandise, defective merchandise, distribution center merchandise, and certain inventory. Also, furniture, fixtures, and equipment were to be sold. Supported by RAS, the Debtors tried to maximize the value of the company. The Debtors, along with RAS, decided that going out of

Administrative Superpriority, (2) Granting Liens, (3) Authorizing Use of Cash Collateral by the Debtors Pursuant to 11 U.S.C. Section 363 and Providing for Adequate Protection, (4) Modifying the Automatic Stay and (5) Scheduling a Final Hearing (Dkt. 43)(March 20, 2009).

⁹⁰ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Limited Objection of the Official Committee of Unsecured Creditors to Debtors' Motion for Interim and Final Orders (I) Authorizing Debtors-in-Possession to Enter into Senior Debtor-in-Possession Credit Agreement and Obtain Post-petition Financing Pursuant to Section 363 and 364 of the Bankruptcy Code; (II) Granting Liens, Security Interests and Superpriority Claims; (III) Authorizing the Use of Cash Collateral; (IV) Affording Adequate Protection to Prepetition Lenders; and (V) Providing for the Payment of Secured Prepetition Indebtedness (Dkt. 118)(April 10, 2009).

⁹¹ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Final Order Pursuant to 11 U.S.C. Sections 105, 361, 362, 363 and 364 and Rules 2002, 4001 and 9014 of the Federal Rules of Bankruptcy Procedure (1) Authorizing Incurrence by the Debtors of Post-petition Secured Indebtedness with Priority Over All Secured Indebtedness and with Administrative Superpriority, (2) Granting Liens, (3) Authorizing Use of Cash Collateral by the Debtors Pursuant to 11 U.S.C. Section 363 and Providing for Adequate Protection, (4) Modifying the Automatic (Dkt. 132) (March 20, 2009).

business sales were the best possible way to realize value from the assets that remained at the closing stores.⁹²

RAS and the Debtors created materials to give to hired liquidators, and after approval by the Debtors, RAS contacted nationally known liquidators confidentially. The Debtors, with the guidance of RAS, contacted and negotiated with six national liquidation firms. Each firm was sent information relating to the Debtors' inventory by SKU, department, and store. Additional information was relayed to the liquidation firms over the course of several weeks. Three liquidators submitted fee-based bids, and two liquidators submitted equity bids with a guaranteed amount.

Ultimately, the Debtors chose Hudson Capital Partners,⁹³ which had submitted an equity-based bid, as the liquidators.⁹⁴ Hudson Capital Partners' guaranteed that the Debtors' would recover 44% of the value of the merchandise included in the sales. If the proceeds generated from the sale were greater than the guaranteed amount and the sale expenses, the first 5% of the aggregate cost value of the merchandise was to be paid to Hudson Capital Partners as fee, the next 2% of the aggregate cost value of the merchandise was to be shared 50% and 50% between Hudson Capital Partners and the Debtor, and all remaining proceeds was to be shared 30% to Hudson Capital Partners and 70% to the Debtors.⁹⁵

⁹² *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Declaration of Timothy D. Boates in Support of Debtors' Chapter 11 Petitions and First Day Motions (Dkt. 16)(March 18, 2009).

⁹³ Hudson Capital Partners is a national liquidation firm that specializes in large-scale liquidations of inventory. See *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Declaration of Timothy D. Boates in Support of Debtors' Chapter 11 Petitions and First Day Motions (Dkt. 16)(March 18, 2009)

⁹⁴ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Declaration of Timothy D. Boates in Support of Debtors' Chapter 11 Petitions and First Day Motions (Dkt. 16)(March 18, 2009).

⁹⁵ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Declaration of Timothy D. Boates in Support of Debtors' Chapter 11 Petitions and First Day Motions (Dkt. 16)(March 18, 2009).

Hudson Capital Partners was also responsible for all expenses incurred in conducting the sales. These expenses included, without limitation, occupancy expenses, payroll expenses, employee benefits, supervision costs, promotional materials and expenses, sale supplies, telephone charges, credit card and bank fees, moving expenses, insurance costs, cleaning fees, and security costs.

Store Closing Sales

Another part of the Debtors' intended reorganization was seeking to conduct store closing sales.⁹⁶ Different from the going out of business sales, the store closing sales focused on getting rid of inventory and maximizing the value of the merchandise, rather than a straight liquidation goal. The Debtors believed it was of the utmost importance to conduct store closing sales immediately to avoid the continuing operation of failing stores. The closing stores were all operating at a loss, draining precious money from the Debtor. Also, the timely store closing sales meant avoiding merchandise at the stores becoming outdated or out of season resulting in diminished value. Most important, however, was the fact that Hudson Capital Partners had made its liquidation and agency agreement contingent on the store closing sales.⁹⁷

Asset Purchase Agreement with Walgreens

The day before the petition day, March 17, 2009, the Debtors entered into an agreement with Walgreens for the sale of substantially all their operating assets, subject to competing bids, including:⁹⁸

⁹⁶ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Declaration of Timothy D. Boates in Support of Debtors' Chapter 11 Petitions and First Day Motions (Dkt. 16)(March 18, 2009).

⁹⁷ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Declaration of Timothy D. Boates in Support of Debtors' Chapter 11 Petitions and First Day Motions (Dkt. 16)(March 18, 2009).

⁹⁸ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Order (A) Authorizing and Approving Agreement; (B) Approving Sale of Certain of the Debtors' Assets Pursuant to Section 363 of the Bankruptcy Code Free and Clear of All Liens, Claims and Encumbrances; (C) Approving the Assumption and Assignment of Certain Executory Contracts and

- a. any owned property located at the purchased pharmacies,⁹⁹ including fixtures, furniture, and equipment;
- b. all prescriptions, prescription records, prescription files, customer lists for each of the purchased pharmacy locations;
- c. any inventory located at the purchased pharmacies;
- d. all improvements, fixtures, and appurtenants at the purchased pharmacies;
- e. all permit rights related to the purchased pharmacies;
- f. all records and books relating to the assets, properties, and operations of the purchased pharmacies;
- g. all rights in and under assumed contracts, meaning real estate leases, modifications, amendments, and supplements associated with the purchased pharmacies;
- h. any other “mutually agreeable” assets.¹⁰⁰

Excluded from purchase were the following assets:

- a. all cash, cash deposits, and accounts receivable
- b. all agreements and contracts other than the assumed contracts
- c. all employee benefit plans and all insurance contracts

Unexpired Leases Pursuant to Section 365 of the Bankruptcy Code; (D) Authorizing the Debtors to Consummate Transactions Related to the Above; and (E) Granting Other Relief (Dkt. 23-1) Exhibit A (March 19, 2009).

⁹⁹ Purchased Pharmacies are all located in New Jersey in the following cities: South Plainfield, Old Bridge, Stirling, Middlesex, Manville, South Freehold, Edison, Westfield, Verona, Fairfield, Hazlet, Ramsey, Vauxhall, Warren, Wyckoff, Little Falls, Norwood, Freehold, Englewood, Parsippany, Lincoln Park, Somerset, Hillside, Florham Park, Port Monmouth, Belleville, Wayne, Sayerville, Boontown, Howell, South Plainfield, and Englishtown. There were 33 locations purchased. *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del, Asset Purchase Agreement (Dkt 23-2) (March 17, 2009)

¹⁰⁰ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del, Asset Purchase Agreement (Dkt 23-2) (March 17, 2009)

- d. all of the Debtors' software, websites, URL addresses, and domain names
- e. all corporate minute books and the Debtors' corporate seal
- f. all assets primarily used in the excluded businesses
- g. all real estate contracts and leases other than those in the assumed contracts
- h. the excluded inventory¹⁰¹
- i. all causes of actions, rights, and claims of the Debtors against third parties
- j. any tax refunds for which the Debtors were liable
- k. all of the Debtors' trademarks

It was also agreed that Walgreens would assume the obligations and liabilities of the Debtors under the assumed contracts arising after the closing date. However, Walgreens did not assume any other

¹⁰¹ Excluded inventory was defined as:

- (i) all items of inventory that fit within one or more of the following categories: (a) sample inventory; (b) inventory out of date within ninety (90) days from Closing Date (or already expired), as shown by the manufacturer's labeled expirations date; (c) prescription items over three years old; (d) diagnostic equipment, test strips, labels, vials, bottles and similar items; (e) inventory that is spoiled, has been damaged or broken, is shopworn or faded (including faded labels), or had visible deterioration; (f) any compounding inventory; (g) any chemicals deemed by Buyer to constitute hazardous materials; (h) obsolete inventory not currently being supplied by distributors to retail stores; (i) all non-retail inventory that is not otherwise saleable in the ordinary course of business (e.g., register tapes, labels, shopping bags, etc.); (j) inventory that does not have a legible NDC, lot number or expiration date and (k) any items that subject to a mandatory or voluntary recall; (ii) all items of front-end inventory that fit within one or more of the following categories (in addition to items of front-end inventory that fit within one or more of the categories set forth in clause (i) above): (w) inventory not in its original packaging or in damaged packaging; (x) seasonal merchandise; (y) live plants and (z) furniture of similar items; (iii) any amount of Inventory that would result in the Purchase Price, together with the purchase price paid under that certain File Transfer Purchase Agreement, exceeding \$65,100,000; and (iv) any other items the parties agree to exclude.

In re Drug Fair Group, Inc., Caase No. 09-10897, Bankr. Del, Asset Purchase Agreement (Dkt 23-2) (March 17, 2009)

liabilities or obligations of the Debtors. The Debtors remained liable for all other liabilities, including, obligations arising prior to closing, any obligations arising prior to closing under the assumed contracts, any liabilities relating to excluded assets, and any tax related liability. Walgreens specifically stated in the agreement that at no time would it be liable for:

- a. any liability arising from the ownership or operation of the purchased assets prior to the closing date
- b. any liabilities with respect to the Debtors' employees
- c. any liabilities arising under the Worker Adjustment and Retraining Act
- d. any legal obligations of the Debtors under HIPAA or other laws/regulations relating to patient privacy.

Walgreens agreed to pay \$54,000,000 for the purchased assets, plus the sum of the prepaid rent amount and the amount by which the inventory amount exceeded the targeted inventory amount¹⁰² less the sum of the amount by which the targeted inventory amount exceeded the inventory amount, the prescription volume reduction amount, and the operating covenant reduction amount.

No other bidders came forward, and the court found the asset purchase agreement was fair. There were no other offers to purchase the assets for greater economic value than the value offered by Walgreens. Walgreens purchased the assets free and clear of all liens. The court determined that the Debtors established sound business purposes for the sales.¹⁰³ It also determined that the Debtors

¹⁰² Target Inventory Amount means \$18,100,000. *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del, Asset Purchase Agreement (Dkt 23-2) (March 17, 2009).

¹⁰³ *In re Drug Fair Group, Inc.*, Case No. 09-10897, Bankr. Del., Order (A) Authorizing and Approving Agreement; (B) Approving Sale of Certain of the Debtors' Assets Pursuant to Section 363 of the Bankruptcy Code Free and Clear of All Liens, Claims and Encumbrances; (C) Approving the Assumption and Assignment of Certain Executory Contracts and

had followed the terms of the sale procedures order and additional procedures for notice of the sale motion, the auction, the sale hearing, and the sale.

Liquidation Plan

After the sale to Walgreens, the Debtors proceeded to sell off their remaining assets.¹⁰⁴ The Debtors also sought to reject several leases on real property and equipment and abandon any personal property remaining at the lease sites.¹⁰⁵ The court allowed all these things,¹⁰⁶ leaving the Debtors with very little in their own hands. With this work done, much of the hurry in the case slowed down.

After several motions to extend the deadline to file a reorganization plan and disclosure statement, the Debtors filed a Chapter 11 Plan of Liquidation on March 17, 2010, one day shy of a year since filing their voluntary petitions.¹⁰⁷ The Debtors filed a proposed Disclosure Statement along with the Plan of Liquidation.¹⁰⁸ The debtors filed a First Modified Chapter 11 Plan of Liquidation on April 20, 2011. The Modifications were limited to clerical matters except for the addition of language in Section 9.1 expressly reserving any claims against the Debtors' former employees, officers, or directors that were held by Cardinal Health, the Debtors' largest Creditor.

Unexpired Leases Pursuant to Section 365 of the Bankruptcy Code; (D) Authorizing the Debtors to Consummate Transactions Related to the Above; and (E) Granting Other Relief (Dkt. 23-1) Exhibit A (March 19, 2009).

¹⁰⁴ *In re Drug Fair Group, Inc., et. al.*, Case No. 09-10897, Bankr. Del., Dkt. 188, 195, 221, and 223.

¹⁰⁵ *In re Drug Fair Group, Inc., et. al.*, Case No. 09-10897, Bankr. Del., Debtors' Motion Pursuant to 11 U.S.C. §§ 105(a) and 554(a) for an Order Authorizing the Debtors to (I) Reject Nunc Pro Tunc Certain Unexpired Nonresidential Real Property Leases (II) Reject Nunc Pro Tunc Certain Unexpired Equipment Leases and (III) Abandon Any Personal Property That Remains on the Premises of the Rejected Leases (Dkt. 220)(May 15, 2009).

¹⁰⁶ *In re Drug Fair Group, Inc., et. al.*, Case No. 09-10897, Bankr. Del., Dkt., 200, 211, 254, 274, and 276.

¹⁰⁷ *In re Drug Fair Group, Inc., et. al.*, Case No. 09-10897, Bankr. Del., Chapter 11 Plan of Liquidation of Drug Fair Group, Inc. et al.(Dkt. 614)(April 20, 2010).

¹⁰⁸ *In re Drug Fair Group, Inc., et. al.*, Case No. 09-10897, Bankr. Del., Disclosure Statement with Respect to First Modified Chapter 11 Plan of Liquidation of Drug Fair Group, Inc. et al.(Dkt. 616)(April 20, 2010).

The plan named Clifford Zucker, CPA, of J.H. Cohn LLP as Plan Administrator^{109, 110}, and gave him power to liquidate the Debtor's remaining assets and implement the plan. The Debtors argued that liquidating under Chapter 11 would preserve more of the estate to satisfy creditors than would a conversion to Chapter 7. The Debtors asserted that conversion to Chapter 7 would have incurred additional administrative expenses without preserving any more of the estate for the creditors. There were no objections to this plan. After the creditor classes entitled to vote on the plan returned ballots overwhelmingly favoring the plan, a confirmation hearing was held on June 3, 2010. Classes 3 and 5 were entitled to vote on the plan. Epiq Bankruptcy Solutions¹¹¹ handled the balloting. No votes were cast for or against the plan by members of Class 3. Members of Class 5 voted almost unanimously (91.71% in number, 98.74% in amount, of those voting) to accept the plan.¹¹² The Court entered an order on June 17, 2010, confirming the First Modified Plan of

¹⁰⁹ Clifford Zucker is a Certified Public Accountant, licensed in the State of New Jersey, and a member of the firm J.H. Cohn LLP. (Dkt. 176-2)(Dkt. 176). According to his firm, he is "a partner in J.H. Cohn's Business Investigation Services Group. Mr. Zucker represents financially troubled companies and unsecured and secured creditors during workout, turnaround, and bankruptcy situations. He has also served as a court appointed liquidating supervisor in numerous matters. Additionally, he performs viability analyses, damage claim analyses, liquidations, litigation support services, and fraud investigations. Mr. Zucker has over 25 years experience in both public accounting and private industry. He has been involved in all facets of management, serving as chief operating officer, chief financial officer, and chief executive officer. He has also been a consultant to both start-up operations and financially troubled companies. His industry experience includes healthcare, financial services, manufacturing, distribution, retail, transportation, hospitality, and telecommunications. Mr. Zucker is a member of the American Institute of Certified Public Accountants, the New Jersey Society of Certified Public Accountants, the Association of Insolvency and Restructuring Advisors, the American Bankruptcy Institute, and the Turnaround Managers Association." His areas of functional expertise listed on his company biography include Bankruptcy and Restructuring, Turnaround and Crisis Management, and Forensic Accounting and Litigation Support. He has worked on the bankruptcy cases of NetBank, Inc., The Brooklyn Hospital Center, and magazine publisher General Media, Inc., and in the fair funds settlement of a late trading matter brought by the SEC against CIBC World Markets Corp. <http://www.jhcohn.com/Services/Business-Investigation-Services/BIS-Partner-Profiles/Clifford-A-Zucker-CPA-CFF.aspx>

¹¹⁰ J.H. Cohn LLP (JHC) is a financial advisory and consulting firm based in Edison, New Jersey, that has consulted with debtors, creditors, and equity constituencies on over 200 bankruptcies. JHC has seven partners working in its Business Investigation Services Group. JHC was founded by Julius H. Cohn in 1919. The firm's current CEO is Thomas Marino. In addition to the Drug Fair case, the firm has worked on the bankruptcies of Fleming Companies, Marcal Paper Mills, Inc., Pharmed Group Holdings, Inc., Thornburg Mortgage, Inc., Tousey, Inc., and WorldCom, Inc.

¹¹¹ Epiq Systems provides technological tools to lawyers, bankruptcy trustees, and other professionals to support bankruptcies, class actions suits, regulatory compliance, financial transactions, and litigation. Epiq has offices in twelve United States cities, including Wilmington, DE, New York, and Chicago, and three international offices.

¹¹² *In re Drug Fair, Inc., et. al.*, Case No. 09-10897, Bankr. Del., (Dkt. 661).

Liquidation in its entirety.¹¹³ The Plan Administrator was therefore permitted to begin the final liquidation process under the plan.

The Plan of Liquidation divided creditors into six classes. Class 1 was Pre-Petition Secured Credit and was not impaired by the plan. This debt was satisfied with proceeds from the earlier sales. Class 2 was Term Loan Secured Credit and was not impaired by the plan. This debt was satisfied with proceeds from the earlier sales. Class 3 consisted of all other secured claims and was impaired by the plan. Class 4 consisted of all Priority Non-Tax Claims under 11 U.S.C. 507(a)(3), (4), (5), (6), (7), or (9) and was not impaired by the plan. Class 5 consisted of all General Unsecured Claims and was impaired by the plan. Class 6 consisted of all Interests and was impaired by the plan.¹¹⁴

Because all claims for Class 1 and 2 claimants were satisfied under the plan, all liens and security interests that were held by those claimants were extinguished by the plan. The plan gave the Administrator discretion to disburse to Class 3 claimants either (i) cash equal to the lesser of (a) the amount of the allowed security claim and (b) the value of the property securing the claim, or (ii) the property securing the claim. Any deficiency claims arising out of a Class 3 secured interest were treated in the plan as a Class 5 General Unsecured Claim. As a result, the recovery projected for Class 3 claims was 100%.¹¹⁵

Class 4 Priority Non-Tax claims were expected to recover 100%. Class 5 claimants, as to be expected, were not so fortunate. Class 5 comprised the largest remaining class of claims against the

¹¹³ *In re Drug Fair Group, Inc., et. al.*, Case No. 09-10897, Bankr. Del., Findings of Fact, Conclusions of law and Order Confirming the First Modified Chapter 11 Plan of Liquidation of Drug Fair Group, Inc. et al. (Dkt. 671)(June 7, 2010).

¹¹⁴ *In re Drug Fair Group, Inc., et. al.*, Case No. 09-10897, Bankr. Del., Disclosure Statement with Respect to First Modified Chapter 11 Plan of Liquidation of Drug Fair Group, Inc. et al.(Dkt. 616)(April 20, 2010).

¹¹⁵ *In re Drug Fair Group, Inc., et. al.*, Case No. 09-10897, Bankr. Del., Disclosure Statement with Respect to First Modified Chapter 11 Plan of Liquidation of Drug Fair Group, Inc. et al.(Dkt. 616)(April 20, 2010).

Debtors at \$55 million, and was expected to recover only about 0.5%, or about \$275,000. Class 5 claimants were to be paid a pro rata share of their allowed claims after payment of all Professional and Administrative Claims and all claims in Classes 1-4. Since the deficiency claims related to Class 3 claimants were included with these claims, much of the shine of that class's 100% recovery was dulled. In addition to the nearly wiped-out Class 5, Class 6 Interests were extinguished entirely by the plan.¹¹⁶

The Disclosure Statement provides a useful chart outlining the treatment of creditors under the plan, which is reproduced here:¹¹⁷

SUMMARY OF EXPECTED RECOVERIES				
Class	Claim/Equity Interest	Treatment of Claim/Interest	Current Amount of Claims	Projected Recovery Under the Plan
N/A	Administrative Claims – Professional Claims	After notice and a hearing in accordance with the procedures established by the Bankruptcy Court, the allowed amounts of such Professional Claims shall be determined by the Bankruptcy Court, and the balance due thereon shall thereafter be immediately paid in full in Cash: (a) by the Debtors from the Holback Escrow Account to the extent such Professional Claims are entitled to be paid from the Professional Fee Carve-Out; or (b) from the Plan Administrator Assets.	Approximately \$350,000	Paid in full pursuant to Plan
N/A	Administrative Claims – Substantial Contribution Claims	Allowed Substantial Contribution Claims shall be paid by the Plan Administrator from the Plan Assets within thirty (30) days of allowance by the Bankruptcy Court.	\$0.00	Paid in full pursuant to Plan
N/A	Administrative Claims – Ordinary	Shall be paid by the Plan Administrator first from the Administrative Reserve then from the Plan Assets in the ordinary course of	\$100,00.00	Paid in full pursuant to

¹¹⁶ *In re Drug Fair Group, Inc., et. al.*, Case No. 09-10897, Bankr. Del., Disclosure Statement with Respect to First Modified Chapter 11 Plan of Liquidation of Drug Fair Group, Inc. et al.(Dkt. 616)(April 20, 2010).

¹¹⁷ *In re Drug Fair Group, Inc., et. al.*, Case No. 09-10897, Bankr. Del., Disclosure Statement with Respect to First Modified Chapter 11 Plan of Liquidation of Drug Fair Group, Inc. et al.(Dkt. 616)(April 20, 2010).

	Course Claims	business in accordance with the terms and conditions of any agreements relating thereto		plan
N/A	Administrative Claims – Other Claims	All such Allowed Administrative Claims shall be paid by the Plan Administrator from the Administrative Reserve, then from the Plan Assets within thirty (30) days of allowance by the Bankruptcy Court.	\$94,318	Paid in full pursuant to Plan
1	Pre-Petition Credit Facility Secured Claims	The holder of each Allowed Class 1 Claim has been paid in Cash or otherwise satisfied in a manner acceptable to the holders of the Class 1 Claims in accordance with the terms of the DIP Orders. The Class 1 Claims shall be deemed satisfied and all liens and security interests granted to secure such obligations shall be deemed canceled and shall be of no further force and effect.	\$0.00	Paid in full prior to Plan
2	Term Loan Credit Facility Secured Claims	The holder of each Allowed Class 2 Claim shall receive the Term Loan Distribution in accordance with the terms of the 9019 Stipulation. The Class 2 Claims shall be deemed satisfied and all liens and security interests granted to secure such obligations shall be deemed canceled and shall be of no further force and effect. In no event shall the holder of a Class 2 Claim be entitled to receive any distribution from the Plan Assets.	\$0.00	Paid in full prior to Plan
3	Miscellaneous Secured Claims	The holder of each Allowed Class 4 Claim shall receive at the discretion of the Plan Administrator from the Plan Assets (i) Cash in an amount equal to the lesser of (a) the amount of Allowed Secured Claim and (b) the value of the Debtors' property securing such Allowed Secured Claim currently in the possession of the Debtors minus the amount of claims secured by such property with legal priority senior to the lien priority of the holder of such Allowed Class 3 Claim or (ii) the property securing such Allowed Class 3 Claim. Any Allowed Deficiency Claim of a Holder of an Allowed Class 3 Claim shall be treated as a Class 5 General Unsecured Claim.	\$600,000	Return of collateral or treatment as set forth in Plan
4	Priority Non-Tax Claims	The holder of each Allowed Class 4 Priority Non-Tax Claim shall receive its Pro Rata share of all Plan Assets remaining after payment in full of Post-Effective Date Claims incurred by the Plan Administrator as of the date(s) of distribution(s), Allowed Professional Claims and Allowed Claims in Class 3 until Allowed Class 4 Claims are paid	\$110,000	100%

		in full.		
5	General Unsecured Claims	The holder of each Allowed Class 5 General Unsecured Claim shall receive (a) a Pro Rata share of the Assigned Escrow Amount, and (b) a Pro Rata share of the remaining Plan Assets after payment of all Allowed Professional Claims required to be paid, all Administrative Claims, all Priority Tax Claims, all Allowed Claims in Classes 2, 3, and 4, and the funding of the Plan Administrator Expense Reserve, all in accordance with the confirmed Plan. In no event shall the holder of a Class 2 Claim be deemed to hold an Allowed Class 5 General Unsecured Claim.	\$55 million	Approx. 0.5%
6	Interests	The holders of the Allowed Interests and Claims in Class 6 shall have their Interests and Claims against the Debtors extinguished as of the Effective Date and shall receive no distributions under the Plan.	N/A	0%

The Plan of Liquidation rejected all executory contracts and unexpired leases that were not rejected or assumed prior to the plan. The plan gave thirty days for creditors to file proofs of claims arising from the rejection of contracts and leases, and provided that an order confirming the plan would forever bar claims outside the thirty-day window.¹¹⁸

The plan allowed creditors to make objections prior to confirmation. The Plan Administrator was allowed to make objections to claims subsequent to the confirmation of the plan. The Administrator was not permitted to make any distributions under the plan until all disputes were resolved in a Final Order of the Bankruptcy Court. Subject to the approval of the court, the Debtors were permitted to settle both claims against them and claims they had against third parties before the plan's effective date. Subsequent to the effective date, the right to settle claims vested

¹¹⁸ *In re Drug Fair Group, Inc., et. al.*, Case No. 09-10897, Bankr. Del., Disclosure Statement with Respect to First Modified Chapter 11 Plan of Liquidation of Drug Fair Group, Inc. et al.(Dkt. 616)(April 20, 2010).

exclusively in the Plan Administrator. The Plan Administrator was required to file all objections to claims within 120 days of the plan's effective date unless the Court granted an extension.¹¹⁹

The plan required the Creditors' Committee to appoint a three-person Plan Administrator Oversight Committee before the effective date, after which the Creditors' Committee would cease to exist. The plan provided for the payment of all administrative and professional claims after the effect date and permitted the Plan Administrator to retain and release professionals pursuant to the execution of the plan.¹²⁰

The plan provided that no Claimholder, Interestholder, or other party in interest shall have any right of action against the Debtors, the Creditors' Committee in their representative capacity, the attorneys for the Debtors and the Creditors' Committee,¹²¹ or any other person related to those parties, related to or arising out of the Chapter 11 proceedings, the confirmation of the plan, or the execution of plan, except for actions for willful misconduct or gross negligence. Further, the plan provided that a vote to accept the plan acted as a release from any Claim, Interest, Cause of Action, or other legal or equitable right, of the Plan Administrator, the Debtors and its employees, officers, or representatives serving as of the effective date, the Creditors' Committee, or anyone who may be derivatively liable through any of the parties.¹²²

¹¹⁹ *In re Drug Fair Group, Inc., et. al.*, Case No. 09-10897, Bankr. Del., Disclosure Statement with Respect to First Modified Chapter 11 Plan of Liquidation of Drug Fair Group, Inc. et al.(Dkt. 616)(April 20, 2010).

¹²⁰ *In re Drug Fair Group, Inc., et. al.*, Case No. 09-10897, Bankr. Del., Disclosure Statement with Respect to First Modified Chapter 11 Plan of Liquidation of Drug Fair Group, Inc. et al.(Dkt. 616)(April 20, 2010).

¹²¹ *See*, George W. Kuney, Unethical Protection? Model Rule 1.8(b) and Plan Releases of Professional Liability, 83 Am. Banker L.J. 481 (2009). A release of this type runs up against Rule 1.8(b), which limits releases sought by lawyers of current or prospective malpractice claims. Rule 1.8(b), its predecessor, or some other substantially similar variant has been enacted in all 50 states, but its protections seem to be largely ignored in Chapter 11 practice. There is no indication in the present case that anyone sought outside counsel prior to agreeing to the release from claims of the attorneys involved as Debtors' Counsel or as Counsel to the Creditors' Committee.

¹²² *In re Drug Fair Group, Inc., et. al.*, Case No. 09-10897, Bankr. Del., Disclosure Statement with Respect to First Modified Chapter 11 Plan of Liquidation of Drug Fair Group, Inc. et al.(Dkt. 616)(April 20, 2010).

The plan recognized the Bankruptcy Code's requirement that confirmation of the plan is not likely to require liquidation or further financial reorganization of the Debtors¹²³. Because the plan called for the sale and liquidation of all the Debtors' assets, the Debtors believed that the plan would be satisfied without the need for any further reorganization. The Debtors believed the plan was a better option than a conversion to a Chapter 7 liquidation. Because much of the work toward liquidation had been done under Chapter 11, the Debtors believed conversion to Chapter 7 would incur additional and unnecessary administrative and professional costs. Thus, it was in the creditors' best interest to go ahead under Chapter 11 because that would preserve more of the estate for payment over to the creditors and the unsecured creditors' position would not improve under Chapter 7. While the Debtors were unable to assure that liquidation would bring in any certain amount for distribution to claimholders, they believed a conversion to Chapter 7 would only serve to delay the process and raise its administrative costs.¹²⁴

Administering the Estate

After the Court entered the order confirming the First Modified Plan of Liquidation on June 17, 2010, the focus of the case shifted from the bankruptcy litigation to the day-to-day management of the estate assets by the Plan Administrator and the attorneys. In his January 2011 Quarterly Report, the Administrator showed a cash balance of just over \$3.1 million in the estate. Mr. Zucker sold some inventory left from the Debtors' operations, leaving virtually nothing but cash in the estate. In December 2010, Mr. Zucker began filing Omnibus Objections to claims by creditors,

¹²³ See, 11 U.S.C. 1129(a)(7), which requires that impaired classes or interests must either accept the plan or be in a position under the plan that is at least as good as the position they would be in under a Chapter 7 liquidation before the Court is permitted to confirm the plan.

¹²⁴ *In re Drug Fair Group, Inc., et. al.*, Case No. 09-10897, Bankr. Del., Disclosure Statement with Respect to First Modified Chapter 11 Plan of Liquidation of Drug Fair Group, Inc. et al.(Dkt. 616)(April 20, 2010).

disputing claims on grounds of overstatement, misclassification, or lack of ripeness before avoidance actions are resolved. Between February 4 and 9, 2011, the Court granted the Administrator's objections.¹²⁵

Between March 14 and 17, 2011, the Administrator filed sixty-one Adversary Actions against creditors of the estate seeking the return of payments made during the ninety-day Preference Period immediately preceding the Debtors' filing of their Chapter 11 petitions.¹²⁶ The case against Corporate Finance Solutions, LLC,¹²⁷ is representative of the claims filed by Mr. Zucker in this vein. After establishing jurisdiction and the relationship between the defendant and the debtor, the claims alleged that the debtor made payments to the defendants during the preference period. In the first count, the Administrator sought avoidance of the transfers,¹²⁸ alleging that the payments were made for antecedent debts, that Debtor was insolvent at the time it made the payments, and the creditors received more through the payments than they would have had the payments not been made and they had received payment under Chapter 7. In the second count, the Administrator sought recovery of the transfers.¹²⁹ In the third count, the Administrator sought disallowance of the

¹²⁵ Dkt. 801, 802, 803, 804, 805, and 806.

¹²⁶ Dkt. 820-1 to 881-1. These adversary actions are outlined in a chart, *infra*, and the docket items are accessible by hyperlink there.

¹²⁷ *Clifford Zucker, as Plan Administrator for Drug Fair Group, Inc. v. Corporate Finance Solutions, LLC (In re Drug Fair Group, Inc.)*, Dkt. 822.

¹²⁸ *See*, 11 U.S.C. § 547(b): “[T]he trustee may avoid any transfer of an interest of the debtor in property—(1) to or for the benefit of a creditor; (2) for or on account of an antecedent debt owed by the debtor before such transfer was made; (3) made while the debtor was insolvent; (4) made—(A) on or within 90 days before the date of the filing of the petition; or (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and (5) that enables such creditor to receive more than such creditor would receive if—(A) the case were a case under chapter 7 of this title; (B) the transfer had not been made; and (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

¹²⁹ *See*, 11 U.S.C. § 550(a): Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553 (b), or 724 (a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from—(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or (2) any immediate or mediate transferee of such initial transferee.

defendants' claims,¹³⁰ alleging that he had demanded repayment of the transfers and that the defendants have failed and refused to repay them. The largest claim was against Cardinal Health for over \$41 million. The rest of the claims were for between \$1,000 and \$700,000. The largest claims, after that against Cardinal Health, were against suppliers and landlords, as shown in the following chart:

Docket Number	Defendant	Total Amount of Preference Period Payments
<u>820</u>	Agilysys	\$53,160.00
<u>821</u>	Corporate Finance Solutions, LLC	\$64,126.13
<u>822</u>	Graphic Communications Holdings, LLC	\$126,324.56
<u>823</u>	Key Equipment Finance	\$29,440.92
<u>824</u>	Li & Fung (Trading) LTD. (Hong Kong)	\$365,859.00
<u>825</u>	McRoberts Protective Agency, Inc.	\$20,941.62
<u>826</u>	PlusNetMarketing Inc.	\$14,675.00
<u>827</u>	Retail Technologies Corporation	\$24,835.14
<u>828</u>	Russell Stover Candies	\$95,520.64
<u>829</u>	The Ultimate Software Group, Inc.	\$40,313.03
<u>830</u>	ATICO International Inc.	\$29,194.38
<u>831</u>	Catalyst Consulting Services Inc.	\$33,653.01
<u>832</u>	Don Wasserman International	\$18,792.50
<u>833</u>	Fleet Services	\$37,408.94

¹³⁰ See, 11. U.S.C § 502(d): Notwithstanding subsections (a) and (b) of this section, the court shall disallow any claim of any entity from which property is recoverable under section 542, 543, 550, or 553 of this title or that is a transferee of a transfer avoidable under section 522 (f), 522 (h), 544, 545, 547, 548, 549, or 724 (a) of this title, unless such entity or transferee has paid the amount, or turned over any such property, for which such entity or transferee is liable under section 522 (i), 542, 543, 550, or 553 of this title.

<u>834</u>	Garda CL Atlantic, Inc.	\$25,232.89
<u>835</u>	Interactive Communications Int'l, Inc.	\$172,274.00
<u>836</u>	JCP&L	\$148,647.83
<u>837</u>	Marsh USA, Inc.	\$70,219.16
<u>838</u>	AFCO	\$256,189.46
<u>839</u>	Procter & Gamble Dist.	\$146,529.88
<u>840</u>	PDX, Inc.	\$45,064.40
<u>841</u>	Loreal Paris	\$22,000.00
<u>842</u>	American Greetings	\$100,000.00
<u>843</u>	General Mills Inc.	\$33,483.78
<u>844</u>	Kimberly Clark	\$11,753.68
<u>845</u>	WIS International	\$102,230.55
<u>846</u>	Benckiser Consumer Prod.	\$26,591.29
<u>847</u>	Ramp Group, LLC	\$59,510.85
<u>848</u>	Berkeley Development Co, L.P.	\$60,817.23
<u>849</u>	Raritan Shopping Center, L.P.	\$102,713.54
<u>850</u>	New Jersey Natural Gas	\$105,561.65
<u>851</u>	Vornado Finance, LLC	\$109,075.26
<u>852</u>	PSE&G Co.	\$144,048.04
<u>853</u>	Cardinal Health	\$41,929,113.37
<u>854</u>	Piedmont Associates, L.L.C.	\$35,062.67
<u>855</u>	Ceridian	\$49,411.72
<u>856</u>	West Long Branch Shopping	\$50,569.04
<u>857</u>	Telesolutions	\$30,809.19
<u>858</u>	SW Lock	\$15,397.13
<u>859</u>	Supreme Security Systems, Inc.	\$14,733.18

<u>860</u>	St. George Center Assoc.	\$37,662.47
<u>861</u>	Rockland Electric Company	\$34,634.37
<u>862</u>	Pitney Partners L.P.	\$47,217.18
<u>863</u>	Hamilton Plaza Assoc., LTD	\$126,790.93
<u>864</u>	H.D. Smith	\$75,243.00
<u>865</u>	Elizabethtown Gas	\$11,818.40
<u>866</u>	Cooperative Communication	\$108,782.90
<u>867</u>	Levin Properties, LP	\$40,176.39
<u>868</u>	Moore Wallace	\$49,359.58
<u>869</u>	Liberty Commons, LLC	\$28,569.13
<u>870</u>	Kennedy Mall Associates	\$51,987.16
<u>871</u>	Pineview Homes, Inc.	\$93,513.87
<u>872</u>	Thermal Air Inc.	\$95,201.02
<u>873</u>	L & R Distributors	\$278,000.00
<u>874</u>	Resnick Distributors	\$636,029.37
<u>875</u>	Bottling Group, LLC	\$143,545.37
<u>876</u>	JK Mgmt., LLC; Levcom Wall Plaza Assoc.	\$150,712.11
<u>877</u>	US Construction and Development, LLC	\$20,000.00
<u>878</u>	Veolia Environmental Services	\$10,060.56
<u>879</u>	1135 River Road Realty, LLC	\$121,058.08
<u>880</u>	Raritan Pharmacy	\$146,801.06
<u>881</u>	WithInvestors Rockaway, LLC	\$103,534.50

The Preference Period payments for which the Plan Administrator is seeking repayment total \$47,198,329.10. Without the Cardinal Health¹³¹ claim, the payments total \$5,269,215.73. The average amount of the claims excluding Cardinal is \$87,820.26.

The adverse actions seem to have been initiated against every person or entity to which the Debtors made any payments during the preference period without regard to the nature of the payments. The complaints are substantially identical and make no reference to the reason the payments were made or the nature of the business relationship Drug Fair had with the defendants. As of this writing, only one defendant, Public Service Electric and Gas, had filed an answer,¹³² but it subsequently withdrew its answer, stating that the answer had been inadvertently filed in the wrong main case.¹³³ As long as it stood, the answer raised three affirmative defenses. First, PSE&G claimed it provided new value for the payments it received during the preference period.¹³⁴ Second, it claimed the payments were made in the ordinary course of business of the Debtors and PSE&G.¹³⁵ Third, PSE&G sought dismissal of the Plan Administrator's Third Count for Disallowance of Claim under § 502(d) for failure to state a claim. Citing *In re Southern Air Transport, Inc.*, 294 B.R. 293, 296 (Bankr. S.C. Ohio 2003), PSE&G argued that the Bankruptcy Court must decide whether a payment was made in preference before it can allow or disallow a claim. Because

¹³¹ Cardinal Health is a multinational company that works in all stages of pharmaceutical distribution. It was founded as a food distributor in Columbus, Ohio, in 1971. It began pharmaceutical distribution in 1979 and went public in 1983. Since then, Cardinal Health has acquired several other distribution companies and is now a Fortune 17 company. Cardinal Health's company history is available at its website at www.cardinal.com.

¹³² Dkt. 884.

¹³³ Dkt. 885.

¹³⁴ See, 11 U.S.C. § 547(c)(4): "The trustee may not avoid under this section a transfer . . . to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor"

¹³⁵ See, 11 U.S.C. § 547(c)(2): "The trustee may not avoid under this section a transfer . . . to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—

- (A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or
- (B) made according to ordinary business terms

the preference issue has not been adjudicated, PSE&G argued that it is not yet liable for any amount under a preference claim, and that the Plan Administrator's § 502 action is premature.

The type of argument employed by PSE&G raises an issue in the manner in which the Plan Administrator proceeded with his adversary actions. There appears to be little investigation into the payments on his part before filing the suits. As a result, actions exist against entities, like the utility companies, who have obvious new value and ordinary course defenses under § 547. The complaints do not specify precisely what the payments were for, and that information will likely only become available if and when defendants file answers.

Conclusion

The Chapter 11 filing of the Debtors was a unique situation. It seems there was never a formal plan to reorganize. The majority of the Debtors' attention was focused the Walgreens deal, which was, for the most part, worked out before the petition was filed. The Chapter 11 liquidation efforts were in large part ancillary to the Walgreens deal. The Chapter 11 filing seems to have been a way to "wash the assets clean" for Walgreens that otherwise could not have been accomplished so easily.

Drug Fair Group

Robby Lockett

Scott Lochridge

Jessica Manning



Quick Facts

- Large retail pharmacy in New Jersey
- Employ about 1500 people
- Headquartered in Somerset, NJ
- Owned by Sun Capital Partners
- “We Care” is the company slogan

DRUG FAIR
we care.

Economic Jeopardy

- 2007 & 2008 competition from stores like Walgreens began to eat away at profits
- \$22,868,000 loss in 2008
- Before filing Chapter 11, Drug Fair sold stores, prescriptions, and other assets to Walgreens



First Day Motions

- Joint Administration
- Bank Accounts
- Utilities
- Customer Programs
- Obtain Credit
- Pay Sales Tax
- Pay Employee Wages
- DIP Financing

Joint Administration

- Drug Fair and CDI group moved for joint administration.
- “if ... two or more petitions are pending in the same court by or against ... a debtor and affiliate, the court may order a joint administration.” -11 U.S.C. § 1015(b)
- This allows for significant cost savings which benefits the party in interest.

Maintain Bank Accounts

- The UST Guidelines requires a debtor to:
 - Establish one DIP account for taxes
 - Close existing accounts and open DIP accounts
- Drug Fair sought relief from the Guidelines claiming compliance with the guidelinese would disrupted operations – ultimately harming the parties in interest.

Prohibit Utilities from Discontinuing

- Utility providers may discontinue its services if the debtor has not furnished assurance of payment within 30 days after the petition date - § 366(c)(2)
- To provide adequate assurance Drug Fair was to deposit ~ \$170 K into an account.
 - ½ of their monthly average.
- The amount was to provide adequate assurance was eventually reduced to ~ \$48 K

Continue Customer Programs

- The debtor may be authorized to pay certain prepetition claims if they can articulate some business justification, other than mere appeasement of major creditors.
 - § 363(b)(1)
- Drug Fair estimated they owed approximately \$20,000 total in prepetition obligations in the form of discounts or store credit.
- Drug Fair claimed it was essential to make these payments to maintain customer loyalty and the value of the estate.

Motion to Obtain Credit

- The debtor may be authorized to pay certain prepetition claims if they can articulate some business justification, other than mere appeasement of major creditors.
 - § 363(b)(1)
- Drug Fair owed a total of \$282 K on account of prepetition insurance policies and related broker fees.
- Failure to pay the premium payments could result in the termination of the insurance.
- Payment, therefore, would allow business operations to continue without interruption.

Motion to Pay Sales Tax

- The debtor may be authorized to pay certain prepetition claims if they can articulate some business justification, other than mere appeasement of major creditors.
 - § 363(b)(1)
- Drug estimated that the total amount of prepetition taxes and fees owed was ~ \$553K.
- Making the payments on time would prevent the accrual of interest and penalties.
- Also, the directors and officers could have been subjected to personal liability.

Motion to Pay Employee Wages

- The debtor may be authorized to pay certain prepetition claims if they can articulate some business justification, other than mere appeasement of major creditors.
 - § 363(b)(1)
- Payroll obligations ~\$710 K
- Unused vacation time ~ \$565 K
- Without the payment employees would suffer hardship and may choose to leave.

Motion to Approve DIP Financing

- If trustee is unable to obtain unsecured credit allowable under section 503 (b)(1) as an administrative expense, the court,... , may authorize the obtaining of credit or the incurring of debt
 - Section 364(c)
- Drug Fair sought entry of interim and final orders authorizing:
 - DIP loans to have senior secured super-priority
 - Use of cash collateral
- \$20 million (interim)
- \$40 million (final)
- Committee Objected to no avail.

Walgreens Deal



Walgreens Deal cont'd

- any owned property located at the purchased pharmacies, including fixtures, furniture, and equipment;
- all prescriptions, prescription records, prescription files, customer lists for each of the purchased pharmacy locations;
- any inventory located at the purchased pharmacies;
- all improvements and fixtures at the purchased pharmacies;
- all permit rights related to the purchased pharmacies;
- all records and books relating to the assets, properties, and operations of the purchased pharmacies;
- all rights in and under assumed contracts, meaning real estate leases, modifications, amendments, and supplements associated with the purchased pharmacies;
- any other “mutually agreeable” assets.



Walgreens Deal cont'd

- all cash, cash deposits, and accounts receivable
- all agreements and contracts other than the assumed contracts
- all employee benefit plans and all insurance contracts
- all of the Debtors' software, websites, URL addresses, and domain names
- all corporate minute books and the Debtors' corporate seal
- all assets primarily used in the excluded businesses
- all real estate contracts and leases other than those in the assumed contracts
- the excluded inventory
- all causes of actions, rights, and claims of the Debtors against third parties
- any tax refunds for which the Debtors were liable
- all of the Debtors' trademarks

Chapter 11 Plan of Liquidation

- Plan filed March, 17, 2010
- First Modified Plan filed April 20, 2010
- Plan defined 6 classes of creditors
- Plan called for the liquidation of the assets remaining after the Walgreens Sale and the GOB/Store Closing Sales

Plan Administrator

- Clifford Zucker, CPA
- JH Cohn, LLP, financial consultants
- Zucker is a Business Investigation Services Partner with JHC, a New Jersey financial services firm that has handled over 200 bankruptcies.

Classes of Claims

- Class 1 – Pre-Petition Secured Creditors
- Class 2 – Term Loan Secured Creditors
- Class 3 – All Other Secured Claims
- Class 4 – Priority Non-Tax Claims
- Class 5 – General Unsecured Claims
- Class 6 – All Interests

Results of Plan

- Classes 1 & 2 – Claims satisfied 100%
- Class 3 – Plan Administrator has authority to give back security property or the cash value of security property. All deficiency claims are extinguished.
- Class 4 – 100% expected recovery
- Class 5 – 0.5% expected recovery
- Class 6 – All Interests extinguished

Adversary Actions

- In March, 2011, the Plan Administrator filed 61 adversary actions to recover payments made during the Preference Period.
- It appears these actions were filed against every recipient of payments, without investigation as to whether the payments were recoverable under §§ 547.

Lessons learned

- Get to know the outside story as much as the inside story
 - Judges
 - Pre-petition deals

Lessons cont'd

- Figure out who the key players are and how they work together as soon as possible
- Sometimes working backwards is easier than working forwards