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6  
7 Bankruptcy Counsel for eStyle, Inc.,  
Debtor and Debtor in Possession

8 **UNITED STATES BANKRUPTCY COURT**  
9 **CENTRAL DISTRICT OF CALIFORNIA, LOS ANGELES DIVISION**

10  
11 In re  
12 ESTYLE, INC., a Delaware corporation,  
dba babystyle and Cadeau Maternity,  
13 Debtor.

Case No. 02:08-bk-13518-SB

Chapter 11

**DEBTOR'S EMERGENCY MOTION FOR  
ORDER AUTHORIZING DEBTOR  
TO HONOR AND COMPLY WITH  
CUSTOMER PROGRAMS AND  
OBLIGATIONS**

DATE: March 21, 2008  
TIME: 10:00 a.m.  
PLACE: U.S. Bankruptcy Court  
Courtroom 1575  
255 East Temple Street  
Los Angeles, CA 90012

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20 Tax Id # 95-4712564  
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I.

**SUMMARY OF RELIEF REQUESTED**

eStyle, Inc. (the "Debtor"), debtor and debtor in possession, hereby moves the Court for an order authorizing (but not directing) the Debtor, in the ordinary course of its business, to honor and comply with customer programs and obligations, including certain prepetition customer claims, gift cards and E-Gift certificates, paper gift certificates/merchandise certificates, customer loyalty programs (described below), customer credits, refunds and charge card credits. Such authorization is necessary and appropriate in order to enable the Debtor to continue its business operations without substantial disruption and in order to avoid jeopardizing the Debtor's reorganization at its inception. The Debtor is a retailer selling directly to the consumer. If the Debtor is not authorized to honor customer programs and obligations, the patronage, confidence and loyalty of the Debtor's customers will be severely harmed. The requested relief is essential to the Debtor's ongoing business operations and to the maintenance of customer confidence. Without such relief, the estate could suffer post-petition damages that would prejudice creditors, the reorganization, and the value of the property of the estate. This "first day" Motion is brought on an emergency basis pursuant to Local Bankruptcy Rule 2081-1(b)(2)(G) in order to avoid immediate and irreparable harm to the estate that would result from the Debtor's failure to honor and comply with customer programs and obligations.

The grounds and reasons supporting this motion are further set forth in the attached memorandum of points and authorities and the Omnibus Declaration of Robert S. Kelleher in Support of Debtor's "First-Day" Motions. As discussed therein, approval of this Motion is necessary to avoid immediate and irreparable harm to the Debtor's ongoing business operations and ability to reorganize.

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II.

**COMMENCEMENT OF CHAPTER 11 CASE**

The Debtor commenced this case by filing a voluntary chapter 11 petition on March 19, 2008 (the "Petition Date"). The Debtor continues to manage and operate its business as a debtor in possession. As a consequence of the filing of its chapter 11 petition, the Debtor is precluded from paying and/or honoring unsecured claims that arose prior to the commencement of the case without Court authorization.

III.

**DEBTOR'S CUSTOMER PROGRAMS AND OBLIGATIONS**

The Debtor is a multichannel retailer of maternity, baby and kids apparel, and toys, gear and related products. As of the Petition Date, the Debtor sells its products directly to the consumer through its 23 retail stores (21 babystyle and 2 Cadeau retail stores), its babystyle.com web site, and a direct mail program. The Debtor sells private label product under the babystyle and Cadeau labels, and also sells product under leading brands. In addition, the Debtor sells its Cadeau brand product to wholesale accounts.

The success of the Debtor's operations and the Debtor's reorganization, and the value of property of the Debtor's estate are dependent upon the patronage, confidence, and loyalty of the Debtor's customers. The support and confidence of the Debtor's customers will be severely harmed if the Debtor is not able to honor and comply with its existing customer obligations and customer programs. Honoring and complying with the Debtor's existing customer programs and obligations is essential in order for the Debtor to (i) meet competitive pressures in its retail business operations, (ii) preserve the going concern value of its business, (iii) ensure customer satisfaction and generate goodwill, and (iv) maintain existing customers and attract new customers. Accordingly, it is imperative that the Court approve this Motion and authorize the Debtor to honor and comply with its customer obligations and customer programs in the ordinary course of business in order to avoid damage to the Debtor's business operations and customer

1 confidence that would result in postpetition damages prejudicing creditors, the Debtor's  
2 reorganization, and the value of property of the Debtor's estate.

3 The Debtor has the following customer programs in place and/or  
4 outstanding obligations to customers:

5 **A. Gift Cards**

6 The Debtor sells gift cards at its stores and through its babystyle.com web  
7 site. The Debtor also sells E-Gift certificates on the web site. The gift cards and E-Gift  
8 certificates can be redeemed at babystyle and Cadeau stores and on the babystyle web  
9 site. The estimated dollar value of gift cards and E-Gift certificates outstanding is  
10 approximately \$190,000 and, on average, approximately \$72,000 of gift cards and E-Gift  
11 Certificates are redeemed each month, with a similar amount of gift cards and E-Gift  
12 Certificates, on average, being purchased each month

13 **B. Gift Certificates/Merchandise Certificates**

14 Prior to using plastic gift cards, the Debtor issued paper gift certificates and  
15 merchandise credits. Occasionally these documents are redeemed. The estimated  
16 potential liability with respect to these items is minimal.

17 **C. Loyalty Programs**

18 The Debtor offers the babystyle rewards program for customers who shop  
19 frequently on the web site. This program entitles the customer to obtain free or reduced  
20 price shipping, free gift-wrap, and gifts based on reaching pre-determined spending  
21 levels. Customers earn "babystyle bucks", which can be used towards future purchases.

22 The Debtor offers the babystyle bucks loyalty program in babystyle retail  
23 stores for frequent buyers. The program entitles the shopper to a discount on purchases  
24 after each time the customer reaches a specific spending amount.

25 **D. Customer Returns and Credits**

26 The Debtor's return policy is that if a customer returns an item within a  
27 specific time period and with the receipt, the Debtor will provide the customer with a  
28 refund in the method of payment used for the original purchase. If an item is returned

1 without a receipt, the customer is given a merchandise credit. The merchandise credits  
2 are valid to make purchases in babystyle and Cadeau stores and on the web site.  
3 Merchandise credits have a one-year expiration period. The company also issues  
4 (electronic) E-credits for customer returns to the web site. The Debtor has a return  
5 reserve on its books for customer returns in the amount of \$150,000. This reserve  
6 approximates 1/2 of one month's average returns for the Debtor's retail stores plus  
7 approximately one month's average returns for the Debtor's direct to consumer (web site)  
8 sales.

9 IV.

10 **THE DEBTOR SHOULD BE AUTHORIZED TO HONOR CUSTOMER PROGRAMS**  
11 **AND CLAIMS**

12 There is no constituency of the Debtor that is more important to the success  
13 of this reorganization case than the Debtor's customers. The continued patronage,  
14 confidence, and loyalty of its customers is essential to the ongoing vitality of the Debtor's  
15 business and the Debtor's ability to reorganize. The Debtor seeks authorization on an  
16 emergency basis to honor and comply with customer programs and claims because any  
17 delay or interruption in honoring customer programs, providing refunds, or in having the  
18 flexibility to resolve customer claims in the ordinary course of business will seriously harm  
19 the Debtor's customer relations at a time when customer confidence, loyalty, and  
20 patronage is most critical.

21 A. **Section 507(a)(7).**

22 Bankruptcy Code Section 507(a)(7) provides for a priority claim with respect  
23 to deposits, as follows:

24 [A]llowed unsecured claims of individuals, to the extent of  
25 \$2,425 for each such individual, arising from the deposit,  
26 before the commencement of the case, of money in  
27 connection with the purchase, lease or rental of property, or  
28 the purchase of services, for the personal, family, or  
household use of such individuals, that were not delivered or  
provided.

1 11 U.S.C. § 507(a)(7). A very substantial percentage of the customer claims come within  
2 the \$2,425 priority provided customer deposits in 11 U.S.C. § 507(a)(7). In the  
3 analogous context of prepetition employee claims, courts frequently have found authority  
4 for immediate payment of prepetition claims which otherwise are entitled to priority  
5 treatment under section 507. The court in In re Chateaugay Corp., 80 B.R. 279, 287  
6 (S.D.N.Y. 1987), stated:

7 A rigid application of the priorities of § 507 would be  
8 inconsistent with the fundamental purpose of reorganization of  
9 one of the Act's grant of equity powers to bankruptcy courts,  
10 which is to create a flexible mechanism that will permit the  
11 greatest likelihood of survival of the debtor and the payment of  
creditors in full or at least proportionately. . . . In this case a  
restrictive interpretation of § 507 or of the powers accorded  
the bankruptcy court judge would similarly defeat the very end  
of chapter 11 cases.

12 In In re Chateaugay Corp., the court held that if sound business judgment supports  
13 paying certain prepetition claimants and the payments served to preserve and maximize  
14 the value for the estate, the court should authorize the payments. Id., at 282. The  
15 Debtor's gift cards, gift certificates, merchandise certificates, E-gift certificates, and the  
16 like, constitute the equivalent of consumer deposits. See In re WW Warehouse, Inc., 313  
17 B.R. 588 (Bankr. D. Del. 2004) (holding that the claims of holders of gift certificates  
18 issued by the debtor are entitled to priority under § 507(a)(6) (per 2005 amendments to  
19 Bankruptcy Code, now § 507(a)(7))).

20 **B. Section 363.**

21 Section 363 of the Bankruptcy Code provides authority for payment of the  
22 small percentage of customer claims, if any, in excess of the \$2,425 priority limit and  
23 those customer claims which are not the equivalent of a return of deposits. Courts have  
24 held that it is appropriate to authorize the Debtor to expend funds outside the ordinary  
25 course of business where in the debtor's judgment the payment is in the best interest of  
26 the estate. See In re Eagle-Picher Indus., Inc., 124 B.R. 1021 (Bankr. S.D. Ohio 1991);  
27 In re Gulf Air, Inc., 112 B.R. 152 (Bankr. W.D. La. 1989); and In re Ionosphere Clubs,  
28 Inc., 98 B.R. 174 (Bankr. S.D.N.Y. 1989); see also In re Federated Dep't Stores, Inc.,

1 1990 Bankr. LEXIS 102 (Bankr. S.D. Ohio 1990) (prepetition deposits and payments  
2 honored). In In re Ionosphere Clubs, Inc., the court stated:

3 Section 363(b) gives the court broad flexibility in tailoring its  
4 orders to meet a wide variety of circumstances. However, the  
5 debtor must articulate some business justification, other than  
6 mere appeasement of major creditors, for using . . . property  
7 out of the ordinary course of business. . . . Eastern had  
8 sustained its burden of articulating sound business reasons  
9 for its decision to pay prepetition wages. Eastern stated that it  
10 was critical for it to pay such prepetition claims in order to  
11 preserve and protect its business and ultimately reorganize,  
12 retain its currently working employees and maintain positive  
13 employee morale.

9 Id., at 175 (citations omitted). In Ionosphere Clubs, Inc., like in Chateaugay, the court  
10 looked to the business judgment of the Debtor, in determining that certain payments on  
11 prepetition claims were in the best interests of the reorganization effort. See Id.; see also  
12 In re Chateaugay, 80 B.R. 175-176; see also In re Structurelite Plastics Corp., 86 B.R.  
13 922, 932 (Bankr. S.D. Ohio 1988) (finding payment of prepetition claims justified where  
14 otherwise debtor's rehabilitative effort would be immediately aborted).

### 15 C. Necessity of Payment

16 The "necessity of payment" doctrine "recognizes the existence of the  
17 judicial power to authorize a debtor in a reorganization case to pay prepetition claims  
18 where such payment is essential to the continued operation of the debtor." In re  
19 Ionosphere Clubs, Inc., 98 B.R. at 176. The Third Circuit, in In re Lehigh & New England  
20 Railway Co., 657 F.2d 570, 581 (3rd Cir. 1981), described the doctrine as follows:

21 [T]he 'necessity of payment' doctrine... [permits]  
22 immediate payment of claims of creditors where those  
23 creditors will not supply services or materials  
24 essential to the conduct of the business until their pre-  
25 reorganization claims shall have been paid.

24 In re Lehigh & New England Railway Co., 657 F.2d at 581 (quoting In re Penn Central  
25 Transp. Co., 467 F.2d 100, 102, n.1 (3rd Cir. 1972)). While the "necessity of payment"  
26 doctrine originally developed in the context of railroad reorganizations under the  
27 Bankruptcy Act, it has been applied in nonrailroad bankruptcies. See In re Gulf Air, Inc.,  
28 112 B.R. at 153; In re Eagle-Picher Indus., Inc., 124 B.R. 1021, 1023 (Bankr. S.D. Ohio

1 1991) ("[T]o justify payment of a pre-petition unsecured creditor, a debtor must show that  
2 the payment is necessary to avert a serious threat to the Chapter 11 process."); In re  
3 Ionosphere Clubs, Inc., 98 B.R. at 176 ("The rationale for the 'necessity of payment' rule,  
4 *i.e.*, facilitating the continued operation and rehabilitation of the debtor in railroad  
5 reorganization cases, is also a paramount goal of Chapter 11."). In Dudley v. Mealey,  
6 147 F.2d 268 (2nd Cir. 1945), cert. denied, 325 U.S. 873, 65 S. Ct. 1415, 80 L. Ed 1991  
7 (1945), a reorganization case involving a hotel, Judge Learned Hand, in applying the  
8 necessity of payment doctrine, stated:

9           Let it [a hotel] once be shut down, and it will lose  
10           much of its value.... Some priority [the tradesmen  
11           supplying the hotel prepetition] may be essential to  
12           preservation of the business during that period as it is  
13           later.

12 Id., at 271. In this case, failure to honor and comply with customer programs and  
13 obligations could doom the Debtor's reorganization from the start.

14           **D.    Recoupment.**

15           The doctrine of recoupment provides further support for the granting of the  
16 Debtor's motion. The Debtor seeks authority to honor prepetition purchase orders and to  
17 give customers credit against their final payments for deposits (*i.e.*, gift certificates)  
18 previously received, and the remaining portions if those executory agreements are  
19 profitable to the Debtor. The doctrine of recoupment "permits the crediting of reciprocal  
20 rights against each other where those rights arose under the same transaction, typically  
21 the same contract." In re Mohawk Indus., Inc., 82 B.R. 174, 176 (Bankr. D. Mass. 1987).

22           A party to a contract (in this instance, the customer) may  
23           recoup its claim for both the prepetition and postpetition  
24           progress payments under the tent [manufacturing] contract  
25           against the value of postpetition deliveries which the debtor  
26           made to it under the contract . . . regardless of the occurrence  
27           of a bankruptcy filing and regardless of the absence of formal  
28           contract assumption by the debtor.

26 Id., at 177.




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1 Debtor provided refunds prior to the commencement of this chapter 11 case; (2) to honor  
2 all gift cards and E-Gift certificates in the ordinary course of business; (3) to honor all  
3 paper gift certificates/merchandise certificates in the ordinary course of business; (4) to  
4 honor the Debtor's customer loyalty programs (as described above) in the ordinary  
5 course of business; (5) to honor all customer credits in the ordinary course of business;  
6 (6) to authorize and direct the Debtor's banks and its other credit card processing agents  
7 to issue credits to the Debtor's customers and recoup and offset from any amounts  
8 payable to the Debtor such amounts as may be validly credited to the Debtor's customers  
9 pursuant to the prevailing policies between the Debtor and its bank or other processing  
10 agents; (7) to honor customer returns of merchandise in the ordinary course of business  
11 in the same manner as they were handled prior to commencement of this case; and (8) to  
12 resolve other customer claims in the ordinary course of business in any manner that the  
13 Debtor deems appropriate based upon its business judgment.

14  
15 DATED: March 21, 2008 Respectfully submitted,

16 **SULMEYERKUPETZ**  
A Professional Corporation

17  
18 By:   
19 David S. Kupetz  
20 Bankruptcy Counsel for eStyle, Inc.,  
Debtor in Possession

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# EXHIBIT 1

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7 Bankruptcy Counsel for eStyle, Inc.  
Debtor and Debtor in Possession

8  
9 **UNITED STATES BANKRUPTCY COURT**  
10 **CENTRAL DISTRICT OF CALIFORNIA, LOS ANGELES DIVISION**

11 In re  
12 ESTYLE, INC., a Delaware corporation,  
13 dba babystyle and Cadeau Maternity,  
14 Debtor.

15  
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18 SSN # 95-4712564  
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Case No. 2:08-bk-13518-SB

Chapter 11

**ORDER GRANTING DEBTOR'S  
EMERGENCY MOTION FOR ORDER  
AUTHORIZING DEBTOR TO HONOR  
AND COMPLY WITH CUSTOMER  
PROGRAMS AND OBLIGATIONS**

DATE: March 21, 2008  
TIME: 10:00 a.m.  
PLACE: U.S. Bankruptcy Court  
Courtroom 1575  
255 East Temple Street  
Los Angeles, CA 90012

21 The "Debtor's Emergency Motion for Order Authorizing Debtor to Honor and  
22 Comply with Customer Programs and Obligations" (the "Motion"), filed by eStyle, Inc. (the  
23 "Debtor"), debtor and debtor in possession in the above-captioned chapter 11 case, came  
24 on for hearing before the Court on March 21, 2008. Appearances at the hearing are  
25 reflected in the record.

26 Having considered the Motion, the Omnibus Declaration of Robert S.  
27 Kelleher in Support of Debtor's "First-Day" Motion, any and all responses to the Motion,  
28

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the representations of counsel made at the hearing, the facts and circumstances of this matter, and good cause appearing therefor,

**IT IS SO ORDERED** as follows:

1. The Motion is granted; and
2. The Debtor is authorized (but not directed) to honor and comply with customer programs and prepetition obligations as described in the Motion.

DATED: \_\_\_\_\_

\_\_\_\_\_  
HON. SAMUEL L. BUFFORD  
UNITED STATES BANKRUPTCY JUDGE

PRESENTED BY:

**SulmeyerKupetz**  
A Professional Corporation

By: \_\_\_\_\_  
David S. Kupetz  
Bankruptcy Counsel for eStyle, Inc.,  
Debtor and Debtor in Possession