IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

	)	Chapter 11
In re:	)	
	)	Case No. 08-10601 (CSS)
DG LIQUIDATION CORP., *et al.*,	)	
	)	Jointly Administered
Debtors.	)	
	)	**Hearing Date: To be determined**
	)	**Objection Deadline: 1/14/09 at 4:00 p.m.**

KENNETH LEVINE'S MOTION TO CONVERT CHAPTER 11 CASES TO CHAPTER 7 CASES

Kenneth Levine ("Levine"), as subrogated secured creditor, unsecured creditor and majority stockholder of the above-captioned debtors ("Debtors"), by and through his undersigned counsel, hereby submits this motion ("Motion") pursuant to section 1112 of title 11 of the United States Code (the "Bankruptcy Code") for an order converting these chapter 11 cases to chapter 7 cases. In support of the Motion, Levine respectfully states as follows:

Preliminary Statement

1. The Debtors have had no business to operate since June 30, 2008. They are receiving no income. Their primary asset is cash, and that cash is either quickly diminishing as it is used to fund these cases or, if administrative expenses are not being paid, the case is continuing to grow more administratively insolvent. A chapter 11 plan was filed months ago, but no confirmation hearing has yet been held. A settlement agreement that could have actually yielded a significant recovery to all creditors has stalled, held hostage by the largest unsecured creditor in the case, Plainfield Special Situations Master Fund, Ltd. ("Plainfield"), against the will of the Debtors and the official committee of unsecured creditors ("Committee").

2. Levine, the only secured creditor in the case, holds a secured claim that is approximately equivalent in size to all of the amount of cash that the Debtors have on hand.

That cash is Levine's cash collateral. The Debtors' only other assets (besides an insurance policy, to the extent that is an estate asset) are their avoidance actions one other litigation, and the projected recovery from those actions is not enough to cover the projected chapter 11 administrative expenses of these cases.

3. Levine has not objected to the use of his cash collateral -- despite the fact that these chapter 11 liquidation cases are more expensive than chapter 7 cases -- because Levine, the Debtors, the Committee and Plainfield have been negotiating an attempted global settlement of potential estate causes of action against Levine in return for releases and the allowance of Levine's claim in a reduced amount. But the settlement negotiations have stalled because Plainfield alone has failed to respond to offers and shows no sign of reviving settlement negotiations.

4. Rather than wait and continue to erode his recovery further for what is essentially the equivalent of a chapter 7 liquidation, Levine does not consent to further funding of these chapter 11 cases with his cash collateral and hereby moves to convert them to chapter 7. Cause exists to convert these cases because (1) the Debtors' estates are diminishing with no reasonable likelihood of rehabilitation, (2) the Debtors will not be able to confirm or consummate a plan and (3) any further use of Levine's cash collateral will be an unauthorized use.

Jurisdiction

5. The Court has jurisdiction to consider this matter pursuant to 28 U.S.C. §§ 157 and 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b). Venue is proper before the Court pursuant to 28 U.S.C. §§ 1408 and 1409.

Background

6. The Debtors filed voluntary petitions for relief under chapter 11 of the Bankruptcy Code on April 1, 2008 (the "Petition Date"). Since the Petition Date, the Debtors have operated their business as debtors in possession pursuant to section 1107 and 1108 of the Bankruptcy Code. No trustee or examiner has been appointed in these cases.

7. On April 10, 2008, the Office of the United States Trustee appointed the Committee. Plainfield is one of four remaining members of the Committee.

8. On June 20, 2008, the Court entered a sale order [Docket No. 345] approving an asset purchase agreement between the Debtors and Belron U.S., Inc. ("Belron"), pursuant to which the Debtors sold substantially all of their assets to Belron in return for $53,411,798.68 in cash proceeds and the assumption of certain liabilities. The sale closed on June 20, 2008. Since that date, the Debtors have had no operations.

9. The Debtors filed their Chapter 11 Plan of Liquidation on August 15, 2008

12. Levine was also the guarantor of the Debtors' prepetition loans. The Debtors were party to a certain credit agreement ("Credit Agreement") dated January 12, 2007 with Guggenheim Corporate Funding, LLC ("Guggenheim"), pursuant to which Guggenheim provided the Debtors with a term loan and revolving loan in the aggregate amount of up to $35 million. That same day, Levine executed a pledge agreement and a guaranty agreement pursuant to which he deposited $6 million into a deposit account to guaranty the Debtors' obligations under the Credit Agreement (the "Levine Guaranty"). Levine then pledged the deposit account to Guggenheim, which took a security interest in the account and perfected that interest by executing a control agreement with Levine.

16. On or about April 30, 2008, Guggenheim exercised its rights under the Levine Guaranty and drew down the entirety of the account that Levine had put under its control: the $10 million that Levine had deposited and approximately $128,000 that had accrued in interest by that time. Guggenheim used the money to reduce the Debtors' obligations to it under

Disclosure Statement p. 13. The Debtors state that they used the proceeds to, among other things, satisfy their remaining obligations to Guggenheim under the Credit Agreement and under a postpetition facility in an aggregate amount totaling $39.2 million. Id.

20. The Debtors have informed all constituencies that they estimate they have a total of $10,651,000 cash on hand remaining in their estates. Because this amount represents proceeds of the sale of assets in which Levine had a security interest under the Credit Agreement

accounting for Levine's claims, there is not enough money left in the estates to pay administrative and priority claims. This case is administratively insolvent.

C. Levine Did Not Object to Use of Cash Collateral While Discussing a Potential Settlement Between Himself, the Debtors and the Unsecured Creditors.

23. From the outset of the case, the Committee announced that it would investigate whether it had legitimate defenses against Levine's Subrogation Claims such as recharacterization and equitable subordination, as well as affirmative claims against Levine for damages relating to his role as a director, officer or stockholder of the Debtors (the "Damages Claims"). The Committee in fact conducted an extensive investigation and never filed any Damages Claims or objected to the Subrogation Claims. Instead, the Committee actively engaged in settlement talks with Levine at and immediately after the June 19 auction. After Levine made his settlement position clear, it took the committee two months to respond because Plainfield blocked Committee acceptance of any deal or counteroffer.

24. Indeed, that "response" two months later was not a counter offer. Rather, on September 5, Plainfield, an individual unsecured creditor, filed a complaint against Levine seeking to recharacterize or subordinate the Subrogation Claims and reserving rights to bring Damages Claims. Despite the fact that Plainfiled asserted estate-owned causes of action, the Debtors and the Committee never joined or initiated a lawsuit of their own against Levine.

25. Thereafter, Levine and the Debtors engaged in negotiations to attempt to settle potential estate causes of action against Levine relating to the Subrogation Claims and Damages Claims. The Debtors filed a Bankruptcy Rule 9019 motion on October 3, 2008 [Docket No. 537] seeking authority to settle with Levine. When Plainfield notified all constituencies that it intended to object and launch significant discovery in support of its

objection, all parties (including Plainfield) agreed to engage in further settlement talks. The Debtors even included the D&O insurer in these negotiations.

26. Unfortunately, these negotiations have stalled, largely because Plainfield has been non-responsive, taking weeks to respond, if at all, to proposals. Moreover, Plainfield has threatened to sue Levine for unspecified claims if Levine attempts to settle with the Committee and Debtors. While Levine cannot conceive of what Rule 11 basis Plainfield has for filing an <u>individual</u> suit against Levine[2] (much less why any claim would have any merit, given that Levine reduced his salary to nearly zero in the two years pre-petition and took no money out of the estate other than reimbursement of travel expenses -- not even indemnification of legal expenses), the explicit threat of suit and that Levine would be forced to spend money to dismiss the suit makes the primary points of a settlement from Levine's standpoint -- finality and ending litigation fees -- illusory. Thus, without Plainfield on board, there will be no settlement, and

unsuccessfully) to liquidate the Debtors through a chapter 11 plan when the same can be done for less in chapter 7.[3] Accordingly, Levine moves to convert these cases from chapter 11 to chapter 7 of the Bankruptcy Code.

Applicable Authority

29. Section 1112(b) of the Bankruptcy Code sets forth the applicable standard for conversion and provides in relevant part:

> [O]n request of a party in interest, and after notice and a hearing, absent unusual circumstances specifically identified by the court that establish that the requested conversion or dismissal is not in the best interests of creditors and the estate, the court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, if the movant establishes cause.

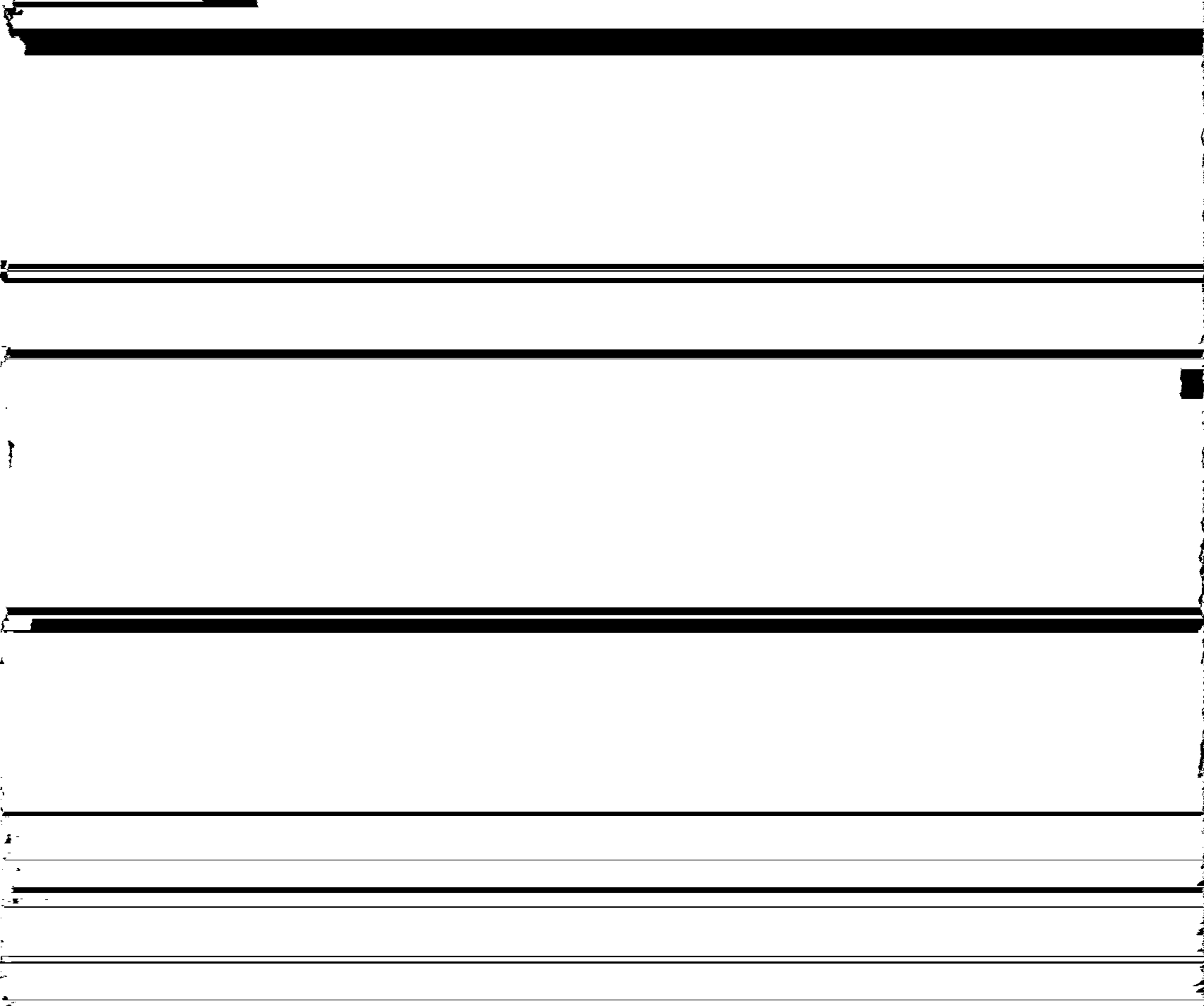
11 U.S.C. § 1112(b)(1).

30. Thus, the current version of section 1112(b)(1) provides that where "cause" is shown, the Court shall convert a chapter 11 case to a chapter 7 case upon request of a party in interest absent "unusual circumstances." Prior to the 2005 amendments to the Bankruptcy Code, section 1112(b) contained the language "may convert" as opposed to the current "shall convert" language. One of the few courts to have directly addressed this linguistic revision observed:

> This change diminishes the discretion the bankruptcy courts have in conversions to Chapter 7. If cause for dismissal or conversion to Chapter 7 exists discretion not to dismiss or convert is limited to those instances in which the court makes specific findings that unusual circumstances 'establish that the requested

that "the statutory language [of section 1112(b)] has been changed from permissive to mandatory"). Therefore, upon a showing of cause, this Court is required to convert the Debtors' chapter 11 cases to chapter 7 cases "absent unusual circumstances specifically identified by the Court that establish that the requested conversion or dismissal is not in the best interests of creditors and the estate." 11 U.S.C. § 1112(b)(1).

31. Section 1112(b)(4) sets forth the following non-exclusive list of what constitutes "cause." That list includes:



A. The Debtors' Estates are Diminishing With No Reasonable Likelihood of Rehabilitation.

A debtor "should not continue in control of its business beyond a point at which reorganization no longer remains realistic," if creditor recoveries are eroding. In re Adbrite Corp., 290 B.R. at 215; In re Johnston, 149 B.R. 158, 161 (B.A.P. 9th Cir. 1992) ("The record shows that [debtor] lacked the income which would indicate a reasonable likelihood of rehabilitation. Furthermore, the position of creditors was continuing to erode and creditors were not likely to be satisfied if the case remained in a Chapter 11. This constituted sufficient grounds for conversion of the case under § 1112(b)(1).")

B. The Debtors Are Unable to Confirm or Consummate a Chapter 11 Plan.

37. Cause for conversion exists where a party in interest shows a "failure to ... confirm a plan, within the time fixed by this title or by order of the court" or an "inability to effectuate substantial consummation of a plan." 11 U.S.C. § 1112(b)(4)(J) and (M); see also In re Great Am. Pyramid Joint Venture, 144 B.R. at 791 ("Under the statutory ground contained in section 1112(b)(2), the court may 'dismiss or convert a chapter 11 case if the court determines that it is unreasonable to expect that a plan can be confirmed in the chapter 11 case.'"). Inability to effectuate a plan arises when the "debtor lacks the ability to formulate a plan or to carry one out." In re AdBrite Corp., 290 B.R. at 216 (citing In re Dark Horse Tavern, 189 B.R. 576, 582 (N.D.N.Y. 1995); see also Hall v. Vance, 887 F.2d 1041, 1044 (10th Cir. 1989) (explaining that application of section 1112(b)(4)(M) is appropriate "whether the reason for the debtor's inability to file is its poor financial condition, the structure of the claims against it, or some other reason").

38. As shown above, the Debtors' estates are administratively insolvent by a significant amount. Indeed, after paying the Subrogation Claims, there will be less than $100,000 available to pay approximately $2 million in administrative and priority claims. Given these facts, there is simply no ability to confirm and consummate a chapter 11 plan. See 11 U.S.C. § 1129(a)(9)(A) ("The court shall confirm a plan only if ... except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that, with respect to a claim of a kind specified in section 507(a)(2) or 507(a)(3) of this title, on the effective date of the plan, the holder of such claim will receive on account of such claim cash equal to the allowed amount of such claim"). Given the foregoing and that the settlement negotiations have hit an impasse, further delays are unjustified because the process would lead to

C. Levine Will Not Consent to the Use of his Cash Collateral, and Any Unauthorized Used is "Substantially Harmful" to Levine.

39. Finally, cause for conversion includes the "unauthorized use of cash collateral substantially harmful to one or more creditors." 11 U.S.C. § 1112(b)(4)(D). As shown above, Levine is subrogated to Guggenheim's rights and is the only secured creditor remaining

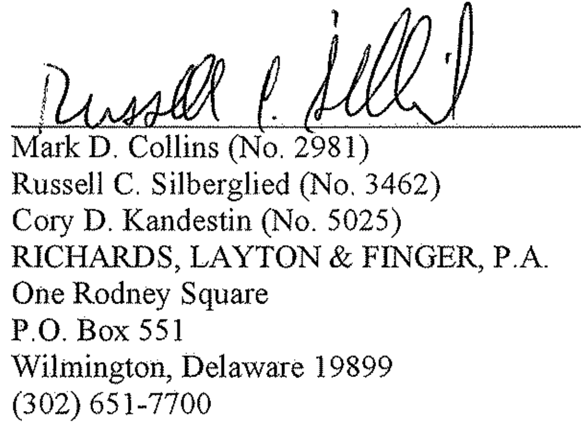
in these cases. Because Levine held a lien on the assets that were sold to Belron, he holds a lien on the cash proceeds of that sale.

(3d Cir. 2004).

42. Conversion is appropriate here because there is neither a business to

WHEREFORE, Levine respectfully requests entry of an order in the form attached hereto as Exhibit A converting these chapter 11 cases to chapter 7 cases and granting such other and further relief as the Court deems just and proper.

Dated: December 22, 2008
Wilmington, Delaware



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