

**UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA**

Lithograph Legends, LLC,

Appellant

Case No: 09-943 (RHK)

vs.

United States Trustee,

Appellee,

Polaroid Corporation,

Debtor in Posses.

APPELLANT'S BRIEF

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STATEMENT REGARDING ORAL ARGUMENT

Appellant Lithograph Legends, LLC, an affiliate of Patriarch Partners, LLP (“Patriarch”), believes oral argument will assist the Court in understanding the unusual factual and procedural background of the auction and approval order that is the subject of this appeal, and therefore why the order should be reversed.

STATEMENT OF JURISDICTION

The United States Bankruptcy Court for the District of Minnesota has original jurisdiction over this case under Title 11 pursuant to 28 U.S.C. §§ 157(a) and 1334(a) and the standing order of reference. This Court has jurisdiction over this appeal pursuant to 28 U.S.C. § 158 because the April 17, 2009 Sale Approval Order (Docket No. 332; Attached as Addendum) of the Bankruptcy Court is a final, appealable order.

STATEMENT OF ISSUES PRESENTED

1. Whether the Bankruptcy Court's Sale Approval Order should be reversed because the Bankruptcy Court improperly disregarded the Debtor's business judgment and thereby rendered the sale process intrinsically unfair.

2. Whether the Bankruptcy Court's Sale Approval Order should be reversed because the Bankruptcy Court failed to follow its own bidding procedures orders concerning valuation of the bids at auction and thereby rendered the sale process intrinsically unfair.

3. Whether the Bankruptcy Court's Sale Approval Order should be reversed as an abuse of discretion because the Bankruptcy Court improperly excluded the winning bidder at auction from participation in the sale approval hearing on the grounds that it lacked standing, thereby rendering the sale process intrinsically unfair.

4. Whether the Bankruptcy Court's Sale Approval Order should be reversed as an abuse of discretion because the Bankruptcy Court's multiple, cumulative errors in improperly disregarding the Debtor's business judgment, in failing to follow its own bidding procedures orders, and in improperly excluding the winning bidder at auction from participation in the sale approval hearing, rendered the auction approval process fundamentally and intrinsically unfair, and thus prevented the estate from receiving the highest and best price.

STATEMENT OF THE CASE

This appeal seeks reversal of the Bankruptcy Court's April 17, 2009 order approving a sale of assets of the Debtor to Hilco/Gordon following an auction at which Patriarch was declared the winner. Patriarch sought a stay of the Sale Approval Order in the Bankruptcy Court, which was denied. Patriarch renewed its motion to stay in this Court, which was heard on April 27 and is currently pending.

STATEMENT OF FACTS

On January 28, 2009, Polaroid filed a motion seeking approval of an auction and bidding procedures for the orderly sale of its assets. On February 18, 2009, the Bankruptcy Court granted the motion (the “Bidding Procedures Order”). (Bidding Procedures Order (Docket No. 118).) The Bidding Procedures Order, among other things, authorized an auction pursuant to section 363 of the Bankruptcy Code, and established procedures to govern the sale (the “Bidding Procedures”). (*See id.* at 2, Ex. A.) The Bankruptcy Court determined that the Bidding Procedures were “fair, reasonable and appropriate and are designed to maximize the value of the Debtors’ estates.” (*Id.* at 2.)

Under the Bidding Procedures Order, the Bankruptcy Court authorized the Debtor to “select, in [its] business judgment, the highest or otherwise best offer(s), and the Successful Bidder or Bidders and the next highest and best offer(s), and the Back-Up Bidder or Bidders” (*Id.* at 5.) Consistent with Polaroid’s right to select the winning bid, the Bidding Procedures provided it with “the right to determine the value of any Qualified Bid . . . and which Qualified Bid or Qualified Bids constitutes the highest or otherwise best offer.” (*Id.* Ex. A at 5.) By its terms, the Order would “inure to the benefit of the” bidders, thus entitling them to rely on, and, if necessary, enforce it. (*Id.* at 8.)

The auction for the Debtor’s assets included three phases. The initial auction took place on March 30-31, 2009. (Auction Tr., Mar. 30-31, 2009 (Docket No. 240).) At the conclusion of the auction, the Debtor, in the exercise of its business judgment, determined Patriarch to be the winning bidder. On April 6, 2009, the Bankruptcy Court

held a hearing on the Debtor's motion for authority to sell its assets. (Hr'g Tr. 5, Apr. 9, 2009 (Docket No. 359) [hereinafter Apr. 9 Tr.].) At the outset of the hearing, at the urging of the creditors' committee, the Debtor requested a chambers conference with the Bankruptcy Court, during which it proposed to re-open the auction and allow the submission of sealed bids. (*Id.* at 12, 21-25.)

The Bankruptcy Court held another hearing on April 9, 2009, following the submission of the sealed bids and a subsequent, higher and better bid by Patriarch. (*Id.* at 16-17.) To maximize the proceeds of the sale, the Debtor urged the Bankruptcy Court to conduct a third phase of the auction. Recognizing that the sealed bid procedure was "obviously less than optimal for generating maximum recovery," the Bankruptcy Court agreed to re-open the auction for a third phase in open court on Thursday, April 16, 2009. (*Id.* at 131; *see* Supplemental Procedures Order, Apr. 9, 2009 (Docket No. 302) [hereinafter Supplemental Procedures Order].)

At the April 9 hearing, the Debtor advised the Bankruptcy Court that it, in consultation with its financial advisors and the creditors' committee, valued the equity portions of each bid at \$650,000 per point of equity and that it did not support revisiting that valuation. (Apr. 9 Tr. 91.) The Court, in articulating the rules for the future phase of the auction, adopted that proposition, stating that equity

will be at the same point unit valuation which I believe was \$650,000.00. [Counsel for the Debtor] has attested to having that issue fully evaluated as to both of the bidding entities and being persuaded that *that was an appropriate measure of the value to be attached for comparability between the two bids.*

(*Id.* at 142.) The Court recognized that by establishing a fixed valuation for the equity, the bidding would be “stripped down to numbers” that could be easily compared. (*Id.* at 72.)

The Bankruptcy Court further explained that, pursuant to the Bankruptcy Code, it could not be involved in the administration of the estate, including the determination of “what sorts of consideration to take into account in receiving bids and the judgment as to the valuation of the consideration if it’s not in cash.” (*Id.* at 109-10.) These matters were entrusted to the Debtor and “significant deference is due” to the Debtor’s decisions. (*Id.* at 110-11). Indeed, the Court found that as long as the Debtor has a business rationale for their valuation of equity, its determination could not be second guessed by the Court. (*Id.* at 85.)

After the April 9 conference, the Court issued the Supplemental Procedures Order, which formally established the valuation rules that were to be used to value and compare the parties’ bids during the continuation of the auction.

- Paragraph 4(a) of the Supplemental Procedures Order provided that the parties’ previously negotiated agreements with Polaroid—the purchase agreements and the LLC agreements—would govern the proposed sale, and would not (with certain exceptions) be subject to change. While Hilco/Gordon and Patriarch had different business plans for the Company post-bankruptcy, the Debtor represented to the Court that the terms of the two LLC agreements were “substantially similar.” (*Id.* at 24.)¹
- To eliminate any debate or uncertainty concerning the value of the equity component of any bid, paragraph 4(c) of the Supplemental

¹ Specifically, Hilco/Gordon intend to liquidate the Company entirely and generate revenues exclusively from licensing rights, while Patriarch plans to rebuild the brand, develop new innovative products, and retain a number of employees.

Procedures Order provided that any equity component of the bids was to be valued equally for both Bidders, at \$650,000.00 per percentage-point-unit of equity. (Supplemental Procedures Order at 3.)

- Polaroid had previously provided the parties with a schedule valuing certain assets. (Hr’g Tr. 111-12, Apr. 16, 2009 (Docket Nos. 342-44) [hereinafter Apr. 16 Tr.].) Paragraph 5 of the Supplemental Procedures Order placed the Bankruptcy Court’s imprimatur on the valuations set forth on that schedule. (Supplemental Procedures Order at 3.) For example, Polaroid’s art collection was fixed in value for bidding purposes at \$6.5 million. (Apr. 16 Tr. 192.)

The Bankruptcy Court held a conference on April 14 to discuss the parties’ LLC agreements, and creditors’ counsel echoed the goal of all involved to have “the agreements intact and try to be in a truly apples to apples situation where the parties will be bidding at auction based on the equity and cash portions of their offers.” (Hr’g Tr. 11, Apr. 14, 2009 (Docket No. 360) [hereinafter Apr. 14 Tr.].)

Polaroid conducted the auction using the rules set forth in the Supplemental Procedures Order. As each bid was submitted, Polaroid and its financial adviser considered it and then announced the bid’s valuation and whether the company officially “accepted” it. After the submission of approximately 27 bids and counterbids, Patriarch made a bid valued at \$86.4 million (net to the estate)—a bid that was \$488,000 higher than Hilco/Gordon’s last bid and whose cash component was \$8.5 million higher. Hilco/Gordon declined to bid further and the auction concluded. The Debtor determined, in consultation with its financial adviser, that Patriarch had submitted the highest and best offer. Polaroid then moved for Bankruptcy Court approval.

The Bankruptcy Court immediately convened the approval hearing. The Debtor offered the testimony of its financial adviser, Stephen Spencer of Houlihan Lokey, in support of its decision to accept the Patriarch offer. Mr. Spencer testified unequivocally and without rebuttal that the Patriarch offer was the highest and best bid. (Apr. 16 Tr. 110-11, 115.) In summation, Debtor's counsel explained that its business judgment was based on the undisputed facts that Patriarch offered the greater total price, Patriarch would pay \$8.5 million more in cash, Patriarch would leave fewer assets with the estate, which reduced the execution risk of future sales, and Patriarch planned to retain a number of employees. (*Id.* at 240-41.) There was no dispute that this Debtor's analysis and decision was fully-informed, undertaken in good faith, and represented the fair business judgment of the Debtor.

During the Sale Hearing, however, certain creditors objected to Polaroid's selection of Patriarch as the winning bidder. The creditors' objections fell into two categories. First, even though both bids included the same equity percentages and each percentage of equity was to be valued at the same Court-ordered value, they claimed that provisions in the Patriarch LLC agreement rendered equity in its new company less valuable in some indeterminate amount. Second, the creditors claimed that the art collection, which the Hilco/Gordon bid would leave behind, was worth more than the \$6.5 million attributed to it in the Court-approved schedule, thus making the Hilco/Gordon bid more valuable. (*Id.* at 244-45.)² The creditors' committee, however,

² The creditors' committee also argued that Hilco/Gordon had modified their last bid to remove a preferred return on their initial capital contribution, and that "you've

had previously accepted both of these valuations in a formal court filing. (Committee’s Objection to Proposed Sale of Debtor’s Assets, April 3, 2009 (Docket No. 243).)

There was no direct evidence—no witness testimony or documents—that the Hilco/Gordon bid was the highest and best offer. Based on the valuations in the Supplemental Procedures Order, the Patriarch bid was clearly the highest offer. In addition, the Debtor had previously represented that it viewed the two LLC agreements to be “substantially similar.” (Apr. 9 Tr. 24.) And at the Sale Hearing, Mr. Spencer testified that he valued the differences between the two LLC agreements at \$0. (Apr. 16 Tr. 154-55.) Mr. Spencer never testified that any “qualitative” factors in the Hilco/Gordon LLC agreement outweighed the benefits of the Patriarch bid or rendered the Hilco/Gordon bid the highest and best. The Bankruptcy Court did not consider, or find, that the Debtor abused its discretion in selecting Patriarch’s offer as the highest and best bid. Rather, the Bankruptcy Court overturned the business judgment of the Debtor based entirely on its view that all deference was owed to the views of the creditors, and none to the decision of the Debtor. (*Id.* at 281.) Contrary to the Supplemental Procedures Order and the creditors’ written filing, the Bankruptcy Court accepted the

(continued...)

heard testimony that that increases the value to the company in the amount of \$5 million per year.” (Apr. 16 Tr. 251.) The actual testimony, however, was that Houlihan Lokey placed “zero” value on this change, because the change simply placed the Hilco/Gordon agreement on par with the Patriarch agreement which already lacked any preferred return on equity. (*Id.* at 154, 191.) Furthermore, had the Bankruptcy Court allowed Patriarch to cross-examine or argue on this point, or had the Court actually reviewed the two LLC agreements, it would have been apparent that this change merely matched the terms of the Patriarch LLC agreement and did not provide any additional value over the Patriarch offer.

creditors' objection that the equity in the Hilco/Gordon bid was, in some unknown amount, more valuable than the equity in the Patriarch bid. Significantly, however, while the Bankruptcy Court permitted the creditors to characterize and challenge certain terms of the Patriarch LLC agreement, the Court did not actually review the two competing LLC agreements, did not compare their terms, did not permit any briefing on the issues, and did not allow Patriarch's counsel to respond to the creditors' arguments.³

In selecting the Hilco/Gordon bid over the Patriarch bid, the Bankruptcy Court also refused to consider Patriarch's proposal to moot the creditors' objection. Since both Patriarch and the Debtor viewed the two LLC agreements as "substantially similar," Patriarch offered to sign the Hilco/Gordon agreement. This would have provided the Debtor with the additional cash and higher net proceeds available from the Patriarch bid together with the additional terms in the Hilco/Gordon LLC agreement that the creditors found attractive. However, the Bankruptcy Court refused to hear this proposal, or to allow the Debtor to consider it and determine, in its business judgment, how to respond, finding that it came "a little late." (*Id.* at 284.) The Bankruptcy Court thus deprived the Debtor of the ability to consider a bid that would unquestionably have been the highest and best and would have maximized the value of the estate.

³ While the Bidding Procedures Order recognized that Patriarch was an intended beneficiary, the Court refused to hear from Patriarch's counsel. (Bidding Procedures Order at 8.) When Patriarch's counsel attempted to participate in the Sale Approval Hearing, the Bankruptcy Court repeatedly cut counsel off, ordering, for example: "you don't have standing to participate in the evidentiary development here" (Apr. 16 Tr. 188), and "I'll ask you to take a seat." (*Id.* at 261-62; *see also id.* at 260, 284.)

At the close of the hearing, the Bankruptcy Court held “that the highest and best offer is that made by Hilco and Gordon Brothers. And that will be the basis from which we go forward here to resolve the rest of this motion.” (*Id.* at 285-86.) At that point, after the Bankruptcy Court had already selected Hilco/Gordon, the Debtor amended its motion to seek “approval of the Hilco Gordon Brothers bid.” (*Id.* at 287.) The Debtor had no choice since the issues had been resolved by the Bankruptcy Court. The Bankruptcy Court then approved the motion “[b]ased on the ruling I just made.” (*Id.*)

SUMMARY OF THE ARGUMENT

The auction and sale approval in this case was intrinsically unfair as a result of a series of legal errors by the Bankruptcy Court. In particular, the Bankruptcy Court

- Ignored the Debtor’s business judgment that Patriarch was the highest and best bidder;
- Undermined the interests of the estate in selecting the lower bid;
- Changed the ground rules of the auction after it was over, in contravention of its own prior orders;
- Refused to allow Patriarch to address these errors, defend its bid or update its bid to reflect the new rules; and
- Chose the Hilco/Gordon bid based up perceived differences in the bidders’ LLC agreements, but without actually admitting them into evidence or reviewing their terms.

Well-settled bankruptcy law requires deference to the business judgment of debtors in a Section 363 sale, and also requires faithful adherence to fair and transparent auction procedures—except perhaps when departures from procedure can increase value for the estate. The Bankruptcy Court conducted the sale hearing in precisely the opposite

manner. It ignored the debtor's judgment and changed the rules of auction to the estate's detriment. These are the type of errors that discourage bidders to invest the time and expense in participating in bankruptcy auctions. These legal errors are by definition an abuse of discretion and, taken together, resulted in an intrinsically and fundamentally unfair auction process. This Court should reverse the Bankruptcy Court's order.

ARGUMENT

A. The Standard of Review

A district court reviews a bankruptcy judge's approval of a sale under section 363 for abuse of discretion. *In re Food Barn Stores, Inc.*, 107 F.3d 558, 562 (8th Cir. 1997). "The bankruptcy court abuses its discretion when it fails to apply the proper legal standard or basis its order on findings of fact that are clearly erroneous." *Regan v. Wetzel (In re Regan)*, ___ B.R. ___, 2009 WL 805144, at *3 (8th Cir. B.A.P. Mar. 20, 2009) (quoting *In re Farmland Indus., Inc.*, 397 F.3d 647, 651 (8th Cir. 2005)).

B. The Bankruptcy Court Improperly Disregarded the Debtor's Business Judgment.

Under section 363 of the Bankruptcy Code, debtors are given "ample discretion to administer the estate, including authority to conduct public or private sales of estate property." *In re Psychometric Sys., Inc.*, 367 B.R. 670, 674 (Bankr. D. Colo. 2007) (quoting *In re Bakalis*, 220 B.R. 525, 532 (Bankr. E.D.N.Y. 1998)). When debtors make a determination to sell the estate's assets, their "business judgment is to be given 'great judicial deference.'" *Id.* The bankruptcy court's proper task is to review the *debtor's choice* of successful bidder under the business judgment rule, and to ensure that the debtor's choice "does not reflect an abuse of the *discretion accorded to it* in making this choice." *In re After Six, Inc.*, 154 B.R. 876, 883 (Bankr. E.D. Pa. 1993) (emphasis added).

The appropriate standard for a bankruptcy court's review of a proposed 363 sale was first established by the Second Circuit in *Equity Security Holders v. Lionel Corp.* (*In*

re Lionel), 322 F.2d 1062 (2d Cir. 1983). “[I]n *Lionel*, the Circuit held that the proper standard for use when considering a motion to sell is the business judgment test. It is the standard which has been adopted by the vast majority of courts.” *In re Gulf States Steel, Inc.*, 284 B.R. 497, 514 (Bankr. N.D. Ala. 2002).⁴

In reviewing a sale proposed by a debtor, the court is not permitted to substitute its judgment for that of the debtor or to “choose between two competing bids.”

Psychrometric Systems, 367 B.R. at 676. As several courts have recognized, “to do so would be to undertake a congressionally prohibited administrative function. Such an action is beyond the jurisdictional mandate of Congress to bankruptcy courts and judges and may be subject to reversal on appellate review.” *Id.* (quoting *In re Landscape Properties, Inc.*, 100 B.R. 445, 447 (Bankr. E.D. Ark. 1988)); *see also In re Trans World Airlines, Inc.*, Case No. 01-00056, 2001 WL 1820326, at *13 (Bankr. D. Del. Apr. 2, 2001) (“It is not the function of the bankruptcy court to independently exercise a business judgment as to which proposal among competing proposals should be adopted by the debtor in effecting a § 363 sale.”); *Gulf States Steel*, 285 B.R. at 514 (“Even though the discretion is not without limit, a Court should not step in and assume a role and responsibility properly placed in the hands of the trustee.”).

These legal rules were not in dispute in the Bankruptcy Court prior to the Sale Approval Hearing. During the April 9 hearing and the April 16 auction, the Bankruptcy

⁴ Because appeals from bankruptcy court decisions are often rendered moot pursuant to Section 363(m), most decisions on this point are issued by bankruptcy courts and district courts, rather than circuit courts.

Court, the Creditors' Committee and Hilco/Gordon all acknowledged that the Debtor's decision was entitled to deference under the business judgment rule. (Apr. 9 Tr. 110-11 (Bankruptcy Court: Debtor's decisions entitled to "significant deference"); Apr. 16 Tr. 52-53 (Hilco/Gordon counsel: "I know it's the Debtor's judgment We've come very far and the Debtor should be allowed to make the right decision here."); *id.* at 55 (Unsecured Creditor's Committee Counsel stating that the "standard" is "the debtor's business judgment").)

After the conclusion of the auction, there was no dispute that the Debtor exercised sound business judgment in selecting Patriarch as the winning bid. The Debtor's financial advisers had marketed the company widely to potential bidders and created a comprehensive data room to assist bidders in evaluating the estate. The Debtor then conducted a thorough, lengthy auction that involved three phases and included two rounds of competitive face-to-face bidding. The auction was conducted pursuant to the ground rules established by the Bankruptcy Court, most, if not all, of which had been agreed to by all the parties in interest. Paramount among those ground rules were valuation principles that were designed to provide a mechanism to compare competing bids and to avoid precisely the type of debate that the Court permitted to occur at the approval hearing. Those valuation principles, which included the \$650,000.00 per-percentage-point equity valuation, were determined in good faith by the Debtor's financial adviser and accepted by the creditors' committee. The Debtor noted that the Patriarch bid was higher in absolute terms and contained more cash, which the creditors also favored over equity. As counsel for the creditors' committee stated on the record,

“[W]e have always made clear that we value cash [W]e did not want to see equity bid up at the expense of cash.” (Apr. 9 Tr. 96.) Further, the Debtor noted that Patriarch intended to retain employees, which is a fundamental policy of the Bankruptcy Code. *See, e.g., After Six*, 154 B.R. at 884. The Debtor’s care and good faith in making its choice was never questioned during the Sale Approval Hearing.

However, in resolving the Debtor’s motion to approve the sale to Patriarch, the Bankruptcy Court held that the Debtor’s business judgment was not relevant at all, let alone entitled to substantial deference. Instead of addressing whether the Debtor had exercised reasoned business judgment in its selection of Patriarch as the winning bid, the Court instead turned to the creditors and inquired whether *their selection* was reasonable: “[T]he Court is to consider the paramount interests of creditors and their reasonable wishes under the circumstances.” (Apr. 16 Tr. 278 (emphasis added); *see also id.* at 281 (“I am content with deferring to the judgment of all of these creditor constituencies”).) In favoring creditors’ views to the exclusion of the Debtor’s choice and the evidence, the Bankruptcy Court committed clear error.

The Bankruptcy Court accepted the creditors’ views on the equity bids as more important than the Debtor’s valuation, which had been adopted by the Court, because the case was headed towards a liquidation rather than a reorganization. However, the case remained a proceeding under Chapter 11 in which no trustee had been appointed. As the court held in *After Six*, even if a Chapter 11 case may ultimately lead to liquidation rather than reorganization, the Debtor’s choice—if supported by reasoned business judgment—is still paramount.

[A] liquidating Chapter 11 case is nevertheless first and foremost a Chapter 11 case. Having neither sought to convert this case to a Chapter 7 case nor to appoint a trustee, the [creditors' committee] has relegated its constituency to a position where, under the Code, its views must be subjected to the deference to the Debtor's wishes.

As we perceive it, the critical issue is whether the Debtor's request satisfies the [363 standards], and its choice of a successful bidder does not reflect an abuse of the discretion accorded to it in making this choice.

After Six, 154 B.R. at 883 (citations omitted). The bankruptcy court reached a similar conclusion in *Trans World Airlines*, 2001 WL 1820326, at *13, which was also a “liquidating” Chapter 11 case. There, the bankruptcy court upheld the debtors’ reasoned business judgment in selecting the highest and best bid, even in the face of the opposition of many creditors, including the official committee. *Id.* The court noted that it was “not appropriate” for a bankruptcy court to “exercise its independent judgment” to select a bidder whose bid had not been accepted by the debtors under the court-ordered bidding procedure. Such a procedure would “be an abuse of discretion.” *Id.*; *see also In re Castre, Inc.*, 312 B.R. 426, 429-31 (Bankr. D. Colo. 2004) (holding that debtor exercised sound business judgment in selection of highest bid); *In re Quality Stores, Inc.*, 272 B.R. 643, 647 (Bankr. W.D. Mich. 2002) (same); *In re United Healthcare Sys. Inc.*, 1997 WL 176574, at *6-7 (D.N.J. Mar. 26, 1997) (same).⁵

⁵ The creditors have argued that their views become paramount in Section 363 sales involving substantially all of the debtor's assets, but none of the cases they cite in support of this claim actually involved approval of a Section 363 sale of assets. *See In re Roth Am., Inc.*, 975 F.2d 949, 952 (3d Cir. 1992) (extension of collective bargaining agreement); *In re Commercial Mortg. & Finance Co.*, No. 08 B 73242, 2009 WL 589673, at *5 (Bankr. N.D. Ill. 2009) (application to impose liens upon assets of debtor's

So too here. The Debtor's business judgment is entitled to deference.

The Bankruptcy Court, however, failed to apply the correct legal standard and undertake the correct legal inquiry. The Bankruptcy Court did not evaluate whether the Debtor abused its discretion under the business judgment rule. Instead, the Bankruptcy Court arrogated to itself the authority to select the highest and best bid (Apr. 16 Tr. 285-86), and exceeded its jurisdiction on a Section 363 sale motion. *See, e.g., Psychrometric Systems*, 367 B.R. at 676. If the Bankruptcy Court had applied the proper legal standard, it would have approved the sale to Patriarch because there is no evidence in the record that the Debtor abused its discretion. Indeed, the creditors did not even claim it had. Rather, the Bankruptcy Court substituted its judgment for that of the Debtor and independently selected between the two bids. This was "an abuse of discretion." *TransWorld*, 2001 WL 1820326, at *12.⁶

C. The Bankruptcy Court Erred by Failing to Follow Its Own Bidding Procedures Orders.

In choosing the Hilco/Gordon bid over the Patriarch bid selected by the Debtor, the Bankruptcy Court revalued the equity portions in the two bids. The Bankruptcy

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subsidiaries); *In re Nellson Nutraceutical, Inc.*, 369 B.R. 787, 796 (Bankr. D. Del. 2007) (modification of bonus plan); *In re S.N.A. Nut Co.*, 186 B.R. 98, 105 (Bankr. N.D. Ill. 1995) (break-up fee); *In re Am. West Airlines, Inc.*, 166 B.R. 908, 912 (Bankr. D. Ariz. 1994) (break-up fee).

⁶ If the Bankruptcy Court believed the creditors' objections had merit, its only option was to disapprove the motion. As discussed further below, the Debtor then could have accepted Patriarch's offer to accept the Hilco/Gordon LLC agreement and resubmitted its motion having cured the creditors' objections.

Court thereby contradicted the Court's own prior order, upon which all parties relied in submitting and evaluating the bids. (*See* Apr. 9 Tr. 131 (noting that the parties "should be able to rely on orders that were entered").) As the Court ruled: "[f]or the purposes of comparing the parties' bids, *the value of any such equity component . . . shall be calculated on the basis of \$650,000.00 per percentage-point-unit of the equity share offered as part of the bid, as previously established by the Debtors.*" (Supplemental Procedures Order at 3 (emphasis added).) Making matters worse, the Bankruptcy Court refused to permit Patriarch to address the Court's decision, by either explaining the Patriarch agreement, clarifying the Patriarch offer, or improving the offer given the Court's new ground rules.

The Eighth Circuit has recognized that bankruptcy courts must balance the often competing considerations of conducting transparent auctions in accordance with bidders' expectations, and maximizing value for the estate. *Food Barn*, 107 F.3d at 564-65. By changing the auction rules and then prohibiting Patriarch to update its bid to account for the new rules, the Bankruptcy Court violated the very mandates of the Eighth Circuit.

In *Food Barn*, the bankruptcy court "orally declared its preliminary inclination to authorize" one deal when, seconds later, a new buyer made a substantially larger offer—which the original buyer then matched. *Id.* at 561. The Eighth Circuit upheld the bankruptcy court's decision to receive the second bid, which had driven up the purchase price for the original buyer. *Id.* at 564-67. The Court observed that acting "consistently with the rules by which the particular sale is conducted and in compliance with the bidders' reasonable expectations" is important because it "encourages fervent bidding

and ensures that interested parties will sincerely extend their best and highest offers at the auction itself.” *Id.* at 564-65.⁷ Those concerns were not controlling, however, because the “judge chose to adopt a very informal and flexible bidding process” that was “marked by a lack of applicable rules and guidelines.” *Id.* at 566. Accordingly, the original buyer was aware of the risk of a late, additional bidder. *Id.* at 567. Further, the Court noted the important “counterweight” of “enhanc[ing] the value of the estate at hand,” which favored allowing the new bid. *Id.* at 564-65.

Here, the parties and the Bankruptcy Court adopted a precise and detailed auction procedure designed to cement the parties’ expectations and to encourage their participation. To the extent the Bankruptcy Court deviated from the procedure, it should have done so in a manner that increased the value of the estate. These twin errors, independently and in combination, were clearly contrary to *Food Barn* and were an abuse of discretion.

These errors were especially egregious considering that there was *no evidence in the record* supporting any monetary value or other quantification whatsoever to the purported differences between the LLC agreements. To the contrary, the only financial expert who testified—Stephen Spencer of Houlihan Lokey—testified that he assigned *no value* to these purported differences. (Apr. 16 Tr. 154-55, 190-91.) He also

⁷ See also *In re Financial News Network*, 126 B.R. 152, 156 (S.D.N.Y. 1991) (“[C]ourt-imposed rules for the disposition of assets are to be enforced strictly in order to provide an adequate basis for comparison of offers ... and to protect other bidders who have limited their bids to the announced terms.” (citations omitted)).

unqualifiedly affirmed that the Patriarch bid was highest and best: “At this time I believe their bid to be the highest and best, yes.” (*Id.* at 111.)

Significantly, the Bankruptcy Court based its decision on findings about the purported differences between the two LLC agreements without actually examining the agreements themselves. Not a single witness, and not a single lawyer who was permitted to speak, ever cited any specific words of Patriarch’s LLC agreement—or Hilco/Gordon’s, for that matter—in support of an argument criticizing the Patriarch agreement. The agreements were not admitted into evidence and the Court refused to accept briefs that would have analyzed and compared them in appropriate detail. (*Id.* at 235-36.) Had that been done, a number of gross distortions of the Patriarch agreement would have been refuted.⁸

⁸ For example, Mr. Spencer testified that there could potentially be unlimited dilution of the estate’s ownership interest under the Patriarch agreement because of a fair value provision based on five times EBITDA. (Apr. 16 Tr. 170-71). This is simply not true. Section 7.8 of the Patriarch agreement expressly provides the minority member with the right to participate pro rata in the subsequent issuances of equity interests at the same price as Patriarch. Moreover, the fair value concept in section 5.7 to which Mr. Spencer referred merely provided that Patriarch could not issue additional equity interests at less than fair value without the consent of the minority member. Rather than harming the minority member as suggested by Mr. Spencer, this provision would have the opposite effect—it would protect the minority member from dilution. Further, the Patriarch agreement also contains other standard minority member protections that Mr. Spencer and the creditors failed to mention, including in sections 7.9 and 7.11 tag-along rights and a right of first refusal on transfers of membership interests. Mr. Spencer and the creditors also incorrectly indicated that there was a lack of transparency in the Patriarch agreement. (*Id.* at 119-20.) That is also not true. Sections 9.2 and 9.4 of the Patriarch agreement provide that the minority member would receive standard access rights pursuant to the Delaware Limited Liability Company Act, including the right to receive, upon request, information regarding the status of the business and financial condition of the company, all tax returns and other information regarding the affairs of

Nonetheless, Patriarch attempted to resolve the creditors' objections by *offering to accept the Hilco/Gordon LLC agreement*. (*Id.* at 283-84.) The Court, however, declined to consider this offer because it came "a little late." This was a clear abuse of discretion. During the Sale Hearing, for the first time, the Bankruptcy Court applied a different valuation metric than had been used during the auction. The Bankruptcy Court had previously indicated that the bids could be compared on an apples-to-apples basis and the comparison would be "stripped down to numbers." (Apr. 9 Tr. 72.) Once the Bankruptcy Court decided to expand its analysis, after the auction closed but before any sale was approved, it should have permitted the winning bidder an opportunity to respond. As the *Food Barn* court recognized, prior to final approval of a 363 sale, the interests of maximizing the value of the estate outweigh the interests of strict procedural formalities. *Food Barn*, 107 F.3d at 564-65; *see also In re Payless Cashways, Inc.*, 281 B.R. 648, 652 (8th Cir. B.A.P. 2002) (bankruptcy court may reopen bidding at any time before it entered an actual order confirming the sale); (Apr. 9 Tr. 107-15) (Bankruptcy Court analysis of *Food Barn*). There would have been no possible prejudice to any party in interest, and only potential upside for the Debtor. However, the Bankruptcy Court prevented the Debtor from even considering this clarification of Patriarch's winning bid based on a technical timing rule. (The Court never asked the Debtor or the creditors for their views of the offer.) Patriarch's modified bid would have provided the estate with

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the company, and also called for the delivery of full financial reports at the end of each fiscal year and on a quarterly basis.

the additional cash and net consideration of the Patriarch bid together with the terms of the Hilco/Gordon LLC agreement that the creditors favored. This would indisputably have been the highest and best offer, but the Debtor never had a chance to accept it. The end result was that the Bankruptcy Court deprived the estate of access to \$8.5 million in additional cash, and \$488,000 in total additional consideration, for no reason whatsoever.⁹ The Bankruptcy Court should be reversed. *See Financial News Network*, 126 B.R. at 156 (reversing bankruptcy order that approved a sale after disqualifying a higher offer based on a technical timing rule).

Finally, by changing the valuation standard in the middle of the approval hearing and selecting the Hilco/Gordon bid, the Bankruptcy Court created significant omissions in the evidentiary record supporting the selection of the Hilco/Gordon bid. Because the Sale Approval Hearing concerned the Debtor's motion to approve the Patriarch bid, the Debtor adduced evidence explaining, for example, the factors that influenced the choice of Patriarch and the care it took in discharging its duties with respect to that choice. The Debtor called the Patriarch CEO, for example, to testify to Patriarch's good faith and proper conduct throughout the bidding process. By contrast, the Creditors' Committee called no witness in support of the Hilco/Gordon bid, and there is, consequently, no evidence in the record of Hilco/Gordon's good faith. The record contains only the

⁹ The creditors have attempted to minimize these differences by noting that \$488,000 represents around 0.5% of the total consideration offered. This ignores that Patriarch's offer included \$8.5 million in additional cash, and also ignores the fact that an auction process involving alternating bids and counterbids—27 in this case—will by its very nature produce a winner whose bid is only incrementally larger than the next highest bid.

statements of counsel, which of course are not evidence. A “finding” of good faith in a sale approval order that is not supported by sufficient evidence in the record does not satisfy the standard of section 363(m) of the Bankruptcy Code. *In re M Capital Corp.*, 290 B.R. 743, 751-52 (9th Cir. B.A.P. 2003).

The Bankruptcy Court’s decision to change the established valuation metrics after the auction closed deprived Patriarch of its right to a fair auction and prevented Polaroid from selecting the highest and best bid. The Court’s procedures, which led to the order, were “infected by fundamental defects in the sale procedure” and, accordingly, the order should be reversed. *McDonnell v. Hotin (In re Hotin)*, 63 B.R. 226, 227 (D. Mass. 1986) (“an order confirming the sale of property may be overturned . . . if infected by fundamental defects in the sale procedure”); *In re Titusville Country Club*, 128 B.R. 396, 400 (Bankr. W.D. Pa. 1991) (“[T]he integrity of the bankruptcy court sale procedures should be protected.”).

D. The Bankruptcy Court Erred in Excluding Patriarch from Participation in the Sale Approval Hearing on the Grounds that Patriarch Had No “Standing.”

Although Patriarch’s counsel attended the Sale Approval Hearing, the Bankruptcy Court ruled that Patriarch had no “standing” to speak to or question witnesses. (Apr. 16 Tr. 184-88.) This ruling is erroneous. Patriarch has standing on at least three independent bases: as the winning bidder defending its bid; as the express beneficiary of Court Orders that were violated; and as a party challenging the intrinsic fairness of the sale.

As the winning bidder, whose bid was the subject of the hearing, Patriarch was a *party in interest* under the Bankruptcy Code, and therefore was entitled to “appear and be heard on any issue in a case under this Chapter.” 11 U.S.C. § 1109(b). By the specific language of this section of the Code, a party in interest is *not* limited to the debtors, the creditors, the trustees, and the other named constituencies. *See* 11 U.S.C. § 102(3); *see also In re Summit Corp.*, 891 F.2d 1, 5 (1st Cir. 1989) (holding that bidder was “party in interest” with standing to participate in discovery “*for the purpose of allowing the submission of competitive bids*”) (emphasis added); *In re Amatex Corp.*, 755 F.2d 1034, 1042 (3d Cir. 1985) (The definition of a “party in interest” should be liberally construed to permit interested parties in bankruptcy cases the “absolute right to be heard and to insure their fair representation.”).

The Third Circuit’s decision in *In re Time Sales Fin. Corp.*, 445 F.2d 385 (3d Cir. 1971), is instructive. In *Time Sales*, the winning bidder in a private sale authorized by the bankruptcy court did not attend the approval hearing on approval of the sale because he did not receive notice. *Id.* at 386. During the approval hearing, a *different* bidder made a slightly higher offer for the property, and that offer was accepted and ultimately approved. *Id.* The Third Circuit reversed. The winning bidder “had a vital interest in attending the hearing personally . . . not only *to protect his bid* but if there were a higher bid or bids *to meet it or them and if necessary and he so desired, to top any raise in the bidding.*” *Id.* at 386 (emphasis added). The “totally unfair exclusion of [the winning bidder] from the hearing on his own bid” could not stand. *Id.* at 387; *see also Felts v. Bishop (In re Winstead)*, 33 B.R. 408, 410 (M.D.N.C. 1983) (finding that the winning bidder “was a

party in interest” and thus was entitled to notice to protect his bid). As with the bidder in *Time*, Patriarch had every right to attempt to protect its winning bid.

Separately, Patriarch had standing to enforce the terms of the Bidding Procedures Order, including the terms requiring deference to the Debtor’s business judgment as well as the valuation rules in the subsidiary Supplemental Procedures Order. The Bidding Procedures Order expressly stated that it “shall be binding upon and inure to the benefit of the Successful Bidder or Bidders and any Back-Up Bidder” (Bidding Procedures Order at 8.) Patriarch therefore was an *intended beneficiary* of the Bidding Procedures Order, and consequently had standing under Rule 71 of the Federal Rules of Civil Procedure to enforce the order. *See E.E.O.C. v. Int’l Ass’n of Bridge, Structural and Ornamental Ironworkers, Local 580*, 139 F. Supp. 2d 512, 521 (S.D.N.Y. 2001).¹⁰

Cases that limit the standing of unsuccessful bidders to challenge the Bankruptcy Court’s approval of a sale are inapposite because Patriarch was not an unsuccessful bidder. To the contrary, Patriarch was named the highest bidder after the auction, and its bid was the subject of the Debtor’s motion to confirm the sale.¹¹ In fact, in *In re Lambert*, 54 B.R. 371, 373 (Bankr. D.N.H. 1985), the court held that the highest bidder on a

¹⁰ Rule 71 is made applicable to a contested matter, like the sale hearing, in a bankruptcy case by Rules 7071 and 9014 of the Federal Rules of Bankruptcy Procedure. *See* Fed. R. Bankr. P. 7071, 9014.

¹¹ Objectors to Patriarch’s motion to stay relied upon cases involving bidders who did *not* win their auctions, who were *not* challenging the intrinsic fairness of the transaction, and who were *not* seeking to enforce court orders entered for their benefit. *See, e.g., In re O’Brien Envtl., Energy, Inc.*, 181 F.3d 527, 531 (3d Cir. 1999); *Imperial Bowl of Miami, Inc. v. Roemelmeyer*, 368 F.2d 323, 327 (5th Cir. 1966); *In re Planned Sys. Inc.*, 82 B.R. 919, 922 (Bankr. S.D. Ohio 1988).

residential property *did* have standing to challenge a trustee’s decision to award the sale to a lower bidder, because the objecting party “simply was not a ‘unsuccessful bidder.’”

Even if Patriarch could be classified as an unsuccessful bidder, Patriarch still has standing on the independent ground that it was (and is) objecting to the structure of the sale as intrinsically unfair. *In re Harwald Co.*, 497 F.2d 443, 444-45 (7th Cir. 1974) (“[W]hen an unsuccessful bidder attacks a bankruptcy sale on equitable grounds related to intrinsic structure of the sale, he brings himself within the zone of interests which the Bankruptcy Act seeks to protect and regulate.”); *The Wine Group v. Diamante (In re Hat)*, 310 B.R. 752, 758 (Bankr. E.D. Cal. 2004) (citing *Harwald*). In particular, Patriarch’s challenge relates to the failure to follow bidding procedures, the decision to devalue equity, and the refusal to allow Patriarch to revise its bid. Courts routinely allow parties to raise challenges to the sale in these circumstances. *Kabro Assocs., LLC v. Colony Hill Assocs. (In re Colony Hill Assocs.)*, 111 F.3d 269, 273-74 (2d Cir. 1997); *Licensing by Paolo, Inc. v. Sinatra (In re Gucci)*, 126 F.3d 380, 389 (2d Cir. 1997); *In re Hat*, 310 B.R. at 758; *Dick’s Clothing & Sporting Goods, Inc. v. Phar-Mor, Inc.*, 212 B.R. 283, 288-89 (N.D. Ohio 1997); *In re Hotin*, 63 B.R. at 227.¹²

¹² Patriarch’s standing for purposes of the hearing, and for purposes of this appeal, are “merged.” *Colony Hill*, 111 F.3d at 274 (quoting *In re Hotin*, 63 B.R. at 227 n. 2). Thus, while we expect objections to Patriarch’s standing to appeal, those objections fail for the same reasons that Patriarch had standing to appear at the sale hearing.

Under section 363(m) of the Bankruptcy Code, the reversal or modification on appeal of a sale approval order does not affect the validity of the sale to an entity that purchased in “good faith.” Although the Bankruptcy Court found that Hilco/Gordon acted in good faith, no evidence was presented at the hearing to support that finding.

CONCLUSION

For these reasons, Lithograph Legends, LLC respectfully requests that the Court reverse the Sale Approval Order.

Dated: April 29, 2009.

/e/ Robert T. Kugler

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Accordingly, this finding was clearly erroneous. *See, e.g., Tadlock v. Powell*, 291 F.3d 541, 546 (8th Cir. 2002) (factual findings must be supported by substantial evidence).

CERTIFICATE OF COMPLIANCE WITH LOCAL RULES 8010-3 AND 7.1

Patriarch, through its undersigned attorney, certifies that its Appellant's Brief complies with the word count and font size limitations of United States Bankruptcy Court, District of Minnesota's Local Rules 8010-3 and 7.1, respectively, as promulgated by the District Court.

Dated: April 29, 2009

/e/ Robert T. Kugler _____
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