



being contemporaneously herewith. In further support of the Motion, the Debtor respectfully represents as follows:

### **JURISDICTION**

1. This Court has jurisdiction to consider this Motion under 28 U.S.C. §§ 157 and 1334. This is a core proceeding under 28 U.S.C. § 157(b). Venue of this case and this Motion in this district is proper under 28 U.S.C. §§ 1408 and 1409. The statutory predicates for the relief requested herein are sections 105(a) and 507(a) of the Bankruptcy Code.

### **BACKGROUND**

2. The Debtor is a diversified retailer operating fifty-nine (59) full-line department stores and three (3) specialty stores in six western states: California, Washington, Alaska, Oregon, Idaho and Nevada. It was founded in 1904 in Fresno, California, and expanded within California and the western states. The Debtor's stores operate under the "Gottschalks" and "Village East" names and are generally large, free-standing and mall-based outlets of between 30,000 and 200,000 square feet, primarily located in mid-sized cities that are otherwise underserved by the larger national chains. The Debtor carries a broad line of brand name and private label merchandise, including fashion clothing, shoes, cosmetics, jewelry, home furnishings and other products. Brands carried by the Debtor include Estee Lauder, Lancome, Clinique, Chanel, Dooney & Bourke, Nine West, Liz Claiborne, Calvin Klein, Nautica, Karen Kane, Ralph Lauren, Columbia, Fossil, Levi Strauss, Southpole, Izod, Quiksilver, Roxy, Woolrich and Carters.

3. The Debtor employs more than 5,282 full time and part time employees. Like other retailers, the Debtor's retail sales are subject to seasonal fluctuations – approximately 33% of the Debtor's annual sales occur in the fourth fiscal quarter (November 1 through

January 31).<sup>2</sup> Of its 62 retail locations, the Debtor owns 5 stores and leases the balance. The Debtor is publicly owned. One of its largest investors is The Harris Company (“Harris”), which sold certain stores to the Debtor in 1998 and is an affiliate of Spanish retailer El Corte Ingles.

4. The Debtor as borrower, the lenders party thereto and General Electric Capital Corporation, as administrative agent and collateral agent (“GECC”), are parties to that certain Second Amended and Restated Credit Agreement dated as of September 26, 2007 (as amended, the “GECC Facility”). The current amount outstanding under the GECC Facility is approximately \$73 million. The obligations under the GECC Facility are secured by a lien in most of the Debtor’s assets including inventory, accounts receivable, equipment, most (but not all) of its real property, and intellectual property (among other things). The Debtor’s principal unsecured obligations consist of, among others, a note in favor of Harris with an outstanding principal amount of approximately \$16 million and approximately \$29 million owed to its trade vendors.

5. In November 2008, the Debtor signed an agreement with Everbright Development Overseas Securities, Ltd., a British Virgin Islands corporation (“Everbright”). Everbright agreed to invest up to \$30 million in exchange for common stock of the Debtor. The Everbright transaction was subject to a diligence condition through December 15, 2008.

6. Shortly after the Everbright agreement was signed, the Debtor was advised that (a) new, lower appraisals conducted by independent appraisers of the value of the Debtor’s inventory and other assets that comprise the “borrowing base” and control the Debtor’s asset-based credit facility agented by General Electric Capital Corporation (“GECC”) and (b) reserves due to a decline in the Debtor’s same-store sales trends in the current retail environment would

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<sup>2</sup> The Debtor’s fiscal year ends on the Saturday nearest to January 31.

lead to a reduction in the Debtor's liquidity compared to budget under its credit line ranging from approximately \$18 million in December 2008 to a projected \$12 million in January, 2009. The Debtor had not anticipated the adjustments at the time it entered the proposed transactions with Everbright. GECC agreed to delay certain of the adjustments in availability under the credit facility for a period of time.

7. Everbright subsequently advised the Debtor that it was unable to go forward with its proposed investments, at least as it was previously structured. The Debtor attempted to modify the amount of the proposed investment from Everbright or raise additional capital from third parties (principally its existing investor, Harris). However, the Debtor's efforts to secure such infusion of funds outside of a chapter 11 proceeding were ultimately unsuccessful, and its sales (like those of virtually all retailers) continued to be impacted by the very weak retail and credit environment. The combination of these factors (and the resulting impact on its access to cash and its line of credit) resulted in the filing of this case.

8. The Debtor filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code on January 14, 2009 (the "Petition Date"). The Debtor intends to use this chapter 11 case to (i) gain access to liquidity, and (ii) execute on one or more options to create value for stakeholders (including a sale of assets or other transaction with a third party investor). The Debtor is considering all possible options for maximizing stakeholder value. Among other things, it will focus on the sale of certain portions or all of its business as well as other third party investments and asset disposition options.

9. GECC has agreed to provide postpetition financing to the Debtor and consented to the use of cash collateral. The proposed postpetition financing arrangement (the "DIP Loan Facility") will provide the Debtor with cash advances and other extensions of credit

in an aggregate principal amount not to exceed \$125 million. The proposed DIP Loan Facility contemplates a sale of the Debtor's business within approximately 60 days of the Petition Date.

10. The Debtor plans to seek approval for a sale process using the following timetable (which is incorporated into the DIP Loan Facility): the acceptance of a stalking horse bid on or about March 2, 2009 and an auction on or about March 17, 2009. The sale would close on an agreed schedule. To further its sale efforts, the Debtor has retained FTI Consulting, Inc. as its financial advisor and Financo, Inc. ("Financo") to act as its investment banker. Financo served as the Debtor's investment banker prior to the Petition Date and is very familiar with the Debtor. It is already working with interested investors and potential buyers. The Debtor believes that the DIP Loan Facility gives it the liquidity to execute on its sale effort.

**EMERGENCY RELIEF REQUESTED**

11. Contemporaneously with the filing of this Motion, the Debtor filed the *Motion of the Debtor and Debtor in Possession for an Order Authorizing the Debtor to Pay Prepetition Wages, Compensation and Employee Benefits Pursuant to Sections 105(a) and 363(b) of the Bankruptcy Code* (the "Employee Wage Motion"). Pursuant to the Employee Wage Motion, the Debtor is seeking entry of an order authorizing the Debtor to pay certain obligations owed to its employees as a result of services provided prior to the Petition Date, including employee payroll and employee benefit programs in the ordinary course, and directing all Banks to honor prepetition checks for payment of prepetition employee obligations. A detailed discussion of the Debtor's payroll and related employee benefits is set forth in the Employee Wage Motion.

12. Pursuant to Rule 9013-1(m) of the Local Rules of Bankruptcy Practice and Procedure for the United States Bankruptcy Court for the District of Delaware (the "Local Rules"), a day or more might pass before the Employee Motion can be heard by this Court. The

Debtor believes that without an order of this Court authorizing payment by the Banks, there is substantial risk that the Banks may not honor the employee payroll checks. Consequently, the Debtor requests entry of an order authorizing its Banks to honor any outstanding checks (the "Payroll Checks") (i) on account of accrued and unpaid salaries and wages of employees, (ii) for amounts that the Debtor is required by law to withhold from employee payroll checks in respect of federal, state and local income taxes, including unemployment contributions and taxes, and social security and Medicare taxes, and (iii) for amounts that the Debtor is required directly to pay in respect of state unemployment taxes and contributions on behalf of employees (collectively, the "Wage Payments").

13. The Debtor recognizes that this Motion seeks extraordinary relief, but submits that the circumstances before the Court merit such relief. In light of the potential delay in obtaining a hearing date, the Debtor is faced with the very real possibility that its Banks will not honor the payroll checks for its employees. If the Debtor's Banks do not honor the Debtor's payroll checks, the morale and confidence of the Debtor's employees will be severely impacted, possibly resulting in employees leaving their jobs and a corresponding significant decrease in the value of the Debtor's estate. Thus, the Debtor believes that the circumstances merit approval of the order submitted herewith.

14. Upon entry of such order, and pending the Court's determination of the first-day motions, including the Employee Wage Motion, the Debtor's Banks will be authorized to honor, upon presentation, any Payroll Checks for employee Wage Payments. The order also provides that Banks are authorized to rely on the representations of the Debtor as to which checks to honor and are prohibited from placing any holds on, or attempting to reverse, any automatic transfers to employee accounts for payment of prepetition payroll.

### **BASIS FOR EMERGENCY RELIEF**

15. On January 8, 2009, the Debtor issued checks and directed deposits to its salaried and hourly employees for the two week pay period from December 21, 2008 through January 3, 2009. The aggregate amount of the wages outstanding for this pay period is approximately \$290,000. Given the relatively brief period of time between the January 8, 2009 payment date and the Petition Date, the Debtor believes that a substantial number of these employee checks have not cleared as of the Petition Date. Approximately sixty percent (60%) of the Debtor's employees receive their pay through physical checks written on the Debtor's payroll account.

16. As noted above, the Debtor believes that there is substantial risk that, without an order of this Court authorizing payment by the Banks, the Banks may not honor the prepetition employee payroll checks. At this critical juncture in the Debtor's case, it is essential that the employee workforce remain in place and properly motivated. If the Debtor fails to meet its payroll, the employees will have little incentive to remain on the job. Even if the employees do not leave their jobs, the Debtor's failure to meet payroll obligations will have a significant detrimental effect on employee morale and thus reduce the employees' willingness to aid in the restructuring of the Debtor through a successful reorganization of the Debtor's business. Thus, if the Debtor does not obtain authority to meet its payroll, the Debtor's estate will be immediately and irreparably harmed.

17. Sections 507(a)(4) and (a)(5) of the Bankruptcy Code give priority up to \$10,950 per individual for prepetition claims for wages, salaries, vacation and claims for contributions to employee benefit plans. See 11 U.S.C. § 507(a)(4), (a)(5). The Debtor believes that all of the prepetition employee obligations, authorization for the payment of which is requested hereby, are entitled to priority under sections 507(a)(4) and (a)(5) of the Bankruptcy

Code. To the extent that any payroll obligations to an individual Employee exceed \$10,950, the Debtor is not requesting authority in this Motion to make such payment. Accordingly, granting the relief requested herein will not adversely affect the Debtor's other unsecured creditors.

18. Additionally, the Debtor submits that the relief requested herein should be authorized pursuant to section 105 of the Bankruptcy Code and under the "doctrine of necessity." Section 105 of the Bankruptcy Code authorizes this Court "to issue any order ... necessary or appropriate to carry out the provisions" of the Bankruptcy Code. 11 U.S.C. § 105. Moreover, under the "necessity of payment" rule, first enunciated by the Supreme Court in Miltenberger v. Logansport, C. & S.W.R. Co., 106 U.S. 286 (1882), a bankruptcy court may use its section 105 equitable powers to permit a debtor-in-possession to pay prepetition claims when payment is necessary to effectuate a successful reorganization. See In re Lehigh & New England Ry. Co., 657 F.2d 570, 581 (3d Cir. 1981) (necessity of payment doctrine "teaches no more than, if payment of a claim which arose prior to reorganization is essential to the continued operation of the [business] during the reorganization, payment may be authorized even if it is made out of corpus"). The Debtor submits that the interim relief requested herein is proper and in accordance with section 105 of the Bankruptcy Code and the doctrine of necessity.

19. Accordingly, the Debtor requests the entry of an interim order pending the Court's determination of the "first day" motions, including the Employee Wage Motion, authorizing and directing the Banks to honor the prepetition checks for the Wage Payments, and prohibiting the Banks from placing any holds on, or attempting to reverse, any automatic transfers to employee accounts for prepetition payroll amounts. Because the payment of such prepetition obligations is permitted by the Bankruptcy Code and applicable case law, the

Debtor's Banks should be permitted to honor checks in payment of such obligations pending the Court's consideration of the Employee Wage Motion at the First Day Hearing.

**REQUEST FOR A WAIVER OF STAY**

20. The Debtor further seeks a waiver of any stay of the effectiveness of the order approving this Motion. Pursuant to Rule 6004(h) of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"), "[a]n order authorizing the use, sale or lease of property other than cash collateral is stayed until the expiration of 10 days after entry of the order, unless the court orders otherwise." As set forth above, the immediate payment of the unpaid Payroll Checks is essential to prevent potentially irreparable damage to the Debtor's operations, value and ability to reorganize. Accordingly, the Debtor submits that ample cause exists to justify a waiver of the ten-day stay imposed by Rule 6004(h) of the Bankruptcy Rules, to the extent it applies.

CONCLUSION

WHEREFORE, the Debtor respectfully requests that the Court enter an order, substantially in the form attached hereto as Exhibit A, granting the relief requested in the Motion and such other and further relief as may be just and proper.

Dated: January 14, 2009  
Wilmington, Delaware

Respectfully submitted,



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Mark D. Collins (No. 2981)  
Michael J. Merchant (No. 3854)  
Lee E. Kaufman (No. 4877)  
RICHARDS, LAYTON & FINGER, P.A.  
One Rodney Square  
920 North King Street  
Wilmington, Delaware 19801  
Telephone: (302) 651-7700  
Facsimile: (302) 651-7701

-and-

Stephen H. Warren  
Karen Rinehart  
Alexandra B. Redwine  
Ana Acevedo  
O'MELVENY & MYERS LLP  
400 South Hope Street  
Los Angeles, California 90071  
Telephone: (213) 430-6000  
Facsimile: (213) 430-6407

*Proposed Attorneys for the Debtor and  
Debtor-in-Possession*

**EXHIBIT A**

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having determined that the legal and factual bases set forth in the Motion establish just cause for the relief granted herein; and the Court having determined that the relief sought in the Motion is in the best interests of the Debtor and its estate; and after due deliberation and sufficient cause appearing therefor; it is hereby

ORDERED, the Motion is GRANTED; and it is further

ORDERED, that the Banks upon which any Payroll Checks are drawn in payment of prepetition payroll obligations, are authorized and directed to honor, upon presentation, any such Payroll Checks; and it is further

ORDERED, that any Banks from which any automatic transfers are made to Employee accounts for payment of prepetition payroll obligations are prohibited from placing any holds on, or attempting to reverse, any automatic transfers to Employee accounts for payment of prepetition payroll obligations; and it is further

ORDERED, that, notwithstanding any other provision of this Order, the Debtor shall not make any payments to an individual Employee in excess of \$10,950 pursuant to the relief granted by this Order; and it is further

ORDERED, that, notwithstanding the other provisions in this Order, the Banks are only authorized to honor the prepetition Payroll Checks to the extent that sufficient funds exist in the applicable accounts to cover such Payroll Checks as they are presented; and it is further

ORDERED, that such Banks are authorized to rely on the representations of the Debtor as to which Payroll Checks and transfer amounts are in payment of prepetition payroll, and any party receiving payment from the Debtor is authorized and directed to rely upon the representations of the Debtor as to which payments are authorized by this Order; and it is further

ORDERED that Rule 6003(b) of the Federal Rules of Bankruptcy Procedure has been satisfied to the extent necessary because the relief requested in the Motion is necessary to avoid immediate and irreparable harm to the Debtor; and it is further

ORDERED, that the Debtor is authorized to take all actions necessary to effectuate the relief granted pursuant to this Order; and it is further

ORDERED, that, notwithstanding the possible applicability of Rules 6004(g), 7062, or 9014, or otherwise of the Bankruptcy Rules, the terms and conditions of this Order shall be immediately effective and enforceable upon its entry; and it is further

ORDERED, that this Court retains jurisdiction with respect to all matters arising from or related to implementing this Order.

Dated: January \_\_\_\_, 2009  
Wilmington, Delaware

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UNITED STATES BANKRUPTCY JUDGE