

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:)
)
CABLE & WIRELESS USA, INC., *et al.*,) Case No. 03-13711 (CGC)
)
Debtors.)
_____)

MEMORANDUM OPINION

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Dated: March 12, 2004

Case, J.

Before this Court is The Motion for Limited Reconsideration of Order (A) Approving the Asset Purchase Agreement With Proposed Purchase, (B) Authorizing the (I) Sale of Substantially all of the Debtors' Assets to Savvis Asset Holdings, Inc., Free and Clear of All Liens, Claims, Encumbrances and Interests and (II) Assumption and Assignment of Certain Executory Contracts, License Agreements and Unexpired Leases and Contracts, and (C) Granting Related Relief (Docket No.556). [Docket No. 665].

BACKGROUND

On December 8, 2003, Cable & Wireless USA, Inc., *et al.*, (the "Debtors" or "Cable & Wireless") filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. The Debtors continue to manage its business and affairs as debtor-in-possession pursuant to §§ 1107(a) and 1108 of the Bankruptcy Code.

The Debtors filed a Motion for an Order (A) Approving the Asset Purchase Agreement With Proposed Purchase, (B) Authorizing the (I) Sale of Substantially all of the Debtors' Assets to Savvis Asset Holdings, Inc., Free and Clear of All Liens, Claims, Encumbrances and Interests and (II) Assumption and Assignment of Certain Executory Contracts, License Agreements and Unexpired Leases and Contracts, and (C) Granting Related Relief on December 11, 2003 [Docket No. 64]. A Notice of Proposed Cure Amounts for Executory Contracts and Unexpired Lease that the Debtors May Assume and Assign in Connection with the Debtors' Motion to Sell Substantially All of Their Assets was filed on December 23, 2003. And the Court granted the Debtors' motion on January 23, 2004 [Docket No. 556].

By motion filed on February 2, 2004, American Airlines, Inc. ("American Airlines")

seeks limited reconsideration of the Court's order with respect to American Airlines' pre-petition contract with the Debtors.

JURISDICTION

This Court has jurisdiction over this matter, as a core proceeding, pursuant to 28 U.S.C. §§ 1334 and 157.

DISCUSSION

American Airlines had a pre-petition contract with the Debtors under which the Debtors provided broad band services.¹ Part of the arrangement provided for the Debtors to collect Texas state taxes imposed upon American Airlines and pay over the taxes to the state on American Airlines' behalf. American Airlines alleges that the Debtors overcharged it approximately \$1.3 million beyond the taxes that should have actually been due.² American Airlines states that it would normally correct this problem by asserting a right of recoupment against future payments due to the Debtors. However, the Debtors have sold substantially all of its assets, including this contract, to Savvis Asset Holdings, Inc. ("Savvis") so there will be no future payments. The Debtors did not sell its rights to seek and receive tax refunds.

American Airlines, therefore, asks for clarification that its right of recoupment continues against Savvis, citing *Folger Adam Security, Inc. v. Dematteis/MacGregor, JV*, 209 F.3d 252,

¹The "facts" stated in this Order are not findings pursuant to Federal Rules of Bankruptcy Procedure 7052. Rather, they are taken from the papers and representations of counsel and are stated to provide a background to American Airlines' objection and the procedural resolution set forth in this Order.

²Apparently, there is no dispute that some amount was overcharged. The reasons are murky: American Airlines has preliminarily put the onus on Debtor while Debtor asserts that the overcharges only arose after American Airlines realized that it was entitled to certain exemptions.

262 (3d Cir. 2000) for the general proposition that “a right of recoupment is a defense and not an interest and therefore is not extinguished by a § 363(f) sale.” *Folger Adam Security, Inc. v. Dematteis/MacGregor, JV*, 209 F.3d 252, 262 (3d Cir. 2000). Savvis counters that allowing American Airlines to enforce recoupment against it would be manifestly unfair because it would have no ability to mitigate its loss by applying for the tax refund since it is not the owner of the refund and did not participate in the transaction that gave rise to the refund. Debtors counter that this is really a fight between Savvis and American Airlines; Cable & Wireless is a liquidating estate with limited resources, has no interest in recovering the refund and should not be burdened with additional administrative costs.

First of all, while relevant and instructive, *Folger* does not provide the full answer to this case. Clearly, under *Folger*, any right to recoupment survived the sale and was not cut off under Section 363(f). However, the Third Circuit made clear that equity and fairness plays a role in cases like this one. The court expressed concern that allowing contracts to be sold “free of clear” of contract defenses would enhance the value of the assets at the expense of an innocent party. *Id.* at 264. The same would happen here if Savvis were required to honor the recoupment claim without a means of recovering the overcharges from Texas. In addition, the principals of the buyer in the *Folger* case were formally associated with the debtors, thereby being charged with knowledge of the potential defenses. That is also not the case here. Here, the appropriate result is to structure a procedure that protects American Airlines’ rights to recover the overcharges while at the same time minimizing additional litigation and unnecessary cost.

Several options present themselves, including: 1) preserving American Airlines’ right to pursue recoupment against Savvis, and Savvis’ right to contest that recoupment is appropriate,

together with assigning Debtors' and/or American Airlines' rights to seek the refund from Texas to the extent that Savvis' payments from American Airlines are actually reduced; 2) requiring the Debtors to seek the refund from Texas for the benefit of American Airlines (perhaps less costs and fees incurred), leaving Savvis out of the loop; 3) assigning the Debtors' rights to the refund to American Airlines, leaving both Debtors and Savvis out of the loop.

Number one has the disadvantage of inviting future litigation between Savvis and American Airlines with no corresponding benefit. Number two has the disadvantage of unnecessarily involving the Debtors in a proceeding in which it has no stake. Thus, of these choices, number three is the most appropriate. American Airlines is the party that asserts that the taxes were incorrectly calculated and the party with the knowledge of why that occurred. It is the party that, under any scenario, would have to bear the burden of proving the overcharges.³ Neither the Debtors nor Savvis "has a dog in this fight." Neither is claiming an interest in the overcharges and neither apparently has any particularly informed knowledge base that would be helpful in establishing them. The economic benefit of the dispute lies with American Airlines and it is there that the economic burden of recovering the money, and the control over how to do it, should rightfully lie.

CONCLUSION

Therefore, the Court will overrule American Airlines' objection on the explicit condition that the Debtors assign all of its right in and to any refund for these taxes to American Airlines

³Even if American Airlines was simply to withhold payment to Savvis in the amount of the alleged overcharges, a likely result would be a lawsuit from Savvis alleging breach of contract. Recoupment is an affirmative defense to such a claim and the burden would fall on American Airlines to prove it.

for American Airlines to pursue as it sees fit. To the extent the Debtors have any documents or files from its relationship with American Airlines that might be relevant to the refund proceeding, it will be required to make such available to American Airlines at a reasonable time and place.

So ordered.



Charles G. Case II
United States Bankruptcy Judge