

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE**

In re:)	
)	Chapter 11
)	
CONEXANT SYSTEMS, INC., <i>et al.</i> , ¹)	Case No. 13-10367 ()
)	
Debtors.)	Joint Administration Requested
)	

**DEBTORS' MOTION FOR ENTRY OF AN ORDER AUTHORIZING, BUT
NOT DIRECTING, THE DEBTORS TO PAY CERTAIN TAXES AND FEES**

Conexant Systems, Inc. and its debtor affiliates, as debtors and debtors in possession in the above-captioned chapter 11 cases (collectively, the “*Debtors*”),² respectfully represent:

Jurisdiction

1. The Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157 and 1334. This matter is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2).
2. Venue in this Court is proper pursuant to 28 U.S.C. §§ 1408 and 1409.
3. The bases for the relief requested herein are sections 105(a), 363, 507(a)(8), 541(d), 1107(a) and 1108 of the Bankruptcy Code, Rule 6004(h) of the Federal Rules of Bankruptcy Procedure (the “*Bankruptcy Rules*”) and Rule 9013-1(m) of the Local Rules of

¹ The Debtors in these chapter 11 cases, along with the last four digits of each Debtor’s federal taxpayer-identification number, are: Conexant Systems, Inc. (9439); Conexant CF, LLC (6434); Brooktree Broadband Holding, Inc. (5436); Conexant, Inc. (8218); and Conexant Systems Worldwide, Inc. (0601). The Debtors’ main corporate address is 4000 MacArthur Blvd., Newport Beach, California 92660.

² A detailed description of the Debtors and their businesses, and the facts and circumstances supporting this motion and the Debtors’ chapter 11 cases, are set forth in greater detail in the Declaration of Sailesh Chittipeddi, President and CEO of Conexant Systems, Inc., in Support of First Day Pleadings (the “*First Day Declaration*”), filed contemporaneously with the Debtors’ voluntary petitions for relief filed under chapter 11 of title 11 of the United States Code (the “*Bankruptcy Code*”), on February 28, 2013 (the “*Petition Date*”).

Bankruptcy Practice and Procedure of the United States Bankruptcy Court for the District of Delaware (the “*Local Rules*”).

Relief Requested

4. By this motion, the Debtors request entry of an order, substantially in the form attached hereto as **Exhibit A** (the “*Order*”), (a) authorizing, but not directing, the Debtors to remit and pay (i) certain franchise, sales and use taxes and other taxes (collectively, as discussed herein, the “*Taxes*”) and (ii) certain business license, patent, United States customs and other fees (collectively, as discussed herein, the “*Fees*”) and (b) authorizing financial institutions to receive, process, honor and pay all related checks and electronic payment requests for payment of Taxes and Fees.

5. The Debtors seek authority to remit and pay a total of approximately \$530,000 for certain Taxes and Fees that accrued before the Petition Date in the ordinary course of business. Specifically, the Debtors request authority, but not the direction, to remit and pay the following: (a) approximately \$30,000 for franchise taxes; (b) approximately \$380,000 for property taxes; and (c) approximately \$28,500 for personal property taxes. Additionally, the Debtors seek authority to pay a total of approximately \$88,000 for domestic patent fees and approximately \$1,100 for certain foreign patent fees that have accrued prepetition.

6. As discussed further below, the relief requested herein is appropriate because a portion of the Taxes is likely not property of the Debtors’ estate under section 541(d) of the Bankruptcy Code. Moreover, non-payment of the prepetition Taxes and Fees will cause immediate and irreparable harm to the Debtors because it (a) would cause the Debtors to incur substantial, irreversible tax penalties from governmental authorities that are likely to be paid in full and in cash as priority claims under section 507(a)(8) of the Bankruptcy Code, (b) could

result in governmental authorities imposing liens related to non-payment of property taxes under section 362(b)(18) of the Bankruptcy Code, (c) could prevent the Debtors from operating their businesses and (d) could expose certain directors and officers of the Debtors to personal liability.

7. Accordingly, the Debtors seek authority pursuant to the Order to remit and pay any Taxes and Fees in the ordinary course of business, whether those amounts accrued before or after the Petition Date.

Basis for Relief

A. The Debtors' Tax Obligations

8. In the ordinary course of business, the Debtors (a) collect sales taxes from their customers, (b) incur franchise taxes, (c) incur fees necessary to operate their businesses - including license, patent, environmental annual reporting fees and other similar assessments - (d) remit such Taxes and Fees to various taxing, licensing and other governmental authorities throughout the United States (collectively, the "*Authorities*"). A list of the Authorities is attached hereto as **Exhibit B**.³ The Debtors pay the Taxes and Fees monthly, bi-monthly, quarterly, semi-annually, annually as required by applicable laws and regulations.

B. Sales and Use Taxes

9. The Debtors' products are sold almost exclusively to manufacturers outside the United States. As a result, the amount of sales and use taxes accrued by the Debtors is minimal. The Debtors remit these sales taxes monthly, quarterly or annually. Annually, the Debtors incur approximately \$24,000 in sales and use taxes. The Debtors believe that they are

³ Although **Exhibit B** is intended to include all Authorities, the Debtors may have inadvertently omitted certain Authorities. The relief requested is intended to apply to all Authorities, whether or not such Authorities are listed on **Exhibit B**.

current with regard to sales and use taxes, but include this description out of an abundance of caution and seek authority to pay sales and use taxes if any become due.

C. Franchise Taxes

10. In the ordinary course of business, the Debtors pay franchise taxes to certain Authorities in the State of Delaware. On a quarterly basis, the Debtors estimate that they remit approximately \$45,000 in franchise taxes for their businesses. The Debtors' franchise taxes come due approximately every three months. The Debtors estimate that approximately \$30,000 of franchise taxes have accrued prepetition. The Debtors seek authority to pay such franchise taxes and continue paying them as they come due in the ordinary course.

D. Personal Property and Real Estate Taxes

11. In the ordinary course of business, Authorities impose taxes on the Debtors relating to property that the Debtors lease for the operation of their businesses. On an annual basis, the Debtors pay approximately \$1,141,000 for personal property and real estate taxes. As of the Petition Date, approximately \$28,500 and \$380,000 of personal property taxes and real estate taxes have accrued, respectively, not including penalties or interest. The Debtors seek authority to pay such personal property and real estate taxes and continue paying them as they come due in the ordinary course.

E. Business License, Patent, United States Customs and other Fees

12. State and local laws require the Debtors to pay fees to obtain and maintain a wide range of business licenses and patents from the applicable Authorities. The method for calculating amounts due for such licenses and patents and the deadlines for paying such amounts varies by jurisdiction. Further, certain states require the Debtors to pay (a) annual reporting fees to state governments to remain in good standing for purposes of conducting business

within the state, (b) various business taxes or fees based on gross receipts or other bases, as determined by the applicable taxing jurisdiction, and (c) various environmental and inspection fees. The Debtors estimate that they pay annually approximately \$15,000 in such fees. The Debtors believe that they are current on such fees, but approximately \$89,000 in foreign and domestic patent-related fees has accrued prepetition. The Debtors seek authority to pay such fees and continue paying them as they come due in the ordinary course.

F. Foreign Taxes and Fees

13. The Debtors have certain non-debtor affiliates that are located in various foreign countries and provide services for the Debtors. As described in the *Debtors' Motion For Entry of an Order Authorizing the Debtors to (A) Continue to Operate Their Cash Management System; (B) Maintain Existing Business Forms; and (C) Perform Under Certain Intercompany Arrangements and Historical Practices Between Debtors and Non-Debtor Subsidiaries*, filed contemporaneously therewith (the "**Cash Management Motion**"), the Debtors reimburse their non-debtor foreign affiliates for all operational expenses, including applicable foreign taxes and fees. In 2012, non-debtor affiliates incurred a total of approximately \$704,000 in tax expenses, which included: (a) a total foreign income tax of approximately \$239,000, (b) foreign business tax of approximately \$120,000, (c) other local foreign taxes of approximately \$25,000 and (d) value-added taxes of approximately \$320,000. The Debtors believe that as of the Petition Date a total of approximately \$2,156,000 has accrued in international tax obligations. The Debtors seek authority to continue paying the foreign taxes and fees as they come due in the ordinary course through reimbursements to the Debtors' non-debtor foreign affiliates.

Supporting Authority

A. Certain of the Taxes Are Not Property of the Debtors' Estate

14. The Debtors' payment of the prepetition Taxes is justified in large part because certain of these amounts are not property of the Debtors' estate pursuant to section 541(d) of the Bankruptcy Code.

15. Specifically, section 541(d) of the Bankruptcy Code provides, in relevant part, that "[p]roperty in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest . . . becomes property of the estate under subsection (a)(1) or (2) of this section *only* to the extent of the debtors' legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold." 11 U.S.C. § 541(d) (emphasis added).

16. Consistent with section 541(d) of the Bankruptcy Code, courts have held that certain types of taxes are not part of a debtor's estate. *See, e.g., Begier v. Internal Revenue Serv.*, 496 U.S. 53, 57-60 (1990) (holding that any prepetition payment of trust fund taxes is not a transfer subject to avoidance because such funds are not the debtor's property); *DuCharmes & Co., Inc. v. Mich. (In re DuCharmes & Co.)*, 852 F.2d 194, 196 (6th Cir. 1988) (per curiam) (same); *Shank v. Wash. State Dept. of Revenue (In re Shank)*, 792 F.2d 829, 833 (9th Cir. 1986) (sales tax required by state law to be collected by sellers from their customers is a "trust fund" tax and not released by bankruptcy discharge); *DeChiaro v. New York State Tax Comm'n*, 760 F.2d 432, 435-36 (2d Cir. 1985) (same); *Rosenow v. Ill. Dept. of Revenue (In re Rosenow)*, 715 F.2d 277, 279 82 (7th Cir. 1983) (same); *Western Surety Co. v. Waite (In re Waite)*, 698 F.2d 1177, 1179 (11th Cir. 1983) (same).

17. Here, a portion of the Taxes, namely the sales and use Taxes, constitute amounts held in trust, which the Debtors are required to collect and/or hold in trust for payment to the Authorities. Accordingly, to the extent these Taxes constitute “trust fund” taxes, they are not property of the Debtors’ estate under section 541(d) of the Bankruptcy Code. *See In re Am. Int’l Airways, Inc.*, 70 B.R. 102, 104-105 (Bankr. E.D. Pa. 1987) (explaining that federal tax trust funds are not property of a debtor’s estate because the debtors do not have a “beneficial interest” in said tax amounts); *In re Dameron*, 155 F.3d 718, 721-22 (4th Cir. 1998) (funds from various lenders held by closing agent in trust for designated third parties not property of debtor’s estate). Because the Debtors do not have an equitable interest in such sales and use Taxes, the Debtors should be permitted to remit these Taxes to the Authorities as they become due, irrespective of the chapter 11 filing.

B. Payment of the Taxes and Fees Will Avoid Unnecessary Distractions in the Chapter 11 Cases

18. Any regulatory dispute or delinquency that impacts the Debtors’ ability to conduct business in a particular jurisdiction could have a wide-ranging and adverse impact on the Debtors’ operations as a whole. Specifically, the Debtors’ failure to pay the Taxes or Fees could adversely impact the Debtors’ business operations because, among other things: (a) the Authorities could initiate audits of the Debtors or prevent the Debtors from continuing their businesses, which, even if unsuccessful, would unnecessarily divert the Debtors’ attention away from the reorganization process; (b) the Authorities could attempt to suspend the Debtors’ operations, file liens, seek to lift the automatic stay and pursue other remedies that will harm the estates; and (c) certain directors and officers might be subject to personal liability – even if such a failure to pay such Taxes and Fees was not a result of malfeasance on their part – which would undoubtedly distract these key employees from their duties

related to the Debtors' restructuring. In many instances, the Authorities may take such actions regardless of the chapter 11 filing. *See, e.g.*, 11 U.S.C. § 362(b)(9) (permitting tax audits and assessments); 11 U.S.C. § 362(b)(18) (allowing creation or perfection of liens for property taxes). Accordingly, the Debtors must continue to pay such amounts as they become due to ensure that they remain focused on operating the business and implementing a successful restructuring.

C. Certain of the Taxes and Fees May Constitute Secured or Priority Claims Entitled to Special Treatment Under the Bankruptcy Code

19. Claims asserted on account of some of the Taxes and Fees are or may be priority claims entitled to payment before general unsecured creditors. *See* 11 U.S.C. § 507(a)(8). Moreover, to the extent that such amounts are entitled to priority treatment under section 507(a)(8)(B) of the Bankruptcy Code, the governmental units also may attempt to assess interest and penalties. *See* 11 U.S.C. § 507(a)(8)(G) (granting eighth priority status to "a penalty related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss"). Thus, the Debtors believe that payment of Taxes and Fees through the relief sought in this Motion only affects the timing of the payment and, therefore, should not unduly prejudice the rights of other creditors.

D. Payment of the Taxes and Fees is Warranted Under the Doctrine of Necessity

20. Courts generally acknowledge that, under appropriate circumstances, they may authorize a debtor to pay (or provide special treatment for) certain prepetition obligations. *See, e.g., In re Just for Feet, Inc.*, 242 B.R. 821, 824-45 (Bankr. D. Del. 1999) (noting that, in the Third Circuit, debtors may pay prepetition claims that are essential to the continued operation of the debtor's business); *In re Ionosphere Clubs, Inc.*, 98 B.R. 174, 175 (Bankr. S.D.N.Y. 1989) (granting the debtor the authority to pay prepetition wages); *Armstrong*

World Indus., Inc. v. James A. Phillips, Inc., (In re James A. Phillips, Inc.), 29 B.R. 391, 398 (Bankr. S.D.N.Y. 1983) (granting the debtor the authority to pay prepetition claims of suppliers who were potential lien claimants). When authorizing payments of certain prepetition obligations, courts have relied upon several legal theories rooted in sections 1107(a), 1108, 363(b) and 105(a) of the Bankruptcy Code.

21. Pursuant to sections 1107(a) and 1108 of the Bankruptcy Code, debtors in possession are fiduciaries charged with “holding the bankruptcy estate[s] and operating the business[es] for the benefit of [their] creditors and (if the value justifies) equity owners.” *In re CoServ, L.L.C.*, 273 B.R. 487, 497 (Bankr. N.D. Tex. 2002). Inherent in a debtor in possession’s fiduciary duties is the obligation to “protect and preserve the estate, including an operating business’s going-concern value,” which, in certain instances, can be fulfilled “only . . . by the preplan satisfaction of a prepetition claim.” *Id.* Indeed, the *CoServ* court specifically noted that the preplan satisfaction of prepetition claims would be a valid exercise of the debtor’s fiduciary duty when the payment “is the only means to effect a substantial enhancement of the estate” *Id.*

22. Consistent with a debtor’s fiduciary duties, where there is a sound business purpose for the payment of prepetition obligations, and where the debtor is able to “articulate some business justification, other than the mere appeasement of major creditors,” courts have authorized debtors to make such payments under section 363(b) of the Bankruptcy Code. *See, e.g., In re Ionosphere Clubs, Inc.*, 98 B.R. at 175 (finding that a sound business justification existed to pay prepetition wages); *In re James A. Phillips, Inc.*, 29 B.R. at 397 (relying upon

section 363 as a basis to allow a contractor to pay the prepetition claims of suppliers who were potential lien claimants).⁴

23. In addition to the authority granted a debtor in possession under sections 1107(a), 1108, 363(b) and 105(a) of the Bankruptcy Code, courts have developed the “doctrine of necessity” or the “necessity of payment” rule, which originated in the landmark case of *Miltenberger v. Logansport, C. & S.W.R. Co.*, 106 U.S. 286 (1882). Since *Miltenberger*, courts have expanded their application of the doctrine of necessity to cover instances of a debtor’s reorganization. See *Dudley v. Mealey*, 147 F.2d 268, 271 (2d Cir. 1945) (holding, in a hotel reorganization matter, that the court was not “helpless” to apply the rule to supply creditors where the alternative was the cessation of operations). The United States Court of Appeals for the Third Circuit, which recognized the doctrine of necessity in *In re Lehigh & New England Ry. Co.*, 657 F.2d 570, 581 (3d Cir. 1981).

24. In *Lehigh*, the Third Circuit held that a court could authorize the payment of prepetition claims if such payment was essential to the continued operation of the debtor. *Id.* (stating that a court may authorize payment of prepetition claims when there “is the possibility that the creditor will employ an immediate economic sanction, failing such payment”); see also *In re Penn Cent. Transp. Co.*, 467 F.2d 100, 102 n.1 (3d Cir. 1972) (holding

⁴ Courts have also authorized payment of prepetition claims in appropriate circumstances pursuant to section 105(a) of the Bankruptcy Code. Section 105(a) of the Bankruptcy Code, which codifies the inherent equitable powers of the bankruptcy court, empowers the bankruptcy court to “issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.” 11 U.S.C. § 105(a). Under section 105(a), courts may permit preplan payments of prepetition obligations when such payments are essential to the continued operation of the debtor’s business and, in particular, where nonpayment of a prepetition obligation would trigger a withholding of goods or services essential to the debtors’ business reorganization plan. See *In re UNR Indus.*, 143 B.R. 506, 520 (Bankr. N.D. Ill. 1992) (permitting the debtor to pay prepetition claims of suppliers or employees whose continued cooperation is essential to the debtors’ successful reorganization); *Ionosphere Clubs*, 98 B.R. at 177 (finding that section 105 empowers bankruptcy courts to authorize payment of prepetition debt when such payment is needed to facilitate the rehabilitation of the debtor).

that the necessity of payment doctrine permits “immediate payment of claims of creditors where those creditors will not supply services or material essential to the conduct of the business until their pre-reorganization claims have been paid”); *In re Just for Feet, Inc.*, 242 B.R. at 824-45 (noting that debtors may pay prepetition claims that are essential to continued operation of the business); *In re Columbia Gas Sys., Inc.*, 171 B.R. 189, 191-92 (Bankr. D. Del. 1994) (same).

25. Today, the rationale for the necessity of payment rule – the rehabilitation of a debtor in reorganization cases – is “the paramount policy and goal of Chapter 11.” *In re Ionosphere Clubs, Inc.*, 98 B.R. at 176; *Just For Feet*, 242 B.R. at 826 (finding that payment of prepetition claims to certain trade vendors was “essential to the survival of the debtor during the chapter 11 reorganization.”); *see also In re Quality Interiors, Inc.*, 127 B.R. 391, 396 (Bankr. N.D. Ohio 1991) (“[P]ayment by a debtor-in-possession of pre-petition claims outside of a confirmed plan of reorganization is generally prohibited by the Bankruptcy Code”, but “[a] general practice has developed . . . where bankruptcy courts permit the payment of certain pre-petition claims, pursuant to 11 U.S.C. § 105, where the debtor will be unable to reorganize without such payment.”); *In re Eagle-Picher Indus., Inc.*, 124 B.R. 1021, 1023 (Bankr. S.D. Ohio 1991) (approving payment of prepetition unsecured claims of tool makers as “necessary to avert a serious threat to the Chapter 11 process”); *Burchinal v. Cent. Wash. Bank (In re Adams Apple, Inc.)*, 829 F.2d 1484, 1490 (9th Cir. 1987) (finding that it is appropriate to provide for the “unequal treatment of pre-petition debts when [such treatment is] necessary for rehabilitation”); Collier on Bankruptcy P. 105.02[4][a] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. rev.) (discussing cases in which courts have relied upon the “doctrine of necessity” or the “necessity of payment” rule to pay prepetition claims immediately).

26. Here, the Debtors' payment of the Taxes and Fees is an exercise of sound business judgment and is necessary to permit a successful reorganization. As discussed above, the Debtors must continue to pay these amounts to continue operating in certain jurisdictions and to avoid costly distractions during these chapter 11 cases. Indeed, it is possible that Authorities would seek to interfere with the Debtors' businesses if the Taxes and Fees were not paid on a timely basis. Additionally, the relief requested herein merely expedites the treatment and distribution to the Authorities that would otherwise be made at a later date under a plan of reorganization. *See* 11 U.S.C. § 507(a)(7).

27. Courts in this jurisdiction have approved relief similar to the relief requested in this motion. *See, e.g., In re School Specialty, Inc.*, No. 13-10125 (KJC) (Jan. 30, 2013) (authorizing payment of prepetition taxes as they come due in the ordinary course of business); *In re THQ Inc.*, No. 12-13398 (MFW) (Dec. 20, 2012) (same); *In re A123 Systems, Inc.*, No. 12-12859 (KJC) (Oct. 18, 2012) (same); *In re Vertis Holdings, Inc.*, No. 12-12821 (CSS) (Bankr. D. Del. Oct. 31, 2012) (same); *In re Neb. Book Co.*, No. 11-12005 (PJW) (Bankr. D. Del. June 28, 2011) (same).⁵

E. Cause Exists to Authorize the Debtors' Financial Institutions to Honor Checks and Electronic Fund Transfers

28. The Debtors represent that they have sufficient availability of funds to pay the amounts described herein in the ordinary course of business by virtue of cash reserves, expected cash flows from ongoing business operations and anticipated access to debtor-in-possession financing. Also, under the Debtors' existing cash management system, the Debtors represent

⁵ Because of the voluminous nature of the orders cited herein, such orders are not attached to this motion. Copies of these orders are available upon request to the Debtors' counsel.

that checks or wire transfer requests can be readily identified as relating to an authorized payment with respect to the Taxes and Fees. Accordingly, the Debtors believe that checks or wire transfer requests, other than those relating to authorized payments, will not be honored inadvertently and that all applicable financial institutions should be authorized, when requested by the Debtors, to receive, process, honor and pay any and all checks or wire transfer requests with respect to the Taxes and Fees.

Waiver of Bankruptcy Rules Regarding Notice and Stay of an Order

29. To implement the foregoing successfully, the debtors seek a waiver of the notice requirements under Bankruptcy Rule 6004(a) and any stay of an order granting the relief requested herein pursuant to Bankruptcy Rule 6004(h), 7062, 9014 or otherwise.

The Debtors' Reservation of Rights

30. Nothing contained herein is intended or should be construed as an admission as to the validity of any claim against the Debtors, a waiver of the Debtors' rights to dispute any claim or an approval or assumption of any agreement, contract or lease under section 365 of the Bankruptcy Code. Additionally, nothing contained herein is intended or should be construed as an admission as to the validity of any claim against the Debtors or a waiver of the Debtors' rights to dispute any claims regarding escheatment. The Debtors expressly reserve their rights to contest any claim or billing dispute. Likewise, if this Court grants the relief sought herein, any payment made pursuant to the Court's order is not intended and should not be construed as an admission as to the validity of any claim or a waiver of the Debtors' rights to subsequently dispute such claim.

Notice

31. The Debtors have provided notice of this motion to: (a) the Office of the United States Trustee for the District of Delaware; (b) the entities listed on the Consolidated List of Creditors Holding the 30 Largest Unsecured Claims filed pursuant to Bankruptcy Rule 1007(d); (c) counsel to the Debtors' prepetition secured lender and debtor in possession lender; (d) the agent for the Debtors' prepetition secured notes; (e) counsel to each of the prepetition equity holders; (f) the Delaware Secretary of State; (g) the Delaware Secretary of Treasury; (h) the Delaware State Attorney General; (i) the Office of the United States Attorney General for the State of Delaware; (j) the Internal Revenue Service; (k) the Securities and Exchange Commission; and (l) each of the Authorities listed on **Exhibit B** attached hereto. In light of the nature of the relief requested in this motion, the Debtors respectfully submit that no further notice is necessary.

No Prior Request

32. No prior motion for the relief requested herein has been made to this or any other court.

[Remainder of page intentionally left blank.]

WHEREFORE, for the reasons set forth herein and in the First Day Declaration, the Debtors respectfully request that the Court enter the Order, substantially in the form attached hereto as **Exhibit A** authorizing, but not directing, the Debtors to pay Taxes and Fees regardless of whether such amounts accrued before or after the Petition Date; (b) authorizing financial institutions to receive, process, honor and pay all related checks and electronic payment requests for payment of Taxes and Fees; and (c) granting such other and further relief as may be appropriate.

Dated: February 28, 2013
Wilmington, Delaware

/s/ Domenic E. Pacitti

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