UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ROME DIVISION

IN RE:	)	CHAPTER 7
	)	
GALEY & LORD, INC., *et al*.,	)	CASE NOS. 04-43097 through 04-43106
	)	
Debtors.	)	(Jointly Administered Under
	)	Case No. 04-43098)

CHAPTER 7 TRUSTEE'S MOTION FOR SUBSTANTIVE CONSOLIDATION OF THE DEBTORS' ESTATES

Comes now, S. Gregory Hays, in his capacity as the duly-appointed chapter 7 Trustee of Galey & Lord, Inc., *et al*. (the "Trustee"), by and through his attorneys of record, and moves this Court to substantively consolidate the estates of Galey & Lord, Inc. ("G&L Inc.") and its affiliated debtors (the "Debtors") into one estate. In support hereof, the Trustee shows the Court as follows:

I. INTRODUCTION

1. The Trustee believes that the assets of the estates are so commingled and intertwined that any attempt to unwind the transactions, and separate the assets (or allocate the proceeds from the sale of such assets), of the Debtors would be difficult, at best, and certainly cost prohibitive when viewed in light of any potential benefit of performing such an exercise. Accordingly, the Trustee seeks entry of an order substantively consolidating the Debtors' estates into one estate.

2. After a careful and thorough analysis, the Trustee believes that it is in the best interest of the Debtors, their estates and all affected creditors (other than possibly the Term Agent, as defined below, which has consented to substantive consolidation) for the Debtors'

estates to be substantively consolidated into one single estate prior to the Trustee's administration of the remainder of the Debtors' estates.

II. BACKGROUND

A. <u>Procedural History</u>

3. On August 19, 2004 (the "Petition Date"), the Debtors, specifically G&L Inc., Swift Textiles, Inc. ("Swift"), Galey & Lord Industries, Inc. ("G&L Industries"), Swift Denim Properties, Inc. ("Swift Properties"), Galey & Lord Properties, Inc. ("G&L Properties"), Greensboro Textile Administration LLC ("Greensboro LLC"), Brighton Weaving LLC ("Brighton"), Flint Spinning LLC ("Flint"), Society Hill Finishing LLC ("Society Hill"), and McDowell Weaving LLC ("McDowell"), filed voluntary petitions for relief under Chapter 11 of Title 11, United States Code (the "Bankruptcy Code"). The Debtors' bankruptcy cases (the "Bankruptcy Cases") are being jointly administered pursuant to an Order of this Court entered on the Petition Date.

4. Pursuant to the Debtors' Third Amended Joint Plan of Reorganization and related Confirmation Order entered in the Debtors' prior bankruptcy cases filed in 2002 in the United States Bankruptcy Court for the Southern District of New York, G&L Inc., as borrower, and each of the other Debtors, as guarantors, entered into a term loan agreement on or about March 5, 2004, with a consortium of lenders party thereto (such lenders or their assignees, the "Term Lenders"), and with General Electric Capital Corporation ("GECC") as initial agent for the Term Lenders (in such capacity, the "Initial Term Agent"), whereby the Debtors became indebted to the Term Lenders in the amount of $130 million (the "Term Loan").

5. With the exception of 33% of the issued and outstanding shares of Greensboro Textile Administration, SCS ("Greensboro SCS"), a wholly-owned non-debtor subsidiary of

Debtor G&L Inc. (the "Unencumbered Foreign Stock"), the Debtors' obligations under the Term Loan were secured by liens on all existing and after acquired personal and real property of the Debtors and proceeds thereof (the "Term Agent Collateral") pursuant to a Security Agreement dated as of March 5, 2004, among the Debtors and the Initial Term Agent.

6. Pursuant to that certain Intercreditor Agreement dated as of March 5, 2004, among the Initial Term Agent, the Term Lenders, GECC, as agent for certain revolver lenders (in such capacity, the "Revolver Agent"), who also held a security interest in and lien upon the Term Agent Collateral to secure a revolving loan to G&L Inc., as borrower, with the other Debtors as guarantors (the "Revolver Loan"), and other parties, the Term Agent (as defined below) as of the Petition Date asserted a first-priority security interest in and lien upon certain of the Debtors' assets, consisting primarily of equipment, real estate, foreign stock other than the Unencumbered Foreign Stock (the "Encumbered Foreign Stock;" together with the Unencumbered Foreign Stock, the "Foreign Stock"), and intellectual property, and a second-priority security interest in and lien upon certain of the Debtors' other assets, consisting primarily of inventory and accounts receivable.[1]

7. On or about April 30, 2004, the Initial Term Agent was replaced in its capacity as agent for the Term Lenders by The Bank of New York, f/k/a BNY Asset Solutions, LLC (the "Term Agent").

8. On the Petition Date, the Debtors filed a motion for approval of the sale of substantially all of the Debtors' assets (the "Sale Motion") to Patriarch GL Acquisition LLC

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[1] The Revolver Agent, in turn, asserted a first-priority security interest as of the Petition Date in the Term Agent Collateral in which the Term Agent asserted a second-priority interest, and a second-priority interest in the Term Agent Collateral in which the Term Agent asserted a first-priority interest (other than intellectual property and the Encumbered Foreign Stock, in which the Revolver Agent did not assert any interest).

("Patriarch") pursuant to an Asset Purchase Agreement, dated September 24, 2004, among Patriarch and the Debtors (the "APA").

9. On October 27, 2004, this Court entered an Order approving the Sale Motion (the "Sale Order").

10. On or about November 9, 2004, the sale of substantially all of the Debtors' assets to Patriarch (the "Patriarch Sale") as approved pursuant to the Sale Order was consummated, yielding cash proceeds, after payment of certain secured, priority and "cure" obligations, of $40 million (the "Net Proceeds").

11. The APA did not purport to allocate value among the assets purchased, other than for tax or financial reporting purposes. Moreover, no effort was made to allocate value (even for tax or financial reporting purposes) among a particular Debtor's assets.

12. On November 29, 2004, the Bankruptcy Cases were converted to cases under Chapter 7 of the Bankruptcy Code. On November 30, 2004, the United States Trustee for Region 21 appointed the Trustee as Chapter 7 Trustee in the Bankruptcy Cases.

13. On March 31, 2005, the Trustee filed a Complaint commencing Adversary Proceeding No. 05-04019 (the "Trustee Adversary Proceeding") against the Term Agent, seeking various forms of relief, including the following: (1) avoidance and recovery of certain payments pursuant to sections 547 and 550 of the Bankruptcy Code; (2) avoidance and preservation for the benefit of the estate of the Term Agent's alleged liens on the Debtors' assets pursuant to sections 544, 547 and 551 of the Bankruptcy Code; (3) a determination of the extent of the Term Agent's

liens in and upon the Net Proceeds; (4) substantive consolidation of the Debtors; and (5) disallowance of the Term Agent's claim pursuant to section 502(d) of the Bankruptcy Code.[2]

14. On November 30, 2005, the Court entered an order approving a Settlement Agreement between the Trustee and the Term Agent (the "Settlement Agreement"), which Settlement Agreement resolved the Trustee Adversary Proceeding (with the exception of certain claims and rights that were preserved as set forth in paragraph 8(b) thereof). One of the issues preserved by the Settlement Agreement is the Trustee's right to seek substantive consolidation of the Debtors' bankruptcy estates. Further, the Term Agent affirmatively agreed, in the Settlement Agreement, to waive any objection to a motion by the Trustee seeking substantive consolidation of the Debtors' estates. See Settlement Agreement, ¶ 5.

B. Factual Background

15. G&L Inc. is a holding company that owns all of the issued and outstanding common stock of Swift and G&L Industries. See Affidavit of James J. Murray in Support of First Day Motions (Docket No. 2; the "Murray Affidavit"), ¶ 3. Swift owns all of the issued and outstanding common stock of Swift Properties. Id. G&L Industries owns all of the issued and outstanding common stock or interests of G&L Properties, Greensboro LLC, Brighton, Flint, Society Hill, and McDowell. Id.

16. Prior to the Petition Date, the Debtors operated primarily through two operating companies: Swift and G&L Industries. Murray Affidavit at ¶ 5. Swift was primarily responsible for the Debtors' production and sale of denim, whereas G&L Industries was primarily responsible for the Debtors' production and sale of twill fabrics and related items. Id.

[2] The Trustee later withdrew his request for substantive consolidation without prejudice for procedural reasons in order that such relief could be sought in the main Bankruptcy Cases, rather than in the Trustee Adversary Proceeding.

G&L Industries and Swift, respectively, owned all of the Debtors' operating assets (inventory, equipment, accounts receivable, real estate, etc.).

17. As evidenced by the Schedules of Assets and Liabilities filed by each of the Debtors pursuant to Rule 1007(b) of the Federal Rules of Bankruptcy Procedure (the "Schedules"), G&L Inc., the parent holding company, had as its only assets its stock ownership in G&L Industries and Swift, as well as the Foreign Stock (*i.e.*, its stock ownership in non-debtor Greensboro SCS). G&L Properties' assets consisted solely of its ownership of all of the intellectual property used by G&L Industries. Murray Affidavit at ¶ 6. Swift Properties' assets consisted solely of its ownership of all of the intellectual property used by Swift. Id. None of the other Debtors owned any assets.

18. Each of the Debtors scheduled its joint and several liability to the Revolver Agent and the Term Agent under the Revolver Loan and the Term Loan, respectively, in its respective Schedules. Only G&L Industries and Swift (the two operating Debtors) scheduled any liabilities other than the debts owed under the Revolver Loan and the Term Loan. G&L Industries scheduled approximately $11.8 million in unsecured nonpriority claims, and additional amounts as tax claims and secured claims. Swift scheduled approximately $5.4 million in unsecured nonpriority claims, and additional amounts as tax claims and secured claims.

19. Prior to the Petition Date, the Debtors maintained a centralized cash management system. Murray Affidavit at ¶ 35. Under this system, G&L Industries and Swift, the two operating Debtors, had various separate bank accounts. Id. Each of these two operating companies maintained a lockbox for cash receipts, which were swept into the same lockbox DDA account. The lockbox DDA account was swept to pay down the Debtors' Revolver Loan.

Id. However, parent G&L Inc. was the entity that drew on the Revolver Loan, and then allocated funds among the operating companies. Id.

20. The Revolver Agent received sufficient proceeds from the Patriarch Sale to fully satisfy and retire the debtor-in-possession financing which had been used, in part, to fully retire the Revolver Loan. All other allowed secured claims against any of the Debtors, other than the Term Loan, have been fully satisfied or reserved.[3]

21. Pursuant to the Settlement Agreement, the Term Agent holds an allowed general unsecured claim in the amount of $112,788,854 (the "Term Agent Claim"). In addition to the Term Agent Claim, the Term Agent has been paid from the Net Proceeds, pursuant to the Settlement Agreement, $18,000,000 in full satisfaction of its allowed secured claim. Thus, with the exception of reserved amounts for payment of disputed secured tax claims upon allowance, the remaining Net Proceeds (approximately $19-20 million after payment of the disputed secured tax claims) are held by the Trustee free and clear of any liens.[4]

22. The Pension Benefit Guaranty Corporation (the "PBGC") filed proofs of claim in each of the Debtors' cases. The PBGC proofs of claim were subsequently amended, resulting in the PBGC asserting a general unsecured claim against each of the Debtors. Each amended proof of claim is identical with regard to amount and type of claim, and differs only as to the Debtor against which it is asserted. The PBGC's claim is for the stated amount of approximately $50,500,000 (the "PBGC Claim").[5]

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[3] Sufficient funds have been reserved from the Net Proceeds to satisfy disputed secured tax claims upon final allowance.

[4] Of this amount, the Trustee has already distributed $8,250,000 to the Term Agent as a prepayment of the expected minimum distribution on the Term Agent's allowed general unsecured claim, as required pursuant to the Settlement Agreement.

[5] The Trustee is still in the process of analyzing the validity of the PBGC's Claim.

23. Additionally, the estates of the (formerly) operating Debtor companies, G&L Industries and Swift (the "Operating Debtors"), have hundreds of unsecured creditors. The Trustee believes, subject to a further and more complete claims review process, that there are valid unsecured claims in the Operating Debtors' cases in the approximate aggregate amount of $4,500,000.[6]

24. Thus, the Trustee estimates (subject to further analysis and assuming allowance of the PBGC Claim in full) that there are currently approximately $168,000,000 in general unsecured, nonpriority claims asserted against the Debtors' estates. If the estates are substantively consolidated, the Term Agent will be entitled to receive approximately sixty-seven and two-tenths percent (67.2%)[7] of the funds to be distributed to general unsecured creditors (including amounts already distributed pursuant to the Settlement Agreement in respect of its allowed general unsecured claim); the PBGC will be entitled to at most (*i.e.*, assuming allowance in full of the PBGC Claim) approximately thirty and one-tenth percent (30.1%)[8] of such funds; and the other general unsecured creditors will entitled to receive approximately two and seven-tenths percent (2.7%)[9] of such funds.

[6] Of the aggregate approximately $17 million in general unsecured claims listed by the Operating Debtors in their Schedules, approximately $8 million was satisfied by Patriarch in connection with the assignment of certain executory contracts pursuant to the Patriarch Sale. The rest appear to be invalid or were not asserted based on an analysis of Proofs of Claims filed in the Chapter 7 case.

[7] $112,788,854/$167,788,854.

[8] $50,500,000/$167,788,854.

[9] $4,500,000/$167,788,854.

III. ARGUMENT AND CITATION TO AUTHORITY

A. Substantive consolidation is appropriate where the economic prejudice of continued debtor separateness outweighs the economic prejudice of consolidation.

25. Substantive consolidation "involves the pooling of the assets and liabilities of two or more related entities; the liabilities of the entities involved are then satisfied from the common pool of assets created by consolidation .... In addition, substantive consolidation eliminates the inter-corporate liabilities of the consolidated entities." Eastgroup Properties v. Southern Motel Assoc., Ltd., 935 F.2d 245, 248 (11th Cir. 1991).

26. "While not specifically authorized by the bankruptcy code, bankruptcy courts have the power to order substantive consolidation by virtue of their general equitable powers." Eastgroup Properties, 935 F.2d at 248. "In 1940, the Supreme Court gave its tacit approval to this equitable power to substantively consolidate two estates." Reider v. Federal Deposit Insurance Corporation (In re Reider), 31 F.3d 1102, 1105 (11th Cir. 1994).

27. In accordance with the general equitable powers conferred by section 105 of the Bankruptcy Code, the overarching test governing substantive consolidation of entities is "whether the economic prejudice of continued debtor separateness outweighs the economic prejudice of consolidation." In re Reider, 31 F.3d at 1107-08. In other words, a court must analyze whether substantive "consolidation yields benefits offsetting the harm it inflicts on objecting parties." Eastgroup Properties, 935 F.2d at 249 (citations and internal punctuations omitted); In re Reider, 31 F.3d at 1108.

28. To evaluate the comparative benefits and harms of substantive consolidation, the United States Court of Appeals for the Eleventh Circuit established a two-part standard which must be met by the proponent of substantive consolidation. "The proponent of substantive

consolidation must show that (1) there is substantial identity between the entities to be consolidated; and (2) consolidation is necessary to avoid some harm or to realize some benefit." Eastgroup Properties, 935 F.2d at 249.

29. If the proponent of substantive consolidation satisfies this two-part standard, a "presumption arises that creditors have not relied solely on the credit of one of the entities involved." Id. (citations and internal punctuations omitted). As such, if the prima facie showing of substantial identity and harm or benefit is made, "the burden shifts to an objecting creditor to show that (1) it has relied on the separate credit of one of the entities to be consolidated; and (2) it will be prejudiced by substantive consolidation." Id. However, where a reasonable creditor would not have relied on the companies' separate credit, the creditor may be estopped from objecting to substantive consolidation. Id.

30. Even if the objecting creditor makes this necessary showing, the Court still may order consolidation "if it determines that the demonstrated benefits of consolidation 'heavily' outweigh the harm. Id. (quoting Drabkin v. Midland-Ross Corp. (In re Auto-train Corp.), 810 F.2d 270, 276 (D.C. Cir. 1987)).

B. There is substantial identity between and among the Debtors.

31. The Eleventh Circuit identified certain factors which may aide a court in its determination as to whether there is substantial identity between the entities to be consolidated. These factors are:

(a) presence or absence of consolidated financial statements;

(b) unity of interests and ownership between various corporate entities;

(c) existence of parent and intercorporate guarantees on loans;

(d) degree of difficulty in segregating and ascertaining individual assets and liabilities;

(e) existence of transfers of assets without formal observance of corporate formalities;

(f) commingling of assets and business functions;

(g) profitability of consolidation at a single physical location;

(h) the parent owning the majority of the subsidiary's stock;

(i) the entities having common officers or directors;

(j) the subsidiary being grossly undercapitalized;

(k) the subsidiary transacting business solely with the parent; and

(l) both entities disregarding the legal requirements of the subsidiary as a separate organization.

See Eastgroup Properties, 935 F.2d at 249-50. The Court in Eastgroup Properties stressed that these factors are non-exclusive examples of information relevant to a court's inquiry, and that no single factor is likely to be determinative. Id. at 250.

32. Based on the factors set forth in Eastgroup Properties, it is clear that there is substantial identity among the Debtors:

(a) Presence of consolidated financial statements. The Trustee's review of the Debtors' books and records revealed that the Debtors utilized consolidated financial statements. In fact, the Debtors even prepared a consolidated liquidation analysis both before and during the Bankruptcy Cases.

(b) Unity of interests and ownership between various corporate entities. Unity of ownership is present, as the parent, G&L Inc., owns, directly or indirectly, all of the stock of all of the other Debtors.

(c) Existence of parent and inter-corporate guarantees on loans. G&L Inc. was the borrower, with all of the other Debtors (the subsidiaries) being guarantors, on both the Revolver Loan (and subsequent post-petition financing that replaced it) and the Term Loan. See Murray Affidavit at ¶¶ 8 & 10. Each of these loans was secured by substantially all of the Debtors' collective assets. Id. Thus, for both of the two major pre-petition financing facilities used by the Debtors, and the post-petition financing, all of the Debtors (parent and subsidiaries) were either the principal obligor or a guarantor of the debt.

(d) Degree of difficulty in segregating and ascertaining individual assets and liabilities. After a review of the Debtors' books and records, the Trustee believes that segregating and ascertaining individual assets and liabilities of the Debtors would be very difficult, if not impossible. As an initial matter, it appears that certain of the Debtors paid expenses of certain of the other Debtors, without reimbursement through an inter-company transfer (occasionally these transactions were noted through book entries; however, to the extent they were recorded as book entries, there was no "true-up" pre-petition). Further, in the Patriarch Sale, Patriarch purchased substantially all of the assets of all of the Debtors. However, there was no allocation of the purchase price among the Debtors, or among the Debtors' assets. The Trustee has determined that many of the Debtors' assets do not lend themselves to easy evaluation (such as intellectual property and partial ownerships in foreign joint ventures). In fact, many of these very issues were in dispute in the Trustee Adversary Proceeding.[10] The Trustee believes that it would be extraordinarily expensive to conduct the appropriate valuations of the assets that would be required in order to allocate the Sale Proceeds (and the Term Agent's allowed secured claim) appropriately among the assets sold to Patriarch, and then to the Net Proceeds.

(e) Existence of transfers of assets without formal observance of corporate formalities. The Trustee believes that the Debtors transferred assets between and among themselves without formal observance of corporate formalities. For instance, a review of the Debtors' books and records has revealed that inter-company loans were made without the usual and appropriate documentation.

(f) Commingling of assets and business functions. A prime example of commingling of assets and business functions by the Debtors is shown by the Debtors' pre-petition payments on the Term Loan. On June 30, 2004, G&L Industries transferred, via two separate wire transfers, funds in the amount of $4,074,429.22 to the Term Agent. These were payments of the regularly scheduled principal and interest payments due on that date. Under the terms of the loan documents, G&L Inc., and not G&L Industries, is the primary borrower under the Term Loan. Nevertheless, G&L Industries made the payment on behalf of all of the Debtors, with no apparent compensation from its affiliated Debtors, or with regard to any value or benefit G&L Industries may have indirectly received from the Term Loan. Moreover, as noted above, the sale to Patriarch caused the ultimate commingling of assets.

[10] Moreover, the Settlement Agreement necessarily further complicated matters because the Term Agent was granted an allowed secured claim thereunder without any allocation of such allowed secured claim to any particular assets or particular Debtor's assets.

(g) Profitability of consolidation at a single physical location. Pre-petition, several of the Debtors shared common office space.

(h) The parent owning the majority of the subsidiary's stock. As noted above, G&L Inc., the ultimate parent company, owns all of the issued and outstanding common stock of Swift and G&L Industries. See Murray Affidavit at ¶ 3. Swift, one of the two operating companies, owns all of the issued and outstanding common stock of Swift Properties. Id. G&L Industries, the other operating company, owns all of the issued and outstanding common stock or interests of G&L Properties, Greensboro LLC, Brighton, Flint, Society Hill, and McDowell. Id. Thus, all of the various subsidiary Debtors' stock is owned by other Debtors.

(i) The entities having common officers or directors. As reflected in the Debtors' Statements of Financial Affairs filed in their respective cases, the Debtors share many of the same officers and directors. For instance, as of the Petition Date, and according to the Debtors' Statements:

(i) G&L Inc., G&L Industries and Swift shared the following eight (8) common officers and directors: Blon Dean Brown, Jr.; Leonard F. Ferro; Anthony Forman; John J. Heldrich; Lawrence F. Himes; John Kourakos; James J. Murray; and Richard Redden;

(ii) G&L Inc. had an additional seven (7) officers and directors in common with G&L Industries; and

(iii) at least three (3) officers or directors, Ferro, Forman and Murray, were officers or directors for each and every one of the Debtors.

(j) The subsidiary being grossly undercapitalized. As reflected in the Schedules, only three of the Debtors had any real and substantial assets, G&L Inc., G&L Industries and Swift. While G&L Properties and Swift Properties own all of the intellectual property, respectively, for G&L Industries and Swift, the actual value of this intellectual property of more than a *de minimis* amount was drawn into question during the Trustee's litigation with the Term Agent. Further, Patriarch assigned a zero value to the intellectual property for tax or financial reporting purposes in connection with the Sale. The other Debtors were all grossly undercapitalized for conducting any business, by virtue of their guarantee of the Term Loan and the Revolver Loan (as well as the post-petition financing that replaced the Term Loan) despite the absence of any assets.

(k) The subsidiary transacting business solely with the parent. As stated above, G&L Properties and Swift Properties conduct no business other than owning and holding all of the intellectual property, respectively, for

G&L Industries and Swift. All of the Debtors, except G&L Industries and Swift, transacted business only with other Debtors.

33. As shown by the foregoing analysis of the facts of this case against the Eastgroup Properties factors, there can be no dispute that there is substantial identity between and among the Debtors. Thus, the first part of the two-part *prima facie* showing is satisfied.

C. Substantive consolidation of the Debtors is necessary to avoid harm to, or realize a benefit for, the Debtors' unsecured creditors.

34. The Trustee believes that substantive consolidation of the Debtors' estates is necessary in this case. Consolidation will provide a tangible benefit to the Debtors' unsecured trade creditors, while only one creditor (other than the Term Agent, who has consented to substantive consolidation under the Settlement Agreement), the PBGC, has even an arguable risk of harm. The Trustee believes that consolidation further will prevent administrative costs from escalating unnecessarily, thereby preserving assets of the estates for distribution to creditors.

35. At this stage of the Bankruptcy Cases, there are essentially only two types of claims that remain to be administered: secured tax claims and general unsecured claims. The Trustee has reserved a sufficient portion of the Net Proceeds for payment in full of all of the asserted secured tax claims, if all of these claims are ultimately allowed in full by the Court during the claims resolution process. Therefore, the only remaining type of claims, among which claims the remaining assets of the estate are to be disbursed, are the general unsecured claims (which claims include the Term Agent's allowed general unsecured claim, the PBGC Claim, and the claims of trade creditors).

36. The Trustee believes that all creditors (with the exception of the Term Agent, whose consent has been obtained) will benefit from substantive consolidation of all of the Debtors into one estate at the expense of the Term Agent. The only potential exception identified by the Trustee is the PBGC. However, the Trustee believes that, even if there may be

a negative impact on the PBGC, it will be relatively *de minimis*, and certainly does not outweigh the benefit to the other creditors.

37. If the estates are not substantively consolidated, the Trustee will be required to allocate assets among the Debtors as of the Petition Date, and assign values to the assets. Valuation and allocation of the assets will be a difficult, expensive and largely speculative process. The Trustee will be required to hire experts, at the expense of the estates, to aid in the process, especially with regard to the intellectual property and Unencumbered Foreign Stock. The process will involve first analyzing which Debtor legally owned each asset as of the Petition Date. Next, the Trustee must assign a value to each asset. Thereafter, the Net Proceeds must be allocated among the assets, a difficult task in itself which will involve issues of marshalling and "deemed surcharge" because the purchase price paid by Patriarch included the assumption of various unsecured debts (administrative claims and "cure" costs).[11]

38. Moreover, the Trustee will have to determine how to allocate the Term Agent's $18 million allowed secured claim among the assets so as to determine what assets and whose assets the remaining Net Proceeds represent. The Term Agent asserted liens against substantially all of the Debtors' combined assets. The Trustee separately challenged the asserted liens against almost every asset class under different theories in the Trustee Adversary Proceeding. Thus, for example, should the $18 million secured claim of the Term Agent represent the portion of the Net Proceeds allocable to real estate and Foreign Stock, leaving only the portion of the Net

[11] The Trustee determined in the course of the Trustee Adversary Proceeding that the appropriate "deemed surcharge" adjustment to be made is approximately 40% (the amount remaining from the $125 million purchase price after satisfaction of senior secured claims was approximately $68 million, of which approximately $28 million was used by the purchaser to satisfy its assumption of administrative and "cure" claims, as well as an undersecured governmental claim, leaving $40 million in Net Proceeds). Thus, the value assigned to each asset, based on that asset's worth, must be reduced by the 40% "deemed surcharge" to determine the portion of the Net Proceeds allocable to such asset.

Proceeds allocable to the equipment, intellectual property and working capital assets available for other creditors to divide (one of the possible outcomes of the Trustee Adversary Proceeding had it not been settled)? Should it instead represent the portion of the Net Proceeds allocable to the equipment, intellectual property, Foreign Stock and pre-petition working capital assets, leaving only the portion of the Net Proceeds allocable to the real estate and post-petition working capital assets available for other creditors to divide (another possible outcomes of the Trustee Adversary Proceeding had it not been settled)?

39. Adding to the complexity of the process will be the need to determine whether, and to what extent, any of the Debtors made improper or fraudulent transfers to another Debtor or a third-party, such as a transfer on account of the debt of another Debtor, that would affect the allocation of assets among the Debtors.

40. The Trustee is prepared to present evidence, if necessary, that the ultimate distribution to the PBGC will not differ dramatically for the PBGC whether the estates are kept separate or if the estates are all consolidated into one estate. In fact, even making assumptions designed to maximize the harm to the PBGC from substantive consolidation, namely (a) that the PBGC Claim will be allowed at $50.5 million; (b) that the assets of the entities against whom only the Term Agent and the PBGC have a claim will equal the “high-end” estimates used by the Trustee in analyzing his claims in the Trustee Adversary Proceeding; (c) that the allowed general unsecured claims other than the general unsecured claim of the Term Agent and the PBGC Claim will equal the “low-end” estimate of $4.5 million; and (c) that the additional administrative cost to the estates of determining the ultimate distribution if the estates are not substantively consolidated versus the additional administrative cost to the estates of determining the ultimate distribution if the estates are substantively consolidated will equal the “low-end”

estimate made by the Trustee, the harm to the PBGC occasioned by substantive consolidation is a reduction in their ultimate expected distribution of only approximately 3.5%.[12] Using more realistic assumptions will decrease this harm to an even more negligible number (in fact, simply changing the PBGC Claim to the amount the Trustee believes to be the valid amount reduces the harm to at most a mere 1.5%).

41. All of the above factors demonstrate that, while the PBGC technically may have the potential to suffer some small harm in the event of substantive consolidation, from a practical perspective any amount of harm is negligible. In fact, the PBGC may benefit from consolidation inasmuch as the Trustee will not be required to engage in a lengthy and costly valuation and allocation process.

42. The other general unsecured creditors of the estates, however, will benefit substantially by substantive consolidation, almost exclusively at the expense of the Term Agent, in the form of increased distributions (expected to be more than twice the distribution if the estates are not substantively consolidated. Accordingly, the second prong of the two-prong Eastgroup Properties test, namely that substantive consolidation is necessary to avoid harm to, or realize a benefit for, the Debtors' unsecured creditors, is met.

D. No creditors relied on the separate credit of any of the Debtors.

43. As shown above, by satisfying the two-part test espoused in Eastgroup Properties, the Trustee has made a *prima facie* showing that substantive consolidation is necessary and appropriate.

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[12] However, this assumes that the timing of distributions will be the same whether the estates are substantively consolidated or not. In fact, however, if the estates are not substantively consolidated, the multi-million dollar distribution to the PBGC will likely be delayed, thereby reducing the present value of the distribution.

44. Therefore, the burden shifts to the PBGC "to show that (1) it has relied on the separate credit of one of the entities to be consolidated; and (2) it will be prejudiced by substantive consolidation." Eastgroup Properties, 935 F.2d at 249.

45. Here, the PBGC is the only creditor the Trustee can envision objecting to consolidation. However, the PBGC did not rely on the separate credit of any of the Debtors. In fact, as stated in its proofs of claim, the PBGC's claim arises by statute, not from business dealings or any other relationship with the Debtors. See 29 U.S.C. § 1362(a) & (b); 29 U.S.C. § 1301(a)(18); and generally 29 U.S.C. §§ 1301-1461. Because the PBGC did not rely on the Debtors' separate credit, any objection by the PBGC to substantive consolidation must be denied.

46. Moreover, the benefits of consolidation heavily outweigh any potential harm, and, therefore, substantive consolidation should be ordered even if the PBGC objects and could somehow show that it reasonably relied on the separate credit of any of the Debtors.

IV. CONCLUSION

47. For the foregoing reasons, the Trustee requests that the Court substantively consolidate all of the Debtors into one estate.

DATED: June 30, 2006.

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