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UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW MEXICO

DROP BOX
United States Bankruptcy Court
Albuquerque, New Mexico

In re

Case No. 11-01-10779-SA
Chapter 11

FURR'S SUPERMARKETS, INC.,

Debtor.

DEBTOR'S REPLY TO OBJECTIONS TO SALE MOTION

Introduction

As the Court is aware, on June 27, 2001, the Debtor conducted an Auction for the sale of its assets, as contemplated by its motion, filed June 1, 2001 (the "Sale Motion"), for authorization to sell its assets to the best bidder. The highest and best bid at the Auction was that submitted by Fleming Companies, Inc. ("Fleming"). Fleming's bid is evidenced by an Asset Purchase Agreement between the Debtor and Fleming (the "APA"). The hearing to consider the Sale Motion and approve the sale to Fleming (the "Sale") is scheduled for June 29, 2001 (the "Sale Hearing").

Under the APA, Fleming will acquire 66 of the debtor's store properties, except that Fleming may elect to reject up to 26 stores before closing. The purchase price will be \$57 million, plus the value of the Debtor's inventory and

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the assumption of certain liabilities. The Debtor expects that the aggregate purchase price will total approximately \$100 million or more (not including assumed liabilities). The purchase price is not subject to reduction if Fleming elects to reject any stores.

The closing of the Sale to Fleming will not occur immediately after Court approval. The APA contemplates that the Debtor will continue to operate its stores for up to approximately two months, while Fleming seeks third-party assignees to acquire the stores. Before closing, the Debtor will file motions seeking authorization to assume and assign the stores leases, and related personal property, to the respective assignees identified by Fleming. For up to 60 days after closing, the Debtor will continue to operate those stores for which Fleming has not yet identified assignees. After 60 days, all remaining stores not assigned to third-party assignees will be transferred to Fleming.

The majority of the objections to the Sale have been filed by landlords under store leases or equipment lessors who furnish the Debtor's stores. Because of the structure of the proposed transaction – as described above – virtually all of these objections are not ripe for determination. At the Sale Hearing, the Debtor will not seek immediate authorization to assign any specific lease to a specific assignee. The Court can hear objections relating to the amount necessary to cure defaults under a lease, the adequacy of assurance of future performance, or

other lease-related issues, when the Debtor moves to assume and assign a particular lease to the assignee designated by Fleming.

Similarly, because the Debtor will not receive the Sale's proceeds until closing, objections to the Sale by creditors asserting priority rights in the proceeds are also without merit. The Debtor's proposed order approving the Sale will provide that the Debtor may not use or distribute the proceeds (other than in the ordinary course of its business operations) without further Court order, and that liens against the assets to be sold will attach to the proceeds in the same order of priority.

The purchase price and the APA's other terms were the subject of intense, prolonged, arms-length negotiations. For that reason, among others, the Debtor believes that Fleming's bid represents the best currently-available value for its assets. The Debtor's secured lenders and (on information and belief) the Creditors' Committee, will support the Sale at the Sale Hearing. For the reasons above and those set forth below, the Court should overrule all objections and approve the Sale.

The Objections

_____The Debtor has received 38 objections to the Sale Motion. Because many of the objections raise identical arguments, the following responds to sub-

stance of the objections by category, identifying in each category which objectors raised the objection.

I. Objections Relating to Leases or Contracts To Be Assigned

The majority of objections to the Sale are from lessors of real or personal property, objecting to the Debtor's assumption and assignment of their leases.¹ As explained above, this objection is not ripe for determination and need not be determined before approval of the Sale. Before the Debtor seeks to assume and assign any specific agreement, either to an assignee or to Fleming, it will move for authorization to do so, on notice to the lessor.

At the hearing on that motion, the Court can decide any issue relating to the assignment. Those issues may include cure of defaults (including the actual amount due for rent, taxes, interest, penalties, attorneys' fees, discharge of mechanics liens, and the like), the identity of the proposed assignee and the adequacy of the assignee's assurance of future performance, or any other lease-related

¹ These objections have been raised by: Floho Partners; Tri-State Commercial Assoc.; International Food Service Holding, Ltd; River Oaks Properties; La Feria Park & Shop; Wechter Family LP; Los Lunas Shopping Center-East; Broadway Vista Partners; FHK Farmington Partners; LSF Bassett, LLP; Developers Diversified Realty Corporation; Sun West Properties N.C., Inc.; Keleher Realty; Nydes Properties SMV Ltd. Co.; Weingarten Realty Investors; Werner Kindermann; Compaq Financial Services Corporation; MDFC Equipment Leasing Corporation; Fleet Capital Leasing; Earthgrains Baking Companies, Inc.; New Mexico Lottery; State National Bank; GE Capital Business Asset Funding Corporation; and Comdisco, Inc.

issue. The Sale Order will provide that all objections regarding assumption and assignment are overruled without prejudice to rights of parties to reassert these objections in connection with an assignment motion. Accordingly, the Court need not rule on those issues at this time.²

II. Objections Relating to the Payment of Year 2001 Taxes

Several landlords and taxing authorities have mistakenly interpreted the Sale Motion as an attempt by the Debtor to relieve itself and any proposed buyer from the obligation to pay taxes for the current year that have accrued but are not yet payable.³ The Debtor intends no such result.

Under the APA, liens for taxes accruing but not yet paid are "Permitted Encumbrances" – that is, Fleming (or a third-party assignee) will acquire the

² The procedure described in this paragraph, which is intended to protect the rights of all parties, is set forth in APA § 13.5.

³ This objection was raised in the following objections: Objection of Andrews ISD and City of Andrews, Andrews County Tax Office and Midland County Tax Office; Limited Objection by Creditor Wichita County, Creditor Wichita Falls Ind. School District, Creditor City of Wichita Falls; Response by (Tax Authorities) Creditor Kermit I.S.D., Creditor Winkler County, Creditor Ector County, Creditor Wichita County Tax Office, Creditor City of El Paso, Creditor Pecos County, Creditor Reeves County; Objection of County of Brewster, Creditor Midland Central Appraising District; and Limited Objection By Creditor Sun West Properties, N.C., Inc.

Debtor's property subject to those liens.⁴ The Debtor and Fleming have agreed – among themselves – to prorate liability for real and personal property taxes at closing, as is customary in transactions of this sort.⁵ But Fleming or its third-party assignee will be liable for all taxes that become due after closing, including all those that accrued pre-closing.

III. Objections Related to Scope of Section 363(k) Release

Several lessors have also asserted that the Sale Motion impermissibly extends the scope of section 365(k) by discharging uncured pre-petition obligations.⁶ As required by the Bankruptcy Code, the Debtor will pay any cure amounts due before an agreement is assumed and assigned. Once the cure amounts are paid, the claim that the Debtor seeks to expand the scope of section 365(k) will be moot, as the Debtor will have satisfied all pre-assignment obligations under the lease.

⁴ APA Article I (definition of "Permitted Encumbrance") and § 2.1 (Purchaser will take subject to Permitted Encumbrances).

⁵ *Id.* at 4.4(b).

⁶ This objection was raised by: Tri-State Commercial Assoc.; GE Capital Business Asset Funding Corporation; River Oaks Properties; La Feria Park & Shop; and LSF Bassett, LLP.

IV. Discharge of Liens

Several taxing authorities, liquor vendors, equipment lessors, and mechanics-lien holders assert that the Debtor should be compelled to pay their claims from proceeds immediately after closing.⁷

The Bankruptcy Code does not require that lienholders receive immediate payment from the proceeds of the sale of collateral. Under Bankruptcy Code § 363(e), the Debtor may sell assets in which another entity has an interest so long as that interest is adequately protected. Under § 363(f)(3), the Debtor may sell assets in which another entity has a lien so long as the sale price exceeds the amount of the lien.

Both tests are satisfied here. The DIP Lenders and the major pre-petition secured lenders have consented to the transaction, thereby satisfying subsection 363(f)(2) as to the liens securing their loans. As to any other liens that

⁷ This objection was raised in the following objections: Objection of Andrews ISD and City of Andrews, Andrews County Tax Office and Midland County Tax Office; Limited Objection by Creditor Wichita County, Creditor Wichita Falls Ind. School District, Creditor City of Wichita Falls; Response by (Tax Authorities) Creditor Kermit I.S.D., Creditor Winkler County, Creditor Ector County, Creditor Wichita County Tax Office, Creditor City of El Paso, Creditor Pecos County, Creditor Reeves County; Objection of County of Brewster, Creditor Midland Central Appraising District; Objection of NetCom Management Group, Inc.; Objection of Dantex Construction Company; Objection of Desert Eagle Distributing Company; Objection of Southern Wine & Spirits of New Mexico; Objection of MDFC Equipment Leasing Corporation; Objection of Premier Distributing Company, Inc.; and Objection of Los Alamos County.

may have priority over the foregoing liens, the Debtor believes the requirements of section 363(f)(3) will be met — that the sale price will exceed the value of the liens on the property to be sold. As to any junior liens, the Debtor believes that the value of the property to be sold will be such that, under sections 506(a) and 506(d), the claims secured by the liens will not be allowed secured claims, and the liens will be void.

More important, the Debtor will not distribute any Sale proceeds without moving for an order approving the distribution, on notice to all entities asserting a lien on the proceeds. That procedure will protect each lienholder's right with respect to the proceeds and provide a forum to resolve any lingering disputes with respect to the validity and priority of liens. If necessary in connection with those proceedings, the Debtor will ensure that an appropriate reserve or other device is utilized to protect lienholders' interests in the proceeds. Accordingly, the Court need not address this objection before approving the Sale.

V. Sale of Assets Under Section 363(b)

Several Objectors assert that the Debtor cannot justify selling its assets except under a reorganization plan, after circulating a disclosure statement and complying with all other confirmation procedures. They contend that the

Debtor has neither shown an adequate business justification for the Sale nor a sufficient emergency to warrant conducting the Sale outside of a plan.⁸

The Debtor submits that both the Sale Motion and the larger record in this case amply demonstrate the need for the prompt Sale of its assets. As explained in the Sale Motion, "[t]he Debtor believes that a return to profitability would require substantial time and additional capital to execute, neither of which the Debtor currently has."⁹ The Debtor will introduce further evidence of the need for a prompt Sale to preserve its going-concern value at the Sale Hearing. The preservation of going-concern value for the benefit of creditors is plainly a sound business purpose, warranting authorization of the Sale.

It is also clear that the "emergency" or "compelling circumstances" standard under the former Bankruptcy Act no longer stands as the only grounds to approve a pre-plan sales. In *In re Lionel Corp.* – the leading case under the Code on pre-plan sales – the Second Circuit rejected the argument that a preconfirmation sale of a substantial asset is permitted only in an emergency.¹⁰ It stated that "the

⁸ This objection is raised by: LSF Basset, L.P.; Weingarten Realty Investors; Premier Distributing Company, Inc.; MDFC Equipment Leasing Corporation; River Oaks Properties; La Feria Park & Shop; Dantex Construction Co.; and Desert Eagle Distributing Company.

⁹ Sale Motion, ¶ 20.

¹⁰ 722 F.2d 1063, 1069 (2d Cir. 1983); *see also Stephens Industries, Inc. v. McClung*, 789 F.2d 386, 390 (6th Cir. 1986) ("We adopt the Second Circuit's

statute requires that notice be given and a hearing conducted, but no reference is made to an "emergency" or "perishability" requirement nor is there an indication that a debtor in possession or trustee contemplating sale must show "cause."¹¹

Some Objectors argue that this Court adopted the "emergency" standard in 1984 when it decided *In re Allison*.¹² But in that case Judge McFeeley indicated that compelling circumstances could justify a sale, even in the absence of an "emergency."

The testimony at trial leads this Court to believe there are compelling facts and circumstances, which *even in the absence of a demonstrated emergency*, would support approval of the [transaction].¹³

The argument that the sale is impermissible under the Bankruptcy Code is, therefore, without merit and should be overruled.

reasoning in *In re Lionel* . . . and conclude that a bankruptcy court can authorize a sale of all a Chapter 11 debtor's assets under § 363(b)(1) when a sound business purpose dictates such action."); *In re Titusville Country Club*, 128 B.R. 396, 399 (Bankr. W.D. Pa. 1991) ("The Bankruptcy Court is no longer bound by the strict standards of "emergency" or "perishability.""); *In re Naron & Wagner, Chartered*, 88 B.R. 85, 87 (Bankr. D. Md. 1988) ("There is no requirement that only an emergency will permit a Chapter 11 debtor's preconfirmation use of Section 363(b)"); *In re Industrial Valley Refrigeration and Air Conditioning Supplies, Inc.*, 77 B.R. 15, 20 (Bankr. E.D. Pa. 1987) (concluding that Third Circuit has abandoned "emergency-only" standard for allowance of pre-confirmation sales); *In re Baldwin United Corp.*, 45 B.R. 385, 386 (Bankr. S.D. Ohio 1984).

¹¹ 722 F.2d at 1069.

¹² *In re Allison*, 39 B.R. 300 (Bankr. D.N.M. 1984).

¹³ *Id.* at 302 (emphasis added).

VI. Miscellaneous Objections

The following discusses several miscellaneous objections that do not easily fit into the above categories.

A. Creditors' Committee Objections

The Committee asserts that the Debtor's sale procedures do not provide for adequate sharing of information with the Committee, prematurely close the data room, and unnecessarily bar potential buyers from the sale process who failed to submit timely bids. The first issue was addressed by the Court at a hearing held on June 22, 2001. As to the second and third issues, the data room has remained open to potential bidders, and the Debtor has agreed to accommodate several parties who indicated that they may submit late bids. All were invited to attend the Auction. Thus, these objections have been satisfied in full.

B. New Mexico Taxation and Revenue Department

The New Mexico Taxation and Revenue Department ("Department") argues that the Sale Motion "should be denied unless the order places \$3.9 million in trust for the benefit of the Department."¹⁴ It is thus clear that the Department does not object to the Sale; it is merely concerned that its liens and interests be adequately protected. The Sale Motion, however, provides this protection, because

¹⁴ Department Obj. at 2.

the Department's liens and interests will attach to the sale proceeds to the same extent and priority as they did to the property sold.¹⁵

The Department also asserts that it will have "an ongoing interest in the assets of" the Debtor's business, citing N.M. Stat. § 7-1-61(B).¹⁶ If the Department asserts that its interests will survive a § 363(f) sale, the argument is wrong. The Bankruptcy Code preempts the State statute and permits sales free and clear of liens and other interests, notwithstanding state or federal law to the contrary.¹⁷ To provide adequate protection, the Department's interests created by N.M. Stat. § 7-1-61(B) will attach to the sale proceeds, but they will no longer attach to the assets sold.

The Department further asserts that a trust fund must be created for unpaid business taxes, citing N.M. Stat. § 7-1-61(C). That statute does not impose

¹⁵ *Accord Harold & Williams Dev. Co., Inc. v. Crestar Bank (In re Harold & Williams Dev. Co., Inc.)*, 163 B.R. 77, 80 (Bankr. E.D. Va. 1994).

¹⁶ Department Obj. ¶ 6.

¹⁷ *See United Mine Workers of Am. 1992 Benefit Plan v. Leckie Smokeless Coal Co. (In re Leckie Smokeless Coal Co.)*, 99 F.3d 573, 581-82 (4th Cir. 1996) (affirming sale free and clear of federal "successor in interest" obligation to finance benefit plan and fund, as obligation flowed from ownership of coal-producing property); *P.K.R. Convalescent Ctrs., Inc. v. Virginia (In re P.K.R. Convalescent Ctrs., Inc.)*, 189 B.R. 90, 93-96 (Bankr. E.D. Va. 1995) (approving sale free and clear of state's depreciation-recapture interest in debtor's property).

the obligation to create a trust fund on the seller or transferor of assets. Thus, the Debtor has no obligation to create a trust fund.

Moreover, a sale under § 363(f) is free and clear of the obligation to create a trust fund. The interests referenced by § 363(f) are construed broadly and include matters other than liens,¹⁸ and courts have held that they "include other obligations that may flow from ownership of the property."¹⁹

In support of its proposition that a trust fund must be created, the Department relies on the distinguishable decision of *In re Wine Boutique*.²⁰ There, the debtor had already distributed most of the sale proceeds to a lender with a lien that was junior to the state's lien for property taxes. The court merely ordered that the remaining proceeds pay off the state's lien. In *dicta*, the court noted that the parties had not complied with state law, potentially exposing the successor-buyer to personal liability for the taxes. There was no discussion, however, of whether the sale was free and clear of liens and interests under § 363(f) or subject to existing liens under § 363(b), and if the former, whether the obligation on the survivor

¹⁸ *Connolly v. Nuthatch Hill Associates (In re Manning)*, 37 B.R. 755, 759 (Bankr. D. Colo. 1984), *aff'd in part and remanded on other grounds*, 831 F.2d 205 (10th Cir. 1987).

¹⁹ *Folger Adam Sec., Inc. v. DeMatteis/MacGregor, JV*, 209 F.3d 252 (3d Cir. 2000).

²⁰ 117 B.R. 506 (Bankr. W.D. Mo. 1990).

would survive the lien-free sale. As discussed above, the buyer at a § 363(f) sale has no obligation to create a trust fund or otherwise satisfy the seller's obligations flowing from the property sold.

The Department also seeks to have the Sale Order determine that it must be paid \$3.9 million (from the business tax trust) and provide that all real property taxes will be paid in full. The attachment of the Department's liens and interests to the sale proceeds provides sufficient adequate protection. The priority and extent of the Department's liens and interests are not now before the Court.

Finally, the Department also asserts that its due process rights were violated because it did not receive adequate notice of the Sale Motion. The Debtor has filed a certificate of service (docket no. 553) which indicates that the Department was served in sufficient time to ensure delivery twenty days before the objection deadline. This satisfies both due process and the Bankruptcy Code and Rules.

C. Liquor Vendors

In addition to demanding payment at closing, discussed in IV. above, two liquor vendors assert that the Debtor's request for a specific determination that the Debtor may transfer its operating licenses and permits to one or more purchasers

free and clear of all liens and similar interests violates the State of New Mexico's rights under the 11th and 21st Amendments.²¹

The Debtor initially notes that, as a result of the structure of the Fleming agreement, no licences of any sort will be transferred until the Debtor files a motion to assign particular stores to Fleming's designated third-party assignees. Accordingly, the Court may wish to defer consideration of this issue.

The liquor vendors, moreover, have no standing to raise the State's rights under these Amendments.²² Further, the Eleventh Amendment applies only to "suits in law or equity." Courts have thus held that core bankruptcy proceedings, such as the Sale Motion, do not implicate the Eleventh Amendment, as there is no suit against the state.²³ Similarly, because the Debtor does not seek monetary relief

²¹ This objection was raised in the following objections: Objection of Southern Wine & Spirits of New Mexico and Objection of Premier Distributing Company, Inc.

²² See *McGowan v. Maryland*, 366 U.S. 420, 428 (1961) (litigant may only assert its own constitutional rights or immunities); *Ford v. West*, 222 F.3d 767, 774 (10th Cir. 2000) (same); *Smith v. Private Industry Council of Westmoreland and Fayette Counties, Inc.*, 622 F. Supp. 160, 166 (W.D. Pa. 1985) (non-profit corporation lacked standing to challenge federal law on basis of 11th Amendment).

²³ See, e.g., *Chandler v. Oklahoma ex rel. Oklahoma Tax Comm'n (In re Chandler)*, 251 B.R. 872, 876 (10th Cir. BAP 2000) ("Although the issue is not squarely before us, existing law indicates that if a monetary recovery or dispossession of assets from a State are not sought in a contested matter, a suit does not exist and, therefore, the Eleventh Amendment does not apply."); *In re Sun Healthcare Group, Inc.* 245 B.R. 779 (Bankr. D. Del. 2000) (entry

against the State in this matter, but rather seeks to prevent state officials from interfering with the sale process, the 11th Amendment is inapplicable.²⁴

Accordingly, the bankruptcy courts in Massachusetts have held, in a series of decisions dating back to 1983, that, notwithstanding the 11th Amendment, liquor licences are property of the estate subject to the jurisdiction of the bankruptcy courts, that State laws conditioning the transfer of these licenses violate the Bankruptcy Code and are thus void under the Supremacy Clause, and that a refusal to transfer a license solely because of outstanding taxes or other liabilities violates the automatic stay provisions of the Bankruptcy Code.²⁵ These courts have also rejected the argument that the Bankruptcy Code must yield to state laws in this area

of DIP financing order, which prohibited state exercise of setoff rights, did not violate Eleventh Amendment); *In re Hechinger Inv. Co.*, 254 B.R. 306, 313 (Bankr. D. Del. 2000) (holding that motion under § 1146(c) seeking declaration that sales of real property were exempt from state tax was not a "suit" if taxes had not previously been collected). *See also Maryland v. Antonelli Creditors' Liquidating Trust*, 123 F.3d 777, 787 (4th Cir. 1997) ("[T]he power of the bankruptcy court to enter an order confirming a plan... derives not from jurisdiction over the state or other creditors, but rather from jurisdiction over debtors and their estates").

²⁴ *See Ex Parte Young*, 209 U.S. 123 (1908); *Goldberg v. Ellett (In re Ellett)*, 243 B.R. 741, 746 (9th Cir. BAP 1999).

²⁵ *In re J.F.D. Enterprises, Inc.*, 183 B.R. 342 (Bankr. D. Mass. 1995); *In re Kick-Off Inc.*, 82 B.R. 648 (Bankr. D. Mass. 1987); *Aegean Fare, Inc. v. Licensing Bd. (In re Aegean Fare, Inc.)*, 35 B.R. 923 (Bankr. D. Mass. 1983).

as a result of the 21st Amendment. As the *J.F.D. Enterprises* court explained, this type of state liquor statute is

about credit, not about import, transport and use. It is a tool used to ensure payments for liquor wholesalers and, as such, squarely conflicts with the priority scheme of the Bankruptcy Code. And in this case, the operation of the statute conflicts with the effective administration of the assets of the estate. As the Twenty-First Amendment has not repealed the Commerce Clause, so has it also not repealed the Bankruptcy Clause. The Twenty-First Amendment is inapplicable to the resolution of the dispute here presented.²⁶

Accordingly, the liquor vendor's constitutional arguments should be overruled.

D. Objection of General Electric Lighting

GE Lighting asserts that the Sale Motion should not be approved because several issues concerning the Debtor's DIP Facility, and the settlement entered into with GE Lighting in connection with the DIP Facility, remain unresolved. The Debtor is researching this issue and hopes to reach a resolution before the Sale Hearing.

E. New Mexico Lottery Authority

The NMLA argues that the "Retailer Contract" between the Debtor and the NMLA, together with the equipment and supplies associated therewith, may not be assigned. The Debtor does not intend to transfer these items; any purchaser

²⁶ *In re J.F.D. Enterprises, Inc.*, 183 B.R at 352 (footnote omitted).

wishing to become a lottery retailer can enter into separate arrangements with the NMLA.

F. Objection of MDFC Equipment Leasing

In addition to the general objections raised by other equipment lessors, MDFC objects to the treatment of three schedules of its master lease as secured financing. MDFC further asserts that these schedules must be treated according to their formal titles – "equipment leases" – until the Debtor institutes an adversary proceeding to recharacterize these transactions. MDFC also contends that its master lease and associated schedules must be assumed or rejected as a whole.

As explained in the Sale Motion and the Exhibits thereto, the Debtor believes that three MDFC "equipment leases" are secured financing, as the Debtor must purchase the equipment covered by these agreements for \$1.00 at the end of the "lease" term.²⁷ The Debtor also anticipates that it may seek to separately assume and assign (or reject) individual schedules of the MDFC equipment lease, and the Debtor believes that it may properly treat each schedule separately for section 365 purposes because each schedule plainly constitutes a separate contract.²⁸ Each schedule is separately executed, provides for a separate lease payment for the

²⁷ See UCC § 1-201(37) (transaction not a "lease" if debtor is bound to purchase goods at end of term or has purchase option for nominal consideration).

²⁸ See *In re Royster Co.*, 137 B.R. 530, 532 (Bankr. M.D. Fla. 1992) (finding separate contracts where the debtor leased railroad cars by attaching riders to a main contract); see also *In re Gardinier, Inc.*, 831 F.2d 974, 976 (11th Cir. 1987).

equipment covered by that schedule, and, in many cases, amends the terms of the master lease, so that each schedule has different terms.

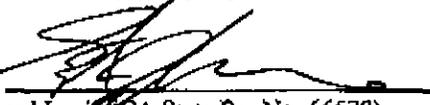
Nevertheless, these issues, and the other issues raised by MDFC, can be addressed when the Debtor files a motion to assign a store that is subject to an MDFC equipment lease. Until such time, this objection is premature.

CONCLUSION

For the foregoing reasons, the Court should overrule the Objections and grant the full relief requested in the Sale Motion.

Dated: Los Angeles, California
June 27, 2001

SKADDEN, ARPS, SLATE,
MEAGHER & FLOM LLP

By: 
Richard Levitt (CA State Bar No. 66578)
Peter W. Clapp (CA State Bar No. 104307)
Stephen J. Lubben (CA State Bar No. 190338)
300 South Grand Avenue, Suite 3400
Los Angeles, California 90071-3144
(213) 687-5000
(213) 687-3600 (fax)

JACOBVITZ THUMA & WALKER
A Professional Corporation

Robert H. Jacobvitz
David T. Thuma
500 Marquette N.W., Suite 650
Albuquerque, New Mexico 87102
(505) 766-9272
(505) 766-9287 (fax)

Attorneys for the Debtor in Possession