

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

In re:

SMURFIT-STONE CONTAINER  
CORPORATION, et al.,<sup>1</sup>

Debtors.

Chapter 11

Case No. 09- 10235 ( )

Joint Administration Requested

**MOTION OF THE DEBTORS FOR AN ORDER AUTHORIZING THE  
PAYMENT OF PREPETITION CLAIMS OF CERTAIN CRITICAL VENDORS**

The above-captioned debtors and debtors-in-possession (each a “Debtor” and collectively, the “Debtors”) hereby move this Court (the “Motion”) pursuant to sections 105(a), 363, 364, 1107 and 1108 of title 11 of the United States Code (the “Bankruptcy Code”) for entry of an order (i) authorizing the Debtors to pay, in their discretion, the prepetition claims of certain critical vendors and (ii) authorizing banks and other financial institutions to receive, process, honor, and pay any and all checks and transfer requests evidencing amounts paid by the Debtors under this Order whether presented prior to or after the Petition Date. The facts and circumstances supporting this Motion are set forth in the concurrently filed Affidavit of Charles A. Hinrichs in Support of First Day Motions (the “Hinrichs Affidavit”). In further support of this Motion, the Debtors respectfully state as follows:

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<sup>1</sup> The Debtors in these chapter 11 cases, along with the last four digits of each Debtor’s federal tax identification number, are: Smurfit-Stone Container Corporation (1401), Smurfit-Stone Container Enterprises, Inc. (1256), Calpine Corrugated, LLC (0470), Cameo Container Corporation (5701), Lot 24D Redevelopment Corporation (6747), Atlanta & Saint Andrews Bay Railway Company (0093), Stone International Services Corporation (9630), Stone Global, Inc. (0806), Stone Connecticut Paperboard Properties, Inc. (8038), Smurfit-Stone Puerto Rico, Inc. (5984), Smurfit Newsprint Corporation (1650), SLP Finance I, Inc. (8169), SLP Finance II, Inc. (3935), SMBI Inc. (2567), Smurfit-Stone Container Canada Inc. (3988), Stone Container Finance Company of Canada II (1587), 3083527 Nova Scotia Company (8836), MBI Limited/Limitée (6565), Smurfit-MBI (1869), 639647 British Columbia Ltd. (7733), B.C. Shipper Supplies Ltd. (7418), Specialty Containers Inc. (6564), SLP Finance General Partnership (TBD), Francobec Company (7735), and 605681 N.B. Inc. (1898). The Debtors’ corporate headquarters are located at, and the mailing address for each Debtor is, 150 North Michigan Avenue, Chicago, Illinois 60601.

## **STATUS OF THE CASE AND JURISDICTION**

1. On January 26, 2009 (the "Petition Date"), each of the Debtors filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code. On the Petition Date, the Debtors also jointly filed motions or applications seeking certain typical "first day" relief, including an order to have these cases jointly administered.

2. The Debtors have continued in possession of their respective properties and have continued to operate and maintain their businesses as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

3. The Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157 and 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2). Venue is proper in this Court pursuant to 28 U.S.C. §§ 1408 and 1409. The statutory predicates for the relief requested herein are sections 105(a), 363, 364, 503(b), 1107 and 1108 of the Bankruptcy Code.

## **BACKGROUND OF THE DEBTORS**

4. Smurfit-Stone Container Corporation ("SSCC") is a holding company that conducts its business operations through its wholly-owned subsidiary Smurfit-Stone Container Enterprises, Inc. ("SSCE"), the surviving entity from the November 1998 merger of Jefferson Smurfit Corporation and Stone Container Corporation. SSCE is the direct or indirect parent company of all of the other Debtors and their respective non-debtor affiliates (collectively with SSCC and SSCE, the "Company"). The Company is one of the leading integrated manufacturers of paperboard and paper-based packaging in North America and is one of the world's largest recyclers of paper. The Company sells a broad range of paper-based packaging products, including containerboard, corrugated containers, kraft paper, and point of purchase displays, to a broad range of manufacturers of industrial and consumer products.

5. The Company operates 162 manufacturing facilities that are primarily located in the United States and Canada, including 14 paper mills (12 in the United States and 2 in Canada), 122 container plants (102 in the United States (including 1 in Puerto Rico), 16 in Canada, 3 in Mexico, and 1 in China), and 26 reclamation plants (all in the United States). The Company also owns approximately one million acres of timberland in Canada and operates wood harvesting facilities in Canada and the United States. The Company employs approximately 21,250 employees, of whom approximately 17,410 are based in the United States. For the fiscal year ended December 31, 2007, the Company recorded revenues of approximately \$7.420 billion, resulting in a net loss of approximately \$115 million for fiscal year 2007. For the quarterly period ended September 30, 2008, the Company reported approximately \$7.450 billion in total assets and \$5.582 billion in total liabilities on a consolidated basis.

6. The Company's financial performance depends primarily upon the market demand for its products and the prices that it receives for such products. The recent downturn in the global economy has resulted in an unprecedented decline in demand for the Company's products, leading to increased inventory levels and downward pressure on the Company's operating income. At the same time, substantial price competition and volatility in the pulp and paper industry has resulted in decreased prices for the Company's products which, coupled with the Company's leveraged financial position and the recent volatility in energy prices and the cost of raw materials, have adversely impacted the Company's financial performance. In addition, recent and dramatic changes in the capital markets have adversely impacted the Company's prospects for refinancing its revolving credit and securitization facilities. Because of these factors, the Debtors have found it necessary to commence these chapter 11 cases.

7. On the Petition Date, following the commencement of these chapter 11 proceedings, certain of the Debtors – including Smurfit-Stone Container Canada Inc., a wholly-

owned subsidiary of SSCE, and certain of its affiliates (collectively, the “Cross-Border Debtors”)<sup>2</sup> – will apply for protection from their creditors in Canada pursuant to the Companies’ Creditors Arrangement Act, R.S.C. 1985, c. C-36 (the “CCAA”) or other insolvency laws in the Ontario Superior Court of Justice (Commercial List) (the “Canadian Court”). The Cross-Border Debtors will seek, *inter alia*, an order from the Canadian Court imposing a stay of all proceedings (the “CCAA Stay”) against the Cross-Border Debtors and their property in Canada.

### **RELIEF REQUESTED**

8. By this Motion, the Debtors seek entry of an order pursuant to sections 105(a), 363, 364, 1107 and 1108 of the Bankruptcy Code and Rule 6003 of the Federal Rules of Bankruptcy Procedure (the “Bankruptcy Rules”) (i) authorizing the Debtors, in their discretion, to pay the prepetition claims of critical vendors that delivered goods or provided services to the Debtors prior to the Petition Date and (ii) authorizing banks and other financial institutions to receive, process, honor, and pay any and all checks and transfer requests evidencing amounts paid by the Debtors under this Order whether presented prior to or after the Petition Date.

### **BASIS FOR RELIEF**

9. Certain vendors (the “Critical Vendors”) have claims for providing (i) essential goods to the Debtors that were received by the Debtors before the Petition Date and/or (ii) essential services that were rendered to, or on behalf of, the Debtors before the Petition Date (collectively, the “Critical Vendor Claims”). By this Motion, the Debtors seek entry of an order authorizing the Debtors, in their discretion, to pay the prepetition claims of such Critical Vendors

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<sup>2</sup> The Cross-Border Debtors are Smurfit-Stone Container Canada Inc., Stone Container Finance Company of Canada II, 3083527 Nova Scotia Company, MBI Limited/Limitée, Smurfit-MBI, 639647 British Columbia Ltd., B.C. Shipper Supplies Ltd., Specialty Containers Inc., SLP Finance General Partnership, Francobec Company, and 605681 N.B. Inc. Smurfit-MBI and SLP Finance General Partnership will not apply for protection under the CCAA but will instead seek recognition of their respective Chapter 11 Cases in the Canadian Court under Section 268 of the Bankruptcy and Insolvency Act, R.S.C. 1985 c. B-3, and will seek to receive all protections of the CCAA Stay.

in an aggregate amount not to exceed \$60 million (the “Critical Vendor Cap”).<sup>3</sup> Given the paramount importance of the goods and services provided by the Critical Vendors, and in order to ensure that the Debtors continue to receive such goods and services, it is imperative that the Debtors be authorized to pay the Critical Vendor Claims on an emergency basis.<sup>4</sup>

10. The Debtors believe that payment of the Critical Vendor Claims is vital to the Debtors’ reorganization efforts because, in several instances, the Critical Vendors are the only source from which the Debtors can procure certain goods and services within a timeframe and at a price that will permit the Debtors to continue operating their businesses. A failure to pay the Critical Vendor Claims would likely result in many of the Critical Vendors refusing to provide goods and services to the Debtors post-petition, and may force the Debtors to obtain such goods and services elsewhere at a higher price or in a quantity or quality that is insufficient to satisfy the Debtors’ requirements.<sup>5</sup>

11. The Debtors have examined whether the payment of Critical Vendor Claims is necessary and will ensure that the Debtors have access to adequate amounts of trade credit on a post-petition basis. Specifically, the Debtors have reviewed their accounts payable and have undertaken a process to identify those vendors who are essential to the Debtors’ operations. The Debtors have further developed certain procedures (for which they seek this Court’s approval) that, when implemented, will ensure that vendors receiving payment of

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<sup>3</sup> Debtors reserve the right to seek to increase the Critical Vendor Cap at a later date if necessary, subject to this Court’s approval.

<sup>4</sup> By this Motion the Debtors also seek the authority, where applicable and consistent with the relief sought in this Motion, to “pay” certain Critical Vendor Claims by cancelling out certain post-petition amounts that may be owed to the Debtors (a “Cancellation”). Such Cancellation would merely serve to avoid the administrative burden of keeping track of payments flowing both to and from the Debtors. To be clear, however, all Critical Vendors receiving “payment” by Cancellation would be subject to the terms and conditions for payment of Critical Vendor Claims set forth in this Motion.

<sup>5</sup> Nothing in this Motion should be construed as a waiver of the Debtors’ right to compel performance of any non-debtor under any agreement.

Critical Vendor Claims will continue to supply trade credit necessary to the Debtors' operations on a post-petition basis and in accordance with the terms of the parties' prepetition dealings.

12. The Debtors consulted with appropriate members of their management team to identify those vendors that are most likely essential to the Debtors' operations using the following criteria: (a) whether the vendor in question is a "sole-source" provider, (b) whether certain customizations prevent the Debtors from obtaining a vendor's goods or services from alternative sources within a reasonable timeframe, (c) if a vendor is not a sole source provider, whether the Debtors have sufficient goods in inventory to continue operations while a replacement vendor is secured, and (d) whether a vendor meeting the standards of (a) or (b) is likely to refuse to continue providing goods or services to the Debtors post-petition if its prepetition outstanding balances are not paid. After carefully assessing the universe of vendors under the foregoing criteria, the Debtors estimated the total payments that would be necessary to ensure the continued supply of critical goods and services to the Debtors following the Petition Date in calculating the Critical Vendor Cap.

13. The Debtors propose to condition the payment of Critical Vendor Claims on the agreement of the individual Critical Vendor to continue supplying goods and services to the Debtors on terms that are as or more favorable to the Debtors as the most favorable trade terms, practices, and programs in effect between the Critical Vendor and the Debtor in the twelve months prior to the Petition Date (the "Customary Trade Terms"), or such other trade terms as are agreed to by the Debtors and the Critical Vendor. The Debtors further propose that all payments of Critical Vendor Claims shall be applied first to the Critical Vendor's claims for goods received by the Debtors within the twenty (20) prior to the Petition Date and the remainder, if any, to the Critical Vendor's claims for good received by the Debtors prior to the

twenty (20) day period before the Petition Date. The Debtors reserve the right to negotiate new trade terms with any Critical Vendor as a condition to payment of any Critical Vendor Claim.

14. The Debtors further propose to take appropriate efforts, in their discretion, to cause each Critical Vendor to enter into an agreement (the “Critical Vendor Agreement”) that includes, without limitation, the following terms:

- (a) The amount of such Critical Vendor’s estimated prepetition claim, after accounting for any setoffs, other credits and discounts thereto, shall be as mutually determined in good faith by the Critical Vendor and the Debtors (but such amount shall be used only for purposes of the Critical Vendor Agreement and the order approving this Motion (the “Critical Vendor Order”) and shall not be deemed a claim allowed by the Court, and the rights of all parties in interest to object to such claim shall be fully preserved until further order of the Court);
- (b) The amount and timing of any payment agreed to be paid in satisfaction of such estimated prepetition claim by the Debtors, subject to the terms and conditions as set forth in the Critical Vendor Order;
- (c) The Critical Vendor’s agreement to provide goods and/or services to the Debtors based upon the Customary Trade Terms (including, but not limited to, credit limits, pricing, cash discounts, timing of payments, allowances, rebates, coupon reconciliation, normal product mix and availability and other applicable terms and programs), or such other favorable trade terms as mutually agreed to by the Debtors and such Critical Vendor, and the Debtors’ agreement to pay the Critical Vendor in accordance with such terms;
- (d) The Critical Vendor’s agreement not to file or otherwise assert against the Debtors, their estates or any of their assets or property (real or personal) any lien (a “Lien”) (regardless of the statute or other legal authority upon which such Lien is asserted) related in any way to any remaining prepetition amounts allegedly owed to the Critical Vendor by the Debtors arising from goods provided to the Debtors prior to the Petition Date, and that, to the extent that the Critical Vendor has previously obtained such a Lien, the Critical Vendor shall immediately take all necessary actions to release such Lien;
- (e) The Critical Vendor’s acknowledgment that it has reviewed the terms and provisions of the Critical Vendor Order and consents to be bound thereby;

- (f) The Critical Vendor's agreement that it will not separately assert or otherwise seek payment of any reclamation claims; and
- (g) If a Critical Vendor who has received payment of a prepetition claim subsequently refuses to supply goods to the Debtors on Customary Trade Terms or other favorable trade terms, any payments received by the Critical Vendor on account of its Critical Vendor Claim will be deemed to have been in payment of then outstanding postpetition obligations owed to such Critical Vendor, and that such Critical Vendor shall immediately repay to the Debtors any payments received on account of its Critical Vendor Claim to the extent that the aggregate amount of such payments exceed the postpetition obligations then outstanding, without the right of setoff or reclamation.

15. Such Critical Vendor Agreements may be in addition to any other agreements between the parties.

16. For those Critical Vendors who have agreed to provide goods or services to the Debtors on terms different from their Customary Trade Terms, the Debtors reserve the right to seek written acknowledgment of such terms on a case-by-case basis. Nothing in this Motion or any order of this Court approving this Motion should be construed as a waiver by any of the Debtors of their rights to contest any invoice of a Critical Vendor under applicable non-bankruptcy law.

17. If a Critical Vendor refuses to supply goods or services to the Debtors on Customary Trade Terms following payment of any portion of its Critical Vendor Claim, or fails to comply with any Critical Vendor Agreement it entered into with the Debtors, the Debtors hereby seek authority to, in their discretion and without further order of the Court, (i) terminate any Critical Vendor Agreement between the Debtors and such Critical Vendor (if applicable), and (ii) deem any payments made to such Critical Vendor on account of its Critical Vendor Claim, whether pursuant to a Critical Vendor Agreement or otherwise, to have been in payment of then-outstanding postpetition claims of such Critical Vendor (the "Terminated Critical Vendor") without further order of the Court. If, however, the Debtors choose not to terminate a



Critical Vendor Agreement immediately upon a refusal by the participating Critical Vendor party to provide goods and/or services in accordance with such Critical Vendor Agreement, they shall not be deemed to have waived the ability to terminate such Critical Vendor Agreement.

18. In the event the Debtors exercise either of the rights set forth in the preceding paragraph, the Debtors request that the Terminated Critical Vendor be required to immediately return any payments made on account of its Critical Vendor Claim to the extent that such payments exceed the postpetition amounts then owed to such Terminated Critical Vendor, without giving effect to any rights of setoff or reclamation. In the event that a Terminated Critical Vendor refuses to acknowledge such recharacterization and to issue the repayment, the Debtors propose that they be authorized to compel such recharacterization and repayment by a motion (on such notice as is required by this Court or by the Local Rules for the United States Bankruptcy Court for the District of Delaware).

A. **PAYMENT OF THE CRITICAL VENDOR CLAIMS IS CRITICAL TO THE DEBTORS' REORGANIZATION EFFORTS**

19. The Debtors believe that authority to pay the Critical Vendor Claims is vital to their reorganization efforts. If this Motion is not granted, the Debtors believe that their access to trade credit on a postpetition basis will be severely limited and that many of the Critical Vendors will stop doing business with the Debtors altogether. Such results would cause immediate and irreparable damage to the Debtors and their estates.

20. The continued availability of trade credit in amounts and on terms consistent with the Debtors' prepetition trade terms is advantageous to the Debtors because it allows the Debtors to preserve working capital while maintaining optimal production levels. The retention or reinstatement of Customary Trade Terms will therefore enable the Debtors to maximize the value of their businesses as a going concern. Conversely, a deterioration in

postpetition trade credit available to the Debtors and a disruption or cancellation of deliveries of goods – many of which are not readily replaceable – would cripple the Debtors’ business operations, increase the amount of funding needed by the Debtors postpetition, and ultimately impede the Debtors’ ability to service their customers, thereby placing their customer base, as well as their successful reorganization, at risk.

21. The goods and services that the Critical Vendors provide to the Debtors can generally be divided into the following categories: (i) Raw Materials and Chemicals, (ii) Plant Maintenance and Repair, (iii) Directed Sourcing and (iv) Customers, each of which is described in further detail below.<sup>6</sup>

**i. Raw Materials and Chemicals**

**a. Wood and Reclaimed Fiber**

22. As described in greater detail in the Hinrichs Affidavit, wood fiber is essential to the paper manufacturing process. The Debtors operate several paper mills throughout the United States and Canada covering a widespread geographic area, all of which require wood fiber for use in the paper making process. In each case, the Debtors derive such fiber from wood, or wood chips (and saw dust) purchased from wood suppliers. Due to the nature of the commodity (wood), the Debtors are required to use local suppliers, in part, because of the high costs of shipping wood between or among regions of the United States or Canada. These high shipping costs make it practically impossible to purchase wood from wood suppliers from other regions. As such, in many regions, the Debtors have very limited (if any) choices as to their supplier of wood.

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<sup>6</sup> The categories of vendors contained herein is not intended to be exclusive. Due to the extensive nature of the Debtors’ operations, it is possible that vendors that provide goods and services not described herein will qualify as a critical vendor based on the criteria set forth above.

23. Typically, the wood suppliers cut wood from their forests on a weekly basis based on the Debtors requirements for that week. As a result, the wood suppliers typically do not carry excess capacity/product that can otherwise be sold to other customers. If the Debtors do not pay the prepetition claims of their wood suppliers, it is highly likely they will refuse to make product available for the Debtors, and in light of the Debtors limited options, the Debtors' mills may not be able to obtain wood chips to process into fiber that is the essential component to the paper making process.

24. The Debtors also use reclaimed or recycled fibers in their manufacturing process. While the process by which the Debtors obtain reclaimed fibers is different from wood fibers, the vendors are similarly critical. The Debtors' primary source of reclaimed fibers comes from arrangements the Debtors have with large generators of recyclable materials – often stores like Wal-Mart, Kroger, and similar stores. Under these arrangements, the Debtors purchase recyclable materials, and transfer certain of the materials to the Debtors' reclamation facilities and sell other materials to outside customers for a profit.

25. Maintaining these arrangements is crucial to the Debtors' reclamation business because they not only provide the Debtors with reclaimed fibers for their recycled paper manufacturing process, but they also provide the Debtors with an additional source of revenue by allowing the Debtors to sell certain materials to outside customers at a profit. The market for purchasing recyclable materials is extremely competitive and if the Debtors do not have the ability to pay some or all of the prepetition amounts owed under these relationships, the Debtors may lose the ability to purchase these materials directly from the recyclable generators. In such a case the Debtors (a) will lose the ability to generate revenue from the sale of certain recyclable materials to outside customers, and (b) be required to purchase recyclable materials for reclaimed fibers from third parties at a higher price.

**b. Chemicals**

26. The paper making process requires the use of several types of chemicals at various stages – the absence of any of these chemicals could curtail the paper making process. For instance, the Debtors use caustic chemicals during the pulping process – a process by which the wood chips are turned into usable bundles of fiber. Processed chemicals, on the other hand, are used after the pulping process and directly impact the end product by inputting characteristics to the sheet of paper and improving the efficiency of the paper making process. Some processed chemicals give the paper color, while others give the paper a smooth or grainy texture depending on the type of chemical. Other chemicals are used to treat the inflow of fresh water from the boiler and steam systems.

27. In many cases, the chemicals used by the Debtors are only available through a limited number of suppliers, making it difficult for the Debtors to find an alternative source without experiencing manufacturing disruptions. In addition, the Debtors' current manufacturing processes have proven successful through the use of its current chemical supply base, and while, in certain circumstances, the Debtors may be able to find the same generic chemical from another supplier, the integration of such replacement chemical into the current manufacturing process may or may not be successful. If unsuccessful, the costs to the Debtors' estates associated with production interruptions and general manufacturing inefficiencies likely would greatly exceed any payment the Debtors would be required to make under this Motion to induce the current critical chemical suppliers to continue supplying product to the Debtors post-petition.

28. Further, in certain cases, the Debtors have negotiated extremely favorable pricing terms with their chemical suppliers as compared to the current market. While technically such chemicals could be purchased through another supplier, the costs to the Debtors' estates

associated with such alternative sourcing in many cases would vastly exceed any payment the Debtors would be required to make under this Motion to induce such suppliers to continue supplying product to the Debtors post-petition.

**c. Inks**

29. Inks are used in the container process to put graphics and wording on packaging and displays. In general, the Debtors carefully choose their ink suppliers in order to produce the highest quality products for their customers. While the Debtors ink suppliers are not technically considered “customer directed,” the Debtors’ customers (and their customers, including the general marketplace) have become accustomed to the quality of the inks and color spectrums used on their packaging and displays. Further, in certain instances, the Debtors’ customers must approve color spectrums (matches) for their packaging and displays. Once the color spectrums are approved, if the Debtors were to use a different ink in their production process, the Debtors would be required to seek customer approval which would likely result in a disruption of product to the Debtors’ customer while such approval is sought.

**ii. Plant Maintenance and Repair**

30. To ensure that a wide range of specialized equipment required for the Debtors’ manufacturing process, including corrugators, boilers, converting machines, and other tooling and material handling equipment operate in an effective, safe and efficient manner, the Debtors rely on specialized maintenance and repair services provided by certain Critical Vendors (collectively, the “Maintenance and Parts Vendors”). Due to the specialized and often hazardous nature of some of the services involved, certain of the services can only be obtained by the Debtors from Maintenance and Parts Vendors with permits or licenses required by state or federal laws and regulations. For example, daily maintenance and repair services can only be performed by certain Maintenance and Parts Vendors possessing specialized skills and/or

licenses when the services involve specialized, proprietary or dangerous elements. Specialized or dangerous elements may include, among other things, high speed rotation motors, toxic substances, high voltage electricity, high pressure boilers, steam systems and dangerous chemicals. Additionally, certain Maintenance and Parts Vendors are the only vendors with the capacity to provide the Debtors with spare parts necessary to maintain and/or repair the Debtors' equipment.

31. The Debtors' plant staffing model places a great deal of importance on the services provided by the Maintenance and Parts Vendors. In certain instances, the Debtors' plants are operated with minimal in-house staffing capable of performing routine maintenance, which is supplemented by the specialized maintenance and repair services provided by the Maintenance and Parts Vendors on a regular or as-needed basis. For example, the Debtors' main unitizing/strapping systems require specialized monthly maintenance from outside vendors.

32. Further, the Debtors require parts to run their equipment on a regular basis. Due to the frequency with which the Debtors require spare parts and the specialized nature of their equipment, the Debtors typically have few options as to the spare parts vendor. Additionally, many of the Debtors' Maintenance and Parts Vendors carry the appropriate number of spare parts in their inventories such that they can support the Debtors' equipment in the event of a part failure. In many cases, such arrangements are crucial to maintain going forward to ensure that the Debtors can quickly replace broken parts and avoid a shut down of their manufacturing equipment.

33. In addition, there are a limited number of vendors able to provide the Debtors with the specialized maintenance and repair services and parts the Debtors require. The Debtors believe that some of the Maintenance and Parts Vendors will refuse to provide

postpetition goods and services to the Debtors if all or a portion of their prepetition claims are not satisfied. Although the Debtors will make every effort to obtain continued performance from the Maintenance and Parts Vendors, it is vitally important that the equipment required for the Debtors' manufacturing process be maintained in an appropriate manner to reduce the risk of disruption to the Debtors' operations. It is, therefore, crucial that the Debtors have the authority to satisfy the prepetition claims of the Maintenance and Parts Vendors. Equipment downtime could result in the Debtors' inability to service their clients, causing significant harm to the Debtors' ability to generate revenue and cash flow.

**iii. Directed Sourcing**

34. In certain cases the Debtors' customers require the Debtors to buy product from a specific source ("Directed Suppliers"). For example, certain of the Debtors' customers require the Debtors use a product from a specific supplier in their corrugating process. In such cases, the Debtors cannot purchase that product from another supplier. If the directed supplier refuses to supply its product to the Debtors unless the supplier's prepetition claim is satisfied in part, or in full, the Debtors will not be able to manufacture its customer's product and will likely lose the customer's business. Thus, it is crucial that the Debtors have the ability to satisfy prepetition claims of Directed Suppliers in order to prevent harm to (or loss of) customer relationships and loss of revenue.

**iv. Customers**

35. In many instances, the Debtors purchase goods from their customers ("Trading Partners"). In such cases, to the extent the Debtors are unable to pay all or a portion of the prepetition claims of the Trading Partners, the Trading Partners will likely cease purchasing

product from the Debtors resulting in a loss of revenue.<sup>7</sup> Further, because of the integrated relationship between the Trading Partners and the Debtors, the Debtors often receive favorable pricing terms on the products they purchase from the Trading Partners. Thus, in the event a Trading Partner ceased to do business with the Debtors altogether, in certain instances, not only will the Debtors lose revenue from the loss of the Trading Partner's customer account, but they may be required to purchase replacement product on less favorable pricing terms.

**B. CASE LAW AND STATUTORY SUPPORT FOR AUTHORIZATION TO PAY CRITICAL VENDOR CLAIMS**

**i. This Court May Authorize Payment of the Critical Vendor Claims Pursuant to Sections 363 and 364 of the Bankruptcy Code**

36. The Court may grant the relief requested herein pursuant to sections 363 and 364 of the Bankruptcy Code. See, e.g., In re UAL Corporation, et al., Case No. 02-48191 (ERW) (Bankr. N.D. Ill. December 11, 2002) (an essential trade motion generated by section 363 is "completely consistent with the Bankruptcy Code" and such payments have further support where the Debtor seeks "the extension of credit under section 364 on different than usual terms, terms that might include payment of a prepetition obligation"); In re James A. Phillips, Inc. Inc., 29 B.R. 391, 397 (S.D.N.Y. 1983) (authorizing, pursuant to section 363, a contractor to pay prepetition claims of some suppliers who were potential lien claimants, because the payments were necessary for the general contractors to release funds owed to the debtors).

37. The relief requested in this Motion contemplates the payment of Critical Vendor Claims of those Critical Vendors who agree to provide postpetition goods and services to

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<sup>7</sup> In their Motion for an Order Authorizing the Debtors to Honor Certain Prepetition Obligations to Customers and Non-Debtor Brokers and to Otherwise Continue Prepetition Customer and Non-Debtor Broker Programs and Practices in the Ordinary Course of Business filed concurrently herewith (the "Customer Motion"), the Debtors request authority to lift the automatic stay for the limited purpose of effecting set-offs of pre-petition amounts owing to and from certain customers. The relief requested herein is intended to apply to those customers that do not have a right to set-off against amounts owed to them by the Debtors, and to customers who are owed amounts in excess of amounts setoff under the Customer Motion.



the Debtors on Customary Trade Terms or other terms acceptable to the Debtors. As a result, the payment of such Critical Vendor Claims is consistent with and appropriate under sections 363 and 364 of the Bankruptcy Code.

38. As detailed above, maintaining the goods and services provided by the Critical Vendors is vital to the Debtors' continuing business operations and the success of these chapter 11 cases. In addition, and as also detailed above, the Debtors have conducted an extensive analysis and review of the Debtors immediate trade needs and supplier base and have concluded that there is a significant risk that the Critical Vendors will cease doing business with the Debtors unless their Critical Vendor Claims are paid. Should any Critical Vendor stop supplying the Debtors, or choose to significantly downgrade the Debtors' trade terms, their businesses would be significantly and perhaps irreparably disrupted because their manufacturing facilities would lack the requisite materials and services needed to supply products to customers. This, in turn, would affect the Debtors' customers', supply chain and operations. Such a scenario would drastically affect the Debtors' revenues, cash flows and profitability and could lead to large customer damage claims against the Debtors. As such, the Debtors submit that the amount of the Critical Vendor Cap is small relative to the likely damage to the Debtors' businesses and estates should the relief requested herein not be granted. Accordingly, not only will the Debtors' other creditors not be impaired by payment of the Critical Vendor Claims, such creditors will in fact benefit by this Court's empowering the Debtors to negotiate payment to Critical Vendors to achieve a smooth transition into bankruptcy with minimal disruption to its operations. In light of the foregoing, the Debtors submit that payment of the Critical Vendor Claims is plainly in the best interests of their estates and creditors.

**ii. The Court May Also Grant the Motion Pursuant to Its General**

### **Equitable Powers under Section 105(a) of the Bankruptcy Code and the Necessity of Payment Doctrine**

39. The Court's general equitable powers are codified in section 105(a) of the Bankruptcy Code. Section 105(a) empowers the Court to "issue any order, process, or judgment that is necessary to carry out the provisions of [the Bankruptcy Code]." 11 U.S.C. § 105(a). A bankruptcy court's use of its equitable powers to "authorize the payment of prepetition debt when such payment is needed to facilitate the rehabilitation of the debtor is not a novel concept." In re Ionosphere Clubs, Inc., 98 B.R. 174, 175 (Bankr. S.D.N.Y. 1989). Under section 105(a), the Court "can permit pre-plan payment of a prepetition obligation when essential to the continued operation of the debtor." In re NVR L.P., 147 B.R. 126, 127 (Bankr. E.D. Va. 1992); see also In re Just for Feet, Inc., 242 B.R. 821, 825 (D. Del. 1999) ("to invoke the necessity of payment doctrine, a debtor must show that payment of the prepetition claims is critical to the debtor's reorganization").

40. Numerous courts have used their section 105(a) equitable powers under the necessity of payment doctrine to authorize payment of a debtor's prepetition obligations where, as here, such payment is necessary to effectuate the "paramount purpose" of chapter 11 reorganization, which is to prevent the debtor from going into liquidation and preserve the debtor's potential for rehabilitation. See In re Lehigh Co. & New England Ry. Co., 657 F.2d 570, 581 (3d Cir. 1981) (holding that "if payment of a claim which arose prior to reorganization is essential to the continued operation of the . . . [business] during reorganization, payment may be authorized even if it is made out of [the] corpus"); In re Ionosphere Clubs, Inc., 98 B.R. 174, 176-77 (Bankr. S.D.N.Y. 1989) (doctrine "recognizes the existence of the judicial power to authorize a debtor in a reorganization case to pay prepetition claims where such payment is essential to the continued operation of the debtor"); see also In re James A. Phillips, Inc., 29 B.R.

391, 394-95 (S.D.N.Y. 1983) (upholding the bankruptcy court's order authorizing the debtor to make postpetition payment of prepetition claims in the ordinary course without notice and a hearing). The "necessity of payment" doctrine "recognizes the existence of the judicial power to authorize a debtor in a reorganization case to pay prepetition claims where such payment is essential to the continued operation of the debtor." Ionosphere Clubs, 98 B.R. at 176; In re Chateaugay Corp., 80 B.R. 279 (S.D.N.Y. 1987). This rule is consistent with the paramount goal of chapter 11, i.e., "facilitating the continued operation and rehabilitation of the debtor . . . ." Ionosphere Clubs, 98 B.R. at 176.

41. Under the doctrine of necessity, a bankruptcy court may exercise its equitable power to authorize a debtor to pay the prepetition claims of certain critical vendors. See In re Columbia Gas Sys., Inc., 136 B.R. 930, 939 (Bankr. D. Del. 1992) (recognizing that "[i]f payment of a prepetition claim 'is essential to the continued operation of [the debtor], payment may be authorized'"). Indeed, it is not uncommon for courts in this District to authorize the payment of critical trade claims where the payment of such claims is essential to the debtor's continued operations. See, e.g., In re Tribune Company, Case No. 08-13141 (Bankr. D. Del. December 8, 2008) (KJC); In re Buffets Holding, Inc., Case No. 08-10141 (Bankr. D. Del. Jan. 24, 2008) (MFW) (entered by BLS); In re American Home Mortgage Holdings, Inc., Case No. 07-11047 (Bankr. D. Del. Aug. 7, 2007) (CSS); In re Tweeter Home Entertainment Group, Inc., Case No. 07-10787 (Bankr. D. Del. June 12, 2007) (PJW); In re Holliston Mills, Inc., Case No. 07-10687 (Bankr. D. Del. May 23, 2007) (MFW); In re Meridian Automotive Systems-Composite Operations, et al., Case No. 05-11168 (Bankr. D. Del. May 27, 2005) (MFW); In re Glass Group, Inc., Case No. 05-10532 (Bankr. D. Del. Mar. 2, 2005) (PJW). This Court has also upheld the relief requested by the Debtors concerning their remedies for breach of a Trade

Agreement. See In re Maxxim Medical Group, Inc., Case No. 03-10438 (Bankr. D. Del. Feb. 19, 2003) (Walsh, J.). The Debtors respectfully submit that similar relief is warranted in these chapter 11 cases.

**iii. The Court May Also Authorize the Relief Requested as a Valid Exercise of the Debtors' Fiduciary Duties**

42. The Debtors, operating their businesses as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code, are fiduciaries “holding the bankruptcy estate[s] and operating the business for the benefit of . . . [their] creditors and (if the value justifies) equity owners.” In re CoServ, 273 B.R. 487, 497 (Bankr. N.D. Tex. 2002). Implicit in the duties of a chapter 11 debtor-in-possession is the duty “to protect and preserve the estate, including operating business’s going-concern value.” Id.

43. It has been noted that there are instances in which a debtor-in-possession can fulfill its fiduciary duty “only . . . by the preplan satisfaction of a prepetition claim.” Id. The CoServ court specifically noted that pre-plan of reorganization satisfaction of prepetition claims would be a valid exercise of a debtor’s fiduciary duty when the payment “is the only means to effect a substantial enhancement of the estate” and also when the payment was to “sole suppliers of a given product.” Id. at 497-98. The court provided a three-pronged test for determining whether a preplan payment on account of a prepetition claim was a valid exercise of a debtor’s fiduciary duty:

First, it must be critical that the debtor deal with the claimant. Second, unless it deals with the claimant, the debtor risks the probability of harm, or, alternatively, loss of economic advantage to the estate or the debtor’s going concern value, which is disproportionate to the amount of the claimant’s prepetition claim. Third, there is no practical or legal alternative by which the debtor can deal with the claimant other than by payment of the claim.

Id. at 498.

44. Payment of the Critical Vendor Claims meets the test set forth in CoServ. As described above, the Debtors have narrowly tailored the Critical Vendor Cap to encompass only those Critical Vendors which are essential to the business and operation of each of the Debtors' businesses. Any interruption of the Debtors' operations could cost the Debtors' estates millions of dollars in lost revenues and furthermore, could cause the Debtors' to lose a significant amount of customers. Accordingly, the harm that would stem from the failure to pay any of the Critical Vendors is disproportionate to the amount of the prepetition claims that the Debtors are seeking to pay hereunder. Moreover, with respect to each Critical Vendor, the Debtors have examined other options short of payment of such Critical Vendor Claims and have determined that to avoid significant disruption of the Debtors' business operations, there exists no practical or legal alternative to payment of the Critical Vendor Claims. Therefore, the Debtors can only meet their fiduciary duties as debtors in possession under sections 1107(a) and 1108 of the Bankruptcy Code by payment of the Critical Vendor Claims. Accordingly, the Court should grant the relief requested herein.

**iv. The Court Should Authorize the Debtors to Satisfy the Critical Vendor Claims Within Twenty Days After the Petition Date as Requested**

45. Pursuant to the recent revisions to Bankruptcy Rule 6003, the Court may authorize payment of a prepetition claim within 20 days after the Petition Date if such relief is necessary to avoid immediate and irreparable harm. As explained above, satisfying the Critical Vendor Claims is essential to the continued, uninterrupted operation of the Debtors' businesses. Without satisfaction of these claims, the Debtors believe that the Critical Vendors will significantly downgrade trade terms and may stop supplying them with critical goods and

services necessary in their operations, thereby hampering the Debtors' ability to successfully reorganize.

46. For the foregoing reasons, the Debtors submit that they have satisfied the requirements of Bankruptcy Rule 6003 and accordingly, the Court should grant the relief requested herein.

47. To the extent Fed. R. Bankr. P. 6004(h) is applicable to this Motion, the Debtors also seek a waiver of the ten-day stay under Fed. R. Bankr. P. 6004(h).

### NOTICE

48. Notice of this Motion has been provided to: (i) the Office of the United States Trustee; (ii) the United States Securities and Exchange Commission; (iii) the Office of the United States Attorney for the District of Delaware; (iv) the Internal Revenue Service; (v) the Debtors' thirty (30) largest unsecured creditors on a consolidated basis; (vi) counsel to the agents for the Debtors' prepetition loan facilities; (vii) counsel to the agents for the Debtors' proposed post-petition lenders; (viii) the indenture trustees for each series of the Debtors' prepetition notes; and (ix) each of the Debtors' cash management banks. Notice of this Motion and any order entered hereon will be served in accordance with Local Rule 9013-1(m). In light of the nature of the relief requested herein, the Debtors submit that no other or further notice is necessary.

WHEREFORE, the Debtors respectfully request that the Court enter an order, in substantially the form attached hereto as Exhibit A (i) authorizing, on an emergency basis, the Debtors to satisfy, in their discretion, the Critical Vendor Claims; and (ii) granting such other and further relief as the Court deems just and proper.

Dated: Wilmington, Delaware  
January 26, 2009

Respectfully submitted,

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