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U.S. BANKRUPTCY COURT
ALBUQUERQUE N.M.

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW MEXICO

In re	:	11-01-10779
FURR'S SUPERMARKETS, INC.,	:	Chapter 11
Debtor.	:	

MOTION FOR ORDER UNDER 11 U.S.C. § 105 AUTHORIZING DEBTOR TO HONOR CERTAIN PREPETITION OBLIGATIONS TO CUSTOMERS AND TO MAINTAIN CERTAIN CUSTOMER SERVICE POLICIES, PROGRAMS AND PRACTICES

Furr's Supermarkets, Inc., debtor and debtor-in-possession (the "Debtor"), hereby moves for an order under 11 U.S.C. § 105 authorizing the Debtor to honor certain prepetition obligations to customers under the Debtor's customer service policies, programs and practices, and to maintain such policies, programs and practices on a postpetition basis.

BACKGROUND

A. The Chapter 11 Filing

1. On February 8, 2001 (the "Petition Date"), the Debtor filed a voluntary petition in this Court for reorganization relief under chapter 11 of title 11 of the United States Code, 11 U.S.C. §§ 101-1330 (as amended, "Bankruptcy Code"). The Debtor

continues to operate its business and manage its properties as a debtor-in-possession under sections 1107(a) and 1108 of the Bankruptcy Code.

2. No creditors' committee has yet been appointed in this case by the United States Trustee.

3. The Court has jurisdiction over this matter under 28 U.S.C. §§ 157 and 1334. Venue is proper under 28 U.S.C. §§ 1408 and 1409. This is a core proceeding under 28 U.S.C. § 157(b)(2).

4. The statutory predicate for the relief requested herein is section 105 of the Bankruptcy Code.

B. The Debtor's Business

5. The Debtor is a leading regional supermarket chain, with operations in New Mexico and Western Texas. The Debtor has a leading market share in this region. The Debtor employs some 4,900 individuals, and operates seventy-one stores.

6. The Debtor's stores offer a broad selection of grocery, meat, poultry, seafood, dairy, fresh fruits, vegetables and frozen food products. The stores also offer an extended line of non-food products, health and beauty care products, housewares, general merchandise and, in many instances, in-store pharmacies.

RELIEF REQUESTED

7. The Debtor seeks permission to honor its prepetition obligations under certain customer service policies, programs and practices designed to ensure customer

satisfaction and loyalty (the "Customer Satisfaction Practices") and to maintain and continue these Customer Satisfaction Practices without interruption.

BASIS FOR RELIEF

8. In the ordinary course of business, and as is customary with most grocery store chains, the Debtor maintains certain Customer Satisfaction Practices. The Debtor seeks authority to maintain and to honor prepetition obligations related to those Customer Satisfaction Practices, which, include, but are not limited to, the following:

a. Rain Check Policy

The Debtor maintains a traditional rain check policy (the "Rain Check Policy") under which the Debtor issues "rain checks" for weekly advertised items that are not in stock and for which no like product is available for sale. Customers may redeem rain checks at the advertised price of the out-of-stock items by presenting them at the supermarket checkout counter. If the Debtor offers a substitute for the advertised item, it will not issue a rain check and instead will sell the substitute at the price advertised for the out-of-stock item.

b. Return, Refund and Exchange Policies

The Debtor has traditionally maintained return, refund and exchange policies to accommodate its customers' needs (collectively, the "Return and Exchange Policies"), including, for example, the "Double Your Money Back" program, which permits customers dissatisfied with a particular product to return the product for twice the amount originally paid. These Policies protect the Debtor's customers in the event that merchandise purchased is the wrong brand, stale, damaged, defective or otherwise unsatisfactory.

c. The Gift Certificate Program

As a further accommodation to its customers, the Debtor maintains a program by which customers can purchase gift certificates which may be redeemed for merchandise at a later date (the "Gift Certificate Program"). The Debtor typically sells the gift certificates at face value, but customers who purchase certain volumes of gift certificates through the Debtor's corporate headquarters may receive a discount on the total purchase price.

d. The Coupon Programs

(1) The Debtor also maintains several coupon redemption programs (the "Coupon Programs"). Under these Coupon Programs, the Debtor (i) redeems its own paper coupons that are included in advertisement circulars, (ii) redeems paper coupons distributed through certain third parties on behalf of the Debtor, (iii) honors third-party manufacturers' paper coupons distributed to the Debtor's customers by the manufacturers, either through the mail or in periodicals, (iv) honors paper coupons distributed to new residents in the Debtor's marketing areas through the Debtor's proprietary "new home owners' mailers" and (v) honors electronic coupons that are

included in advertisement circulars and then redeemed by consumers who are members of one of the Debtor's preferred customer programs, including the Furr's Club Program and the Newsamerica Smartsource Program, a pilot program in 12 of the Debtor's stores.

(2) When a customer or employee redeems a valid paper coupon in one of the Debtor's stores, the Debtor deducts the appropriate amount from the item's purchase price at the point of sale. In the case of third-party and manufacturer coupons, the Debtor collects the coupons and delivers them to the respective party through a processing agent in return for a cash refund equal to the aggregate face amount of the coupons plus a small processing fee.

(3) As with paper coupons, the Debtor offers electronic coupon discounts on various items based on the Debtor's own and manufacturers' coupon programs to customers who are members of one of the Debtor's preferred customer programs. Customers redeem electronic discounts by presenting their loyalty cards (currently, the Furr's Club Card and the Furr's Smartsource Card) evidencing their membership at the Debtor's stores at the time of checkout.

e. State Lotteries

(1) The Debtor sells lottery tickets (the "Lottery Sales") at certain of its stores in New Mexico and West Texas. Each store deposits the proceeds of Lottery Sales into its depository bank account. Each week, each state debits the

Debtor's bank accounts in the amount of the prior week's Lottery Sales. The states compensate the Debtor for making the Lottery Sales by paying the Debtor a percentage of the sales, which varies by state.

(2) Continuation of the Lottery Sales is important to the Debtor's ongoing business operations. Not only does the Debtor earn money directly from the sale of the lottery tickets, but it is also compensated indirectly because the lottery sales attract customers to the Debtor's stores. If the Debtor prevents a State from collecting prepetition lottery proceeds, the State may terminate its lottery sales agreement with the Debtor, adversely affecting the Debtor, its estates and creditors.

f. <u>Money Orders and MoneyGrams</u>

(1) The Debtor has an arrangement with Travelers Express Co., Inc. ("Travelers") whereby the Debtor's stores offer customers the ability to purchase money orders for cash (the "Money Orders"). To obtain a Money Order, a customer pays the principal amount of the Money Order plus a small transaction fee to the Debtor's courtesy counter representative. The Debtor pays Travelers in advance for the Money Orders. Once the Debtor sells the Money Orders to its customers, the Debtor processes the customers' payments in accordance with the Debtor's ordinary course cash management system.[1]

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1 The Debtor's cash management system is described in more detail in the cash management motion, filed concurrently herewith.

(2) As an additional convenience service, through a relationship with Wells Fargo Bank, the Debtor also sells wire transfers ("MoneyGrams") to its customers. As with the Money Order program, a customer pays the principal amount of the MoneyGram, plus a small transaction fee, to the Debtor's courtesy counter representative. The funds are then wired by Wells Fargo to the location specified by the customer. The Debtor deposits the receipts from its customers in payment of the MoneyGrams into an account maintained at Wells Fargo specifically for this purpose. Wells Fargo collects the deposits from the Debtor's MoneyGram account on a daily basis.

(3) The convenience of purchasing Money Orders and MoneyGrams attracts many customers to the Debtor's stores. Discontinuing the sale of Money Orders and MoneyGrams will not only eliminate a direct source of income generated by the sales of the Money Orders and MoneyGrams themselves; it could also indirectly impact the Debtor's income by engendering customer dissatisfaction, which, in turn, could result in customer flight and reduced sales.

g. Coinstar Deposit Program

The Debtor provides Coinstar machines in its stores ("Coinstar Deposit Program"), which allow customers to bring their change to the store, deposit it into the machines and receive a receipt for use to purchase goods or receive cash back.

The deposits of receipts from the Coinstar machines are transferred via Automatic Clearing House to the Debtor's Concentration Account.[2]

h. Recycling Program

The Debtor offers a program whereby customers may receive $ .25 cash compensation for returning recyclable six-pack wine carriers (the "Recycling Program").

i. Charitable Contributions

(1) The Debtor's commitment to its customers extends to the various communities in which the Debtor's stores operate. As part of its commitment to these communities, the Debtor has established the Furr's Foundation, through which it conducts various fundraising events to raise money from partner vendors and employees, which it contributes ("Charitable Contributions") to community organizations, such as the United Way and the Boy Scouts of America. In addition, through a partnership with Escrip, Inc., the Debtor has established the Escrip Program (the "Escrip Program"), through which its customers may elect to have a percentage of their total purchases donated to a charity of their choice.

(2) The Debtor's Charitable Contributions and the Escrip Program provide enormous benefit to the communities in which the Debtor operates, as well as creating goodwill among its customers and suppliers. The loss of the ability to

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[2] The Concentration Account is described in the cash management motion.

continue such contributions, to participate in the Escrip Program and to honor prepetition commitments to charitable organizations would result in a loss of the Debtor's stature among its community constituents.

(3) Other than the small fraction of revenues from customers who have chosen to participate in the Escrip Program, none of the funds contributed to charity under the charitable programs comes from the Debtor's revenues or other assets. Except with respect to the fractional Escrip revenues, the Debtor does not seek authorization in this Motion to make original charitable contributions but merely to forward charitable contributions collected from others to the intended beneficiaries.

j. Direct Marketing Programs

(1) To reward loyal customers and to re-attract customers with declining purchasing records, the Debtor has implemented various direct marketing programs ("Direct Marketing Programs") Under these programs, the Debtor offers its loyal customers favored customer incentives, such as coupons for free items, and offers customers whose purchases have declined coupons for discounts on various items as an incentive to return.

(2) These Direct Marketing Programs have been successful in preserving the customer satisfaction and loyalty of the Debtor's favored customers and in re-establishing the customer loyalty of customers who have strayed. The loss of

these Direct Marketing Programs could have a negative impact on customer satisfaction, loyalty and sales.

k. General Customer Satisfaction

Although the Debtor makes every effort to provide its customers with a completely satisfactory shopping experience, there are some occasions when a customer is dissatisfied. To preserve its customer relationships, the Debtor will often provide a dissatisfied customer with a letter thanking the customer for his or her patronage, with a gift certificate as a sign of the Debtor's commitment toward correcting the problem.

l. On-Line Shopping Services

To enhance customer convenience and simplify the shopping experience, the Debtor offers on-line shopping services ("On-Line Shopping Services") for customers in the Albuquerque, Santa Fe and West El Paso areas at its website, furrs.com. On furrs.com, customers may select the items they wish to purchase and are offered the option of picking up their prepared order at one of the Debtor's stores or having their order delivered to their homes for a nominal fee.

m. Customer Protection Program

In the ordinary course of business, the operation of the Debtor's stores inevitably generates minor personal injury claims. When a customer reports an accident or injury to a store manager, the Debtor's in-house claims adjusters review the circumstances. If the claim appears valid, the Debtor will frequently offer a small cash payment to settle the dispute and maintain customer good will. These settlement payments average approximately $16,000 per month, or an average of approximately $230 per week per store. The typical settlement is $500 or less, although some are more. The Debtor believes that customer loyalty and customer-employee relations would suffer if it failed to make payments under this program on account of prepetition accidents or injuries.

n. Discount Programs

In an effort to enhance employee-customer satisfaction, the Debtor has established an Associate Discount Program under which the Debtor offers its employees a 5% discount on purchases greater than $30. In addition, the Debtor has established the Value Partners Program, which offers discounts similar to the Associate Discount Program to selected suppliers. Members in the Discount Programs obtain their discounts by presenting cards evidencing their membership at the Debtor's stores at the time of checkout.

o. Other Policies

The Debtor maintains certain other consumer policies (the "Other Policies"), including, postage stamp sales, rug cleaner rental and customer utility bill collection and payment, which are designed to enhance customer satisfaction. The success and ultimate viability of the Debtor's business is dependent upon customer satisfaction and loyalty. The uninterrupted maintenance of its Customer Satisfaction Practices is essential to maintaining that satisfaction and loyalty. The disruption and adverse publicity that would necessarily result from a failure to meet customer obligations or to continue its Customer Satisfaction Practices would threaten the Debtor's customer base and ultimately threaten its ability to reorganize successfully.

9. The Debtor cannot quantify precisely the aggregate amount of outstanding obligations with respect to these Practices. The Debtor budgets approximately $100,000 per week for coupon redemptions, and typically issues approximately $2,500 per week in rain checks (although it has issued more in recent weeks). Regardless of the aggregate amount, these Practices bring customers into the stores and generate sales and additional revenues.

APPLICABLE AUTHORITY

10. Arguably, the Debtor's obligations to honor prepetition "rain checks," discount coupons and other Customer Practices Policies constitute prepetition claims. For obvious reasons, however, a failure to do so would drastically impact sales and customer loyalty. To the extent that these obligations are prepetition claims, this Court may, under the authority of section 105 of the Bankruptcy Code, authorize the Debtor to pay them.

11. Bankruptcy Code section 105(a) grants courts broad authority to enforce the provisions of the Code under equitable common law doctrines. Under that section:

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

11 U.S.C. § 105(a).

12. Numerous courts have used their section 105(a) powers under the "doctrine of necessity" to authorize payment of a debtor-in-possession's prepetition obligations where, as here, such payment is an essential element of the preservation of the debtor-in-possession's potential for rehabilitation.[3] See, e.g., In re Lehigh & New England Ry. Co., 657 F.2d 570, 581 (3d Cir. 1981) (doctrine of necessity permits "immediate payment of claims of creditors where those creditors will not supply services or material essential to the conduct of the business until their pre-

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[3] The "doctrine of necessity" is an outgrowth of the "necessity of payment rule," first articulated in Miltenberger v. Logansport, C. & S.W. Ry. Co., 106 U.S. 286, 311-12 (1882) (payment of pre-receivership claim prior to completion of reorganization permitted to prevent "stoppage of . . . [crucial] business relations . . ."). The "necessity of payment rule" applies to railroad reorganizations; the "doctrine of necessity" serves a similar function in chapter 11 cases. Each, however, recognizes the existence of judicial power to authorize a debtor-in-possession to pay prepetition claims if vital to its continued operations.

reorganization claims shall have been paid"); In re Ionosphere Clubs, Inc., 98 B.R. 174, 175 (Bankr. S.D.N.Y. 1989) (use of equitable powers to "authorize the payment of prepetition debt when such payment is needed to facilitate the rehabilitation of the debtor is not a novel concept").

13. The "doctrine of necessity" is frequently invoked early in reorganization cases, during the so-called "breathing spell," when preservation of the estate is most critical and often extremely difficult. For example, in In re Structurlite Plastics Corp., 86 B.R. 922, 931 (Bankr. S.D. Ohio 1988), the court embraced "the principle that a bankruptcy court may exercise its equity powers under section 105(a) to authorize payment of prepetition claims where such payment is necessary to 'permit the greatest likelihood of survival of the debtor. . . .'" Id. at 931 (citing In re Chateaugay Corp., 80 B.R. 279, 287 (S.D.N.Y. 1987)). The court explained that "a per se rule proscribing the payment of prepetition indebtedness may well be too inflexible to permit the effectuation of the rehabilitative purposes of the Code." Structurlite, 86 B.R. at 932. Flexibility of payment is particularly critical when the prepetition creditor provides vital services to the debtor.

14. Customer expectations and satisfaction can only be maintained through the continuation of the Customer Satisfaction Practices, including honoring prepetition obligations arising under such Practices. Because maintenance of the Debtor's

customer base is critical to a successful reorganization, entry of an order authorizing payment of such obligations is necessary and appropriate.

15. The Debtor has served notice of this Motion by hand delivery on the United States Trustee and by facsimile on the Debtor's secured creditors and its twenty largest unsecured creditors. In view of the nature of the relief requested, the Debtor submits that this notice is proper and adequate under the circumstances.

WHEREFORE, the Debtor requests that the Court enter an order (i) authorizing the Debtor to honor prepetition obligations under its Customer

Satisfaction Practices and to maintain and continue those Practices without interruption and (ii) granting such other and further relief as is just and proper.

Dated: Albuquerque, New Mexico
February 7, 2001

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