The Bare Necessities of Critical Vendor Motions—It's a Jungle Out There

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The Seventh Circuit's decision in *In re Kmart Corp.*[1] ("*Kmart*") and other recent decisions from courts around the country have intensified the debate regarding whether a bankruptcy court has the authority to allow a debtor to pay prepetition unsecured claims outside the context of a confirmed plan of reorganization. The recent backlash against the payment of prepetition claims of "critical vendors" is a direct result of the fact that courts are routinely granting "critical vendor" motions, often with very little evidentiary basis for such extraordinary relief. Upon the filing of a case, it is also not uncommon for debtor's counsel to receive unsolicited calls from vendors asking how they too can get on the "critical vendor" list. Much in the same way as the Third Circuit's decision in *In re O'Brien Environmental Energy*[2] resulted in more rigorous scrutiny of break-up fees in the context of Section 363 asset sales, the Seventh Circuit's *Kmart* decision is likely to have the same effect on "critical vendor" motions.

Much of the debate has focused upon whether there is statutory authority in the Bankruptcy Code for the Necessity of Payment Rule–the theoretical underpinning for the payment of "critical vendors." Critics of the Necessity of Payment Rule stress the fact that the Bankruptcy Code does not contain any specific provision authorizing payment of prepetition claims outside of a plan of reorganization. However, critics ignore the fact that, at the commencement of Chapter 11 bankruptcy cases, courts routinely authorize the payment of prepetition claims of parties *other* than trade creditors. The filing of virtually every Chapter 11 bankruptcy

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case is accompanied by a motion authorizing the debtor to pay prepetition claims owed to employees, including unpaid wages and business expenses, and to honor prepetition employee benefit plans. Similarly, many debtors seek first day orders authorizing them to honor customer programs including prepetition warranties, deposits, and other practices designed to convey to customers that the debtor will operate "business as usual" during the Chapter 11 process. In light of the attention drawn to "critical vendor" motions, it is surprising that these other first day orders do not attract nearly the same level of opposition. Critics of the Necessity of Payment Rule attempt to distinguish these cases by arguing that the issue is merely one of timing, as many of these claims enjoy priority under Section 507 of the Bankruptcy Code and such claims must be paid in full prior to the payment of general unsecured claims.[3] That distinction, however, is unpersuasive since the debtor's ability to satisfy priority claims at all is often unknown when such motions are granted. This is especially true in the not so uncommon case where the prepetition lender is undersecured and is not likely to be paid in full. The argument also fails because many routine employee wage motions seek authorization to pay claims which exceed the statutory priority cap or are not priority claims at all (i.e., reimbursement of business expenses).

Prepetition claims of employees are not the only claims which are often authorized for payment at the beginning of a case. Many postpetition financing orders contain mechanisms pursuant to which proceeds of postpetition financings are used first to pay prepetition claims. The effect of such practice is to convert prepetition secured claims into postpetition secured claims enjoying superpriority administrative status which must be paid in full, and ahead of other administrative claims, as a condition of confirmation of a plan of reorganization. Such provisions in financing orders are often the subject of negotiation with creditors' committees; however, if the committee ultimately concludes that the debtor requires postpetition financing to continue operating, and such financing is not available from a source other than the existing lender, it is likely that some form of a debt-rollover will be approved as part of a comprehensive financing package.

While people can debate whether or not the Necessity of Payment Rule survived the codification of the Bankruptcy Code or whether the Bankruptcy Code provides an independent basis to support preplan payment of prepetition claims, the practical reality is that courts *must* have the flexibility to deal with those rare situations where a creditor exerts its leverage over the debtor and the debtor has no legal mechanism to compel the creditor to continue trading with the debtor. Accordingly, rather than focus on whether there is any authority to permit payment of prepetition claims outside the context of a plan, the courts should fashion clear, objective, rigorous standards which a debtor would have to meet to obtain such extraordinary relief. Part I of this Article briefly examines the historical underpinnings of the Necessity of Payment Rule. Part II reviews the various provisions of the Bankruptcy Code that are often cited as support for the payment of prepetition claims prior to confirmation of a plan. Part III critiques the dominant argument against the practice–that it frustrates the goal of "equality of distribution." Part IV discusses judicial attempts to articulate uniform guidelines in the application of the Necessity of Payment Rule and offers suggestions for other procedural and substantive safeguards which can be used to appropriately balance the interests of creditors and debtors.

I. The Historical Underpinnings of the Necessity of Payment Rule.

A court's authority to authorize the payment of debts incurred prior to the appointment of an equity receiver dates back to the United States Supreme Court's decision in *Miltenberger v. Logansport, C. & S. W. R. Co.*[4]. In *Miltenberger*, the Supreme Court established the principle that a court has the authority to grant an equity receiver discretion to pay preexisting debts "necessary and indispensable" to the continued operation of the business as part of the receiver's general duty to protect and preserve property under their charge. The Necessity of Payment Rule, as it came to be known, was frequently applied by the Supreme Court in the decades following *Miltenberger* and became part of equity receivership jurisprudence.[5]

Whether the Necessity of Payment Rule applied to non-railroad reorganizations is not entirely clear. *Dudley v. Mealey*[6] is often cited by proponents to support the application of the Necessity of Payment Rule beyond railroad reorganizations. In *Dudley*, the Second Circuit, during the course of its opinion reversing confirmation of a plan, discussed whether a reorganization plan could grant a preference to unsecured creditors who had furnished supplies to the hotel prior to the appointment of a receiver. The court ultimately concluded that a receiver's authority to pay debts incurred prior to the appointment of the receiver was not limited to railroad cases; however, the court did not reference the Necessity of Payment Rule or cite *Miltenberge*r, but instead discussed cases that applied the "Six Months Rule." The "Six Months Rule," unlike the Necessity of Payment Rule is a rule about priorities and provided that certain expenses incurred during the six months preceding the appointment of the receiver were entitled to priority. Unlike the Necessity of Payment Rule, the "Six Months Rule" was codified in Section 77B of the Bankruptcy Act and later in Section 1171(b) of the Bankruptcy Code[7]. Critics of the Necessity of Payment Rule argue that *Dudley v. Mealey* was not a case about the Necessity of Payment Rule. Accordingly, the absence of any reported decision applying the doctrine outside the context of railroad cases, coupled with Congress's decision to codify only the "Six Months Rule" in the Bankruptcy Code, conclusively establishes that the Necessity of Payment Rule has no vitality under the Bankruptcy Code. The counter to this argument is that railroad reorganizations and traditional equity powers exercised by receivers are the bedrock upon which the Bankruptcy Act of 1933 and 1934, the Chandler Act of 1938, and the Bankruptcy Code are based. As Congress took its cues from railroad reorganizations in enacting bankruptcy legislation, it would be inappropriate to reject the Necessity of Payment Rule without a clear indication from Congress that it intended to do so. Moreover, proponents contend that the Congress's decision to restrict the "Six Months Rule" to railroad reorganizations without a corresponding restriction of the Necessity of Payment Rule demonstrates that the doctrine is not so limited.

Both sides do agree, however, that the Bankruptcy Code does not specifically mention the Necessity of Payment Rule and does not contain a specific provision permitting or prohibiting the payment of prepetition claims outside of a plan of reorganization. On several recent occasions, the Supreme Court has stressed that the "normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific. The [U.S. Supreme] Court has followed this rule with particular care in construing the scope of the Code."[8] Accordingly, if one views the Necessity of Payment Rule as engrained in pre-Code jurisprudence, then it may be ignored only if the Bankruptcy Code evidences Congress's clear intent to do so. Conversely, if the Necessity of Payment Rule is merely an antiquated doctrine which, at most, had limited application to railroad cases before Congress adopted the nation's first uniform bankruptcy laws, then the lack of clear authority in the Bankruptcy Code to support the practice may be fatal.[9]

II. The Bankruptcy Code Supports the Payment of General Unsecured Claims Prior to Plan Confirmation Under Certain Circumstances.

Separate and apart from whether the Necessity of Payment Rule survived codification of the Bankruptcy Code, proponents argue that several sections of the Bankruptcy Code authorize the pre-plan payment of general unsecured claims.

A. Section 105, In Conjunction With Other Provisions of the Bankruptcy Code, Can Support the Pre-Plan Payment of Prepetition Claims.

Section 105(a) of the Bankruptcy Code provides, in pertinent part, that: "the Court may issue *any* order, process, or judgment that is *necessary* or *appropriate* to *carry out* the *provisions of this title*." (emphasis added). The Supreme Court has repeatedly admonished that "when the statute's language is plain, 'the sole function of the courts', at least where the disposition required by the text is not absurd, 'is to enforce it according to its terms.'"[10] Congress's choice of words in Section 105–"any," "necessary," "appropriate," "carry out," "provisions of this title"–all suggest that Congress intended an expansive interpretation of the section which would not hamstring the courts in addressing issues which arise in bankruptcy cases.

Several courts find authority in Section 105 for the payment of prepetition claims outside of a plan without resort to other sections of the Bankruptcy Code. These courts generally reason that Section 105 can be used to further the general policy provisions of Title 11 which include (1) "to permit the successful rehabilitation of debtors,"[11] and (2) to "preserv[e] going concerns and maximiz[e] property available to satisfy creditors."[12] Thus, Section 105(a) empowers the bankruptcy court to authorize payment of prepetition claims when such payments are essential to ensure the survival of the debtor pending its reorganization, which, in turn, will enhance the probability of maximizing the value of estate assets and ultimately, return to creditors.[13]

Critics argue that Section 105 can only be used to implement *specific* provisions of the Bankruptcy Code. This argument proves too much. Section 105 would be rendered superfluous if there was already a specific provision in the Bankruptcy Code authorizing the action. Rather, provided that there is a bridge from Section 105 to another provision of the Bankruptcy Code and the proposed action is necessary to carry out the policies of Chapter 11, a court should find authority to take certain action.[14] As discussed below, several provisions of the Bankruptcy Code provide courts with such a bridge to support payment of prepetition claims outside of a plan.

B. Sections 1107 and 1108

Recently, a court has found sufficient authority in Sections 1107 and 1108 of the Bankruptcy Code to authorize payment of prepetition claims if necessary to enable the debtor to fulfill its fiduciary duty to maximize creditor recoveries through the debtor's continued operation. Under Section 1107, a debtor in possession has the powers of a trustee.[15] Section 1108 provides that "unless the court, on request of a party in interest and after notice and a hearing, orders otherwise, the trustee may operate the debtor's business." In *In re CoServ,L.L.C.*,[16] the court reasoned that payment of prepetition claims may, on occasion, be the only way to satisfy a debtor in possession's fiduciary duty to protect and preserve the estate. Examples cited by the *CoServ* court included foreign creditors beyond the jurisdiction of the bankruptcy court, prepetition warranty or refund claims of customers and prepetition claims necessary to preserve a debtor's license from revocation by the state's police powers. The *CoServ* court concluded that:[17]

> It may be that payment of a prepetition unsecured claim is the only means to effect a substantial enhancement of the estate, and here, too, payment would be justified. These are simply examples of claims that might require satisfaction for the debtor in possession to perform its fiduciary obligations. In such instances it is only logical that the bankruptcy court be able to use Section 105(a) of the Code to authorize satisfaction of the prepetition claim in aid of preservation or enhancement of the estate.

C. Section 363.

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." Section 363(b)(1) was first cited as authority for pre-plan payment of prepetition claims by the Bankruptcy Court for the Southern District of New York in *In re Ionosphere Clubs, Inc.*[18] The language of Section 363(b)(1) is broad enough to make a payment to prepetition creditors if necessary to aid in the debtor's reorganization. While the Seventh Circuit in *Kmart* ultimately concluded that the Bankruptcy Court erred in authorizing the payment of prepetition claims pursuant to the "critical vendor" motions filed at the beginning of the bankruptcy case, it did leave open the possibility that, under appropriate circumstances, Section 363 could be used to support pre-plan payments. After rejecting Sections 105, 364 and 503(b)(1) as providing sufficient authority for the Necessity of Payment Rule, the Seventh Circuit turned to Section 363:[19]

> [Use of Section 363] is more promising, for satisfaction of a pre-petition debt in order to keep "critical" supplies flowing is a use of property other than in the ordinary course of administering an estate in bankruptcy. Capital Factors insists that Section 363(b)(1) should be limited to the commencement of capital projects, such as building a new plant, rather than the payment of old debts–as paying vendors would be "in the ordinary course" but for the intervening bankruptcy petition. To read Section 363(b)(1) broadly, Capital Factors observes, would be to allow a judge to rearrange priorities among creditors (which is what a critical-vendors order effectively does), even though the Supreme Court has cautioned against such a step. See *United States v. Reorganized CF&I Fabricators of Utah, Inc.*, 518 U.S. 213 (1996); *Noland*, *supra*. Yet what these decisions principally say is that priorities do not change unless a statute supports that step; and if Section 363(b)(1) is such a statute, then there is no unsuperable problem. If the language is too open-ended, that is a problem for the legislature. Nonetheless, it is prudent to read, and use Section 363(b)(1) to do the least damage possible to priorities established by contract and by other parts of the Bankruptcy Code. We need not decide whether Section 363(b)(1) could support payment of some pre-petition debts, because *this* order was unsound no matter how one reads Section 363(b)(1).
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> The foundation of a critical-vendors order is the belief that vendors not paid for prior deliveries will refuse to make new ones. Without merchandise to sell, a retailer such as Kmart will fold. If paying the critical vendors would enable a successful reorganization and make even the disfavored creditors better off, then all creditors favor payment whether or not they are designated as "critical." This suggest a use of Section 363(b)(1) similar to the theory underlying a plan crammed down the throats of an impaired class of creditors: if the impaired class does at least as well as it would have under a Chapter 7 liquidation, then it has no legitimate objection and cannot block

> the reorganization. See generally, *Bank of America v. 203 N. LaSalle St. Partners*, 526 U.S. 434 (1999). For the premise to hold true, however, it is necessary to show not only that the disfavored creditors *will* be as well off with reorganization as with liquidation–a demonstration never attempted in this proceeding–but also that the supposedly critical vendors would have ceased deliveries if old debts were left unpaid while the litigation continued. If vendors will deliver against a promise of current payment, then a reorganization can be achieved, and all unsecured creditors will obtain its benefit, without preferring any of the unsecured creditors.

As stated by the Seventh Circuit, critics challenge use of Section 363 as support for "critical vendor" motions because payment of trade vendors is not an "out of the ordinary course" transaction for which authority under Section 363 may be obtained. That argument does not withstand scrutiny. Bankruptcy cases are replete with examples of use of Section 363 as authority to support transactions that could be considered "ordinary course" outside of bankruptcy. For example, Section 363 is primary authority use to support the continued honoring of customer programs and practices. Section 363 is also cited as authority to support implementation of senior management incentive-based compensation and the continued use of a debtor's prepetition cash management system. While those types of motions are sometimes opposed, rarely are they opposed on the grounds that Section 363 does not authorize such "ordinary course" transactions.[20]

D. Section 364.

Section 364 of the Bankruptcy Code authorizes a debtor to obtain unsecured credit on such terms as the bankruptcy court, after notice and a hearing, may allow. Section 364 provides:

> (a) If the trustee is authorized to operate the business of the debtor under section... 1108... of this title, unless the court orders otherwise, the trustee may obtain unsecured creditor and incur unsecured debt in the ordinary course of business allowable under section 503(b)(1) of this title as an administrative expense.
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> (b) The court, after notice and a hearing, may authorize the trustee to obtain unsecured credit or to incur unsecured debt other than under subsection (a) of this section, allowable under section 503(b)(1) of this title as an administrative expense.

Section 364 is intended to encourage post-bankruptcy lending to facilitate a debtor's reorganization efforts. A trade creditor who extends post-petition credit is granted an administrative expense for his post-bankruptcy shipments as an incentive to extend credit. In some instances, however, an administrative expense claim might not be sufficient to induce a creditor to ship essential goods and services and that trade creditor may insist on more lucrative credit terms, such as COD payment, payment assured through a standby letter of credit, or by granting a security interest. It may also, however, be necessary and/or desirable to simply pay the prepetition invoices to induce the trade creditor to extend postpetition credit. In this instance, Section 364 authorizes the payment as a part of a financing package.

If a trade creditor agreed to extend unsecured credit to a debtor and requested 15% interest on the credit extended, a court would have no trouble finding that it had the *authority* to approve such a financing package. What is the difference if, in lieu of seeking interest, the debtor wants to retire a portion of its prepetition debt to that creditor? In fact, the latter alternative actually benefits the debtor's creditors by reducing outstanding debt while the first option depletes the estate by the payment of interest. Section 364 does not contain any restrictions on what type of incentives may be provided to parties in order to induce them to provide a debtor with financing. The Seventh Circuit in *Kmart* specifically rejected Section 364 as providing authority for critical vendor orders holding that Section 364 "authorizes the debtor to obtain credit (as Kmart did) but has nothing to say about how the money will be disbursed or about priorities among creditors." The Seventh Circuit also reasoned that a debtor that has obtained debtor in possession financing should either be able to pay the critical vender COD or obtain authority from the debtor in possession lender to create a superpriority "vendor's lien" or letter of credit to alleviate the critical vendor's concerns.[21] While those alternative solutions are theoretically possible, they are often times difficult to implement and may not convince a truly critical vendor to continue transacting business with the debtor.

Notwithstanding *Kmart*, other courts have relied upon Section 364 as authority for the pre-plan payment of the prepetition debts of certain critical vendors. In *In re Payless Cashways, Inc.*[22], the bankruptcy court held that Section 364 authorizes the payment of the prepetition invoices if the vendors agreed to extend postpetition unsecured credit on certain terms to the debtor. The debtor, a retailer of building materials, sought to provide certain lumber suppliers with an administrative claim equal to 90%

of the amount of their prepetition claims if they provided the debtor with postpetition credit. The court granted the motion over the objection of the United States Trustee. Initially, the court noted that the Bankruptcy Code does not prohibit the payment of prepetition claims. Section 549, which authorizes a Chapter 7 trustee to set aside postpetition payments of prepetition claims not authorized by the court, implicitly recognizes that, under certain circumstances, payment of prepetition claims may be appropriate. The court then recognized that Section 364(b)'s grant of authority to allow a debtor to obtain credit out of the ordinary course of business and allowable as an administrative expense, authorized payment of prepetition claims provided the debtor could meet the following six-part test:

(1) did the debtor comply with Bankruptcy Rule 4001;

(2) was the transaction negotiated at arms length;

(3) is the borrowing critical to the future of the business, given the condition of the business at the time the motion is heard and the status of the debtor's other postpetition financing, if any;

(4) does the transaction confer a benefit on the estate and its creditors, not just the critical vendors;

(5) are the interested parties represented and, if not, what is the level of sophistication of unrepresented parties;

(6) what is the extent of support from the creditor body?

Critics argue that payment of prepetition claims under the guise of Section 364 is analogous to cross-collateralization of postpetition financing with prepetition collateral. Courts, however, have not uniformly rejected cross-collateralization as an appropriate incentive in those circumstances where a debtor is unable to obtain financing to sustain operations[23]. In fact, prepetition debt rollovers, a common part of many debtor in possession financing orders, are often approved with the support of the unsecured creditors' committee.

E. Section 507 Does Not Limit Administrative Claims to Postpetition Claims.

In *Kmart* the debtor argued that payment of prepetition claims can constitute an administrative expense if they are necessary to preserve the estate. Section 503(b) provides that, "after notice and a hearing, there shall be allowed administrative expenses... including–the actual, necessary costs and expenses of preserving the estate, including wages, salaries or commissions for services rendered after the commencement of this case."[24] The first clause of Section 503(b)(1) limits administrative claims to those that are "actual, necessary costs and expenses of preserving the estate." That language does not limit those costs to postpetition costs. While the statute goes on to say that administrative claims *include* "wages, salaries or commissions for services rendered *after* the commencement of the case," the language, rather than being limiting, is inclusive. The Seventh Circuit, however, rejected this argument, stating, "Section 503, which deals with administrative expenses is similarly irrelevant. Pre-filing debts are not administrative expenses; they are the antithesis of administrative expenses... Treating pre-filing debts as 'administrative' claims against the post filing entity would impair the ability of bankruptcy law to prevent old debts from sinking a viable firm."[25]

II. Equality of Distribution–While an Important Principal–Is Not Absolute and Does Not Conflict With Recognition of the Necessity Doctrine.

The principal argument advanced by critics of the Necessity of Payment Rule is that it undermines the principle of equality of distribution which is fundamental to the Bankruptcy Code. This argument is flawed for several reasons.

A. The Necessity of Payment Rule is Not a Rule About Priorities.

The Necessity of Payment Rule is not, strictly speaking, a rule about priorities; rather, it is a rule that gives a debtor discretion, under appropriate circumstances, to pay prepetition claims. The Supreme Court and several circuit courts have consistently stated that a creditor may not invoke the Necessity of Payment Rule as a basis for having their claims paid ahead of other claims.[26]

Critics contend that recognition of the Necessity of Payment Rule results in the categorical subordination of claims prohibited by the Supreme Court in *U.S. v. Reorganized CF & I Fabricators of Utah, Inc.*[27] and *U.S. v. Noland.*[28] In those cases, the Supreme Court ruled that it was error for a bankruptcy court to approve the *categorical* subordination of unsecured tax penalty claims to other general unsecured claims without any showing of special circumstances. Critical vendor orders, however, do not seek to categorically place certain claims ahead of others by the very nature of their claims. Rather, the specific circumstances surrounding each claim is evaluated to determine whether such circumstances justify providing the debtor with discretion to satisfy those claims in full or in part outside the context of a Chapter 11 plan.[29]

B. The Bankruptcy Code Only Prohibits "Unfair Discrimination" Among Creditors of Equal Priority.

The Supreme Court has recognized, as does the Bankruptcy Code, a debtor's ability to provide different treatment of claims of like priority in appropriate circumstances. Rather than a bright line rule, differential treatment is authorized provided that the disparate treatment does not amount to unfair discrimination.[30] In *Mason v. Paradise Irr. Dist.,*[31] the Supreme Court affirmed confirmation of a plan that provided preferential treatment to a creditor who provided the debtor with funds to refinance certain obligations. In ruling that these circumstances justified differential treatment, the Supreme Court reasoned:[32]

> But as we have seen, he who furnishes new capital to a distressed enterprise has long been accorded preferred treatment. The Reconstruction Finance Corporation contributes something that Mason does not. It furnishes the underwriting which makes the refinancing possible. It gives something of value for the preferred treatment which it receives. The other security holders of the same class give nothing new. That difference warrants a difference in treatment (case citations omitted). The plan, of course, must be fair and equitable and it must "not discriminate unfairly " in favor of any creditor.

Section 1122 of the Bankruptcy Code governs a debtor's classification of claims under a plan.[33] Section 1122 does not require similar claims to be put in the same class and treated the same; rather, Section 1122 only prohibits dissimilar claims from being classified together. A debtor has discretion to classify similar claims separately if the classification is not designed to gerrymander and there are "good business reasons" to do so.[34] In *In re Ionosphere Clubs, Inc.*, the court reasoned as follows:[35]

> Furthermore, even in the context of reorganization, a majority of both cases and commentators have rejected the concept that all creditors of equal rank must receive equal treatment. Section 1123 of the Code does require the same treatment for each claim or interest of a particular class. However, it does not automatically follow that all creditors of equal rank must be treated alike. Section 1123 is only relevant in the context of Section 1122 which provides, in relevant part, that a plan *may* place a claim or an interest in a particular class

> only if such claim or interest is substantially similar to the other claims or interests of such class.
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> Cases interpreting the classification and treatment provisions of Section 1122 and 1123 of the Code, and their predecessor provisions under the Bankruptcy Act, have held that a debtor may place claimants of the same rank in different classes and thereby provide different treatment for each respective class.

Section 1129 of the Bankruptcy Code specifically permits a plan to treat similar claims differently provided that it does not amount to "unfair discrimination."[36] There are many decisions permitting differential treatment based upon the contribution of a creditor to the reorganization effort.[37]

If a plan may provide better treatment to creditors who facilitate the debtor's reorganization, why shouldn't the debtor be able to accomplish the same thing in the context of approval of critical vendor motions? The response often given to this question is that a plan contains certain procedural safeguards which are not present in the context of expedited motion practice. As discussed below, courts can address the procedural concerns raised by critical vendor motions by implementing certain safeguards designed to provide parties with adequate notice of the issuance of critical vendor orders. Moreover, since only a rejecting *class* of creditors can raise an "unfair discrimination" objection to confirmation, it is inappropriate for a *single* creditor to prevent the functional equivalent at the early stages of the bankruptcy case especially where the creditors committee supports the debtor's desire to pay select prepetition claims to facilitate reorganization.

C. "Equality of Distribution," While Perhaps Paramount in a Chapter 7 Case, Is Overshadowed by the Goal of "Rehabilitation of the Debtor" In the Chapter 11 Context.

Nobody questions that two overriding principals under the Bankruptcy Code are "equality of distribution" and "rehabilitation of the debtor". The issue is what should occur when these principals are in tension as is the case with attempts to authorize prepetition claims outside of a plan. The answer may be different depending upon whether the goal of the bankruptcy case is a financial reorganization or a liquidation. In refusing to rule that cross-collateralization is impermissible per se, under Section

364 of the Bankruptcy Code, the Ninth Circuit in *In re Adams Apple*, recognized the tension of these competing principles:[38]

> First, appellants claim that the cross-collateralization clause violates a fundamental tenet of bankruptcy law that like creditors must be treated alike. This argument is simply a restatement of their general assertion that cross-collateralization clauses are illegal per se. It is flawed because the "fundamental tenet" conflicts with another "fundamental tenet"–rehabilitation of debtors, which may supersede the policy of equal treatment. Cases have permitted unequal treatment of pre-petition debts when necessary for rehabilitation in such contexts as (i) pre-petition wages to key employees; (ii) hospital malpractice premiums incurred prior to filing; (iii) debts to providers of unique and irreplaceable supplies; and (iv) peripheral benefits under labor contracts.

III. The Focus of the Debate Should be on When–Not If–a Court Can Authorize the Payment of Prepetition Claims Outside of a Plan.

Courts could advance the discourse regarding the Necessity of Payment Rule by establishing clear uniform guidelines regarding the circumstances under which the debtor may be allowed to pay prepetition claims outside the context of a plan. The current patchwork of decisions throughout the country and the varying degrees that some courts authorize the practice are factors in a debtor's decision on where to file its bankruptcy case, and is also an impediment to a debtor's ability to normalize relationships with trade creditors postpetition. While critics contend that a bright line rule rejecting the pre-plan payment of unsecured claims under any circumstance will reduce the expectations of trade creditors and eliminate the problem altogether, that view is naïve. Trade creditors are creative and will find ways to obtain repayment of their prepetition claims by, among other things, increasing the cost of product shipped postpetition. A categorical rejection of the practice will drive the practice underground where it will be virtually impossible for creditors or the debtor to exercise any real degree of control.

The majority of reported decisions contain very little guidance as to the circumstances under which courts should grant critical vendor motions; rather, the decisions contain conclusory language which is difficult to apply. In *In re Structurlite Plastics Corp.*,[39] the court established a two-part-test to determine if the payment was "absolutely vital" and could be approved under the Court's general equitable powers of Section 105(a): (1) absent payment, would the debtor's rehabilitative attempt have to be "immediately aborted?"; (2) would authorizing the payment create the greatest likelihood of payment to creditors in full or at least proportionately?[40] In *In re Eagle-Picher Industries, Inc.*,[41] the bankruptcy court held that all that is required is a showing that payment is "necessary to avert a serious threat to the Chapter 11 process." Similarly, in *In re UNR Industries, Inc.*,[42] the court held that the Necessity of Payment Rule authorized the payment of prepetition claims "as long as payment of those claims will help to stabilize the debtors' business relationships without significantly hurting any party."[43]

Recently, in *In re CoServ*,[44], the Bankruptcy Court for the Northern District of Texas articulated a four-part test to govern requests for approval of critical vendor motions. First, the debtor would need to demonstrate that "dealing with the claimant is virtually indispensable to profitable operations or preservation of the estate." Presumably, this would cover approval of prepetition customer programs and sole suppliers of goods to the debtor. On the other hand, the mere inconvenience or potential decrease in profitability if alternative vendors were used would likely not suffice. Second, the "failure to deal with the claimant risks probable harm or eliminates an economic advantage disproportionate to the amount of the claim." The court said a debtor could meet this prong of the test by showing either "meaningful economic gain to the estate" or "serious economic harm will be avoided through payment of the prepetition claim." Third, there must not be any "practical or legal alternative to payment of the claim." In other words, if the non-debtor can be forced to continue providing goods and services pursuant to an executory contract or is within the reach of the court's jurisdiction and its refusal to deal with the debtor amounts to a violation of the automatic stay, this prong would not be satisfied. The court also alluded to the ability to provide the creditor with alternative security for the payment of its postpetition claims such as deposits or COD terms. It is unclear, however, whether a creditor's refusal to deal with the debtor, even assuming those other assurances are available, would be fatal if the other prongs of the test are satisfied. Lastly, the debtor must demonstrate that "payment is the only alternative." It is unclear, however, what this last prong adds to the standard.

In *Kmart*, the Seventh Circuit left open the possibility of approving payment of prepetition claims under Section 363 if the debtor can demonstrate that paying the critical vendors would enable a successful reorganization and that creditors will be better off with a reorganization rather than a liquidation. The *Kmart* test, however, may be tantamount to a rejection of the payment of prepetition claims as a practical matter. This is because while a debtor may, in limited circumstances, demonstrate that its business cannot be sustained without the critical vendor, the converse is not necessarily true–that payment of the creditor will lead to a successful reorganization. Similarly, it may be difficult for the debtor to establish a causal connection between the payment of such claims and an increase in distributions unsecured creditors would receive under a plan. This is especially true in those increasingly common cases where the secured creditor is significantly undersecured and the case is being prosecuted as a vehicle to dispose of the debtor's assets through a Section 363 sale and the likelihood of any recovery to general unsecured creditors is remote at best.

Much of the concern with the entry of critical vendor orders stems from the emergency nature of the requests, the inability to provide adequate notice to parties, and the unrestricted nature of the orders that are entered. These issues, however, can be addressed short of a bright-line rule rejecting the practice all together. Similar to guidelines which have been established by courts throughout the country with respect to postpetition secured financing, courts could establish guidelines addressing the procedural and substantive aspects of critical vendors' motions. Such guidelines could include the following. First, such requests should not be approved on an emergency basis as part of first day orders; rather, courts should wait until a creditors' committee is appointed and has sufficient time to evaluate the request. If a creditors' committee, having a fiduciary duty to general unsecured creditors, determines that preferring certain unsecured creditors over others is in the best interests of the debtor's estate and will aid in the debtor's reorganization, that should mitigate towards granting the motion. Second, notice of the motion should be served on all creditors and clearly identify that the effect of the motion is to pay certain claims of unsecured creditors which would not otherwise be paid prior to confirmation of a plan. Third, the motion should clearly identify which creditors are covered by the request and the proposed amount to be paid to each such creditor. Courts should not grant generalized motions seeking a dollar amount to be used in the debtor's discretion. Fourth, just as a creditor must demonstrate the lack of alternatives to support secured postpetition financing, the motion should contain admissible evidence that the debtor cannot obtain the goods in question from alternative suppliers, or, if it can, what the added costs would be to the estate if the debtor was forced to go elsewhere. Fifth, if the motion is based upon the threat of a creditor not to continue transacting business with the debtor without payment of the prepetition claim, the debtor should submit a declaration from the creditor setting forth such position. Sixth, the motion should identify the credit terms a vendor must agree to provide as a condition to receiving a payment on account of their prepetition claim and whether any alternatives exist to provide the creditor with assurances of postpetition payment. Seventh, the debtor must disclose whether there is any contractual relationship with the creditor which would legally obligate the creditor to continue doing business with the debtor regardless of whether the prepetition claim is paid. Lastly, to the extent practicable, courts should conduct an evidentiary hearing on any critical vendor motion to determine if the debtor has satisfied its burden of demonstrating that payment of prepetition claims is in the best interests of the debtor's estate.

IV. Conclusion.

Courts must have the flexibility to adequately address real life circumstances that threaten to derail reorganization cases. The bargaining leverage created by commercial relationships between debtors and certain of their suppliers are examples of such circumstances. While courts must be skeptical of conclusory statements that failure to authorize payment of prepetition claims will be devastating to the success of the reorganization, appropriate procedures can and should be adopted to carefully balance the interests of all stakeholders and attempt to harmonize the sometimes conflicting goals of debtor rehabilitation and equality of treatment.

RESEARCH REFERENCES:

Norton Bankr. L. & Prac. 2d §§ 27:3, 85:6, 85:7; Bankr. Serv., L Ed §§ 12:468, 12:275, 20:299.

West's Key Number Digest, Bankruptcy 3025, 3025.1, 3026

NOTES

1. In re Kmart Corp., 359 F.3d 866, 42 Bankr. Ct. Dec. (CRR) 166, Bankr. L. Rep. (CCH) ¶ 80054 (7th Cir. 2004).

2. In re O'Brien Environmental Energy, Inc., 181 F.3d 527, 34 Bankr. Ct. Dec. (CRR) 879 (3d Cir. 1999).

3. See In re CoServ, L.L.C., 273 B.R. 487, 493, 38 Bankr. Ct. Dec. (CRR) 266, 47 Collier Bankr. Cas. 2d (MB) 851 (Bankr. N.D. Tex. 2002) ("Thus, in the case of CoServ's wage claims, only the Lender (whose cash collateral would be used to pay wage and benefit claims) and professionals (accorded priority under Section 507(a)(1) and so entitled to payment ahead of employee claims having priority under Section 507(a)(3) and (4)) could be affected. All these persons supported payment of wage claims. Later cost claimants, if any, will extend their credit and so create

their priority claims under Section 507(a)(1) on notice of prior satisfaction of junior employee claims." The argument that consent of creditors is sufficient to justify payment of prepetition claims may be practically appealing but does not provide a statutory basis for the payment of such claims. Moreover, even if consent was sufficient, it is difficult to imply consent of putative administrative claimants from the fact that an order has been entered authorizing payment of claims of junior priority. Lastly, paying prepetition wage claims of current employees could also discriminate among claims of terminated employees or claims of all employees which, while typically not paid at the beginning stages of a case, are entitled to the same priority upon a distribution (i.e. vacation and other employee benefit claims). Accordingly, there is no principled distinction between the payment of prepetition wage claims and those of trade creditors.

4. Miltenberger v. Logansport C. & S.W.R. Co., 106 U.S. 286, 1 S. Ct. 140, 27 L. Ed. 117 (1882).

5. See In re Chicago, R.I. & P. Ry. Co., 90 F.2d 312, 113 A.L.R. 487 (C.C.A. 7th Cir. 1937).

6. Dudley v. Mealey, 147 F.2d 268 (C.C.A. 2d Cir. 1945).

7. Section 1171(b) of the Bankruptcy Code provides that "Any unsecured claim against the debtor that would have been entitled to priority if a receiver in equity of the property of the debtor had been appointed by a federal court on the date of the order for relief under this title shall be entitled to the same priority in the case under this chapter."

8. U.S. v. Noland, 517 U.S. 535, 116 S. Ct. 1524, 134 L. Ed. 2d 748, 28 Bankr. Ct. Dec. (CRR) 1331, 35 Collier Bankr. Cas. 2d (MB) 1, Bankr. L. Rep. (CCH) ¶ 76920, 96-1 U.S. Tax Cas. (CCH) ¶ 50252, 77 A.F.T.R.2d 96-2143 (1996); Cohen v. de la Cruz, 523 U.S. 213, 118 S. Ct. 1212, 140 L. Ed. 2d 341, 32 Bankr. Ct. Dec. (CRR) 400, 38 Collier Bankr. Cas. 2d (MB) 1891, Bankr. L. Rep. (CCH) ¶ 77644 (1998).

9. The Seventh Circuit in Kmart, was not convinced that the "Necessity of Payment Rule" had any vitality under the Bankruptcy Code: "The 'doctrine of necessity' is just a fancy name for a power to depart from the Code. Although courts in the days before bankruptcy law was codified wielded power to reorder priorities and pay particular creditors in the name of 'necessity' (citations omitted)–today it is the Code rather than the norms of nineteenth century railroad reorganizations that must prevail. Miltenberger and Fosdick predate the first general effort at codification, the Bankruptcy Act of 1898. Today the Bankruptcy Code of 1978 supplies the rules. Congress did not in terms scuttle old common law doctrines, because it did not need to; the Act curtailed, and then the Code replaced, the entire apparatus. Answers to contemporary issues must be found within the Code (or legislative halls). Older doctrines may survive as glosses on ambiguous language enacted in 1978 or later, but not as freestanding entitlements to trump the text. (citations omitted)."In re Kmart Corp., 359 F.3d 866, 871, 42 Bankr. Ct. Dec. (CRR) 166, Bankr. L. Rep. (CCH) ¶ 80054 (7th Cir. 2004).

10. Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1, 120 S. Ct. 1942, 147 L. Ed. 2d 1, 36 Bankr. Ct. Dec. (CRR) 38, 43 Collier Bankr. Cas. 2d (MB) 861, Bankr. L. Rep. (CCH) ¶ 78183 (2000) (quoting U.S. v. Ron Pair Enterprises, Inc., 489 U.S. 235, 241, 109 S. Ct. 1026, 103 L. Ed. 2d 290, 18 Bankr. Ct. Dec. (CRR) 1150, Bankr. L. Rep. (CCH) ¶ 72575, 89-1 U.S. Tax Cas. (CCH) ¶ 9179, 63 A.F.T.R.2d 89-652 (1989), in turn quoting Caminetti v. U.S., 242 U.S. 470, 485, 37 S. Ct. 192, 61 L. Ed. 442 (1917).

11. N.L.R.B. v. Bildisco and Bildisco, 465 U.S. 513, 527, 104 S. Ct. 1188, 79 L. Ed. 2d 482, 11 Bankr. Ct. Dec. (CRR) 564, 9 Collier Bankr. Cas. 2d (MB) 1219, 5 Employee Benefits Cas. (BNA) 1015, 115 L.R.R.M. (BNA) 2805, Bankr. L. Rep. (CCH) ¶ 69580, 100 Lab. Cas. (CCH) ¶ 10771 (1984).

12. Bank of America Nat. Trust and Sav. Ass'n v. 203 North LaSalle Street Partnership, 526 U.S. 434, 453, 119 S. Ct. 1411, 143 L. Ed. 2d 607, 34 Bankr. Ct. Dec. (CRR) 329, 41 Collier Bankr. Cas. 2d (MB) 526, Bankr. L. Rep. (CCH) ¶ 77924 (1999). See also In re Enron Corp., In re Enron Corp., 274 B.R. 327, 39 Bankr. Ct. Dec. (CRR) 12, 47 Collier Bankr. Cas. 2d (MB) 1171, Bankr. L. Rep. (CCH) ¶ 78598 (Bankr. S.D. N.Y. 2002).

13. See In re Just For Feet, Inc., 242 B.R. 821, 826, 43 Collier Bankr. Cas. 2d (MB) 476 (D. Del. 1999) (Section 105 provides "a statutory basis for the payment of pre-petition claims"); In re NVR L.P., 147 B.R. 126, 127 (Bankr. E.D. Va. 1992) ("[U]nder 11 U.S.C. § 105 the court can permit pre-plan payment of a prepetition obligation when essential to the continued operation of the debtor."); In re UNR Industries, Inc., 143 B.R. 506, 519-520 (Bankr. N.D. Ill. 1992), order rev'd, 173 B.R. 149 (N.D. Ill. 1994) (Necessity Doctrine permits payment of prepetition claims of suppliers and employees "whose continued cooperation is essential to the debtor's successful reorganization."); In re Eagle-Picher Industries, Inc., 124 B.R. 1021, 1023, 21 Bankr. Ct. Dec. (CRR) 755, Bankr. L. Rep. (CCH) ¶ 73859 (Bankr. S.D. Ohio 1991) ("[T]o 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, 175, 19 Bankr. Ct. Dec. (CRR) 149, Bankr. L. Rep. (CCH) ¶ 72706, 112 Lab. Cas. (CCH) P 11293 (Bankr. S.D. N.Y. 1989); In re Chateaugay Corp., 80 B.R. 279, 18 Collier Bankr. Cas. 2d (MB) 1193 (S.D. N.Y. 1987); In re Mirant Corp., 296 B.R. 427, 41 Bankr. Ct. Dec. (CRR) 193 (Bankr. N.D. Tex. 2003); In re Equalnet Communications Corp., 258 B.R. 368, 370-371, 37 Bankr. Ct. Dec. (CRR) 101 (Bankr. S.D. Tex. 2000).

14. In U.S. v. Energy Resources Co., Inc., 495 U.S. 545 (1990), the Supreme Court authorized the debtor to direct payments to be made to taxing authorities to trust fund claims for which the officers and directors were personally liable. While the Supreme Court could not point to a specific provision in the Bankruptcy Code authorizing the debtor to direct tax payments in such a manner, the Supreme Court did find that the debtor's ability to do so in that case was necessary to the success of the reorganization, rejecting the IRS's argument that such a ruling violated the priority of tax claims under Section 507 of the Bankruptcy Code.

15. Section 1107(a) provides that "Subject to any limitations on a trustee serving in a case under this chapter, and to such limitations or conditions as the court prescribes, a debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all the functions and duties, except the duties specified in sections 1106(a)(2), (3) and (4) of this title, of a trustee serving in a case under this chapter."

16. In re CoServ, L.L.C., 273 B.R. 487, 497, 493, 38 Bankr. Ct. Dec. (CRR) 266, 47 Collier Bankr. Cas. 2d (MB) 851 (Bankr. N.D. Tex. 2002).

17. In re CoServ, L.L.C., 273 B.R. 487, 497, 493, 38 Bankr. Ct. Dec. (CRR) 266, 47 Collier Bankr. Cas. 2d (MB) 851 (Bankr. N.D. Tex. 2002).

18. "A bankruptcy court is empowered pursuant to Section 363 of the Bankruptcy Code to authorize a debtor to expend funds in the bankruptcy court's discretion outside the ordinary course of business. Section 363(b) gives the court broad flexibility in tailoring its orders to meet a wide variety of circumstances. (citation omitted). However, the debtor must articulate some business justification, other than the mere appeasement of major creditors, for using, selling or leasing property out of the ordinary course of business, before the court may permit such disposition under Section 363(b). (citations omitted). In re Ionosphere Clubs, Inc, 98 B.R. 174, 175 (Bankr. S.D.N.Y. 1989).

19. In re Kmart Corp., 359 F.3d 866, 872, 873, 42 Bankr. Ct. Dec. (CRR) 166, Bankr. L. Rep. (CCH) ¶ 80054 (7th Cir. 2004).

20. See 11 U.S.C. § 364.

21. In re Kmart Corp., 359 F.3d 866, 873, 42 Bankr. Ct. Dec. (CRR) 166, Bankr. L. Rep. (CCH) ¶ 80054 (7th Cir. 2004).

22. In re Payless Cashways, Inc., 268 B.R. 543, 546-547, 47 Collier Bankr. Cas. 2d (MB) 568 (Bankr. W.D. Mo. 2001).

23. See In re Adams Apple, Inc., 829 F.2d 1484, 1490, 17 Collier Bankr. Cas. 2d (MB) 1132, Bankr. L. Rep. (CCH) ¶ 71995, 9 Fed. R. Serv. 3d 602 (9th Cir. 1987) ("Cross-collateralization clauses may provide the only means for saving a failing company…. If the lender is the sole

lender willing to finance the debtor, a cross-collateralization clause may mean the difference between an ongoing enterprise and a company in liquidation.")

24. See 11 U.S.C. § 503(b)(1).

25. In re Kmart Corp., 359 F.3d 866, 872, 42 Bankr. Ct. Dec. (CRR) 166, Bankr. L. Rep. (CCH) ¶ 80054 (7th Cir. 2004).

26. Miltenberger v. Logansport C. & S.W.R. Co., 106 U.S. 286, 1 S. Ct. 140, 27 L. Ed. 117 (1882); Gregg v. Metropolitan Trust Co., 197 U.S. 183, 25 S. Ct. 415, 49 L. Ed. 717 (1905); Carbon Fuel Co. v. Chicago, C. & L. R. Co., 202 F. 172 (C.C.A. 7th Cir. 1912); In re Boston and Maine Corp., 634 F.2d 1359, 23 C.B.C. 765 (1st Cir. 1980); Matter of B & W Enterprises, Inc., 713 F.2d 534, 11 Bankr. Ct. Dec. (CRR) 141, 9 Collier Bankr. Cas. 2d (MB) 302, Bankr. L. Rep. (CCH) ¶ 69397 (9th Cir. 1983).

27. U.S. v. Reorganized CF & I Fabricators of Utah, Inc., 518 U.S. 213, 116 S. Ct. 2106, 135 L. Ed. 2d 506, 29 Bankr. Ct. Dec. (CRR) 271, 35 Collier Bankr. Cas. 2d (MB) 463, 20 Employee Benefits Cas. (BNA) 1289, Bankr. L. Rep. (CCH) ¶ 76971, 96-1 U.S. Tax Cas. (CCH) ¶ 50322, 77 A.F.T.R.2d 96-2562 (1996).

28. U.S. v. Noland, 517 U.S. 535, 116 S. Ct. 1524, 134 L. Ed. 2d 748, 28 Bankr. Ct. Dec. (CRR) 1331, 35 Collier Bankr. Cas. 2d (MB) 1, Bankr. L. Rep. (CCH) ¶ 76920, 96-1 U.S. Tax Cas. (CCH) ¶ 50252, 77 A.F.T.R.2d 96-2143 (1996). See In re CoServ, L.L.C., 273 B.R. 487, 494, 38 Bankr. Ct. Dec. (CRR) 266, 47 Collier Bankr. Cas. 2d (MB) 851 (Bankr. N.D. Tex. 2002) ("Finally, this Court questions whether the broad authority Debtors would accord it is consistent with recent Supreme Court decisions reversing categorical subordination of claims (citing Noland and Reorganized CF&I Fabricators). While preferring 'critical vendors' may not equate to subordination of a tax or a tax penalty, it has the smell of a similar inappropriate adjustment of Congressionally established priorities–and therefore is at odds with the rationale of Noland and CF&I Fabricators").

29. See In re Just For Feet, Inc., 242 B.R. 821, 825-826, 43 Collier Bankr. Cas. 2d (MB) 476 (D. Del. 1999) ("The Supreme Court cases cited by the parties do not hold that a bankruptcy court may never use its equitable powers to authorize payment to vendors when such payment is critical to the reorganization. Rather, Noland and Reorganized CF&I prohibit a court from subordinating tax claims under Section 510(c) without sufficient justification for reordering the statutory priorities established by the Code. The necessity of payment doctrine recognizes that paying certain pre-petition claims may be necessary to realize the goal of chapter 11–a successful reorganization."

30. American United Mut. Life Ins. Co. v. City of Avon Park, Fla., 311 U.S. 138, 61 S. Ct. 157, 85 L. Ed. 91, 136 A.L.R. 860 (1940).

31. Mason v. Paradise Irr. Dist., 326 U.S. 536, 66 S. Ct. 290, 90 L. Ed. 287 (1946).

32. Mason v. Paradise Irr. Dist., 326 U.S. 536, 543, 66 S. Ct. 290, 90 L. Ed. 287 (1946).

33. Section 1122(a) of the Bankruptcy Code provides that "Except as provided in subsection (b) of this section [dealing with administrative convenience classes], a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to other claims or interests of such class."

34. Matter of Wabash Valley Power Ass'n, Inc., 72 F.3d 1305, 34 Collier Bankr. Cas. 2d (MB) 877, Bankr. L. Rep. (CCH) ¶ 76739 (7th Cir. 1995); In re U.S. Truck Co., Inc., 800 F.2d 581, 583-587, 14 Bankr. Ct. Dec. (CRR) 1327, 15 Collier Bankr. Cas. 2d (MB) 553, 123 L.R.R.M. (BNA) 2849, Bankr. L. Rep. (CCH) ¶ 71460 (6th Cir. 1986); Matter of Briscoe Enterprises, Ltd., II, 994 F.2d 1160, 1166-1167, 24 Bankr. Ct. Dec. (CRR) 717, 29 Collier Bankr. Cas. 2d (MB) 528, Bankr. L. Rep. (CCH) ¶ 75351 (5th Cir. 1993).

35. In re Ionosphere Clubs, Inc., 98 B.R. 174, 178, 19 Bankr. Ct. Dec. (CRR) 149, Bankr. L. Rep. (CCH) ¶ 72706, 112 Lab. Cas. (CCH) ¶ 11293 (Bankr. S.D. N.Y. 1989).

36. See In re Leslie Fay Companies, Inc., 207 B.R. 764 (Bankr. S.D. N.Y. 1997).

37. In re Lafayette Hotel Partnership, 227 B.R. 445, 41 Collier Bankr. Cas. 2d (MB) 446 (S.D. N.Y. 1998), aff'd, 198 F.3d 234 (2d Cir. 1999) (plan can treat a creditor who provides ongoing funding to a debtor differently from other creditors); In re Kliegl Bros. Universal Elec. Stage Lighting Co., Inc., 149 B.R. 306, 28 Collier Bankr. Cas. 2d (MB) 575, Bankr. L. Rep. (CCH) ¶ 75098 (Bankr. E.D. N.Y. 1992) (authorizing different treatment for union claims because the union's support was necessary to continued operations); In re Richard Buick, Inc., 126 B.R. 840 (Bankr. E.D. Pa. 1991) (vendor who refuses to continue to do business with debtor may be treated differently under plan); In re Crawford, 324 F.3d 539, 41 Bankr. Ct. Dec. (CRR) 62, Bankr. L. Rep. (CCH) ¶ 78822 (7th Cir. 2003) (recognizing that several situations would support separate classification where separate classification would result in creditor body as a whole being better off); Matter of Jersey City Medical Center, 817 F.2d 1055, 17 Collier Bankr. Cas. 2d (MB) 244, Bankr. L. Rep. (CCH) ¶ 71791 (3d Cir. 1987); Matter of U.S. Truck Co., Inc., 47 B.R. 932, 12 Bankr. Ct. Dec. (CRR) 1088 (E.D. Mich. 1985), judgment aff'd, 800 F.2d 581, 14 Bankr. Ct. Dec. (CRR) 1327, 15 Collier Bankr. Cas. 2d (MB) 553, 123 L.R.R.M. (BNA) 2849, Bankr. L. Rep. (CCH) ¶ 71460 (6th Cir. 1986).

38. In re Adams Apple, Inc., 829 F.2d 1484, 1490, 17 Collier Bankr. Cas. 2d (MB) 1132, Bankr. L. Rep. (CCH) ¶ 71995, 9 Fed. R. Serv. 3d 602 (9th Cir. 1987).

39. In re Structurlite Plastics Corp., 86 B.R. 922, 17 Bankr. Ct. Dec. (CRR) 808, 19 Collier Bankr. Cas. 2d (MB) 1, Bankr. L. Rep. (CCH) ¶ 72584 (Bankr. S.D. Ohio 1988).

40. In re Structurlite Plastics Corp., 86 B.R. 922, 17 Bankr. Ct. Dec. (CRR) 808, 19 Collier Bankr. Cas. 2d (MB) 1, Bankr. L. Rep. (CCH) ¶ 72584 (Bankr. S.D. Ohio 1988).

41. In re Eagle-Picher Industries, Inc., 124 B.R. 1021, 1023, 21 Bankr. Ct. Dec. (CRR) 755, Bankr. L. Rep. (CCH) P 73859 (Bankr. S.D. Ohio 1991).

42. In re UNR Industries, Inc., 143 B.R. 506, 520 (Bankr. N.D. Ill. 1992), order rev'd, 173 B.R. 149 (N.D. Ill. 1994).

43. See Matter of Lehigh and N. E. Ry. Co., 657 F.2d 570, 581 (3d Cir. 1981) ("…[i]n order to justify payment under the 'necessity of payment' rule, a real and imminent threat must exist that failure to pay will place the continued operation of the railroad in serious jeopardy."

44. In re CoServ, L.L.C., 273 B.R. 487, 38 Bankr. Ct. Dec. (CRR) 266, 47 Collier Bankr. Cas. 2d (MB) 851 (Bankr. N.D. Tex. 2002).