

**IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF SOUTH CAROLINA**

In re:

CAFE HOLDINGS CORP., *et al.*,<sup>1</sup>

Debtors.

Chapter 11

Case No. 18-\_\_\_\_\_( )

(Joint Administration Requested)

**DEBTORS' MOTION FOR ENTRY OF ORDER (I) AUTHORIZING  
PAYMENT OF CERTAIN PREPETITION TAXES AND FEES  
AND (II) AUTHORIZING FINANCIAL INSTITUTIONS  
TO PROCESS AND CASH RELATED CHECKS AND TRANSFERS**

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The above-captioned debtors and debtors in possession (collectively, the “**Debtors**”) hereby move this Court for entry of an order (the “**Order**”), substantially in the form attached hereto, pursuant to sections 105(a), 363(b), 507(a)(8), and 541 of title 11 of the United States Code, 11 U.S.C. §§ 101-1532 (the “**Bankruptcy Code**”), (a) authorizing, but not directing, the Debtors, in their sole discretion, to remit and pay (i) sales, use, property, income, net worth, and other similar taxes (collectively, the “**Taxes**”) and (ii) fees for licenses, permits, and other similar charges and assessments (collectively, the “**Fees**”), including any penalties and interest thereon, to various federal, state, county, and city taxing and licensing authorities (each, an “**Authority**,” and collectively, the “**Authorities**”), (b) authorizing the Debtors’ banks and financial institutions (collectively, the “**Banks**”) to receive, process, honor, and pay all checks and electronic payment requests relating to the foregoing, and (c) granting related relief. A schedule identifying the Authorities is attached hereto as **Exhibit A**. In support of this motion, the Debtors submit the

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<sup>1</sup> The Debtors in these cases, along with the last four digits of each Debtor’s federal tax identification number, are: Cafe Holdings Corp. (7910); Cafe Enterprises, Inc. (4946); CE Sportz LLC (2009); and CES Gastonia LLC (0863). The location of the Debtors’ corporate headquarters is 4324 Wade Hampton Blvd., Suite B, Taylors, South Carolina 29687.

*Declaration of Eric Easton in Support of Chapter 11 Petitions and First Day Relief* (the “**First Day Declaration**”). In further support of this motion, the Debtors respectfully state as follows:

### **JURISDICTION AND VENUE**

1. This Court has jurisdiction over this matter pursuant to 28 U.S.C. § 1334 and Local Civil Rule 83.IX.01, D.S.C. This matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A). The Debtors confirm their consent, pursuant to Rule 7008 of the Federal Rules of Bankruptcy Procedure (the “**Bankruptcy Rules**”), to the entry of a final order by the Court in connection with this motion to the extent that it is later determined that the Court, absent consent of the parties, cannot enter final orders or judgments in connection herewith consistent with Article III of the United States Constitution.

2. Venue is proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

3. The bases for the relief requested herein are sections 101(2), 105(a), 363(b), 507(a)(8), and 541 of the Bankruptcy Code and Rule 1015(b) of the Bankruptcy Rules.

### **BACKGROUND**

4. On the date hereof (the “**Petition Date**”), each of the Debtors commenced with this Court a voluntary case under chapter 11 of the Bankruptcy Code. Each Debtor is authorized to continue to operate its business and manage its properties as a debtor in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code. As of the date hereof, no trustee, examiner, or statutory committee has been appointed in these chapter 11 cases.

5. Additional information regarding the Debtors, including their business operations, corporate and capital structure, and the events leading to the Petition Date, is more fully set forth in the First Day Declaration.<sup>2</sup>

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<sup>2</sup> Capitalized terms not otherwise defined herein shall have the meanings ascribed to them in the First Day Declaration.

**RELIEF REQUESTED**

1. By this motion, the Debtors seek authority to pay all Taxes and Fees in the ordinary course of business that were owed to the Authorities prepetition, but were not in fact paid or processed prepetition, or that were paid prepetition in an amount less than is actually owed, or to the extent any such payments made prepetition were rejected, lost, or otherwise not received in full by any Authority, and to pay any amounts owing on account of federal and state audits.<sup>3</sup> Furthermore, to the extent that any checks, drafts, deposits, or transfers issued or initiated by the Debtors on account of prepetition Taxes and Fees have not cleared as of the Petition Date, the Debtors also seek an order authorizing the Banks to honor and process such payments.

**THE DEBTORS' TAXES**

2. In the ordinary course of business, the Debtors incur or collect and remit a variety of taxes, including sales and use, personal property, income, and other similar taxes (collectively, the “**Taxes**”). The Debtors also incur various business license, permit, and other fees and assessments (collectively, the “**Fees**”) in connection with obtaining the licenses and permits that are necessary to operate their businesses. The Debtors remit such Taxes and Fees to the Authorities in accordance with applicable laws. The Taxes and Fees are paid monthly, quarterly, or annually to the respective Authorities, depending on the given Taxes or Fees and the Authority to which they are paid.

**A. Sales and Use Taxes**

3. The Debtors incur or collect and remit an assortment of sales, use, and other similar taxes in connection with the operation of their restaurants. In some states where the Debtors

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<sup>3</sup> For the avoidance of doubt, the relief requested herein is without prejudice to the Debtors’ rights to contest the amounts of any Taxes and Fees on any grounds the Debtors deem appropriate, which rights are hereby expressly reserved.

operate, the Debtors are required to collect sales taxes from purchasers of their products and services on a per sale basis and then remit sales taxes to the applicable Authority. Additionally, the Debtors may incur and collect use taxes when they purchase taxable products for which no sales tax was charged by their vendors. The sales and use taxes collected or incurred are typically remitted to the Authorities in the month or quarter following the month or quarter in which the related transactions occurred. In general, sales taxes accrue as the Debtors' products are sold and are calculated based upon a statutory percentage of the sale price. The Debtors paid approximately \$6,562,000 in sales taxes in 2017. As of the Petition Date, the Debtors estimate that approximately \$1,038,274 in sales and use taxes has accrued but is unpaid. This figure includes \$322,805 attributable to prior periods, which is currently in arrears; \$534,434 attributable to the most recent measurement period, which will be during the first 21 days of these chapter 11 cases; and the remainder attributable to the current measurement period, which will become due in December 2018. The Debtors believe that approximately \$650,000 of sales and use taxes will accrue from the Petition Date through the remainder of the calendar year 2018. By this motion, the Debtors seek authority to pay all sales and use taxes due and owing as of the Petition Date and to continue to pay sales and use taxes going-forward in the ordinary course of business, including amounts accrued prior to the Petition Date.

**B. Property Taxes**

4. The Debtors incur personal property taxes in many of the jurisdictions in which they operate. To avoid the imposition of statutory liens on their personal properties, the Debtors typically pay these taxes in the ordinary course on an annual or semi-annual basis, depending on the jurisdiction. The Debtors estimate that approximately \$1,574,700 in personal property taxes have accrued and are unpaid as of the Petition Date, and believe that no personal property taxes

will come due during the first 21 days of these chapter 11 cases.<sup>4</sup> By this motion, the Debtors seek authority to pay all property taxes due and owing as of the Petition Date and to continue to pay property taxes in the ordinary course of business.

**C. Income and Net Worth Taxes**

5. The Debtors pay income and similar types of taxes to certain state and local Authorities to operate their business in the applicable taxing jurisdictions. The various Authorities assess income and net worth taxes in a variety of ways (minimum tax, tax on income, tax on capital, tax on gross receipts or margin). The Debtors generally make estimated payments for income and net worth taxes on a quarterly basis, with the requirement to remit quarterly estimated taxes in some cases. The Debtors estimate that, as of the Petition Date, approximately \$31,200 of income and net worth taxes have accrued and are unpaid and currently estimate that no income and net worth taxes come due during the first 21 days of these chapter 11 cases. By this motion, the Debtors seek authority to pay all income and net worth taxes due and owing as of the Petition Date to state and local Authorities and to continue to pay income and net worth taxes in the ordinary course of business.

**D. Business License, Permits, and Other Fees**

6. Many Authorities require the payment of Fees for the right to conduct business within their jurisdictions. Those charges may include fees for business licenses, annual reports, permits, liquor licenses, and health and fire inspections. These Fees are computed in a variety of ways, but are generally flat rate fees, which are paid on a monthly, quarterly, or annual basis, depending on the requirements of the particular jurisdiction. The Debtors are frequently required

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<sup>4</sup> In addition, the Debtors generally operate their restaurants in leased premises, where the underlying leases obligate the Debtors to satisfy real property taxes for those premises. As a result, the Debtors will be paying real property taxes for their leased premises in accordance with the terms of their leases and section 365(d)(3) of the Bankruptcy Code.

to obtain multiple licenses and permits and pay associated Fees for each location where the Debtors conduct business in a given jurisdiction. The Debtors believe that approximately \$58,043 in Fees that relate (in whole or in part) to prepetition periods may be outstanding, and estimate that approximately \$66,103 (*i.e.*, \$9,435 in bank fees, \$54,580 in alcohol license fees and \$2,088 in business license fees) will come due during the first 21 days of these chapter 11 cases. By this motion, the Debtors seek authority to pay all Fees due and owing as of the Petition Date and to continue to pay Fees in the ordinary course of business.

**E. Federal and State Audits**

7. At present, there are no active audits with respect to the Debtors' Taxes. However, should such an audit arise, the Debtors seek authority, in their discretion, to satisfy any amounts owing pursuant to a federal or state audit in the ordinary course of business.

**BASIS FOR RELIEF**

**A. The Court Should Permit the Debtors, in Their Discretion, to Pay Outstanding Taxes and Fees.**

8. Numerous grounds justify granting the relief requested herein. First, a portion or all of the Taxes and Fees may be entitled to priority status under section 507(a)(8) of the Bankruptcy Code and, therefore, must be paid in full under any chapter 11 plan. *See* 11 U.S.C. § 1129(a)(9)(c). Thus, the Debtors submit that the payment of such Taxes and Fees as requested by this motion will likely affect only the timing of the payments, and not the amounts that would ultimately be received by the Authorities. Further, paying such Taxes and Fees will give the Authorities no more than they otherwise are entitled under a chapter 11 plan, and will save the Debtors the potential interest expense (and penalties) that might otherwise accrue if the relief requested herein is not granted.

9. Second, the Debtors' failure to pay the Taxes and Fees could have a material adverse impact on their ability to operate in the ordinary course of business and, thus, harm the Debtors' chapter 11 efforts, to the detriment of all constituents. For example, the Authorities could initiate audits of the Debtors if the Taxes and Fees are not paid on time, which would unnecessarily divert the Debtors' attention away from the chapter 11 process and result in unnecessary expenses. Moreover, if the Debtors do not pay such amounts in a timely manner, the Authorities may attempt to suspend the Debtors' operations, file liens, seek to lift the automatic stay, seek payment from the Debtors' directors and officers, or pursue other remedies that could materially harm the Debtors' estates and their efforts in connection with these chapter 11 cases.

10. Third, certain of the Authorities might assert that the Taxes are so-called "trust fund" taxes that the Debtors are required to collect from third parties and hold in trust for the benefit of such Authorities. To the extent that the Debtors collect sales, use, and other Taxes on behalf of the Authorities, such Taxes may not constitute property of the Debtors' estates. *See Begier v. IRS*, 496 U.S. 53, 57-60 (1990) (holding that any prepetition payment of trust fund taxes is not an avoidable preference because such funds are not property of the debtor's estate); *In re Dameron*, 155 F.3d 718, 721-22 (4th Cir. 1998). As a consequence, the Debtors would not have an equitable interest in such Taxes and, assuming they could be identified and traced, such amounts would not constitute property of the Debtors' estates and would not be subject to the automatic stay. *See City of Farrell v. Sharon Steel Corp.*, 41 F.3d 92, 95 (3d Cir. 1994). Accordingly, because the Debtors have no equitable interest in trust fund taxes, payment of any such Taxes does not prejudice the rights of any of the Debtors' other creditors. *See* 11 U.S.C. § 541(d). The Debtors should therefore be able to pay any Taxes that constitute trust fund taxes as they become due and payable.

11. Fourth, even if some of the Taxes would not ordinarily be considered “trust fund” taxes in a particular jurisdiction, sections 105(a) and 363(b) of the Bankruptcy Code authorize the requested relief. Section 105(a) of the Bankruptcy Code allows 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). Similarly, section 363(b)(1) of the Bankruptcy Code authorizes a debtor to use property of the estate other than in the ordinary course of business after notice and a hearing. 11 U.S.C. § 363(b)(1).

12. The well-settled “necessity of payment” doctrine also supports the requested relief. This rule authorizes post-petition payment of prepetition obligations where necessary to preserve or enhance the value of a debtor’s estate for the benefit of all creditors. *See, e.g., Miltenberger v. Logansport, C. & S.W. Ry. Co.*, 106 U.S. 286, 311 (1882) (articulating a legal theory later termed the “doctrine of necessity” or the “‘necessity of payment’ doctrine” and holding that payment of a pre-receivership claim prior to reorganization was permitted to prevent stoppage of crucial business relations); *In re Lehigh & N. E. R. Co.*, 657 F.2d 570 (3d Cir. 1981) (adopting the “necessity of payment” doctrine for the Third Circuit); *In re Boston and Me. Corp.*, 634 F.2d 1359, 1382 (1st Cir. 1980) (recognizing the existence of a judicial power to authorize trustees to pay claims for goods and services that are indispensably necessary to the debtors’ continued operation); *Southern Ry. Co. v. Flourney*, 301 F.2d 847, 852 (4th Cir. 1962) (“The principle of necessity of payment [espoused in Miltenberger] has since been carried into different factual surroundings as the basis for granting superiority to business-operating accounts.”); *In re Synteen Tech., Inc.*, No. 00-02203, 2000 WL 33709667, at \*2 & n.5 (Bankr. D.S.C. April 14, 2000); *In re Just For Feet, Inc.*, 242 B.R. 821, 824 (D. Del. 1999) (granting approval to pay prepetition claims of certain trade vendors which were critical to the debtors’ reorganization); *In re Columbia Gas Sys., Inc.*, 171

B.R. 189, 191-92 (Bankr. D. Del. 1994) (noting that debtors may pay prepetition claims that are essential to continued operation of business).

13. Debtors frequently invoke the necessity of payment doctrine early in a chapter 11 case when preservation of the estates is most critical. Bankruptcy courts routinely invoke their equitable powers to authorize a debtor to pay certain critical prepetition claims under section 105(a) of the Bankruptcy Code if “authorizing the payment of the prepetition debt creates ‘the greatest likelihood of . . . payment of creditors in full or at least proportionately.’” *In re Structurelite Plastics Corp.*, 86 B.R. 922, 932 (Bankr. S.D. Ohio 1988); *see also In re Sharon Steel Corp.*, 159 B.R. 730, 737 (Bankr. W.D. Pa. 1993) (stating that to justify payment of a prepetition claim “the Debtor is required to show that the payment is necessary to avert a serious threat to the Chapter 11 process”); *In re Ionosphere Clubs, Inc.*, 98 B.R. 174, 176 (Bankr. S.D.N.Y. 1989) (stating that the “necessity of payment” rule “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”).

14. Fifth, some states hold corporate officers personally liable for unpaid sales, use, and other taxes in certain circumstances. *See, e.g.*, JOHN F. OLSEN, DIRECTOR & OFFICER LIABILITY: INDEMNIFICATION AND INSURANCE § 3:21 (2003) (stating “some states hold corporate officers personally liable for any sales tax and penalty owed and not paid by the corporation regardless of cause”). To the extent that any such “trust fund” taxes remain unpaid by the Debtors, their officers could be subject to lawsuits or criminal prosecution during the pendency of these chapter 11 cases. Even the possibility of any such lawsuit or criminal prosecution would most certainly distract the Debtors and their officers from their efforts in these chapter 11 cases.

15. Finally, in numerous chapter 11 cases in this and other districts, courts have exercised their equitable powers under section 105(a) of the Bankruptcy Code to authorize debtors

to pay prepetition tax obligations in light of the foregoing considerations. *See, e.g., In re THQ Inc.*, Case No. 12-13398 (MFW) (Bankr. D. Del. Dec. 20, 2012); *In re BI-LO, LLC*, C/A 09-2140-hb (Bankr. D.S.C. April 3, 2009). *In re Polymer Group, Inc.*, C/A 02-05773-jw (May 14, 2002); *In re Georgetown Steel Co., LLC*, C/A 03-13156-jw (Oct. 21, 2003). The Debtors submit that the circumstances of these chapter 11 cases warrant granting similar relief, and that doing so is in the best interests of the Debtors, their estates, and creditors, and therefore should be granted.

**B. The Court Should Authorize the Debtors' Banks to Honor Payments in Respect of the Taxes and Fees.**

16. The Debtors also request that the Court authorize the Debtors' Banks, when requested by the Debtors in their sole discretion, to receive, process, honor, and pay any and all checks or electronic fund transfers drawn on the Debtors' bank accounts to pay all prepetition obligations described herein, whether such checks or other requests were submitted prior to or after the Petition Date. The Debtors further request that the Banks be authorized to rely on the Debtors' designation of any particular check or electronic payment request as approved pursuant to any order of the Court granting the relief requested in this motion.

17. Any delay in paying the outstanding Taxes and Fees would be detrimental to the Debtors, their creditors, and their estates. Indeed, the Debtors' ability to manage and run their business operations with as little disruption as possible requires, in part, that they remain in good stead with the Authorities in respect of their obligations on account of Taxes and Fees.

18. Accordingly, for the reasons set forth herein, the Debtors submit that cause exists for granting the requested relief.

**THE REQUIREMENTS OF BANKRUPTCY RULE 6003 ARE SATISFIED**

19. Pursuant to Bankruptcy Rule 6003, the Court may grant relief regarding a motion to use property of the estate within 21 days after the Petition Date if the relief is necessary to avoid

immediate and irreparable harm. Immediate and irreparable harm exists where the absence of relief would impair a debtor's ability to reorganize or threaten the debtor's future as a going concern. *See In re Ames Dep't Stores, Inc.*, 115 B.R. 34, 36 n.2 (Bankr. S.D.N.Y. 1990) (discussing the elements of "immediate and irreparable harm" in relation to Bankruptcy Rule 4001).

20. As described above, authorizing the Debtors to pay any prepetition amounts due and owing on accounts of Taxes and Fees and to continue to pay Taxes and Fees on a post-petition basis in the ordinary course of business is integral to the Debtors' ability to transition their operations into these chapter 11 cases. Failure to receive such authorization and other relief during the first 21 days of these chapter 11 cases would severely disrupt the Debtors' operations at this critical junction. Accordingly, the Debtors submit that they have satisfied the requirements of Bankruptcy Rule 6003 to support the relief requested on the terms described herein.

#### **WAIVER OF BANKRUPTCY RULE 6004(A)**

21. To successfully implement the foregoing, the Debtors seek a waiver of the notice requirements under Bankruptcy Rule 6004(a) to the extent applicable to this Motion.

#### **RESERVATION OF RIGHTS**

22. Authorization to pay any amounts under this motion shall not be deemed to constitute post-petition assumption or adoption of any contract, program, or policy pursuant to section 365 of the Bankruptcy Code. The Debtors reserve all their rights under the Bankruptcy Code with respect thereto. Moreover, authorization to pay all amounts under this motion shall not affect the Debtors' right to contest the amount or validity of any Taxes and Fees.

#### **NOTICE**

23. Notice of this motion has been provided to the following parties: (i) the Office of the United States Trustee for the District of South Carolina; (ii) the Office of the United States

Attorney General for the District of South Carolina; (iii) the Internal Revenue Service; (iv) Atalaya Administrative LLC; (v) ACM Fatz VII LLC; (vi) Midtown Madison Management LLC; (vii) Shrayne Capital, LLC; (viii) Benefit Street Partners; (ix) Milestone Partners; (x) Old Mill Stream, LLC; (xi) Triangle Mezzanine Fund LLLP; (xii) Sysco; (xiii) the holders of the thirty (30) largest unsecured claims against the Debtors on a consolidated basis; (xiv) all parties who, as of the filing of this motion, have filed a notice of appearance and request for service of papers pursuant to Bankruptcy Rule 2002; and (xv) all applicable government agencies to the extent required by the Bankruptcy Rules and the Local Rules. The Debtors submit that, in light of the nature of the relief requested, no other or further notice need be given.

**NO PRIOR REQUEST**

24. The Debtors have not previously sought the relief requested herein from this or any other Court.

**CONCLUSION**

WHEREFORE, for the reasons set forth herein, the Debtors respectfully request that the Court (a) enter an order, substantially in the form attached hereto, granting the relief requested herein, and (b) grant such other and further relief as is just and proper.

**McNAIR LAW FIRM, P.A.**

November 15, 2018

/s/ Michael H. Weaver

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**TABLE OF AUTHORITIES PURSUANT TO LOCAL RULE 9013-2**

1. *In re Synteen Tech., Inc.*, No. 00-02203, 2000 WL 33709667 (Bankr. D.S.C. April 14, 2000).

2000 WL 33709667

Only the Westlaw citation is currently available.  
United States Bankruptcy Court, D. South Carolina.

In re: SYNTEEN TECHNOLOGIES, INC. Debtor.

No. 00-02203-W.

April 14, 2000.

## ORDER

[WAITES](#), Bankruptcy J.

\*1 THIS MATTER comes before the Court upon Synteen Technologies, Inc.'s ("Debtor") Motion for Order Authorizing Debtor to Pay Certain Pre-Petition Claims ("Motion") filed on March 10, 2000. A preliminary hearing was held on March 16, 2000, and by Order entered March 24, 2000, the Court granted in part and denied in part Debtor's Motion. The Court denied at that time Debtor's request to pay the pre-petition claim of Marchem Dublon, Inc. ("Marchem"), pending a final hearing on the Motion. Rutland Plastics Technologies, Inc. ("Rutland") objected to the Motion and was present at the final hearing to prosecute its objection. After considering the pleadings filed, the evidence presented at the hearing on the Motion, and the arguments of counsel, the Court makes the following Findings of Fact and Conclusions of Law pursuant to [Rule 52 of the Federal Rules of Civil Procedure](#), made applicable by [Rule 7052 of the Federal Rules of Bankruptcy Procedure](#).<sup>1</sup>

## FINDINGS OF FACT

1. On March 10, 2000, Debtor filed its voluntary petition for relief under Chapter 11 of the Bankruptcy Code. Debtor is operating its business as debtor-in-possession pursuant to [11 U.S.C. §§ 1107\(a\) and 1108](#)<sup>2</sup> of the Bankruptcy Code.

2. Notice of the hearing on Debtor's Motion appears to have been properly served on all creditors and parties in interest.

3. Debtor is a company with forty-four (44) employees and engaged in the business of manufacturing and distributing technical industrial textiles in the North American market. Debtor converts fiberglass and polyester yarns into fabric which is then used as a reinforcement mesh in synthetic stucco; as the primary reinforcement in soil retaining wall applications and soil stabilization applications (collectively "geogrid"); in asphalt overlay applications; in welding and other high temperature applications, such as insulation; and

as a reinforcement in single-ply roofing membranes.

4. In its Motion, Debtor seeks to pay the pre-petition claim of Marchem in the amount of \$47,177.89. Marchem provides a coating for Debtor's geogrid which was developed specifically for Debtor.

5. If Marchem's pre-petition claim is not paid immediately, Marchem indicated that it will cease providing its products to Debtor.

6. Debtor's production of geogrid constitutes forty percent (40%) of its overall business.

7. Pursuant to an oral agreement between Debtor and Marchem, Marchem agreed not to provide the coating to any of Debtor's competitors; however, under the agreement, Debtor is not required to purchase a set amount of product from Marchem.

8. Rutland is an unsecured trade creditor of Debtor in the approximate amount of \$34,749.60. Rutland manufactures a coating similar in nature to Marchem's and has provided such product to Debtor in the past.

9. Rutland and Marchem are essentially competitors in the market place. Not only do Marchem and Rutland compete for customers, but, in the past, they have also competed for qualified employees. In fact, Marchem's sales/marketing representative which deals with Debtor's account formerly serviced Debtor in the same capacity for Rutland.

\*2 10. As of the date of the hearing, Debtor had a limited supply of Marchem's product, less than a week's worth. Debtor needs more of Marchem's coating in order to fill a major order; furthermore, because the business is entering its busy season, its continuing operations would be seriously jeopardized if it were forced to suffer a delay in the provision of the coating.

11. Rutland indicates that it can meet the specifications of Marchem's product with its own new product for Debtor's use within two to four weeks.

12. Rutland filed an Objection to the Motion for Entry of Order Authorizing Debtor to Pay Certain Pre-Petition Claims on March 22, 2000.<sup>3</sup>

## CONCLUSIONS OF LAW

[Section 363\(b\)\(1\) of the Bankruptcy Code](#) 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." In addition, bankruptcy courts have inherent equitable power under [§ 105\(a\)](#) to "issue any order, process, or judgment that is necessary to carry out the provisions of this title." While authorization to pay a

pre-petition claim is an extraordinary relief, the equitable powers as specified in § 105(a) give bankruptcy courts the permission to allow payment of a pre-petition claim “when essential to the continued operation of the debtor.” *In re NVR L.P.*, 147 B.R. 126, 127 (Bankr.E.D.Va.1992). As the court in *In re NVR* noted, however, “section 105 may not be used as a vehicle to discriminate among priority claims when there is no compelling business need for such discrimination.” *Id.*<sup>4</sup>

Generally, in order for the court to authorize the payment of a pre-petition claim, the movant must meet the “necessity of payment” rule which “recognizes the existence of the judicial power to authorize a Debtor in a reorganization case to pay pre-petition claims where such payment is essential to the continued operation of Debtor.”<sup>5</sup> *In re Ionosphere*, 98 B.R. 174, 176 (Bankr.S.D.N.Y.1989); see also *In re Boston and Maine Corp.*, 634 F.2d 1359, 1382 (1st Cir.1980) (recognizing the existence of judicial power to authorize trustees to pay claims for goods and services that are indispensably necessary to debtor’s continued operation); *In re Eagle-Picher Ind., Inc.*, 124 B.R. 1021, 1023 (Bankr.S.D.Ohio 1991) (“In applying the view of the law which we adopt, we consider that to justify payment of a pre-petition unsecured creditor, a debtor must show that the payment is necessary to avert a serious threat to the Chapter 11 process.”); *In re Ionosphere Clubs, Inc.*, 98 B.R. 174, 176 (Bankr.S.D.N.Y.1989) (quoting *In re Lehigh & New England Ry. Co.*, 657 F.2d 570, 581 (3rd Cir.1981) (“The ‘necessity of payment’ doctrine ... [permits] immediate payment of claims of creditors where those creditors will not supply services or material essential to the conduct of the business until their pre-reorganization claims shall have been paid.”)). The “rule of necessity” is not one of mere convenience; and, in proposing payment of a pre-petition obligation, the movant must show a “compelling business justification” that is in the best interest of both the debtor and other creditors. *In re NVR*, 147 B.R. at 127. Courts usually take into consideration whether the payment of the obligation at issue is critical to the reorganization of debtor’s business or fundamentally necessary to the continuation of debtor’s operations. *Id.*

\*3 In the case now before the Court, Debtor has proved that a compelling business justification warrants payment of Marchem’s claim. Rutland objected on the ground that Debtor has failed to show that it cannot obtain a similar or identical product from another vendor without the necessity of paying pre-petition claims. Rutland further argued that it has previously sold similar coating products to Debtor and presently offers to supply Debtor with either the product it formerly produced for Debtor or with any modified version of the product that Debtor might require, without payment of the pre-petition claim held by Rutland.

First, the Court finds that Marchem’s coating and the coating that Rutland has previously sold to Debtor do differ. Testimony offered by Debtor at the hearing on the Motion indicated that Debtors’ management believes that

Marchem’s coating is more durable and resistant and is better suited for Debtor’s application than Rutland’s present product. As to Rutland’s argument that it can produce a comparable product to Marchem’s and provide Debtor a sample of the coating in approximately two to four weeks; the Court concludes that such a time delay in the provision of the product would interrupt the continuing operations of Debtor which in turn would harm the bankruptcy estate and all creditors.

At the hearing on the Motion, counsel for Marchem indicated that the demand that it be paid its pre-petition claim before it will further provide Debtor its products was unequivocal. Evidence indicates that Marchem’s pre-petition claim represents the first significant billing due to Marchem since its new relationship with Debtor; therefore, the claim is seen as more critical to their business dealings. The Court finds that Debtor has a genuine need for Marchem’s product and ongoing contracts with clients currently require additional coating from Marchem in order for Debtor to fulfill its obligations. Due to the technical and specialized nature of the products in question, the Court shall not second guess Debtor’s business judgment and in effect mandate that Debtor use another supplier’s coating. Debtor has decided that the Marchem product is a superior product and essential to Debtor’s business.<sup>6</sup> Furthermore, Debtor cannot afford any delays at this time, given the fact that it presently needs the coating in order to fill its customers’ current orders. It is therefore,

ORDERED that Debtor is authorized to pay the pre-petition claim of Marchem in the amount of \$47,177.89.<sup>7</sup>

AND IT IS SO ORDERED.

#### All Citations

Not Reported in B.R., 2000 WL 33709667

Footnotes

- 1 The Court notes that to the extent any of the following Findings of Fact constitute Conclusions of Law, they are adopted as such, and to the extent any Conclusions of Law constitute Findings of Fact, they are so adopted.
- 2 Further references to the Bankruptcy Code shall be by section number only.
- 3 Prior to filing the formal objection, on or about March 16, 2000, Rutland filed a letter with the Court indicating that they objected to the proposed payment of the pre-petition claim of Marchem.
- 4 The parties agree that precedent in the Fourth Circuit does not establish a *per se* rule against the authorization to pay pre-petition claims. See, e.g., *Official Committee of Equity Security Holders v. Mabey (In re A.H. Robbins Co., Inc.)*, 832 F.2d 299, 302 (4th Cir.1987).
- 5 In analyzing the Fourth Circuit decision of *In re A.H. Robbins Co., Inc.*, 832 F.2d at 302, the court in *In re NVR* noted in a footnote: The Fourth Circuit has interpreted § 105(a) as generally not permitting a distribution to unsecured creditors in a Chapter 11 proceeding except under and pursuant to a plan of reorganization that has been properly presented and approved. However, it is unclear whether the broad language in Mabey failed to address the “necessity of payment” exception deliberately or by happenstance. This court assumes the latter for purposes of this opinion since the “necessity of payment” rule was not directly at issue in Mabey.  
*In re NVR*, 147 B.R. at 127 n. 2.
- 6 The Court would caution that its recognition of a debtor’s business judgment in the context of the payment of pre-petition claims is not a blank check. A debtor has a fiduciary duty to all creditors of the bankruptcy estate. To fulfill its duty when faced with a demand by an essential supplier for payment of a prepetition claim, a debtor must attempt to negotiate the most lenient payment terms possible. As such, even though the Court has authorized payment of the Marchem pre-petition claim, Debtor, in fulfilling its fiduciary duty to protect all creditors, should use its best efforts in good faith to negotiate with Marchem in an attempt to pay the pre-petition amount over time. A lump-sum payment, in fact, would most likely strain Debtor’s finances. Debtor also has a fiduciary duty to continue examining comparable products and to look for better products at a more affordable price.
- 7 After the ruling in this matter but prior to the entry of this Order, counsel for Debtor advised the Court, by letter dated April 4, 2000, that Marchem had modified its demand to have its claim paid in full in order for it to further provide its products to Debtor. The letter informed the Court that, as a result of Debtor’s negotiations with Marchem concerning the payment of the Marchem’s pre-petition claim, Marchem had agreed to accept immediate payment of 50% of its pre-petition claim, approximately in the amount of \$23,589, with the remaining claim to be paid through the Chapter 11 Plan. On this basis, Marchem agreed to continue to provide Debtor with its coating on a “cash in advance” basis.

**EXHIBIT A**

**Authorities**

<i>Authority</i>	<i>Address</i>			
Internal Revenue Service	Department of the Treasury	Ogden	UT	84201-0012
Georgia Department of Revenue	1800 Century Blvd. NE	Atlanta	GA	30345
NC Department of Revenue	501 N. Wilmington St.	Raleigh	NC	27604
SC Department of Revenue	300 A Outlet Pointe Blvd.	Columbia	SC	29210
Tennessee Department of Revenue	500 Deaderick St.	Nashville	TN	37242
Virginia Department of Revenue	1957 Westmoreland St.	Richmond	VA	23230
SC DOR	300A Outlet Pointe Blvd.	Columbia	SC	29214
NC ABC Commission	400 E Tryon Road	Raleigh	NC	27610
TN ABC Commission	500 James Robertson Parkway	Nashville	TN	37243
Macon Tax Office	6055 Lakeside Commons Drive Ste. 220	Macon	GA	31210
City of Hendersonville	145 5th Ave	Hendersonville	NC	28792
City of Asheville	Asheville City Hall, 70 Court Plaza, 4 <sup>th</sup> Floor	Asheville	NC	28802
Buncombe County	94 Coxe Avenue	Asheville	NC	28801
City of Shelby	300 S. Washington St.	Shelby	NC	28150
Cleveland County	County Administration Building 311 E. Marion St., 2 <sup>nd</sup> Floor	Shelby	NC	28151
Town of Forest City	128 N. Powell St.	Forest City	NC	28043
Burke County	Burke County Government Center 200 Avery Avenue	Morganton	NC	28680
Richmond County Tax	1401 Fayetteville Road	Rockingham	NC	28379
City of Rockingham	514 Rockingham	Rockingham	NC	28379
McDowell County	60 E Court Street	Marion	NC	28752
Town of Franklin	95 East Main Street	Franklin	NC	28734
City of Lenoir	801 West Avenue NW	Lenoir	NC	28645
Caldwell County	905 West Avenue NW	Lenoir	NC	28645

**EXHIBIT A-1**

Town of Greeneville	200 College Street	Greeneville	TN	37745
City of Bristol	801 Anderson	Bristol	TN	37620
City of Elizabethton	136 S Sycamore Street	Elizabethton	TN	37643
City of Kingsport	225 W Center Street	Kingsport	TN	37660
Columbia County	630 Ronald Reagan Drive Bldg. A	Evans	GA	30809
Barrow County	30 N Broad Street	Winder	GA	30680
Athens-Clarke County	375 Satula Avenue	Athens	GA	30601
City of Blairsville	P.O. Box 307	Blairsville	GA	30514
City of Jasper	200 Burnt Mountain Road	Jasper	GA	30143
VA ABC	2901 Hermitage Road	Richmond	VA	23220
SC DHEC	2600 Bull Street	Columbia	SC	29201
NC DHHS	1632 Mail Service Center	Raleigh	NC	27699
State of TN	P.O. Box 198990	Nashville	TN	37219
Pulaski County Environmental Health	143 Third St. NW Ste. 4	Pulaski	VA	24301
Columbia County Health Dept.	1930 William Few Parkway	Grovetown	GA	30813
Barrow County Environmental Health	15 Porter St. E	Winder	GA	30680
Clarke County Environmental Health	189 Paradise Blvd	Athens	GA	30607
Union County Health Dept.	46 Hughes Street, Ste. B	Blairsville	GA	30512
City of Easley	205 North First Street	Easley	SC	29640
City of Greenwood	520 Monument St.	Greenwood	SC	29646
City of Columbia	1401 Main Street	Columbia	SC	29201
City of Greer Finance Department	301 E Poinsett	Greer	SC	29651
City of Orangeburg	979 Middleton Street	Orangeburg	SC	29115
Town of Lexington	111 Maiden Lane	Lexington	SC	29072

Richland County Business Service Center	2020 Hampton St. 3 <sup>rd</sup> Floor	Columbia	SC	29204
Town of Greeneville	200 N. College Street	Greeneville	TN	37745
Columbia County Licensing and Permits	630 Ronald Reagan Drive Building A	Evans	GA	30809
City of Rock Hill Planning Dept. Business Licenses	155 Johnston St., Ste. 300	Rock Hill	SC	29730
Department of Revenue	500 Deaderick Street	Nashville	TN	37242
Barrow County Licenses	30 N Broad Street	Winder	GA	30680
City of Marion	194 Main Street	Marion	NC	28752
City of Aiken	135 Laurens St. SW	Aiken	SC	29801
Department of Revenue	500 Deaderick Street	Nashville	TN	37242
Department of Revenue	500 Deaderick Street	Nashville	TN	37242
City of Camden	1000 Lyttleton Street	Camden	SC	29020
City of Clinton	211 North Broad St., Ste. A	Clinton	SC	29325
Athens-Clarke County Finance Department	375 Satula Ave.	Athens	GA	30601
City of Blairsville	62 Blue Ridge Street	Blairsville	GA	30512
Pulaski County	52 W Main Street Ste. 200	Pulaski	VA	24301
City of Jasper	200 Burnt Mountain Road	Jasper	GA	30143
Town of Cheraw	309 Kershaw Street	Cheraw	SC	29520