

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:) Chapter 11
FUHU, INC., *et al.*,¹)
Debtors.) Case No. 15-12465 (____)
)
) (Joint Administration Requested)

**DEBTORS' MOTION FOR AUTHORITY TO HONOR CERTAIN
OBLIGATIONS TO CUSTOMERS AND TO MAINTAIN CUSTOMER PROGRAMS**

Fuhu, Inc., and Fuhu Holdings, Inc. (the "Debtors") move this Court (the "Motion") for entry of interim and final orders, pursuant to Sections 105(a), 363(b), and 503(b)(1) of the Bankruptcy Code, to honor their outstanding obligations on account of their Customer Programs, as described below, and to continue the Customer Programs in the ordinary course of business. The Customer Programs relate to both the hardware and software components of the Debtors' products, including returns, repairs, and exchanges; as well as continued customer access to the Debtors' exclusive online content.

Jurisdiction

1. This Court has jurisdiction over this Motion under 28 U.S.C. § 1334. Venue of this proceeding is proper pursuant to 28 U.S.C. § 1409. This is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2).

¹ The Debtors, together with the last four digits of each Debtor's tax identification number, are: Fuhu, Inc. (7896); and Fuhu Holdings, Inc. (9761). The location of the Debtors' headquarters and service address is 909 N. Sepulveda Blvd., Suite 540, El Segundo, CA 90245.

Background

2. On the date hereof, the Debtors each filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code (the "Petition Date"). Debtors have requested that these cases be jointly administered.

3. The Debtors have continued in possession of their property and have continued to operate and manage their businesses as debtors-in-possession pursuant to Sections 1107(a) and 1108 of the Bankruptcy Code. No request has been made for the appointment of a trustee or examiner, and no official committee has been appointed in this case.

4. The factual background regarding the Debtors, including their current and historical business operations and the events precipitating the chapter 11 filing, is set forth in detail in the *Master Statement of Facts and Declaration of James Mitchell in Support of First-Day Motions* (the "First Day Declaration") filed concurrently herewith and fully incorporated herein by reference.²

Basis for Relief

5. Pursuant to Sections 105(a), 363(b), and 503(b)(1) of the Bankruptcy Code, the Debtors request an order authorizing them to honor certain pre-petition obligations to their customers and to continue the Customer Programs, as defined below, in the ordinary course of business.

² Capitalized terms used but not defined herein shall have the meanings ascribed to them in the First Day Declaration.

The nabi Products

6. The Debtors sell nabi tablets and related accessories through retailers, such as Walmart, and the Debtors' website, www.nabishop.com ("nabi Shop"). On nabi Shop, the Debtors sometimes offer promotions and discounts, such as bundling of accessories or seasonal discounts. To the extent that a customer purchases hardware directly from the Debtors' website, the Debtors fulfill such orders with the assistance of a third-party fulfillment agent.

7. When customers purchase tablets through nabi Shop, the Debtors offer customary customer-service features, such as returns and exchanges, as well as repairs. When a customer purchases a tablet through a retailer, subsequent requests to repair that tablet are made directly to the Debtors.

8. Regardless of a customer's point of purchase, customers contact the Debtors for warranty and repair issues. The Debtors refer to the program they use to allow their customers to submit hardware for repairs as "nabi Cares." In determining whether to repair or replace a defective tablet, the Debtors sometimes elect to exchange a non-functioning tablet for a refurbished one.

9. In administering nabi Cares, the Debtors contract with a third-party to accomplish the repairs and refurbishing. The Debtors do not charge customers for assistance through nabi Cares. Honoring the nabi Cares program would not require the Debtors to make a cash outlay, other than ordinary course post-petition expenses associated with payments to the Debtors' third-party vendor for its repairs to nabi Cares hardware.

10. Prior to commencement of these Chapter 11 cases, in the ordinary course of its business, the Debtors maintained numerous programs to allow their products to be

constantly updated and tailored by their end-users. When customers purchase a nabi tablet, they may receive the benefit of their bargain only if both the hardware and software components function. Similar to other consumer electronic products companies, the Debtors operate software on the tablets they sell to customers, allowing the customers to access content provided by the Debtors.

11. The Debtors operate a content subscription service allowing customers to customize their tablets. Each customer creates an account, which allows the personalization of content, including saving preferences and purchasing certain content. Under the nabi Pass program, customers may access all of nabi's content, including movies, music, "apps," television shows, e-books, games, and videos for \$4.99 per month, which is charged to the customer's account on a monthly basis. Under the nabi Pass Tab program, the Debtors provide customers with both hardware and software under a subscription agreement of one or two years. During the subscription period, the customer makes monthly payments that allow access to the Debtors' online content, and that also serve as an installment payment on the tablet. At the end of the subscription period, the customer may keep the tablet for a small fee.

12. The Debtors also maintain a virtual currency, called nabi Coins, which allows their customers to purchase credits for later downloads and access to certain content. Some of the content Debtors offer, including their music service, nabi Radio, and their e-books service, Speakaboos, is delivered by a third-party provider. The Debtors process the customer's payment for the third-party provider's content and then remit payment to the third-party.

13. The Debtors believe that the total potential cash outlay associated with honoring nabi Coins is approximately \$10,000. The Debtors believe that honoring the nabi Coins is an essential goodwill gesture to its customers.

14. Accordingly, the Debtors request that the Court authorize the Debtors to take the following actions with respect to the above-described customer-related programs (collectively, the "Customer Programs"):

- a) honor any orders placed by customers on the Debtors' website, allowing the Debtors to fulfill the orders and ship goods to customers with the assistance of third-party vendors, as necessary and applicable;
- b) honor customers' requests for returns or exchanges of products purchased in the pre-petition period, in the Debtors' discretion and in the ordinary course of business;
- c) honor customers' warranty claims under the nabi Cares program, consistent with past practices, even if a claim may have arisen pre-petition;
- d) honor any ongoing promotions or discounts that were in effect during the pre-petition period and had been expected to be in effect until a date in the post-petition period;
- e) honor all outstanding nabi Coins when tendered or cashed in by customers;
- f) honor all nabi Pass and nabi Pass Tab subscriptions, even to the extent that they constitute pre-petition claims; and
- g) allow payments made by customers to the Debtors for the purchase of content delivered by third-party content providers to be remitted to those third parties in the ordinary course of business, even in the event that a portion of the period covered by such purchase includes the pre-petition period, in order to allow the customers' access to that content to remain uninterrupted.

Legal Authority and Argument

15. All of the Customer Programs are designed to drive sales and ensure customer satisfaction, meet competitive pressures, develop and sustain customer loyalty, improve profitability, and generate goodwill for the Debtors and their products, thereby retaining current customers, attracting new ones, and ultimately enhancing net income.

16. The benefits of the Customer Programs are integral to the Debtors' efforts to stabilize their business and ultimately deliver the most value to all stakeholders in these Chapter 11 cases. The Debtors believe that they must quickly assure customers of the Debtors' continued ability to fulfill their obligations under the pre-petition Customer Programs in order to maintain valuable customer relationships following the commencement of these Chapter 11 cases, particularly given the increased pressure from competitors that the Debtors believe will inevitably arise.

17. Sections 1107(a) and 1108 of the Bankruptcy Code authorize a debtor-in-possession to continue to operate its business. Pursuant to Section 503(b)(1) of the Bankruptcy Code, a debtor may incur, and the court, after notice and a hearing, shall allow as administrative expenses, among other things, "the actual, necessary costs and expenses of preserving the estate." 11 U.S.C. § 503(b)(1). In addition, pursuant to Section 363(b) of the Bankruptcy Code, a debtor may, in the exercise of its sound business judgment and after notice and a hearing, use property of the estate outside of the ordinary course of business. *See* 11 U.S.C. § 363(b). The Debtors believe the use of estate funds to continue the Customer Programs is permitted by Sections 503(b)(1) and 363(b) of the Bankruptcy Code as necessary costs of preserving the

estates. Honoring the Customer Programs will enable the Debtors to retain valuable relationships which will help strengthen the Debtors' business.

18. Additionally, Section 507(a)(7) of the Bankruptcy Code establishes a priority for "unsecured claims of individuals, to the extent of \$2,775 for each such individual, arising from the deposit, before the commencement of the case, of money in connection with the purchase, lease, or rental of property, or the purchase of services, for the personal, family, or household use of such individuals, that were not delivered or provided." 11 U.S.C. § 507(a)(7). The Debtors respectfully submit that the holders of nabi Coins, nabi Pass, and other purchases made pre-petition may be entitled to priority claims under Section 507(a)(7) of the Bankruptcy Code if the Court does not authorize the Debtors to honor such Customer Programs. *See In re WW Warehouse, Inc.*, 313 B.R. 588 (Bankr. D. Del. 2004) (finding that gift certificate holders are entitled to priority status under Section 507(a)(7)). As priority claimholders, such holders would be paid in full before any general unsecured obligations of the Debtors are satisfied. Accordingly, the relief requested may affect only the timing of the Debtors' performance of their obligations to honor these Customer Programs and will not prejudice the rights of general unsecured creditors or other parties in interest.

19. Courts have noted that there are instances in which a debtor-in-possession can fulfill its fiduciary duty "only . . . by the preplan satisfaction of a prepetition claim." *In re CoServ, L.L.C.*, 273 B.R. 487, 497 (Bankr. N.D. Tex. 2002); *see also In re Just for Feet, Inc.*, 242 B.R. 821, 825 (D. Del. 1999); *In re Mirant Corp.*, 296 B.R. 427, 429-30 (Bankr. N.D. Tex. 2003) (allowing debtors to pay claims "reasonably believe[d]" to be authorized under the *CoServ* test or whose payment was necessary "in the exercise of their business judgment . . . in order for

[the d]ebtors to continue their respective businesses”). The *CoServ* court specifically noted that pre-plan satisfaction of pre-petition claims would be a valid exercise of a debtor’s fiduciary duty when the payment “is the only means to effect a substantial enhancement of the estate.” *CoServ*, 273 B.R. at 497.

20. The proposed continuance of Customer Programs should be authorized pursuant to Section 105 of the Bankruptcy Code and under the “doctrine of necessity.” The Court’s power to utilize the doctrine of necessity in Chapter 11 cases derives from the Court’s inherent equity powers and its statutory authority to “issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.” 11 U.S.C. § 105(a). The United States Supreme Court first articulated the doctrine of necessity more than a century ago, in *Miltenberger v. Logansport Ry. Co.*, 106 U.S. 286 (1882), in affirming the authorization by the lower court of the use of receivership funds to pay pre-receivership debts owed to employees, vendors, and suppliers, among others, when such payments were necessary to preserve the receivership property and the integrity of the business in receivership. *See id.* at 309. The modern application of the doctrine of necessity is largely unchanged from the Court’s reasoning in *Miltenberger*. *See In re Lehigh & New Eng. Ry.*, 657 F.2d 570, 581-82 (3d Cir. 1981) (“[I]n order to justify payment under the ‘necessity of payment’ rule, a real and immediate threat must exist that failure to pay will place the continued operation of the [debtor] in serious jeopardy.”).

21. The doctrine of necessity “recognizes the existence of the judicial power to authorize a debtor in a reorganization case to pay pre-petition claims where such payment is essential to the continued operation of the debtor.” *In re Ionosphere Clubs, Inc.*, 98 B.R. 174, 176 (Bankr. S.D.N.Y. 1989); *In re Eagle-Picher Indus., Inc.*, 124 B.R. 1021, 1023 (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.”).

22. The continuity, viability, and revitalization of the Debtors’ business is dependent on the development and maintenance of the loyalty of their customers. It is essential that the Debtors be permitted to continue the Customer Programs and honor their pre-petition obligations thereunder. If the Debtors are unable to do so, their operations will be irreparably harmed. Where retaining loyalty and patronage of customers is critical to the ongoing operations of a debtor for the benefit of its estate and creditors, courts in this and other districts have granted relief similar to that requested here. *See, e.g., In re Cache, Inc.*, Case No. 15-10172 (MFW) (Bankr. D. Del Feb. 5, 2015); *In re Ultura (LA) INC., et al.*, Case No. 14-12382 (KH) (Bankr. D. Del. Oct. 23, 2014); *In re Savient Pharmaceuticals, Inc.*, Case No. 13-12680, ECF No. 42 (interim) (MFW) (Oct. 16, 2013); *In re Exide Technologies*, Case No. 13-11482, ECF No. 323 (KJC) (Bankr. D. Del. July 11, 2013); *In re A123 Sys., Inc.*, Case No. 12-12859, ECF No. 284 (KJC) (Bankr. D. Del. Nov. 7, 2012).

23. Most, if not all, of the Customer Programs are standard practice in the Debtors’ consumer electronics industry. The Debtors’ principal competitors maintain programs similar to those offered by the Debtors. The Debtors’ inability to honor their Customer Programs would place them at a severe disadvantage relative to their competitors, which could be fatal to the Debtors’ reorganization.

24. The Debtors’ ability to continue the Customer Programs, which are essential to their business model, is necessary to reassure customers, preserve goodwill, and maintain critical business relationships. The Debtors submit that the resulting benefit of

continued customer satisfaction and loyalty during the pendency of this case will far exceed the cost of such programs. Considering the potential for loss of competitiveness absent the relief requested herein, and the resulting impact on the Debtors' business, the Debtors submit that their request for authorization to continue the Customer Programs in the ordinary course of business and to perform and honor their pre-petition obligations thereunder, as they deem appropriate in their business judgment, without further application to the Court, is in the best interest of the Debtors, the estates and creditors, and should be approved in all respects.

The Requirements of Bankruptcy Rule 6003 Are Satisfied

25. Pursuant to Bankruptcy Rule 6003, the Court may grant relief regarding a motion to pay all or part of a prepetition claim within twenty-one days after the Petition Date if the relief is necessary to avoid immediate and irreparable harm. Fed. R. Bankr. P. 6003. Immediate and irreparable harm exists where the absence of relief would impair a debtor's ability to reorganize or threaten the debtor's future as a going concern. *See In re Ames Dep't Stores, Inc.*, 115 B.R. 34, 36 n.2 (Bankr. S.D.N.Y. 1990) (discussing the elements of "immediate and irreparable harm" in relation to Bankruptcy Rule 4001).

26. Moreover, Bankruptcy Rule 6003 authorizes the Court to grant the relief requested herein to avoid harm to the Debtors' customers and other third parties. Unlike Bankruptcy Rule 4001, Bankruptcy Rule 6003 does not condition relief on imminent or threatened harm to the estate alone. Rather, Bankruptcy Rule 6003 speaks of "immediate and irreparable harm" generally. *Cf.* Fed. R. Bankr. P. 4001(b)(2), (c)(2) (referring to "irreparable harm to the *estate*") (emphasis added). Indeed, the "irreparable harm" standard is analogous to the traditional standards governing the issuance of preliminary injunctions. *See 9 Collier on*

Bankruptcy ¶ 4001.06[3] (16th ed. 2014) (discussing source of “irreparable harm” standard under Rule 4001(c)(2)). Courts will routinely consider third-party interests when granting such relief. *See, e.g., Capital Ventures Int’l v. Republic of Argentina*, 443 F.3d 214, 223 n.7 (2d Cir. 2006); *see also Linnemeir v. Bd. of Trs. of Purdue Univ.*, 260 F.3d 757, 761 (7th Cir. 2001).

27. There is no question that the Debtors’ failure to honor their Customer Programs would likely result in immediate and irreparable harm to the Debtors’ relationships with their customers. The Customer Programs are an integral part of the service and products provided by the Debtors to their customers. In addition, the Customer Programs are essential to the Debtors’ success in retaining customer satisfaction, sustaining goodwill, and ensuring that the Debtors remain competitive notwithstanding the commencement of these chapter 11 cases. Restricting or canceling the Customer Programs could jeopardize customer relationships and irreparably harm the Debtors’ reputation and ability to assure that customers continue to use the Debtors’ services.

Satisfaction of Bankruptcy Rule 6004(a) and 6004(h)

28. To implement the foregoing successfully, the Debtors request that the Court enter an order providing that notice of the relief requested herein satisfies Bankruptcy Rule 6004(a) and that the Debtors have established cause to exclude such relief from the fourteen-day stay period under Bankruptcy Rule 6004(h). Fed. R. Bankr. P. 6004(a),(h).

No Previous Request

29. No previous motion or application for the relief sought herein has been made to this or any other court.

Notice

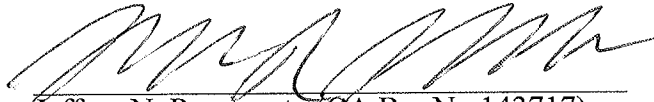
30. The Debtors will provide notice of this Motion to the following parties, or their counsel, if known: (a) the Office of the United States Trustee; (b) the Debtors' twenty (20) largest unsecured creditors on a non-consolidated basis; (c) the Debtors' prepetition and post-petition lenders; and (d) any party that has requested notice pursuant to Bankruptcy Rule 2002. As the Motion is seeking "first day" relief, within two business days of the hearing on the Motion, the Debtors will serve copies of the Motion and any order entered respecting the Motion as required by Local Rule 9013-1(m). The Debtors submit that, in light of the nature of the relief requested, no other or further notice need be given.

WHEREFORE, the Debtors respectfully request that this Court:

- (a) authorize the Debtors to maintain, renew, implement, and/or terminate their Customer Programs in the ordinary course of business, including the satisfaction of claims arising under the Customer Programs, without further order of the Court; and
- (b) grant the Debtors such other and further relief as is just and proper.

Dated: December 7, 2015

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