Peter A. Franklin III
Texas Bar No. 07378000
Doug Skierski
Texas Bar No. 24008046
LOCKE LIDDELL & SAPP LLP
2200 Ross Avenue, Suite 2200
Dallas, Texas 75201
(214) 740-8000 (Telephone)
(214) 740-8800 (Telecopier)

ATTORNEYS FOR SHAWN K. BROWN,
CHAPTER 11 TRUSTEE

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION

In re:	§	
	§	
LORAX CORPORATION	§	**Case No. 02-48396-DML-11**
	§	**(Chapter 11)**
Debtor.	§	

TRUSTEE'S SUPPLEMENTAL BRIEF IN SUPPORT OF JOINT MOTION FOR ORDER APPROVING SETTLEMENT AGREEMENT PURSUANT TO FEDERAL RULE OF BANKRUPTCY PROCEDURE 9019

TO THE HONORABLE D. MICHAEL LYNN,
UNITED STATES BANKRUPTCY JUDGE:

Shawn K. Brown, Chapter 11 Trustee (the "Trustee") for the Lorax Corporation (the "Debtor"), among others, filed a Joint Motion for Order Approving Settlement Agreement Pursuant to Federal Rule of Bankruptcy Procedure 9019 (the "Joint Motion"). In support of the Joint Motion, the Trustee would show the Court as follows:

I.

INTRODUCTION

The Movants[1] are involved in contentious litigation regarding the ownership of the

[1] Capitalized terms used in this Brief have the same meanings attributed to them in the Joint Motion unless otherwise defined herein. This Brief addresses only limited issues raised by the Court. The Trustee does not abandon any of the arguments contained in the Joint Motion, which is incorporated fully herein by reference.

Property. The Movants have reached an agreement to settle the disputes among them (the "Agreement").

Among other things, the Agreement removes the impediment to the title to the Property created by the dispute among the Movants and provides for the Trustee to sell the Property at an Auction. The Agreement further provides for a Marketing Period before the Auction. The Agreement requires the Brinkmann Parties to make a minimum bid at the auction. The Movants believe the minimum bid would be sufficient to pay all of the Debtor's known secured and administrative priority claims as well as provide a distribution to the Debtor's unsecured creditors. The distribution to creditors could grow if additional bidders are attracted to participate in the Auction.

The Estate does not have sufficient funds to purchase insurance on the Property. The Brinkmann Entities have purchased insurance covering their interest in the Property. The roof on the Improvements is in need of repairs that will cost, very conservatively, more than $1,000,000.00. The Estate does not have the funds to pay for such repairs. The Debtor has no business that the Trustee can operate on a long-term basis. The Property must be liquidated. The condition of the Property will, because the Estate has insufficient funds to pay for repairs or maintenance, deteriorate and its value will decline. The Property is a wasting asset that should be sold for the best price obtainable as soon as practicable.

The Official Committee of Unsecured Creditors (the "Committee") filed an objection to the Agreement. In its Objection, the Committee does not attack the general structure of the Agreement or protest the sale of the Property, but asserts that the consideration paid to the Estate is insufficient. At the first hearing on the Joint Motion, the Court suggested that the terms of the settlement might violate the standards set forth by the Fifth Circuit in <u>Pension Benefit Guaranty</u>

Corp. v. Braniff Airways, Inc. (In re Braniff Airways, Inc.), 700 F.2d 935 (5th Cir. 1983).[2] The Trustee believes that the terms of the Agreement do not violate the Braniff standards and that the Agreement is not a *sub rosa* plan. Moreover, even if the Agreement could not be approved under the Braniff standards (which the Trustee denies), because the Property is a wasting asset, the Agreement should be approved despite Braniff.

II.

ARGUMENTS AND AUTHORITIES

A. The Agreement can be confirmed after considering the Braniff standards.

1. The Braniff standards

In Braniff, the Fifth Circuit reversed the bankruptcy court's approval of a sale transaction/settlement agreement. It did so based upon a general concern that the transaction dictated the terms of the plan in that case and was therefore a *sub rosa* plan. Braniff, 700 F.2d at 940. The Fifth Circuit enumerated three specific concerns illustrating why the transaction at issue was impermissible. Id. at 939-40. The court concluded that the transaction at issue exceeded the authority provided by Section 363(b) of the Bankruptcy Code because it provided for far more than the "use, sale or lease" of the debtor's property. Id. at 939.[3]

---

[2] The Fifth Circuit has held that when a party objects to a settlement as a *sub rosa* plan, the objector must "specify exactly what protection is being denied." Institutional Creditors of Continental Airlines, Inc. v. Continental Airlines, Inc. (In re Continental Airlines, Inc.), 780 F.2d 1223, 1228 (5th Cir. 1986). Because the Committee has not challenged the Agreement on these grounds, no such objection should be considered. In addition, because there has been no allegation that any particular protection has been denied, it is difficult for the Trustee to counter any such argument.

[3] The Trustee intends to seek approval of the sale contemplated by the Agreement in a separate motion and does not, in the Joint Motion, seek approval of a sale pursuant to Section 363. Accordingly, Braniff is arguably inapplicable. See Drexel Burnham Lambert, Inc. v. Flight Transportation Corp. (In re Flight Transportation Corp.), 730 F.2d 1128, 1135 (8th Cir 1984) (holding that Braniff was inapposite because the agreement at issue was not a Section 363 sale).

The court found that the transaction was a *sub rosa* plan because it required a significant restructuring of the rights of certain of the debtor's creditors. Id. Specifically, the transaction (i) changed the composition of the debtor's assets and had the effect of dictating certain terms of the debtor's plan; (ii) required certain creditors to vote for a plan to be proposed later; and (iii) provided for a release of all claims by all parties against the debtor, its secured creditors and its officers and directors. Id. at 939-940. Based upon these factors, the court determined that the transaction proposed was, in fact, a reorganization that had to be pursued through the plan process laid out in the Bankruptcy Code. Id.

2. The Agreement survives application of the Braniff standards.

In Braniff, the composition of the debtor's assets was changed in that the debtor paid $250,000,000 for "scrip" worth $750,000,000 of travel aboard the airline owned by a settling party. The scrip was limited in use to the debtor's reorganization and there were restrictions regarding the persons to whom such scrip could be issued by the debtor. Id. at 939-940.

The Agreement, in contract to the Braniff transaction, provides for payment to the Estate in cash only. The composition of the Debtor's assets is being changed from an illiquid asset to cash (if this were the only test, no sale of assets could be approved pre-plan). Unlike in Braniff, the Debtor will have more, rather than less, cash at the end of the transaction. Also unlike Braniff, there is no restriction on the use of the cash, other than that it must be administered in compliance with the Bankruptcy Code. None of the terms of a plan are dictated by the Agreement. The Agreement therefore does not have the first characteristic of a *sub rosa* plan set forth in Braniff. Similarly, the second characteristic described in the Braniff decision is not implicated because the Agreement does not require any party to vote for a plan.

In the Agreement, the Trustee Parties and the Brinkmann Parties exchange mutual releases.[4] The Agreement does not release any claims belonging to third parties that any such parties may have against the Trustee Parties or the Brinkmann Parties. Unlike the transaction at issue in Braniff, the Agreement does not release all claims against the Debtor or the other settling parties, nor does it release all of the Debtor's claims. The Agreement only releases claims related to the Litigation among the Parties.[5] The Fifth Circuit's holding in Braniff does not, on these specific points, bar approval of the Agreement.

3. The Agreement is not a *sub rosa* plan.

The broader concern addressed in the Braniff decision is that courts not approve settlement agreements that are *sub rosa* plans without giving the parties in interest the protections afforded by the Bankruptcy Code. The Property must be sold. The Trustee anticipates filing a liquidating plan. The liquidating nature of this case is dictated by the Debtor's financial and other circumstances, not by the Agreement. The Agreement clears the way to allow a sale, but does not dictate that term of the Debtor's eventual plan.

In addition, it is important to recognize that the Property cannot be sold unless and until the title to the Property is determined. The Agreement clears the title to the Property and is therefore a necessary stepping-stone to a plan, but is not itself a plan. The Agreement simply does not establish any plan terms and is not a *sub rosa* plan. It should therefore not be denied approval on that basis.

---

[4] The Releases includes certain entities which are not named parties to the Litigation, but which provide valuable consideration for such releases.

4. The liquidating nature of this case mitigates in favor of approval.

The fact that the Debtor's case will end in liquidation (the Trustee anticipates filing a liquidating plan shortly after approval of the Agreement if the Agreement is approved) mitigates in favor of approving the Agreement. See Drexel Burnham Lambert, Inc. v. Flight Transportation Corp. (In re Flight Transportation Corp.), 730 F.2d 1128 (8th Cir 1984).[6] In Flight Transportation ("FTC"), the Eighth Circuit considered a settlement of complex securities litigation initiated against a bankrupt issuer of certain securities. FTC, 730 F.2d at 1130-1133. The settlement at issue in FTC determined that certain funds were property of the FTC bankruptcy estate. Id. at 1134. The agreement at issue in FTC further allocated certain litigation proceeds to different funds based upon certain distinctions among FTC's creditors. Id. The Eighth Circuit confirmed the settlement despite such provisions. In doing so, it held that the fact that FTC would ultimately be liquidated, rather than reorganized, was relevant. The court held that the primary concern was not "the future profitable conduct of the business, but…the size of the bankrupt's estate and how it is to be divided." Id. at 1135. The Eighth Circuit found that Braniff was inapposite because the agreement at issue was not a Section 363 sale. Id. The court further held that the agreement in FTC did not dictate the terms of a plan, did not require anyone to vote for a plan and released only the claims of the plaintiffs against the FTC estate and would therefore be approved even if Braniff applied.

---

[5] A more complete description of the releases is contained in the Agreement at 3-4, ¶¶ 3-4.

[6] See also In re Naron & Wagner, Chtrd., 88 B.R. 85 (Bankr. D. Md. 1985). In Naron, the court allowed the sale of the last of the debtor's major assets (a computer distribution subsidiary) because the debtor could not afford to continue to operate the subsidiary and a quick sale would preserve the subsidiary's going-concern value, thus achieving a higher return for the debtor's creditors. Naron, 88 B.R. at 90. The court found that when a chapter 11 debtor proposes to sell substantially all of its assets, parties in interest should be given notice that the debtor intends to sell its assets and that the only outcome to be had is the distribution of funds post-liquidation. Id. The Joint Motion, which was served upon all parties in interest, clearly states that the Property is the Debtor's major asset and that it will be sold. No objection has been filed asserting that the Property should not be sold or that the Debtor

The Agreement would determine that the Property is property of the Estate, allowing the Trustee to move towards a sale of the Property. The Agreement gives the Estate the best chance of generating the largest possible return to the Debtor's creditors at the earliest date. This fact, in a liquidation context, mitigates in favor of approving the Agreement.

B. The Agreement should be approved despite the Braniff standards.

Even if the Agreement were a *sub rosa* plan (which the Trustee denies), the Agreement should be approved because the Property is a wasting asset and should be sold as quickly as practicable. This concept survives from the Bankruptcy Act. Under the Bankruptcy Act, which had more restrictive standards for pre-plan asset sales, the Agreement would be approved under the present circumstances, as set forth below. Because the Property is a deteriorating asset, under the more liberal standards of the Bankruptcy Code, the Agreement should clearly be approved even if it were a *sub rosa* plan.

In Committee of Equity Security Holders v. Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063 (2d Cir. 1983), the debtor sought to sell its major asset (its ownership of 82% of the common stock of another corporation) for $43,000,000. Evidence showed that the price paid was "fair" but that the asset was not "wasting away." Lionel, 722 F.2d at 1065. The debtor stated that the asset could have been sold through a plan, but that it had applied for the pre-plan sale at the insistence of the creditors' committee. The bankruptcy court found that cause to sell was sufficiently shown by the committee's insistence upon the sale. Id. The Second Circuit discussed the history of sales outside the ordinary course of business under both the Act and the Code. Id. at 1066-1068. The court rejected the concept that only an emergency justifies a sale pursuant to Section 363. Id. at 1069. The court found that in order to justify a sale pursuant to

---

should not be liquidated.

Section 363, there must be an articulated business justification, other than appeasement of major creditors, for using, selling, or leasing property out of the ordinary course of business. Id. at 1071. The court adopted a rule requiring that a court considering a Section 363(b) application expressly find from the evidence presented that a good business reason to grant the application. Id. The Court suggested that judges look to such factors as the proportionate value of the asset to the estate as a whole, the amount of elapsed time since the filing, the likelihood that a plan of reorganization will be proposed and confirmed in the near future, the effect of the proposed disposition on future plans of reorganization, the proceeds to be obtained from the disposition vis-à-vis any appraisals of the property, which of the alternatives of use, sale, or lease the proposal envisions and, most importantly, whether the asset is increasing or decreasing in value. Id. The court held that in Lionel, there was no such justification for the proposed sale because the asset at issue was not merely not wasting, but was appreciating in value and also found that the price offered was insufficient. Id.

The Lionel factors favor approving the Agreement (although the factors do not fit particularly well to this matter, in part because they contemplate a sale, where the Joint Motion seeks approval of an Agreement). There is no real prospect of reorganization and thus such plans are not impacted by the sale; rather, as set forth above, the facts that the Debtor's assets will be liquidated favors approval of the Agreement. There are no viable alternative uses for the Property because the Estate cannot afford to insure, repair or maintain it. The Property is decreasing in value. Each of these factors favors approving the Agreement. Because the Agreement provides for an auction process, the proceeds obtained for the Property will be whatever the market will bear, with a minimum of the Brinkmann Parties' bid, which the Movants believe is sufficient to pay the Estate's known secured creditors, its administrative

expenses and a dividend to its unsecured creditors. This also favors approval of the Agreement. In short, a majority of the Lionel factors favor approval of the Agreement.

Under the Bankruptcy Act, more restrictive standards were applied to the pre-plan sale of a debtor's assets outside of the ordinary course of business. See Int'l Bank of Miami v. Brock (In re Dania Corp.), 400 F.2d 833 (5th Cir. 1968), cert. denied 393 U.S. 1118 (1969). In Dania, the debtor filed a voluntary petition for reorganization under Chapter X of the Bankruptcy Act. The trustee appointed in the Dania case attempted to enter into a settlement in which 124,560 shares of stock belonging to the debtor (out of 174,893) would be sold. A secured creditor objected to the sale because, *inter alia*, no emergency existed to warrant such a sale, which was practically a liquidation. Id. at 836. The court held that the Act did not require imminent danger that the assets be lost, it only required "cause." Id. at 837. The court further held that allowing the debtor to liquidate assets and relieve itself of burdensome debts was sufficient cause to approve the pre-plan sale at issue. Id. at 837.

Similarly, the Agreement should allow the Debtor to pay off its known secured creditors (thus cutting off accruing interest) and leave funds for distribution to the Debtor's unsecured creditors. Moreover, because of the condition of the Property and the Estate's inability to pay to maintain or repair it or to obtain insurance coverage for more than the secured creditor's interest in the Property, there is cause to approve the Agreement providing for the sale of the Property.

Other courts, applying more restrictive standards than those suggested by the Fifth Circuit in Dania, also approved pre-plan sales of all of a debtor's assets.[7] By way of example,

[7] See In re Boogaart of Florida, Inc., 17 B.R. 480 (Bankr. S.D. Fla. 1981). In Boogaart, the debtors determined that in order to maximize dividends to creditors, their assets should be liquidated (based upon their continuing operating losses). The debtors held an auction and sought approval of sales to the successful bidders. Objections were filed asserting, *inter alia*, that liquidation prior to plan confirmation was improper. The court held that Section 363 provides that a court may approve the sale of the property of the estate other than in the ordinary course of business,

the Chapter 11 debtor in Mesta Machine Co. v. Mellon Bank, N.A. (In the Matter of Mesta Machine Co.), 30 B.R. 178 (Bankr. W.D. Penn. 1983) sought to sell certain assets. The debtor offered testimony showing that it had made strenuous efforts to sell its assets and that the value of the assets had deteriorated and would continue to deteriorate. Mesta, 30 B.R. at 179-180. In light of such deterioration, the court found that the sale was fair and equitable. Objections to the sale were filed arguing, *inter alia*, that the sale was impermissible absent an emergency.[8] Id. at 180. The court held that it could authorize the pre-plan asset sale because the deterioration of the debtor's assets constituted an "emergency" sufficient to justify the asset sale. Id. at 181 (multiple citations omitted).

Similarly, in In re Brookfield Clothes, Inc., 31 B.R. 978 (S.D.N.Y. 1983), the debtor needed to either obtain permanent financing or negotiate a sale of its business or assets. Brookfield, 31 B.R. at 979. The debtor met its expenses through interim financing agreements. Id. The debtor ceased operations when its unionized employees went on strike because the debtor did not meet certain health and welfare benefit obligations. Id. at 980. The debtor could not obtain the funds necessary to resume operations. Id. at 981. The stoppage of operations

---

including the authorization of the sale of most of a debtor's assets prior to the proposal of a plan of reorganization. The court found that the value of the debtors' assets was rapidly decreasing and the debtors' estates were suffering continuing losses. Id. at 483-484. Accordingly, the court held that liquidation before proposal of a plan was desirable because it would increase the amounts distributed to creditors after a plan was confirmed. Id. at 484. See also In re Thrifty Liquors, Inc., 26 B.R. 26 (Bankr. D. Mass. 1982). In Thrifty Liquors, the debtor suffered substantial losses as the result of its inability to obtain sufficient credit and inadequate working capital. Thrifty Liquors, 26 B.R. at 27. The trustee in Thrifty Liquors could not obtain credit to adequately stock the debtor's inventory, increasing the likelihood that the debtor would continue to lose money. The trustee solicited participation in a plan filed by the debtor, or, alternately, the purchase of the debtor's assets as a going concern. After a hearing, the court accepted the trustee's business judgment regarding the proposed sale. The Court found that the erosion of the debtor's assets and the diminution in the value of such assets justified the trustee's decision and warranted the court's authorization of the sale of all of the debtor's assets prior to confirmation of a plan. Id. at 28. Thrifty Liquors cites In re Solar Manufacturing Corp., 176 F.2d 493 (3[d] Cir. 1949) for the proposition that a Section 363(b) sale should be permitted in an emergency situation; however, the court does not go so far as to state than an emergency is required.

[8] Objectors to the sale argued that Solar Manufacturing, supra, set a standard which states that sales pursuant to Section 363(b) prior to submission of a plan of reorganization are impermissible absent an emergency.

diminished the likelihood of realizing on the debtor's receivables. Its inventory was depreciating. The debtor then sought to sell substantially all of its assets for approximately $1,200,000. Kredietbank, a senior lien holder, objected to the proposed sale because it involved substantially all of the debtor's assets, which Kredietbank asserted could only be accomplished through a plan or through Chapter 7 liquidation. The debtor showed that it had made continuous but unsuccessful efforts to sell its and that its business was worth more as a going concern than it would be in a liquidation. Id. at 980-981. The court discussed the more restrictive standards under the Act and the more liberal standards under Section 363. It then found that pre-plan all-asset sales are permitted under Section 363 and that the circumstances confronting the debtor were sufficiently exigent to warrant authorization of such a sale.9 The "wasting asset" in question was the "going concern" value of the debtor's business. Id. at 986.

The Property is a wasting asset. It is physically deteriorating and the Estate cannot afford to prevent such deterioration. Absent some unforeseen event, it will continue to decrease in value while interest and *ad valorem* taxes continue to accrue. Under the circumstances, the Agreement should be approved, thus allowing the Trustee to move towards selling the Property through an auction, collect rent from Texas Rag Time, possibly lease parts of the Property and realize the best return on the Property for the benefit of the Estate and its creditors.

[9] The court cites Solar Manufacturing, supra, and states that the debtor bore its burden of showing the existence of an emergency situation warranting the bankruptcy court's authorization of a sale.

III.

CONCLUSION

BASED UPON THE FOREGOING, the Movants request that the Court enter an order approving the Agreement attached to the Joint Motion as Exhibit 1 and granting the Movants such other and further relief to which they may be justly entitled.

Respectfully submitted,

LOCKE LIDDELL & SAPP LLP

/s/ Doug Skierski May_21, 2004

Peter A. Franklin III
Texas Bar No. 07378000
Doug Skierski
Texas Bar No. 24008046
LOCKE LIDDELL & SAPP LLP
2200 Ross Avenue, Suite 2200
Dallas, Texas 75201
(214) 740-8000 (Telephone)
(214) 740-8800 (Telecopier)

ATTORNEYS FOR SHAWN K. BROWN,
CHAPTER 11 TRUSTEE

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the above and foregoing instrument has been sent to the parties listed below, either electronically or by United States mail on this 21st day of May 2004.

/s/ Doug Skierski May 21, 2004
Doug Skierski

Lorax Corporation
5912 End O'Trail
Ft. Worth, TX 76112

Rudy Sauseda
P.O. Box 173
Grand Saline, TX 75140

Keith Langenbeck
4538 Hockaday
Dallas, TX 75229

Ronald D. Wilson
203 Lakeridge Village #215
Dallas, TX 75238

U.S. Trustee
1100 Commerce St., Room 976
Dallas, TX 75242-1496

Dallas Manufacturing Company, Inc.
c/o J. Baxter Brinkman
4215 McEwan Rd.
Dallas, TX 75244

John H. Carney
One Meadows Bldg.
6700 N. Central Expressway
Dallas, TX 75206

Texas Ragtime, Inc.
c/o Mark Smith
Touchstone Bernays Johnstone
Beall & Smith
1201 Elm St., Suite 4700
Dallas, TX 75270

ATCO Products, Inc.
c/o Barry Clement
601 S. IH 45
Ferris, TX 75125

Arthur E. Leerskov, Jr.
729 East Corsicana Street #528
Athens, TX 75751-2610

Charles J. Cain
Hughes & Luce, LLP
111 Congress Avenue, Suite 900
Austin, TX 78701

Henderson County Appraisal District
c/o Bill Jackson, Chief Appraiser
P.O. Box 430
Athens, TX 75751-0430

Texas Commission on Environmental
Quality
P.O. Box 13087
Austin, TX 78711-3087

Henderson County Tax Assessor/Collector
c/o Mr. Milburn Chaney
101 E. Tyler Courthouse Annex
Athens, TX 75751

Henderson County Chamber of Commerce
201 North Main Street
Henderson, TX 75652

Dan Moore, City Attorney
City of Athens
P.O. Box 392
Athens, TX 75751

Enterprise National Bank of
Palm Beach, N.A.
11811 U.S. Highway One
North Palm Beach, FL 33410

Texas Power & Light Co.
611 E. Tyler St.
Athens, TX 75751

TXU Gas Co.
P.O. Box 650654
Dallas, TX 75265-0654

Megan M. Cooley
Kelly Hart & Hallman
201 Main Street, Suite 2500
Fort Worth, TX 76102

Comerica Bank-Texas
P.O. Box 650282
MC 6514
Dallas, TX 75265-0282