

Daily Bankruptcy Review Small-Cap

From The First Sign of Distress To The Last Phase of Reorganization September 10, 2008

Lender Pushes For Liquidation Of Auto Parts Maker Intermet

By Jacqueline Palank

Lender CapitalSource Finance LLC, arguing that **Intermet Corp.**'s efforts to reorganize will fail because it's relying on a "temporary band-aid" to stop its "hemorrhaging" of cash, is calling for the auto-parts maker's Chapter 11 case to be converted to a Chapter 7 liquidation.

Monday, CapitalSource urged the U.S. Bankruptcy Court in Wilmington, Del., to convert Intermet's Chapter 11 reorganization case to a Chapter 7 liquidation, in which an independent official would divvy up the company's assets among its creditors.

CapitalSource such a move is necessary because Intermet isn't merely bleeding money, but is "hemorrhaging money" at a rate of more than \$250,000 per day. And it doesn't seem likely that Intermet will be able to line up new financing, according to the lender.

"Any legitimate prospect of debtors obtaining any debtor-in-possession financing or a sufficient equity infusion to facilitate debtors' dire working capital needs is merely pie in the sky at this time, which prospects will not improve as these Chapter 11 cases continue and debtors' financial picture further erodes," CapitalSource said in court papers.

Without prospects for new financing, CapitalSource said Intermet has "no realistic hope" of successfully reorganizing, especially amid an economic downturn, tight credit markets and the declining production rates of its customers, domestic auto manufacturers. Therefore, the "most prudent option" for Intermet, CapitalSource argued, is liquidation.

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Shoe Pavilion Picks Liquidator To Handle More Store Closings

By Rachel Feintzeig

Shoe Pavilion Inc. wants to hire Gordon Brother Retail Partners LLC to conduct a second round of store closing sales at 27 of its Western U.S. locations after the liquidator emerged as the winning bidder at an auction last week.

The going-out-of-business sales are part of a deal Shoe Pavilion reached with lender Wells Fargo Retail Finance Inc. last week that allows it to attempt to sell 63 of its stores as a going concern. The lender had initially been pushing for a total liquidation of the footwear chain.

Under Gordon Brothers' winning bid, subject to bankruptcy court approval, the liquidator will pay Shoe Pavilion 34% of the retail price of the merchandise at the stores plus a payment of \$200,000, for a total of over \$4.8 million. Shoe Pavilion also stands to gain 75% of the proceeds from the sale of equipment, furniture, and fixtures at the stores plus additional bonuses dependent on how much merchandise the stores sell.

Gordon Brothers' offer outbid the stalking horse or lead bidder, a joint venture comprised of Great American Group, DB Capital and Tiger Capital, at last Thursday's auction. The group had originally offered 30.25% of the retail price of the merchandise but reduced its offer to 29.75% after merchandise projections by Shoe Pavilion were found to be significantly lower than the joint venture's initial predictions.

Gordon Brothers outbid Great American group, DB Capital and Tiger Capital at auction, leaving Shoe Pavilion with a \$675,000 net increase from the original bid, despite the \$100,000 in break-up fees it now owes the joint venture.

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Lender Wants Receiver To Control Cupertino Shopping Center

By Jacqueline Palank

Cupertino Square LLC's secured lender is fighting to keep the shopping mall operator from taking back control of its property from a court-appointed receiver because of the company's "poor track record" in managing the mall.

Gramercy Warehouse Funding I LLC asked the U.S. Bankruptcy Court in San Jose, Calif., to allow a state court-appointed receiver to keep control of Cupertino Square Shopping Center - what Gramercy said was a poorly managed mall in California's Silicon Valley.

"The debtor's poor track record in operating the property was among the original bases for the appointment of the receiver, and there is no basis to believe that the risk of such mismanagement would not renew if the property is turned over to the debtor," Gramercy said in court papers Friday. "The potential for such mismanagement would clearly prejudice all creditors, not to mention Gramercy... and would similar jeopardize the reorganization prospects of the debtor - if any."

Cupertino Square and Gramercy have been battling in a California state court since April over a \$195 million construction loan Gramercy provided, litigation in which Gramercy won a court-appointed receiver to take over control of the mall's assets in June.

Cupertino Square said it filed for Chapter 11 protection last week to keep Gramercy from seeking a

foreclosure sale of its property. While a Chapter 11 bankruptcy filing halts all pending litigation and allows a company to control its assets as it works to reorganize or liquidate, Gramercy says it's in the best interests of all creditors for the receiver to continue his efforts to stabilize Cupertino Square's cash flow.

"The receiver has spent over 11 weeks working hard to stabilize the property, and tenants are making regular payments" on their leases, Gramercy said. "Disrupting the normalized flow of cash at the property would jeopardize value for all parties in interest."

A California state court handed control of the mall to receiver Douglas Wilson on June 17, authorizing him to spend funds as needed to preserve the property's value as well as operating costs, applying any proceeds or profits to the debt owed Gramercy and depositing mall tenants' rent payments into a "lockbox" account.

Gramercy said Wilson would "maintain the status quo" in terms of his duties, subject to the bankruptcy court's supervision, and wouldn't perform any additional duties without seeking the court's approval first.

Bankruptcy Judge Marilyn Morgan will consider Gramercy's request at a hearing set for Oct. 10. *DBR*

Small-Cap Bankruptcy Stock Table

52-Week Hi (\$)	52-Week Lo (\$)	Company	Ticker	Tuesday Close (\$)	\$ Change for Wk	% Change for Week	YTD % Change	5 Sessions Ago Close (\$)	12/30/07 Close (\$)	Shares Out 000s
8.99	0.06	Ampex Corp.	AMPXQ	0.060	-40.00	-50.00%	-98.01%	0.10	3.020	3.8970
0.05	0.001	Capco Energy Inc.	CGYNQ	0.007	0.00	6.06%	-72.00%	0.007	0.025	165.6590
0.06	0.0004	Fedders Corp.	FICC	0.000	-60.00	0.00%	-80.00%	0.001	0.002	29.5290
1.43	0.0551	Immunicon Corp.	IMMCQ	0.060	-7.69	8.33%	-92.77%	0.065	0.830	31.5000
0.49	0.001	Interep Natl Radio Sales Inc.	IREP	0.001	0.00	-50.00%	-99.44%	0.001	0.180	7.7240
1.01	0.17	Lexington Precision Corp.	LEXPQ	0.590	-20.27	0.00%	47.50%	0.740	0.400	5.0220
1.59	0.03	Manchester Inc.	MNCSQ	0.060	-7.69	-23.53%	-86.05%	0.065	0.430	34.2800
0.10	0.001	Medicor Ltd.	MDCRQ	0.004	0.00	0.00%	-20.00%	0.004	0.005	23.7460
7.15	0.4	Pacifinet Inc.	PACT	0.750	-10.71	-6.67%	-82.44%	0.840	4.270	14.0350
1.64	0.0001	PRB Energy Inc.	PPRBQ	0.010	0.00	0.00%	-96.43%	0.010	0.280	8.7220
0.73	0.051	SCO Group Inc.	SCOXQ	0.160	-15.79	-15.56%	68.42%	0.190	0.095	21.8860
4.92	0.016	Sharper Image Corp.	SHRPQ	0.016	-20.00	0.00%	-99.43%	0.020	2.800	15.1490
0.16	0.005	Thinkpath Inc.	THPHF	0.005	0.00	-28.57%	-95.00%	0.005	0.100	9.8400
0.09	0.001	Tweeter Home Entmt Group Inc.	TWTRQ	0.001	-75.00	166.67%	-94.74%	0.004	0.019	25.5640
3.75	0.04	Whitehall Jewelers Hldgs Inc.	WHJHQ	0.060	0.00	0.00%	-94.06%	0.060	1.010	39.9530
1.10	0.006	Congoleum Corp.	CGMC	0.008	-27.27	-8.33%	-98.43%	0.011	0.510	3.6630

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Despite U.S. Bankruptcies, U.K. Jeweler Signet To Enter Market

By Karen Talley

You might call Signet Group PLC a diamond in the rough.

The U.K. jeweler has chosen one of the toughest retail environments in memory to shift its strategy and focus exclusively on the U.S. for growth and greater investor recognition.

Some U.S. jewelers have faced losses, while others were forced to seek bankruptcy protection.

But while the stakes are high given current conditions, so are the rewards. U.S. consumers bought \$65.5 billion of jewelry in 2007, according to the Department of Commerce.

And Signet isn't coming in cold. The company owns the well-known Kay Jewelers chain, where, according to its catchy promotional jingle, "Every kiss begins with Kay."

To raise its profile on Wall Street, Signet is changing its primary listing to the New York Stock Exchange from the London Stock Exchange and conducting a reverse stock split to bring shares back toward the mid-\$20s, where they last peaked in March 2007. Signet's American depositary receipts recently traded at \$10.97, down 4 cents on the day. The ADRs trade at a price-earnings ratio of about 11, based on forward-year estimates, compared with about 9 for the specialty stores industry, according to FactSet Research.

Signet's shares begin trading on the NYSE on Thursday under the symbol SIG. The company did not choose the date; requirements related to the switch dictated the timing, the company said.

To further cement its U.S. commitment, Signet is shifting its physical headquarters from London to its Akron, Ohio, center. The two jewelry chains that Signet operates in England will see no further physical expansion.

But the procedural steps, and all of the road shows Signet is holding in the U.S. to attract investors, hardly guarantee that the company won't be tripped up by the extended economic slowdown.

Signet Group Chief Executive Terry Burman acknowledges that conditions are less than optimum, but also speaks confidently about the company's aspirations for one of the retail industry's most discretionary groups.

Signet plans "to expand in order to gain profitable market share," Burman said.

Right now, the strategy does not appear to be working very well. On Wednesday, Signet reported a sharp drop in second-quarter profit, battered by weak revenue from the U.S., where same-store-sales fell 5.8%.

Burman acknowledged that the consumer environment on both sides of the Atlantic remains "very challenging."

Just a few days before, Zale Corp., Kay Jewelers' chief rival, reported that it swung to a fiscal fourth-quarter net loss as margins shrank amid continuing inventory reductions. But sales did rise, and the company provided an earnings outlook above analysts' estimates.

Burman, a veteran jewelry merchant who has been with Signet for 15 years, is looking further down the line and positioning the company "for the time the economy recovers."

Kay Jewelers is the company's rock, operating around 900 stores and accounting for \$1.5 billion of Signet's overall \$2.7 billion U.S. sales last fiscal year. Industry data put Signet's sales just below the largest jewelry seller in the U.S., Wal-Mart Stores Inc., although the retailer declined to provide its own figures. On the high end of the spectrum, Tiffany Inc. had \$1.4 billion in U.S. jewelry sales last year.

Signet's blueprint for 2008 is to open 45 new Kays, in addition to changing over to the Kay name 11 regional jewelry stores that Signet operates. But 19 Kay stores are being closed, and the openings compare with last year's 58 Kay outlets through new stores and conversions.

All told, though, Burman is quite confident with a concept that places a trained "diamondologist" in each store to help customers, whose average annual household income is \$67,000, to make purchases that average \$327 each.

The company also operates a higher-end chain in the U.S., Jared The Galleria Of Jewelry, whose 154 stores are about four times the size of the average 1,500-square-foot Kay store. Seventeen Jareds are planned to open this year, compared with 26 in the last fiscal year.

On the upper rungs of the retail jewelry spectrum, Tiffany is doing quite well, but with a big push from demand in its European and Asian-Pacific regions.

Signet is confining its expansion to the U.S. because "we see a lot of opportunities here and feel better to have a narrow and deep focus," Burman said.

But the U.S. jewelry industry has already seen a raft of retail failures this year, including the high-profile bankruptcies of **Whitehall Jewelers Holdings Inc.**, **Friedman's Jewelers** and **Fred Leighton Holding Inc.**

Others are expected.

... continued on page 6

Valley Club Homes LLC Proposes Chapter 11 Reorganization Plan

By Rachel Feintzeig

Valley Club Homes LLC is asking a judge to consider its plan to exit bankruptcy and repay creditors with funds generated from the sale of homes in its Ketchum, Idaho luxury development and a possible \$15 million refinancing package.

The real estate developer filed its Chapter 11 plan and disclosure statement, or plain-language plan outline, with the U.S. Bankruptcy Court in Twin Falls, Idaho, on Friday. It must secure bankruptcy court permission to send the disclosure statement out to creditors for a vote.

Valley Club Homes' proposed plan includes "various options," among them a \$15 million bridge loan provided by Marcus & Millichap Special Assets Group that the company would use to repay senior lender California National Bank and unsecured creditors.

Alternatively, Marcus & Millichap could help Valley Club raise \$6.3 million in capital to pay down the California National Bank loan to \$12 million - eventually paying off the entire loan over the course of five years - and repay unsecured creditors in full.

Valley Club Homes is also looking to sell several of its lots in an effort to amass funds to repay creditors.

For example, Mountain West Bank, owed nearly \$2 million, will be repaid from the sale of the lot securing its claim. If Valley Club is unable to sell the property by Feb. 28, 2010, Mountain West Bank will be able to foreclose on the property. Valley Club Homes has already made a deal with lender D.L. Evans Bank allowing for the "automatic stay" rule, which protects companies under Chapter 11 from foreclosure attempts, to be lifted in February of 2009 if Valley Club can't sell the two properties securing D.L. Evans' \$4.2 million loans before then.

California National Bank has been trying to obtain relief from the automatic stay since Valley Club Homes first filed for bankruptcy. Just last week, the senior lender asked a judge for permission to seize

about \$12.4 million in real estate securing loans it made to the luxury developer in 2006.

Its requests remain "unresolved," according to Valley Club Homes. The bankrupt developer is strongly opposing the move, arguing that the bank has "substantial equity" in its collateral, which includes 2 developed lots and 30 vacant lots.

Moreover, Valley Club Homes believes that the property "is the only feasible source of repayment of unsecured creditors of the estate."

"If that asset is removed," it said, "reorganization efforts will be at a standstill."

Currently, Valley Club Homes aims to pay all unsecured creditors in full, according to the plan. After all unsecured creditors are paid, any remaining funds will be distributed to the company's equity holders.

Valley Club Homes, whose luxury development is located next door to the famed Sun Valley resort area in the Idaho Rockies, filed for bankruptcy in April. The development, known as Village Green at the Village Club, boasted \$3 million custom homes and a Tom Fazio-designed golf course. *DBR*

Shoe Pavilion (continued from page 1)

Shoe Pavilion hopes to kick off the sales Sept. 16 at 27 locations in California, Washington, Nevada, Arizona and Oregon.

The company had initially wanted to conduct store closing sales at 28 locations but since then has decided to keep two of the stores and swap in a third.

Shoe Pavilion filed for bankruptcy on July 15, after suffering from "significant" operating losses for the past year and a half due to the poor state of the retail economy, high rent for its retail locations and underperforming stores. The company sells designer label and name brand footwear at affordable prices. *DBR*

DAILY BANKRUPTCY REVIEW SMALL-CAP

Published by Dow Jones Newsletters

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SINGLE-USER PRICING

\$3,600/year

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Manhattan Art Gallery Balks At Bank Of America's Info Demands

By Kristina Doss

Salander-O'Reilly Galleries LLC says Bank of America has placed an "absurd burden" on the Manhattan art gallery by insisting that it explain the whereabouts of \$8 million in artwork that was used to secure a loan from the bank.

Bank of America's request is inappropriate, the art gallery said in court papers Thursday, because it has already provided some business records relating to the artwork on a voluntary basis to the bank.

The art gallery warned that any additional documents that the bank is seeking will impose an "undue financial and administrative burden on the estate." Salander-O'Reilly Galleries, along with owner Lawrence Salander, entered bankruptcy protection late last year in an effort to "prevent a race to the courthouse" amid allegations that they sold artwork they didn't own in order to pay off their debts. The gallery has called the allegations "hearsay."

Recounting its own experience with the gallery, Bank of America said in court papers last month that it had lent Salander and his wife, Julie, \$2 million in 2005. In exchange, artwork with an appraisal value of about \$8 million was used to secure the loan.

A couple of years later, the Salanders defaulted under the financing arrangement, prompting Bank of America to inquire about the status of the artwork.

The bank said it believes some of the artwork has been sold in violation of the Salanders' obligations under their financial arrangement with Bank of America.

The bank acknowledged that counsel for the art gallery agreed to hand over some information regarding the whereabouts of the artwork, but he wouldn't commit to producing any further documents on a voluntary basis.

As a result, Bank of America sought bankruptcy court approval last month to issue a subpoena that would force the art gallery to cooperate and hand over information regarding the artwork. The bank also wants the art gallery's chief restructuring officer, who has the most knowledge regarding the location and disposition of the pieces of art, to help the bank in its quest.

Salander-O'Reilly Galleries explained in court papers Thursday that its CRO handed over electronic records to Bank of America that were relevant to the bank's campaign. But he didn't hand over documents that were stored at a warehouse for good reason.

The CRO found that the records located at the warehouse consisted of thousands of pages of "primarily archival, non-financial documents that are un-indexed and completely unorganized," the art gallery said. As a result, the CRO determined that "a review of such documents would not be fruitful even if the debtor could afford the time and money necessary to undertake such a herculean task."

Salander-O'Reilly Galleries warned that if Bank of America's document requests are permitted, the art gallery would have to hunt for the "proverbial needle in the haystack and spend thousands of dollars to do so."

The art gallery also said that its efforts to resolve competing ownership claims over artwork and liquidate its assets for the benefit of creditors would be diverted if Bank of America gets its way.

The U.S. Bankruptcy Court in Poughkeepsie, N.Y., will consider the art gallery's objection to Bank of America's information requests at a hearing on October 2. *DBR*

From Dow Jones

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Moody's: Junk-Bond Default Rates To Climb 'Well Into 2009'

By Kathy Shwiff

Default rates on speculative-grade bonds rose in August, according to Moody's Investors Service, which expects the rates to continue increasing "well into 2009."

"How high default rates eventually climb will depend in large part on the extent and duration of the developing global economic slowdown," said Kenneth Emery, director of corporate default research.

Moody's global speculative-grade default rate rose to 2.7% in August, a four-year high, from 2.5% in July. A year ago, the rate was 1.4%. The U.S. figure rose to 3.3% from July's revised level of 3%. Last August, it was 1.4%.

Moody's predicted that global junk-bond default rates would reach 4.9% by year's end and 7.4% a year from now.

On a dollar-volume basis, the global speculative-grade bond default rate almost doubled to 2.7% in August from 1.4% in July because of Residential Capital LLC, the mortgage-lending arm of GMAC. Last week, ResCap announced that it will shed 5,000 jobs - or 60% of its work force - by the end of the year and stop making home loans through third-party brokers. The company, which has bled red ink for the past seven quarters, lost \$4.3 billion in 2007.

In the U.S., the dollar-weighted bond default rate doubled last month to 3% because of ResCap. The year-earlier figure was 1%.

The five rated defaults in August were all based in the U.S. So far this year, 53 Moody's-rated corporate issuers have defaulted, compared with 13 defaults in the same period of 2007. Of the 53 defaulters, 46 are in the U.S., five in Canada, and one each in Bulgaria and France. The largest defaulter was Florida condo developer **WCI Communities Inc.**, which filed for bankruptcy last month.

Moody's speculative-grade corporate distress index - which measures the percentage of rated issuers that have debt trading at distressed levels - rose to 22.4% in August from 21.1% in July. A year ago, the index was at 4.3%. Distress refers to bonds that trade at yields more than 10 percentage points above comparable Treasury securities and is usually reserved for the most troubled high-yield companies.

In the leveraged loan market, **Portola Packaging Inc.** was the only Moody's-rated loan defaulter in August. The company filed for Chapter 11 bankruptcy on August 27.

The trailing 12-month U.S. leveraged-loan default rate edged higher to 2.9% in August from 2.8% in July. A year ago, the rate was 0.3%. Leveraged loans are senior to bonds and therefore less susceptible to default. *DBR*

Signet (continued from page 3)

"It doesn't appear avoidable," said Russell Shor, senior industry analyst at the Gemological Institute of America, which assesses the quality of diamonds before they are sold through retailers. "There is a very big squeeze going on as some of these retailers carry high debt at a time they are looking at lower sales trends that have not showed signs of abating."

As for Signet's forward step, "It's a bold move," Shor said.

The main pitfalls would be an economy that stubbornly remains soft and the Internet, where jewelry is a big seller, especially through online outfit Blue Nile Inc., Shor said.

Signet's strategy is to keep the existing Kay base mainly in malls, where the shops have traditionally operated. But new Kay stores, as well as Jareds, will be placed "off-mall," which means they will operate as stand-alone stores on mall grounds, at outlet centers or as part of large strip centers. The off-mall approach is meant to capture an increasing amount of consumers that prefer to shop that way, Burman said.

In terms of trying to keep material costs down, Signet engages in hedging in regard to gold and says the kind of diamonds it sells has been seeing little price inflation. The company is also in the midst of a trial program to buy unpolished diamonds, which it feels may provide better margins and consistency of supply.

And while the diamond industry is expected to see fewer players, which could be seen as a plus for Signet, consolidation also could make for large combinations that would raise competition.

Still, Signet comes with attributes that include a "strong and well-established" management team and above average store productivity, said Goldman Sachs analyst Lucy Chamberlain.

But even with that stability, the company remains dogged by a weak economy that isn't offering much in terms of improvement.

"I wish we knew when conditions will change," Burman said. "It would make running the business so much easier." *DBR*

NEW CHAPTER 7 BANKRUPTCY FILINGS

The following is a list of some new small-capitalization Chapter 7 bankruptcy filings made during the week ended September 5.

<u>Company</u>	<u>Court</u>	<u>Location</u>	<u>Contact</u>	
A & A Finishing Products Inc.	Ft. Lauderdale, FL	Sunrise, FL	Harry J. Ross	561-482-2400
A Stitchin Good Time Inc.	Chicago	Oswego, IL	Lincoln M. King	630-820-0333
Arian Consulting Inc.	California, Central	Los Angeles, CA	Charles Shamash	323-852-1600
Askjac LLC	New Jersey, Trenton	Bridgewater, NJ	Mr. McLaughlin	973-467-2700
BCS Construction & Development Inc.	California, Central	Westlake Village, CA	Judith A. Brecka	310-452-1210
Blesteoc Inc.	Jacksonville, FL	Jacksonville, FL	Nancy Draughon	904-391-0030
Campbell Home Builders LLC	New Jersey, Trenton	Chesterfield, NJ	Mr. Niedermayer	609-261-8400
Citizens Trust Financial Group Inc.	Baltimore, MD	Sparks, MD	Constance Hare	410-547-0300
Common Ground Electrical Services	Orlando, FL	Clermont, FL	Joel L. Gross	352-536-6288
Country Garden Flowers Inc.	Tampa, FL	Land O Lakes, FL	Linda Lee Wynn	813-274-4994
D&D Auto Transport Inc.	Jacksonville, FL	Port Orange, FL	Robert Zipperer	386-226-1151
International Computer Supplies Inc.	Miami, FL	Miami, FL	Jose M de la O	305-442-6009
International Pastry and Coffee Inc.	California, Central	Bellflower, CA	Theresa Hana	562-633-7369
Jack Rabbit Energy Systems LLC	Bridgeport, CT	Stamford, CT	Ellery Plotkin	203-325-4457
Mantiff Dayton Hospitality LLC	New Jersey, Newark	Wayne, NJ	Mr. Sodono	973-243-8600
Mora Group Inc.	Miami, FL	Doral, FL	Cesar Dominguez	305-764-6489
One Source Mortgage	New Jersey, Newark	Hackensack, NJ	Gary S. Jacobson	908-647-1022
S&E Xpress Inc.	Texas Southern	El Paso, TX	E.P. Bud Kirk	915-584-3773
Security National Warranty LLC	Chicago	Northbrook, IL	Mr. Benjamin	312-853-3100
Statewide Family Insurance Services Co.	Tampa, FL	Osprey, FL	R. John Cole, II	941-365-4055
Tayeeb Foods Inc.	Cedar Rapids, IA	Cedar Rapids, IA	R. L. Sole	319-366-4313

Intermet *(continued from page 1)*

“These cases must be converted now,” CapitalSource said, “so that an orderly liquidation of debtors’ estates can occur to preserve the remaining value of debtors’ assets.” The leader of a group of lenders that owed about \$20 million, CapitalSource has been fighting Intermet’s efforts to use the cash collateral securing the loan from CapitalSource as well as other loans Intermet received before its bankruptcy filing.

Despite Intermet receiving the court’s interim approval to use this cash over CapitalSource’s objections, the lender says it still won’t be enough. Intermet’s budgets show that the company will run out of cash by the first week of November, according to CapitalSource.

CapitalSource also argued that all Intermet’s secured debt, including what CapitalSource is owed, may exceed the value of the company’s assets, indicating that secured creditors may not be paid in full. It also indicates that Intermet may not be able to pay the costs it racks up while under Chapter 11 protection, the lender argued, such as the fees of its attorneys and advisers.

Intermet, along with 19 of its affiliates, filed for Chapter 11 protection on Aug. 12, its second filing in about four years. The manufacturer produces cast metal components for such U.S. car makers as Chrysler LLC and Ford Motor Co. *DBR*

VIEWPOINT

Caveat Emptor: Is That Sale Really 'Free And Clear'?

By Shai Y. Waisman and Rachel Ehrlich Albanese



Shai Y. Waisman



Rachel Ehrlich
Albanese

One of a series of opinion columns by bankruptcy professionals.

Potential purchasers take note - a consummated sale may not actually be "free and clear" even if the purchaser received the protection of a good faith purchaser under section 363(m) of the Bankruptcy Code.

In a case drawing a great deal of attention, the bankruptcy appellate panel of the 9th U.S. Circuit Court of Appeals recently held that outside a plan of reorganization, section 363(f) of the Bankruptcy Code does not permit a secured creditor to credit-bid its secured claim and purchase estate property free and clear of valid, non-consenting junior liens. The case, *Clear Channel Outdoor, Inc. v. Knupfer*, represents a significant contrast to the common practice of approving sales where the highest bid for the debtor's assets is approved "free and clear of all interests," including non-consenting, valid liens that are stripped and attach to the proceeds of the sale, even if the collateral is worth less than the claims it secures.

The debtor (PW), owned 14 parcels of prime real estate in Burbank, Calif. DB Burbank, LLC (DB) held a first- priority lien on substantially all of PW's assets. After PW filed for Chapter 11 to avoid foreclosure, DB worked with the trustee to consolidate and sell all of the debtor's property and development rights. A binding term sheet provided that DB would be the stalking horse bidder for all of PW's assets for a purchase price of \$41,434,465, the full amount of its secured claim. At the sale, DB was the highest bidder.

The bankruptcy court approved the sale to DB, free and clear of all liens and encumbrances, including a consensual lien securing a \$2.5 million claim held by a junior creditor, Clear Channel Outdoor, Inc. and found that DB was a purchaser in good faith. Clear Channel appealed, and the bankruptcy court and the bankruptcy appellate panel denied a stay of the sale pending appeal. The sale closed while the appeal was pending.

The court held that although the transfer of title to DB was equitably moot in light of the complex events that had occurred with respect to the sale, the "lien-stripping" aspect of the sale was not moot. Because reinstating Clear Channel's lien would not raise the same issues as invalidating the sale, the court held that the issue of Clear Channel's lien was discrete and separable from the title transfer and, accordingly, is not equitably moot.

The fact that DB received 363(m) protection did not alter the court's conclusion. The court noted that, by its terms, section 363(m) applies only to a sale or lease of property under section 363(b) or (c), not to lien-stripping under section 363(f). Further, because section 363(m) omits the "use" prong of section 363(b) and (c), it does not protect an "out-of-the-ordinary-course use" approved by the bankruptcy court. Thus, the court concluded that Congress intended section 363(m) only to address "changes of title or other essential attributes" in a sale or changes in possession of a lease; the terms of that sale, including the "free and clear" term, are not protected.

In another departure from common practice, the court held that the junior lienholder's lien should not have been eliminated, notwithstanding that the value of the purchased assets was less than the amount of the first lienholder's claim.

The court analyzed the bankruptcy court's ability to authorize a sale free and clear under sections 363(f)(3) and (5) of the Bankruptcy Code, after determining

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sections 363(f)(1), (2) and (4) were inapplicable. (Query whether state foreclosure law may be applicable, however, thus permitting lien-stripping under section 363(f)(1) - an issue not addressed by the PW court).

The court attempted to reconcile section 363(f)(3)'s use of the term "the aggregate value of all liens," which appears to refer to the economic value of such liens, with the other provisions of the Bankruptcy Code that refer not to the economic value of the property secured by the liens but to the face value of claims secured by those liens. Numerous bankruptcy courts, including in the 2nd and 3rd Circuits, have found that a debtor may use section 363(f)(3) to sell assets free and clear of liens held by junior lienholders, where such liens are not supported by the collateral's value.

The PW court disagreed with these courts and rejected the contention that the "aggregate value of all liens" means the aggregate value of all allowed secured claims. In its view, if the value of the property being sold is less than the total amount of secured claims, the total of all allowed secured claims will equal, not exceed, the sale price, which contravenes the statutory requirement that the price be "greater than" the value of all liens. The court ultimately held that section 363(f)(3) does not authorize the sale free and clear of a lienholder's interest if the purchase price is equal to or less than the aggregate amount of all claims held by creditors who hold a lien in the property being sold.

The court also had an unconventional take on section 363(f)(5) and rejected the bankruptcy court's conclusion that the plain meaning of section 363(f)(5) permits a sale free and clear of a junior lien whenever the interest can be paid with money. Instead, the court "assume[d] that paragraph (5) refers to a legal and equitable proceeding in which the non-debtor could be compelled to take less than the value of the claim secured by the interest." If full payment were required, section 365(f)(5) would mirror section 363(f)(3) - a provision directed specifically at liens - and render 363(f)(3) superfluous, which is an unacceptable result. The court noted it was not the amount of the payment at issue, but whether a mechanism exists to extinguish the interest without paying it in full. The court also noted that the bankruptcy court failed to make a finding as to the availability of a proceeding in which Clear Channel could be compelled to release its lien for payment of an amount less than the full value of its claim, and rejected the contention that cramdown is such a proceeding.

This case has important implications for purchasers in section 363 sales. If PW is followed by other courts, purchasers that are not paying consideration sufficient to retire all secured debt may have to buy subject to unsatisfied secured debts. Likewise, junior lienholders may now have greater leverage in blocking sales where the value of the collateral does not support the claims it secures, which could have significant import for debtors with second lien debt. It remains to be seen whether other courts will adopt the PW court's analysis of section 363.

(Opinions expressed are those of the authors, not of Dow Jones Newsletters.)

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From The Tape

Real Estate Company May Seek Bankruptcy In Coming Months

Presenting a bleak outlook for its future, financially troubled Feldman Mall Properties Inc. of Great Neck, N.Y., said in a federal filing it may be forced to close its doors by the end of this year, *Newsday* reported. The real estate investment trust, hammered by the downturn in the housing market, weak retail sales at malls, and the credit crunch, said in a filing with the Securities and Exchange Commission Friday that prospects for remaining in business are dim. As of June 30, it had only \$7,500 in cash on hand “and no availability under our in-place financing arrangements” to obtain more cash. Additionally, Feldman said, it doesn’t believe it will be able to be profitable this year or even next year. To remain a going business, Feldman said, it will have to sell properties, enter into joint ventures with other REITS, and modify its debt agreements. “If the company is unable to raise sufficient additional capital or negotiate appropriate modifications” to its debt arrangements, “the company will be unable to fund its ongoing operations beginning as early as the fourth quarter of 2008 and will be required to pursue other alternatives, which may include bankruptcy filings.”

Soaring Costs Of Oil Force Companies To Get Leaner

Conventional wisdom had long held that some industries would collapse if oil topped \$100 a barrel, the *South Florida Sun-Sentinel* reported. As oil neared \$150, sending costs higher for everything from jet fuel to plastic jars, the question was how many companies would succumb. The surprising answer: Not many. Some have even thrived. Of course, the adjustment hasn’t been smooth. Business bankruptcies are higher than they were a year ago, soaring in industries like trucking, which have excess capacity and are unable to pass on higher costs. But many businesses have proved resilient. A surge in exports thanks to the weak dollar helped, but so have price increases and cost-cutting. Companies have culled unprofitable products, cut production costs and passed along price increases. Airlines have laid off thousands of employees, dropped routes, sold planes and raised fares 20% in the last year - the fastest rate of increase in 15 years. Consumer product makers have shrunk everything from tubs of butter to jugs of laundry detergent. Retailers from The Yankee Candle Co. Inc. to Target Corp. have passed on higher prices to consumers. “We are squeezing every dollar out of our working capital,” said James Craigie, chairman and chief executive of Church & Dwight Co.

Sales Slump, High Food Costs Spell Hard Times For Eateries

The culinary fare at the Florida Restaurant & Lodging Show in Orlando was impressive, with sizzling steak, gourmet gelato and endless cups of finely brewed coffee among the many items on the menu, the *Orlando Sentinel* reported. But not even the handcrafted microbrews being served in the “liquid lounge” could wash away convention-goers’ worries about the tanking economy. “It’s tough for all these restaurant guys,” said Bob Ekstrom, vice president of sales for BelGioioso Cheese Inc., an exhibitor at the show. Ekstrom said he has noticed restaurant owners and chains have been less willing to splurge on his company’s high-end products. “We see it,” he said, referring to the industry-wide slump. “We don’t ship as much cheese.” A combination of slipping sales and rising food costs have been giving heartburn to restaurateurs and the vendors that cater to them. It has also thrust several mid-tier restaurants into bankruptcy – including Don Pablo’s Mexican Restaurants and Hop’s Grillhouse and Brewery restaurants, both owned by **Avado Brands Inc.** “We are certainly dealing with issues that we have not had to deal with before,” said John Moon, owner of Coach-N-Four, a casual-dining steakhouse in Fort Walton Beach, Fla.

Group Of Writers Try To Save Twain House From Bankruptcy

Life has come full circle for Mark Twain’s storied house in Hartford, Conn., the *Pittsburgh Post-Gazette* reported. Dogged by a slumping economy, rising prices and a sizable mortgage, the place is again threatened by bankruptcy. In response, a group of writers have planned a benefit reading. Stewart O’Nan, who lives in nearby Avon, Conn., and Philip Beard of Aspinwall, Pa., are among the dozen on the reading list. “This is THE Twain house, and it deserves to be saved,” O’Nan said last week. “They got themselves into a financial bind, so the writers are happy to pitch in.” Twain’s own financial setbacks forced him to abandon his dream house in 1891 and begin a long lecture tour to pay his creditors. He sold the house in 1901. He built it in 1874, an eclectic three-story mix of gables, turrets, Tiffany glass and up-to-date conveniences, a place for his wife and three lively daughters to live in comfort and style. After several owners, the house was acquired by a nonprofit organization that started renovating the structure in 1974. By 2003, a \$19.5 million museum was opened adjacent to the home, a financial burden that has yet to be lifted.