

**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 DEBTORS TO  
HONOR CERTAIN PREPETITION OBLIGATIONS TO CUSTOMERS AND BROKERS  
AND TO OTHERWISE CONTINUE PREPETITION CUSTOMER AND BROKER  
PROGRAMS AND PRACTICES IN THE ORDINARY COURSE OF BUSINESS**

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, 1107(a) and 1108 of title 11 of the United States Code (the “Bankruptcy Code”) for entry of an order (i) authorizing the Debtors to honor certain prepetition obligations to customers and non-debtor brokers and to otherwise continue their prepetition customer and independent broker programs and practices in the ordinary course of business, and (ii) authorizing banks and other financial institutions to honor and process all checks and wire transfers related to the payment of such prepetition obligations. 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 the 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, 1107(a) 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 request the entry of an order granting the Debtors authority to operate in the ordinary course of business and to (i) perform their prepetition obligations related to the Customer Programs (as defined below) as they determine advisable, (ii) continue, renew, replace, modify and/or terminate any of the Customer Programs, as the Debtors determine advisable, in the ordinary course of business and without further application to this Court, (iii) maintain their relationships with the Brokers (as defined below), and (iv) perform and pay certain prepetition obligations the Debtors owe to the Brokers.

9. Prior to the Petition Date, and in the ordinary course of their business operations, the Debtors engaged in certain practices to develop and sustain a positive reputation with their customers and in the marketplace for their products (collectively, the “Customer Programs”). The Customer Programs, many of which are customary in the Debtors’ industries, include, among others, rebates, prebates, pre-payments, adjustments, performance/volume

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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.

discounts and early payment discounts. Each of these Customer Programs is described in greater detail below. The goals of the Customer Programs are to meet competitive pressures, ensure customer satisfaction and generate goodwill for the Debtors, thereby retaining current customers, attracting new ones, and ultimately enhancing the Debtors' revenue and profitability.

10. The Debtors desire to continue during the post-petition period those Customer Programs that they believe are beneficial to their businesses. The Debtors believe that such relief is necessary to preserve critical customer relationships. Indeed, the Debtors believe that the total operational and administrative cost to the Debtors to continue the Customer Programs is relatively insignificant when compared to the revenue that the Debtors generate from their customers. Accordingly, the Debtors hereby seek the authority to continue the Customer Programs on a post-petition basis in the ordinary course of business.

11. In addition, in light of the fact that some of the Customer Programs, as they relate to prepetition agreements between the Debtors and their customers, may represent unperformed prepetition obligations, the Debtors seek this Court's authorization to perform all prepetition obligations under the Customer Programs.<sup>3</sup> Because the industry in which the Debtors operate is highly competitive, some of the Debtors' customers may cease to purchase the Debtors' products and may turn to other sources if the Debtors fail to timely perform their prepetition obligations under the Customer Programs. Therefore, unless the Debtors are able to assure their customer base that they will honor the Customer Programs during these chapter 11 cases, the Customers may seek alternative suppliers, which would result in an immediate loss of

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<sup>3</sup> Nothing contained herein shall constitute, nor shall it be construed as, a request to assume or adopt any executory contract with respect to any Customer or Broker. The Debtors expressly reserve all rights with respect to the continuation or cessation of any contract with any Customer or Broker and the assumption, adoption, modification or rejection of any executory contract with any Customer and Broker. Furthermore, the Debtors reserve the right to contest the amounts claimed to be due, if any, by any Customer or Broker in the ordinary course of business.

revenue and cash flow for the Debtors. For these reasons and the reasons set forth below, the Debtors assert that it is in the best interests of the Debtors and their estates to maintain and continue the Customer Programs in the ordinary course of business.

12. Further, prior to the Petition Date, and in the ordinary course of business, the Debtors utilized the services of several independent brokers or broker groups (collectively, the “Brokers”) in order to obtain new customers and maintain long-term customer relationships for certain of their products through various sale and distribution channels. The Debtors hereby seek the authority to maintain their relationships with the Brokers and to perform certain prepetition obligations the Debtors owe to the Brokers. The Debtors believe that the relief requested herein is crucial to their reorganization efforts because the Brokers are essential to the Debtors’ overall business. Indeed, the Debtors believe that a failure to immediately pay the prepetition amounts owing to the Brokers would have an immediate material and adverse effect on the Debtors’ business resulting from, inter alia, (i) loss of sales revenue if the Brokers reduced or ceased their efforts to sell the Debtors’ products and (ii) potential damage to customer relationships supported by the Brokers. For these reasons, and those discussed below, maintaining relationships with the Brokers is necessary in order for the Debtors to stay competitive, maintain their presence in the marketplace, and preserve their customer base during the course of these chapter 11 cases.

### **CUSTOMER PROGRAMS**

13. The Debtors seek to continue the Customer Programs because they have produced positive results in the past and are responsible for generating valuable goodwill, repeat business, and increased revenue. The Debtors believe that continuing the Customer Programs in the ordinary course of business during these chapter 11 cases is essential to maximizing the value

of their estates for the benefit of all stakeholders. The following are general descriptions of the Customer Programs and the prepetition obligations relating thereto.

## **I. Customer Rebates and Allowances**

14. The Debtors offer rebates and allowances to certain customers to incentivize such customers to buy the Debtors' products. A customer's rebate or allowance is calculated based upon various factors related to the sale of product to such customer. Each rebate or allowance program is unique and custom-negotiated by the Debtors and the respective customer to fit the specific demands of the customer. Under each such customer rebate or allowance program, customers accrue rebates or allowances either monthly, quarterly or annually. The accrued rebates or allowances are then either paid by the application of certain credits to the customer's account or through periodic cash payments to the customer. Depending on the specific terms of each customer's rebates or allowance program, the rebates or allowances are generally paid or credited to the customer either monthly, quarterly or annually. In certain limited circumstances the Debtors will advance a customer funds (a "pre-bate") based on specific annual volume commitments in order to secure future business. Further, under certain circumstances, in order to incentivize customers to purchase product from the Debtors, the Debtors agree that they will identify and guarantee packaging and supply chain savings for their customers over a certain period of time. To the extent the Debtors do not meet the targeted savings, the Debtors typically issue the customer a cash rebate to make up the difference.

15. The Debtors accrued approximately \$60 million in cash rebates and allowances due to their customers on account of sales made during fiscal year 2008. As of the Petition Date, the Debtors estimate that \$24.5 million of outstanding but unpaid customer rebates and allowances are due, approximately \$20 million of which represent cash rebates owed to

customers. The Debtors' believe that any failure to honor their obligations to pay prepetition rebates and allowances to their customers would significantly undermine the Debtors' relationship with their customers and would impair the Debtors' ability to successfully attract new customers. Further, current customers may seek alternative suppliers, thereby adversely impacting the Debtors' ability to generate revenue. Moreover, in the event that the Debtors do not honor such rebate and allowance claims, the affected customers may attempt to offset their rebates or allowances against the amount they owe the Debtors, which would further negatively impact the Debtors' cash flows and revenues.

16. By this Motion, the Debtors are requesting authority to honor their customer rebates and allowances. Because the potential harm to the Debtors' businesses from not honoring the rebates and allowances outweighs the cost to their estates, the Debtors believe that such relief is warranted and necessary to promote their reorganization efforts and maximize the value of their estates for the benefit of all creditors in these cases.

## **II. Customer Adjustments**

17. Despite the Debtors' continuous focus on and dedication to quality, it is inevitable that certain unexpected situations will arise in which the products supplied to the Debtors' customers do not conform to such customers' specifications (the "Nonconforming Goods"). In certain circumstances, the Debtors have warranted that their products, upon delivery, will meet certain specifications required by the customers. Similarly, despite the Debtors' efforts to manage their supply chain, it is inevitable that certain products will occasionally be misdelivered, delivered in an inaccurate quantity, or damaged in transit (the "Misdelivered Goods," and together with the Nonconforming Goods, the "Adjusted Goods").



18. Additionally, from time to time, the Debtors correct billing errors after an invoice has been sent to the customer. Such errors include duplicative invoicing (when two invoices are created for the same shipment), improper invoicing (when the invoice created does not properly reflect the goods shipped or is otherwise incorrect), duplicative payment (when a customer makes two payments on account of the same shipment), mispricing (when a customer is charged or pays an incorrect price – either too high or too low – for the Debtors’ products), and various other billing and payment errors (collectively, the “Invoicing Errors”). The Debtors routinely issue credits or refunds for reimbursement of Invoicing Errors to customers.

19. In the event of delivery of Adjusted Goods or an Invoicing Error, the Debtors and the affected customer will generally agree to adjust the amount owed by such customer in connection with the affected shipment (the “Invoice Adjustments”) or will agree to correct the products previously shipped. The correct goods or adjustment will be in such quantity or amount as is allocable to the Adjusted Goods or sufficient to correct the Invoicing Error, as appropriate.

20. The Debtors may also incur, directly or indirectly, additional shipping charges in connection with expediting delivery in order to ensure timely delivery of corrected goods. Alternatively, the Debtors may directly or indirectly incur charges in connection with the sorting or repair of the Adjusted Goods if such activities are practicable.

21. The Debtors believe that their practices related to remedying Invoicing Errors and Adjusted Goods (collectively, the “Customer Adjustments”) are standard in the Debtors’ industry and are done in the ordinary course of their business, such that court authority is unnecessary. However, out of an abundance of caution, the Debtors seek authority to continue the Customer Adjustments and to pay any prepetition obligations relating thereto.

22. Honoring the Customer Adjustments is undoubtedly in the best interests of the Debtors and their estates. The Debtors' failure to remedy Invoicing Errors and deliver corrected goods would significantly harm customers' confidence in the Debtors and their products. Moreover, in the event that the Debtors do not credit customers' accounts in connection with Invoicing Errors, those customers with claims related to Invoicing Errors may attempt to offset those claims against the amount they owe the Debtors. A failure to honor the Customer Adjustments would have a long-term negative impact on the Debtors' reputation and would hurt the Debtors' industry position. Accordingly, when compared to the harm that could arise should the Debtors fail to honor the Customer Adjustments, the Debtors submit that payments on account of Customer Adjustments will have minimal impact on their estates. As of the Petition Date, it is difficult for the Debtors to track the number of Adjusted Goods or the cost associated with other Customer Adjustments including Invoicing Errors because such amounts are generally netted against outstanding invoices and not separately settled. However, as of the Petition Date, the Debtors believe that they have minimal amounts, if any, outstanding on account of prepetition Customer Adjustments. Accordingly, through this Motion, the Debtors request authority to honor any prepetition Customer Adjustments that may arise.

### **III. Pre-Payments**

23. There are certain instances when the Debtors will receive payment from their customers in advance of providing goods and services (the "Pre-Payments"). These instances include: (i) pre-payments from the Debtors' produce customers and (ii) situations where products are billed and manufactured by the Debtors in advance of actual delivery to their customers. In each of these instances, the Debtors have no actual cash liability to their customers as the Debtors are simply honoring obligations that the customers have paid for in advance.

24. Certain of the Debtors' customers, specifically produce farmers, will often be billed in advance of the Debtors' delivery of goods to such customers. More specifically, these customers will pay in advance for an entire season's worth of packaging products in order to either obtain a pricing discount or fix the price at which they buy product from the Debtors. Then, throughout the year and at times specified by the customer, the Debtors will manufacture, deliver and invoice product to such customers. Through this Motion, the Debtors are requesting authority to continue providing these customers with their products in the ordinary course of the Debtors' business and to honor their obligations to customers who have made Pre-Payments.

25. Similarly, from time to time, the Debtors hold certain goods previously invoiced to the customer and manufactured by the Debtors to be shipped from the Debtors' warehouses at a later date specified by the customer (collectively, the "Bill and Hold Products"). Pursuant to customer agreements affecting the Bill and Hold Products, the Debtors no longer hold title to these goods, and instead collect a fee to store such goods until delivery is effected. Through this Motion, the Debtors are requesting authority to continue to provide these customers with delivery of their Bill and Hold Products in the ordinary course of the Debtors' business and to honor their obligations to customers who have prepaid for such Bill and Hold Products.

#### **IV. Pass Through Costs**

26. The Debtors also perform certain "middle-man" functions on behalf of some of their customers related to the purchasing of tooling equipment and the coordination of waste management services. In many cases, the Debtors need to acquire specialized tooling equipment (e.g., printing plates and cutting dies) in order to produce the end products ordered by their customers. In such situations, the customer will often intend to own such specialized tooling equipment and will use the Debtors to sub-contract the tool production and to perform

quality control assessments. The tooling would, in many instances, be used by the Debtors at the Debtors' location, although the customers would retain title to the tooling. The Debtors technically buy the tooling from third-party suppliers but, in the instances where such tooling will be owned by a customer, the customer will either advance funds to the Debtors prior to payment of the third-party tool-maker or will reimburse the Debtors for funds the Debtors paid to the third-party tool-maker for the specialized tooling (collectively, the "Tooling Payments"). In such instances, the Debtors have no equitable interest in either the tooling or the funds advanced by the customers. Therefore, the Debtors, out of an abundance of caution, request the authority to continue to serve as a "middle-man" with respect to the Tooling Payments, regardless of whether such payments involve prepetition or post-petition transactions or transfers.

27. The Debtors also act as a "middle-man" with respect to the coordination of certain of their customer's waste management services. In such instances, the Debtors are paid a fee to reduce a customer's costs for waste disposal by coordinating the customer's waste management services. In many instances, a third party servicer receives and audits the customer's waste removal invoices (the "Waste Management Auditor"). The customers, in turn, pay to the Debtors the invoice amount and the Debtors forward such payment to the Waste Management Auditor or directly to the waste hauler. There is no profit in the payment the Debtors receive from their customers and the Debtors merely act as an intermediary between their customer and the Waste Management Auditor or waste hauler to facilitate the payment of the waste removal invoices. If the Debtors do not remit payment to the Waste Management Auditor, the customers' waste management invoices will not be paid, which would likely result in the termination of the customer's waste removal service and the customer being directly liable to the waste management vendors for amounts already paid to the Debtors. Through this

Motion, the Debtors are requesting authority to pay all amounts owing to Waste Management Auditors or waste haulers regardless of whether such amounts are on account of monies received by the Debtors from their customers prior to or after the Petition Date.

#### **V. Exchange Customers/Customer Setoffs**

28. In the ordinary course of business, the Debtors purchase goods from certain of their customers (the “Exchange Customers”), thus creating both a payable and receivable with such customers. As a result, Exchange Customers will have a right to setoff monies they owe to the Debtors against payables the Debtors owe to them. Through this Motion, the Debtors request that the Court modify the automatic stay, solely to the limited extent necessary to permit the Debtor to effect setoffs of undisputed claims with the Exchange Customers without further order of this Court. The Debtors believe that such a procedure is appropriate in order to reduce the administrative burdens on the Exchange Customers to seek and this Court to adjudicate approval of setoffs, and to ensure that the Debtors’ cash flow is not impaired by Exchange Customers exercising self help remedies by refusing to pay for the Debtors’ goods in excess of the amounts owed to them by the Debtors. As of the Petition Date, the Debtors believe, in the aggregate, the Exchange Customers owe the Debtors more than the Debtors owe the Exchange Customers on account of goods delivered prior to the Petition Date.<sup>4</sup>

29. In certain other instances, the Debtors trade product with their Exchange Customers. In such instances, no money changes hands; rather, the Debtors “pay” for the Exchange Customers’ product by trading the equivalent value of the Debtors’ product.

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<sup>4</sup> To be clear, by this Motion, the Debtors are only seeking authority to effectuate setoffs with their Exchange Customers to the extent that such Exchange Customer otherwise had a right to setoff its claims against the Debtors claims under section 553 of the Bankruptcy Code. In other words, the Debtors are not seeking to give their Exchange Customers any greater rights than they would otherwise have under state law and the Bankruptcy Code. Further, by this Motion, the Debtors are not seeking to pay any prepetition claim of any Exchange Customer that exceeds the agreed upon amount being setoff.

Typically, at the time the product is ordered, the Debtors and the Exchange Customer agree on the quantity (usually in tons) of product to be traded. Because the exchanges of product are not instantaneous, it is possible that the Debtors will not have completed their obligations to deliver product under certain “trades” as of the Petition Date. If the Debtors fail to honor these obligations, it is likely that certain of these Exchange Customers will no longer desire to trade product and thus require the Debtors to use their cash to purchase products from the Exchange Customers, or simply cease buying from and/or selling to the Debtors altogether. Therefore, by this Motion, the Debtors request authority to perform all prepetition obligations to deliver product under such arrangements with their Exchange Customers.

### **BROKERS**

30. As mentioned above, the Debtors utilize Brokers to obtain new customers and to maintain long-term customer relationships for certain of their products. In general, the Brokers are responsible for the promotion, sale, solicitation and confirmation of orders from customers for the Debtors’ products. In addition, the Brokers are generally responsible for communications with Customers relating to the sale and marketing of the Debtors’ products. Among other things, the Brokers generally provide the Debtors with information as to changes in requirements, nature, quality or quantity of products, any complaints or other problems with the products, delivery or other matters, credit worthiness of the customers, and changes in the market, including matters that relate to competition of the Debtors.

31. The Brokers for which the relief is sought by this Motion are not employees of the Debtors. The vast majority of Brokers are, however, under contract with the Debtors. Typically, the Brokers accrue commissions calculated based on the amount of the Debtors’ product sold by the Brokers to customers located in certain areas of the United States

and Canada (the “Customers”). The commissions are thereafter generally paid to the Brokers at the time the price of any products sold by the Brokers becomes part of the Debtors’ net revenues or upon actual receipt by the Debtors of payments from Customers for the products sold by the Brokers. The Brokers’ compensation is designed to ensure that the Brokers maximize their efforts in enlisting new Customers and maintaining existing quality Customers.

32. The Debtors hereby seek the authority to maintain their relationships with the Brokers and to perform certain prepetition obligations the Debtors owe to the Brokers. The Debtors believe that the relief requested herein is necessary to their reorganization efforts because the Brokers are essential to the Debtors’ overall business and the Debtors believe that a failure to pay the prepetition amounts owing to the Brokers would have a material, adverse effect on the Debtors’ business. First, for the majority of the Brokers, the sole source of revenue from the sale of product for the Debtors is from the commissions earned on account of the sale of the Debtors’ products. The majority of Brokers do not receive any profit margin on the products they sell. In addition, for the vast majority of Brokers, there are no specific performance goals or quotas placed obligating the Debtors to sell a pre-defined amount of product or to aggressively solicit new Customers. In other words, the Brokers’ incentive to expend the effort to sell the Debtors’ products (as opposed to a competitor’s product) is tied directly to the Brokers’ commission package.<sup>5</sup> Accordingly, the Debtors believe that if the Brokers are not paid on account of the prepetition obligations, the Brokers can and will substantially reduce their sales efforts on behalf of the Debtors as their only incentive to sell the Debtors’ products is the ongoing payment of commissions.

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<sup>5</sup> With respect to some Brokers’ contracts, the only performance standard placed upon a Broker is a nonspecific duty to generally use the Broker’s “best efforts to develop markets and actively promote the sale and use” of the Debtors’ products.

33. Moreover, with respect to certain Brokers, the Debtors' ability to sell to Customers serviced by those Brokers is curtailed on account of the terms of the agreements between the Debtors and those Brokers. Some Broker contracts contain exclusivity provisions, which prohibit the Debtors from hiring new brokers or directly marketing their items to certain Customers. Accordingly, any substandard performance by these Brokers would, in essence, substantially limit the Debtors' ability to sell their products to such Customers. Additionally, other Broker contracts allow the Broker to sell other companies' non-competing products to the Customers. Accordingly, the Debtors are concerned that without payment of commissions due to such Brokers, their sale and promotion of the Debtors' products might decrease as compared to the sale and promotion of other companies' products.

34. With respect to all Brokers, the uninterrupted payment of the Brokers is critical to maintaining the Brokers' loyalty to the Debtors.<sup>6</sup> One factor contributing to the Brokers' loyalty to the Debtors during the prepetition period was the Debtors' ability to make timely payments to the Brokers. In the event the Brokers go unpaid, the Debtors believe that the Brokers may not put forth the same effort previously expended on account of the Debtors' products or may cease to represent the Debtors at all. As these Brokers are essentially representatives of the Debtors with respect to the Customers, the Brokers' happiness and willingness to successfully market the Debtors' products to the Customers are of utmost import to the reorganization of the Debtors' businesses.

35. The Debtors believe that, if certain Brokers' quality of performance were to deteriorate or certain Brokers were forced to cease operations, the effect of this failure to serve the Customers would be very damaging to the Debtors' business and their ability to reorganize.

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<sup>6</sup> Furthermore, because some of the Brokers are individuals or small companies, any disruption in the payments to such Brokers could materially harm their livelihood or business operations. If these companies are forced to close their doors, the Debtors may not have as much or any presence in the industries serviced by such Brokers.



The Debtors' goodwill, presence, and recognition within the various industries described above, which are enhanced by these Brokers, would be substantially harmed by a loss of Brokers and the resulting erosion of the Debtors' customer base and revenue streams.

36. As explained above, the Debtors compensate their Brokers in arrears by commissions that are calculated based on the amount of the Debtors' products sold to Customers. As of the Petition Date, the Debtors' estimate that the aggregate cost of performing all of their prepetition obligations owed to their Brokers will be approximately \$3 million.

### **BASIS FOR RELIEF**

#### **A. Customer Programs**

37. Sections 1107(a) and 1108 of the Bankruptcy Code authorize a debtor-in-possession to operate its business. Further, section 363(c) of the Bankruptcy Code authorizes a debtor-in-possession operating its business pursuant to section 1108 of the Bankruptcy Code to use property of the estate in the ordinary course of business without notice or a hearing. The Debtors submit that continuing, renewing, replacing, and/or terminating the Customer Programs in the ordinary course of business is permitted by sections 363(c), 1107(a) and 1108 of the Bankruptcy Code without further application to the Court.

38. The Court may also authorize continuation of the Customer Programs under section 363(b) of the Bankruptcy Code. That section provides that "[t]he trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate." 11 U.S.C. § 363(b)(1) (2004). Under this section, a court may authorize a debtor to pay certain prepetition claims. See Ionosphere Clubs, 98 B.R. 174, 175 (Bankr. S.D.N.Y. 1989) (authorizing payment of prepetition claims where the debtors articulate "some business justification, other than the mere appeasement of major creditors"); see also In re James

A. Phillips, 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). As discussed more fully herein and in the Hinrichs Affidavit, the importance of the Debtors' major customers to their business operations cannot be overstated. As a result, the relief requested herein is necessary to maintain the value of the Debtors' estates for the benefit of all creditors, and therefore should be granted.

39. Additionally, section 105(a) of the Bankruptcy Code authorizes the Court to issue "any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." 11 U.S.C. § 105(a). 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"). The Debtors submit that maintenance of the Customer Programs is critical to their reorganization efforts and should therefore be approved under section 105(a) of the Bankruptcy Code.

40. Retaining loyalty and patronage of customers is critical to successful chapter 11 cases, and courts in this District have thus regularly granted relief similar to that requested here. See, e.g., In re Tribune Company, et. al., Case No. 08-13141 (Bankr. D. Del. December 8, 2008) (KJC); In re Hilex Poly Co. LLC, et. al., Case No. 08-10890 (Bankr. D. Del.

May 7, 2008) (KJC); In re Linens Holdings Co., et al., Case No. 08-10832 (CSS) (Bankr. D. Del. May 2, 2008); In re Buffets Holding, Inc., Case No. 08-10141 (Bankr. D. Del. Jan. 23, 2008) (MFW) (entered by BLS); In re Remy Worldwide Holdings, Inc., et al., Case No. 07-11481 (Bankr. D. Del. Oct. 10, 2007) (KJC); In re Holliston Mills, Inc., Case No. 07-10687 (Bankr. D. Del. May 23, 2007) (MFW); In re Pliant Corp., et al., Case No. 06-10001 (Bankr. D. Del. Jan. 4, 2006) (MFW); In re Meridian Automotive Systems-Composites Operations, Inc., Case No. 05-11168 (Bankr. D. Del. April 27, 2005) (MFW); In re Ultimate Electronics, Inc., et al., Case No. 05-10104 (Bankr. D. Del. Jan. 12, 2005) (PJW); In re KB Toys, Inc., Case No. 04-10120 (Bankr. D. Del. Jan. 16, 2004) (PJW). The Debtors respectfully submit that similar relief is warranted in these chapter 11 cases.

41. Finally, as described by one court, prepetition customer claims clearly meet the requirements for post-petition payment because without satisfaction of prepetition customer claims, a debtor's goodwill and its going concern value would be destroyed. In re CoServ, 273 B.R. 487, 497 (Bankr. N.D. Tex. 2002). Maintaining the Debtors' ability to generate revenue will be absolutely crucial to the Debtors' ability to confirm a plan of reorganization that will provide a basis for the long-term success and profitability of the Debtors, to the benefit of all of the Debtors' constituencies. In addition, as described above, the damage to the Debtors' prospects for rehabilitation if the Debtors were put in a position where their Customer Programs could no longer be honored is clearly disproportionate to the cost of maintaining the Customer Programs.

42. The success and viability of the Debtors' businesses are dependent upon the development and maintenance of customer loyalty. The commencement of these chapter 11 cases will no doubt create apprehension on the part of customers or potential customers

regarding their willingness to continue or to commence doing business with the Debtors. The Debtors believe that without the requested relief, the stability of the Debtors' business will be significantly undermined, and otherwise loyal customers may explore alternative sources for their packaging products. As described above, the damage that would result if the Debtors failed to honor their prepetition obligations with respect to Customer Programs significantly outweighs any arguable harm to the Debtors' estates. To preserve the value of the Debtors' businesses, the Debtors must be permitted, in their sole discretion, to continue honoring or paying all Customer Programs without interruption or modification. In addition, to provide necessary assurances to customers on a going-forward basis, the Debtors request authority to continue honoring or paying all obligations to Customers that arise in the ordinary course of the Debtors' businesses from and after the Petition Date.

## **B. Brokers**

43. This Court has the authority to permit the Debtors to pay prepetition amounts owing to the Brokers pursuant to sections 105(a) and 363(b) of the Bankruptcy Code. The fundamental purpose of a chapter 11 reorganization is to rehabilitate the Debtors' businesses to preserve jobs and maximize value for creditors and shareholders. To help accomplish these goals, section 363(b) of the Bankruptcy Code provides "[t]he trustee after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate." 11 U.S.C. § 363(b)(1). Courts have properly relied on section 363(b)'s broad authority to allow debtors in possession to pay prepetition claims in circumstances where, as here, the estate will obtain more value for all creditors or avoid more harm by making the prepetition payment. See In re Synteen Tech., Inc., No. 00-02203-W, 2000 WL 33709667, at \*2 (Bankr. D.S.C. 2000); In re Ionosphere Clubs, Inc., 98 B.R. 174,176-77 (Bankr. S.D.N.Y. 1989).

44. Furthermore, under section 105(a) of the Bankruptcy Code, the court is given broad discretion to “issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.” 11 U.S.C. § 105(a). It is essential to the Debtors’ operations and, thus, to the success of their reorganization efforts, that the relief requested herein be granted. The Debtors’ payment of their Brokers will help ensure that the Debtors’ operations continue seamlessly. Accordingly, in light of the foregoing, the Debtors believe that the relief requested herein is in their best interests and the best interests of their estates and creditors, and should be approved.

45. Numerous courts have used their section 105(a) equitable powers under the necessity of payment doctrine<sup>7</sup> 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 & New England Ry., 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 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”); In re James A. Phillips, Inc., 29

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<sup>7</sup> This doctrine, first articulated by the United States Supreme Court in Miltenberger v. Logansport, C. & S.W.R. Co., 106 U.S. 286, 311-12 (1882), recognizes the existence of 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.

B.R. 391, 394-95 (S.D.N.Y. 1983) (upholding the bankruptcy court's order authorizing the debtor to make post-petition payment of prepetition claims in the ordinary course without notice and a hearing). Ultimately, the "necessity of payment" doctrine is intended to facilitate the paramount goal of chapter 11; namely, "facilitating the continued operation and rehabilitation of the debtor..." Ionosphere Clubs, 98 B.R. at 176.

46. As is set forth in the Hinrichs Affidavit, authorizing, but not requiring, the Debtors to perform their prepetition obligations owed to the Brokers in order to maintain the Debtors' business relationships with the Brokers will enable the Debtors to maintain their current Customer base and continue to attract new business through their Brokers. If the Brokers are not timely paid, it is likely that they will no longer be willing to provide the same quality of service to the Debtors. Moreover, any burden to the estate to pay such obligations is significantly outweighed by the resulting loss of business that would be caused by a failure to pay such obligations and the deleterious effects on the Brokers and Customers. Because of the importance of the Brokers to the Debtors' overall industry presence and operations, the Debtors believe that paying such prepetition claims to the Brokers is integral to the Debtors' business going forward and their ability to maintain their enterprise value and to serve their Customers. As a result, the Debtors submit that authorization to continue to operate in the ordinary course regarding the payment of prepetition amounts owed to Brokers is appropriate and justified under sections 363(b) and 105(a) of the Bankruptcy Code.

47. In addition, the claims against the Debtors resulting from non-payment of the prepetition amounts due under the written Broker agreements would most likely constitute "cure" obligations under section 365(b)(1)(A) of the Bankruptcy Code to the extent the Debtors' contractual relationships with the Brokers are executory contracts that the Debtors decide to

assume in the exercise of their business judgment. At this early stage of these bankruptcy cases, the Debtors have not determined which Broker contracts will be assumed. Rather than take such an action at this time, the Debtors propose to continue the status quo by paying, in their discretion, the prepetition amounts due under the Broker agreements as set forth herein. Then, after the Debtors have had the opportunity to review their executory contracts and develop a plan of reorganization, the Debtors can determine which of the Broker contracts they wish to assume.

48. Finally, the Debtors submit that their ability to continue to operate in the ordinary course with respect to the Brokers is warranted under section 363(c)(1) of the Bankruptcy Code. Section 363(c)(1) provides that a debtor in possession “may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing.” 11 U.S.C. § 363(c)(1). Section 363(c)(1) is intended to give a debtor in possession “the flexibility to engage in ordinary transactions without unnecessary creditor and bankruptcy court oversight, while protecting creditors by giving an opportunity to be heard when transactions are not ordinary.” In re Roth American, Inc., 975 F.2d 949, 952 (3rd Cir. 1992) (explaining that section 363(c)(1) strikes a balance between the debtors ability to carry on with its daily operations without excessive oversight and the need to protect secured creditors from the dissipation of assets); In re Crystal Apparel, Inc., 207 B.R. 406, 409 (S.D.N.Y. 1997); In re Sieling Assocs. Ltd. P’ship, 128 B.R. 721, 724 n.3 (Bankr. E.D. Va. 1991) (explaining that section 363(c)(1) allows a debtor in possession to ‘exercise reasonable judgment in carrying out its everyday affairs and . . . avoid excessive judicial involvement in its reorganization.’) (citing In re D’Lites of America, Inc., 108 B.R. 352, 355 (Bankr. N.D. Ga. 1989)).

49. Pursuant to the recently revised Bankruptcy Rule 6003, the Court may approve a motion to pay all or part of a prepetition claim within 20 days after the Petition Date only if such relief is necessary to avoid immediate and irreparable harm. As described above, the Customer Programs and Broker relationships are vital to the Debtors' operations and are necessary to maintain the amiable relations and goodwill of the Debtors' customers. The Debtors submit that failure to satisfy the Customer Programs and maintain Broker relationships in the ordinary course of business during the first 20 days of the chapter 11 cases would cause irreparable damage to the Debtors' reorganization efforts. Accordingly, the Debtors submit that they have satisfied the requirements of Bankruptcy Rule 6003.

50. 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**

51. 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, but not directing, the Debtors to honor their prepetition obligations to their customers and to continue the Customer Programs in the ordinary course of business, (ii) authorizing, but not directing, the Debtors to honor their prepetition obligations to and maintain their relationships with the Brokers in the ordinary course of business; and (iii) 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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