UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

In re	:	Case Nos. 06-61794, 06-61796 and 06-61797
CEP HOLDINGS, LLC, *et al.,*	:	Chapter 11
	:	Honorable Marilyn Shea-Stonum
Debtors.	:	
	:	Related to Docket Entry Nos. 1

MOTION OF THE UNOFFICIAL COMMITTEE OF PRE-PETITION TRADE CREDITORS TO CONVERT THE DEBTORS' CHAPTER 11 CASES TO CHAPTER 7 CASES PURSUANT TO 11 U.S.C. § 1112(b)

The Unofficial Committee of Pre-Petition Trade Vendors (the "Trade Committee"), by and through its undersigned counsel, files this Motion to Convert the Debtors' Chapter 11 Cases to Chapter 7 Cases Pursuant to 11 U.S.C. § 1112(b) (the "Motion "), and in support thereof states as follows:

Introduction

1. The Trade Committee seeks immediate conversion of the liquidating chapter 11 bankruptcy cases filed by CEP Holdings, LLC ("Holdings"), Creative Engineered Polymer Products, LLC ("CEP"), and Thermoplastics Acquisition, LLC ("Thermoplastics", with Holdings and CEP, collectively are the "Debtors") to chapter 7 bankruptcy cases because: (i) they operate to benefit only General Motors Corporation, Visteon Corporation and Delphi Corporation (collectively, the "Customers") by a costly scheme intended to maximize the inventory build for the Customers regardless of the impact upon other parties in interest and (ii) the losses resulting from the Debtors' express plan to augment the Customers' inventory (which plan is evidenced in the Debtors' first day pleadings) coupled with the Debtors' express intent not to attempt a rehabilitation of the Debtors' operations (also contained in the Debtors' first day pleadings) constitutes "cause" for conversion.

The Bankruptcy Filing

2. On September 20, 2006 (the "Petition Date"), the Debtors each filed their respective voluntary petitions for relief under chapter 11 of title 11 of the United States Code, 11 U.S.C. §§ 101, *et seq.* (the "Bankruptcy Code").

Jurisdiction and Venue

3. This Court has jurisdiction over these bankruptcy cases under 28 U.S.C. §§ 157(b) and 1334 because they arise under the Bankruptcy Code. This matter is a core proceeding 28 U.S.C. § 157(b)(2).

4. Venue for the Debtors' bankruptcy cases is proper in this District under 28 U.S.C. §§ 1408 and 1409.

5. The statutory predicates for this Motion are 11 U.S.C. §§ 105 and 1112(b).

Background

6. In August 2005, The Reserve Group and certain individual insiders thereof acquired substantially all of the assets (other than accounts receivable) of CEP from the CRT Capital Group through Holdings, a wholly owned affiliate of The Reserve Group. The acquisition price for CEP was approximately $13.5 million, of which $12.5 million was funded through secured term debt by Wachovia Capital Finance Corporation ("Wachovia"), and a $1.0 million cash investment, or an equity contribution, from The Reserve Group.

7. In December 2005, The Reserve Group, through Thermoplastics, a wholly owned subsidiary of CEP, acquired substantially all of the assets of the Thermoplastics division from Parker-Hannifin Corporation for purchase price consideration of approximately $7.1 million; the entire purchase price of which was funded from the proceeds of loans by Wachovia as well as a $4.2 million seller-retained secured note.

8. The Debtors' alleged prepetition secured debt is primarily comprised of (i) two working capital-based revolving credit loans from Wachovia, (ii) multiple term loans from

Wachovia and (iii) seller retained debt relating to the Parker-Hannifin sale of Thermoplastics. In addition, Wachovia has been selling the Customers subordinated participation interests in the Wachovia loan facilities. As of the Petition Date, the Customers have purchased at least $2.9 million of subordinated participation interests.

9. Collectively, CEP and Thermoplastics (as well as a non-debtor Mexican affiliate, Composite Parts Mexico S.A. de C.V.), comprise a ten (10) facility operation with approximately $190 Million in gross annual revenue.

10. By March 2006, CEP had overdrawn its revolving credit availability with Wachovia by over $2.0 million. By April 2006, the Debtors were subject to an initial forbearance agreement with Wachovia due to a multitude of alleged defaults under their various loan agreements with Wachovia. Likewise, the Debtors requested and obtained a variety of financial accommodations from the Customers necessary to sustain operations in order to satisfy the purchase orders of the Customers.

11. During the period from January 2006 to April 2006, the trade obligations of the pre-petition Debtors ballooned from approximately $18.9 million to $27.9 million, after the Debtors, already significantly overleveraged, used practically every dollar of secured financing available to them. It is the position of the Trade Committee that the officers and directors of the Debtors caused the Debtors to finance their operations with trade debt that they knew or should have known the Debtors would be unable to repay.

12. In June 2006, the Debtors encouraged their trade vendors, with pre-petition claims in the aggregate amount of approximately $26.5 million, to organize an unofficial committee for purposes of representing the interests of trade creditors in an out-of-court restructuring effort by the Debtors. The trade creditors did organize in July 2006, and formed the Trade Committee, which is comprised of six (6) members – Lanxess Corporation, DuPont, Rhodia Inc., BASF Corporation, Gold Key Processing, LTD. and Excel Polymers LLC (the holders of claims aggregating approximately $6.5 million of the approximately $26.5 million in

total trade debt, or approximately 25% of the aggregate pre-petition trade debt of the Debtors (and their Mexican affiliates).[1]

13. Without taking into account certain subordinated participation loans from the Customers, by July 31, 2006 the Debtors had approximately $32.4 million of allegedly secured debt.

14. During the few months immediately preceding the Petition Date, the Debtors, Wachovia and the Customers have worked together to formulate a bankruptcy strategy that benefits no one but the Debtors, Wachovia and the Customers, as evidenced by the Proposed Interim DIP Order.

15. Through information obtained by the Trade Committee in its pre-petition investigation of the Debtors and their operations and the Debtors' first day pleadings, the Trade Committee has ascertained the following information (which list is not exhaustive) about the Debtors that is important to this Court's consideration of whether the Debtors' chapter 11 bankruptcies should be converted to a chapter 7 liquidation:

(a) The Debtors failed to operate profitably or at "break-even" in any month since the acquisition of the Debtors' facilities by The Reserve Group in August 2005 and December 2005, respectively;

(b) The Debtors have already obtained concessions from their Customers in the form of "immediate pay" of accounts receivable due from the Customers, resulting in a significant paydown of obligations to Wachovia - yet the Debtors still had and continue to have insufficient liquidity to operate in the ordinary course of business in the absence of incurring additional secured debt;

(c) As a result of the Debtors' "cash burn" and the inability to generate sufficient cash flow to permit operations in the ordinary course, the Customers were required to fund approximately $2.9 million in pre-bankruptcy loans on a junior participating basis in the Wachovia revolving credit facilities to provide the Debtors sufficient availability to sustain even the most basic operations;

[1] The Trade Committee intends to impress upon the Office of the U.S. Trustee the need to quickly organize an official committee of unsecured creditors pursuant to section 1102 of the Bankruptcy Code, and likewise inform the U.S. Trustee of the willingness of the Trade Committee to serve as the official committee in the Debtors' cases subject to the addition of other creditors as the U.S. Trustee deems necessary and appropriate.

(d) Based upon the Trade Committee's analysis of documentation provided to it by the Debtors and other independent sources, the Trade Committee forecasts that the Debtors will lose no less than $1 million on a monthly basis from operations through the foreseeable future;

(e) The operating losses of the Debtors in chapter 11 will continue to be funded either through cash infusions or junior secured and superiority loans from the Customers or some combination of the two (if so permitted by the Court), with all such loans resulting in immediate and substantial harm to the interests of general unsecured creditors; See the proposed Emergency Order Authorizing Debtors To: (A) Use Cash Collateral on an Emergency Basis; (B) Incur Postpetition Debt on an Emergency Basis; (C) Grant Adequate Protection and Provide Security and Other Relief to Wachovia Capital Finance Corporation (Central); and (D) Grant Certain Related Relief (the "Proposed Interim DIP Order"),

(f) The Proposed Interim DIP Order is a mechanism for which the Customers can cause the Debtors to build the Customers' inventory, regardless of the impact on the Debtors' estates and then effectuate the closings of the Debtors' facilities if the Customers have no further use for those facilities; see generally the Proposed Interim DIP Order and ¶ 8(d), (f) of the Proposed Interim DIP Order,

(g) The Proposed Interim DIP Order provides the Customers, non-fiduciaries to these bankruptcy estates, with the sole discretion to elect which of the Debtors' facilities will be promptly liquidated and which will be sold on any orderly basis; see ¶ 8(d) of the Proposed Interim DIP Order,

(h) Throughout the Proposed Interim DIP Order, in many instances the unsecured creditors will bear the brunt of the costs associated with the build of parts banks at various facilities for the benefit of the Customers as a result of further post-petition participation in the Wachovia facilities;

(i) The Proposed Interim DIP Order proposes to have a Chapter 11 Trustee appointed in the event the Debtors fail to maintain production for bank builds requested by the Customers; see ¶ 14 of the Proposed Interim DIP Order and

(j) The Proposed Interim DIP Order provides that in the Customers' pursuit to augment their inventory at the cost of the bankruptcy estates, their professional fees ($450,000) will be paid from estate proceeds.

16. Based on discussions with counsel for the Debtors, the documents made available to the Trade Committee by the Debtors and those documents currently of record with this Court, it is readily apparent that the Debtors intend to liquidate their assets over the next few months. If this Court allows the Debtors to proceed in chapter 11, the short term operations

of the Debtors (continued for the sole benefit of the Customers) will result in a continuing diminution of the value of the Debtors' estates and thereby significantly reduce the likelihood of unsecured creditors receiving any meaningful distribution from the assets of the Debtors' estates.

Relief Requested

17. The Trade Committee seeks an order of this Court converting the Debtors' chapter 11 liquidating cases to cases under chapter 7 of the Bankruptcy Code pursuant to 11 U.S.C. § 1112(b) to expedite the inevitable liquidation of the Debtors' estates, halt the diminution of value resulting from continuing operational losses funded with additional debt (having priority above general unsecured creditors) and thereby maximize a distribution to all creditors.

18. As discussed above, since The Reserve Group acquired CEP and Thermoplastics in highly leveraged transactions, the Debtors have consistently lost money, resulting in liquidity problems and the rapid deepening of the Debtors' insolvency. Ongoing operating losses and related post-petition expenses incurred by the Debtors for the sole benefit of the Customers and funded with secured and priority debt strip value otherwise available to unsecured creditors. Rehabilitation of the Debtors is not even contemplated in these bankruptcy cases as it is unquestionably unrealistic. Therefore, these chapter 11 liquidating cases should be immediately converted to chapter 7 cases.

Argument

19. Conversion of these chapter 11 liquidation cases to chapter 7 cases is appropriate because the immediate net liquidation value of the Debtors' estates is greater than the liquidation value of the same estates after they operate for the benefit of the Customers to allow the Customers to resource production while the Debtors incur additional secured and priority debt in that process.

20. Section 1112(b) of the Bankruptcy Code provides, *inter alia*, that on 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 [chapter 11] to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of the estate, if the movant establishes cause.

11 U.S.C. § 1112(b)(1).

21. Subsection (b)(4) of section 1112 of the Bankruptcy Code identifies various "causes" for conversion, but the list is not exhaustive. In re Erin Farms Inc., 336 B.R. 600 (6th Cir. 2005) (Non-precedential). Generally, proof of any one of these factors is sufficient to justify conversion. Id. Subsection (b)(4) states that "cause" for conversion includes, *inter alia*, . . . substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation . . .." 11 U.S.C. § 1112(b)(4)(A).

22. The inquiry under section 1112(b) is fact specific, focusing on the circumstances of each case and rests in the sound discretion of the bankruptcy court. In re Timbers of Inwood Forest Assocs., Ltd., 808 F.2d 363, 72 (5th Cir. 1987) aff'd, 484 U.S. 364 (1988). As discussed below, the circumstances surrounding these chapter 11 liquidation cases demonstrate the propriety of conversion.

a. Conversion is Appropriate Because (i) the Debtors' Operations Result in Nothing But Losses, and (ii) the Debtors Will Not and Cannot Rehabilitate Their Businesses.

23. Cause for conversion exists when a moving party can demonstrate the substantial or continuing loss to or diminution of the debtor's estate and an absence of a reasonable likelihood of rehabilitation. 11 U.S.C. §1112(b); In re ABEPP Acquisition Corp., 191 B.R. 365 (Bankr. N.D. Ohio 1996); In re Timbers of Inwood Forest Assocs., Ltd., 808 F.2d 363, 371-72 (5th Cir. 1987) aff'd, 484 U.S. 364 (1988).

24. Section 1112(b)(4)(A) of the Bankruptcy Code contemplates a "twofold" inquiry into whether cause exists for conversion. 11 U.S.C. § 1112(b)(4)(A); Citi-Toledo, 170 B.R. at 606. First, the bankruptcy court must identify "*some*" loss or diminution of value. Citi-Toledo, at 606. For instance, a debtor's incurring of additional administrative claims or other indebtedness that might further erode the position of the unsecured creditors is sufficient to satisfy this first test. Id. Second, there must be an absence of a reasonable likelihood of rehabilitation, id., which means that the debtor must intend to do more than just liquidate within the chapter 11 proceeding. See In re ABEPP Acquisition Corp., 191 B.R. 365 (Bankr. N.D. Ohio 1996).

25. Both elements of the twofold analysis of subsection 1112(b)(4)(A) are clearly satisfied in this case as discussed below.

(i) Since The Reserve Group Purchased the Debtors, The Debtors Have Never Operated Profitably

26. Since the highly leveraged acquisitions of CEP and Thermoplastics, the Debtors have generated nothing but substantial losses. Even with significant prepetition accommodations from their Customers, the Debtors have never been able to operate profitably or operate on a break even basis.

27. As of the date of this Motion, the Debtors continue to generate significant operational losses and the Debtors anticipate incurring additional expenses during their chapter 11 liquidations as evidenced in their first day pleadings, which include, but are not limited to:

(i) in the chapter 11 liquidation, the Debtors anticipate that Customers, for no other benefit than their own, will lend the Debtors an additional no less than $1,500,000 on a postpetition basis, seeking protections under section 364 of the Bankruptcy Code, to allow the Customers to increase their inventory of the parts manufactured by the Debtors until they can find alternative vendors and elect to close the Debtors facilities. See ¶ 3(c)(ii) of the Proposed Interim DIP Order. This additional postpetition debt will further erode the position of the unsecured creditors who are effectively bearing the brunt of these loans by a reduced distribution;

(iii) in the chapter 11 liquidation, the Debtors intend to create an employee incentive program, which program will potentially result in the expenditure of $1,273,000; see Exhibit F to Proposed Interim DIP Order, and

(iv) in the chapter 11 liquidation, the Debtors propose to make substantial deposits to utilities and cure amounts in arrearages to utilities, select leases and other select service providers.

28. The conversion of these chapter 11 liquidation cases to chapter 7 liquidation cases will promptly cause liquidation of the Debtors without the incurrence of additional debt that can only be repaid—if ever—at the expense of unsecured creditors. Additionally, there will be no need to further leverage the Debtors (for the sole benefit of the Customers and to the detriment to all other general unsecured creditors); pay $1,273,000 in incentive compensation to the Debtors' officers and employees or make cure payments and tender deposits.

29. In short, in a chapter 7 proceeding, the net value of the Debtors' estates for the benefit of unsecured creditors will be greater and the distribution of that value will be distributed to *all* creditors of the estates, rather than to a select few.

30. Based on the foregoing, the first part of the two-fold analysis set forth in subsection 1112(b)(4)(A) of the Bankruptcy Code is easily satisfied. Not only have these Debtors suffered substantial losses, but they will continue to do so to the detriment of unsecured creditors of their bankruptcy estates if they remain in chapter 11.

(ii) There is No Intention of Rehabilitation or a Reasonable Expectation of Rehabilitation.

31. The Debtors' chapter 11 cases are planned liquidations that undeniably diminish or eliminate returns otherwise available to unsecured creditors. As evidenced by the documents of record with this Court, rehabilitation of the Debtors and their business operations is not a possibility in these cases as the Customers have determined to work with the Debtors for the period minimally necessary for them to resource production.

32. Conversion from a chapter 11 case to a chapter 7 case is appropriate where the debtor is continuing to lose money and intends to liquidate. See ABEPP Acquisition, 191 B.R. at 367; Matter of Natrl. Plants and Lands Mgt. Co., Ltd., 68 B.R. 394, 395 (Bankr. S.D.N.Y. 1986).

33. Courts have consistently concluded that a liquidation does not equate to the "rehabilitation" of the debtor. See, e.g., ABEPP Acquisition, at 368 (Debtor's intention to liquidate was one of the reasons the court converted the bankruptcy case); In re Jeanette Corp. *et al.*, 85 B.R. 319, 343-44 (W.D. Pa. 1988) (where debtors' assets other than a cause of action were sold during chapter 11 case, proposed plan of liquidation was "not a plan for rehabilitation of the [d]ebtor") vacated on other grounds by Moody v. Simmons, 858 F.2d 137 (3d Cir. 1988); Matter of E. Paul Kovacs and Co., Inc., 16 B.R. 203, 206 (Bankr. D. Ct. 1981)("rehabilitation referred to in § 1112(b)(1) means more than liquidation under chapter 11 . . .."); Matter of Natural Plants and Lands Mgt. Co., Ltd., 68 B.R. 394 (Bankr. S.D.N.Y. 1986) (conversion of chapter 11 case to chapter 7 under 11 U.S.C. § 1112(b)(1) is proper upon request of United States trustee where, *inter alia*, debtor is experiencing $60,000 loss per month and has filed self-liquidating chapter 11 plan).

34. The term "rehabilitation" as used in section 1112(b)(1) of the Bankruptcy Code means "to put back in good condition; re-establish on a firm, sound basis". ABEPP Acquisition, 191 B.R. at 368 (citation omitted); In re V Companies, 274 B.R. 721, 725 (Bankr. N.D. Ohio 2002).

35. Furthermore, "'[r]ehabilitation' is not 'reorganization'; thus, the standard under section 1112(b)(1) is not the technical one of whether the Debtor can confirm a plan but, rather, whether the Debtors' business prospects justify [the] continuance of [a] reorganization effort," 7 LAWRENCE P. KING, *ET AL.*, Collier on Bankruptcy ¶ 1112.04[5][a][ii] (15th Ed. Rev. 2004), or, as here, serve no reorganization purpose whatsoever. See Matter of Woodbrook Assoc., 19 F.3d 312, 317 (7th Cir. 1994) (Although "reorganization" may include a liquidating plan,

rehabilitation does not.); see also, In re Ledges Apts., 58 B.R. 84, 87 (Bankr. E.D. Va. 1986) ("Rehabilitation is not reorganization. Reorganization encompasses rehabilitation and may contemplate liquidation. Rehabilitation, on the other hand, may not include liquidation.").

36. It is beyond dispute that these chapter 11 cases are nothing more than liquidation cases, which, when coupled with substantial losses partially funded through the incurrence of additional debt, thereby causing diminution in value of the estates, compels conversion of these chapter 11 cases to chapter 7 under the present set of facts. It should not be overlooked that these chapter 11 cases, if permitted to go forward, will proceed on the dollar of the general unsecured creditors who are the very parties seeking conversion of the Debtors' chapter 11 liquidation proceedings. To maximize value to the estates and to all of the creditors, these chapter 11 cases should be promptly converted to chapter 7 cases.

WHEREFORE, the Unofficial Committee of Trade Creditors respectfully requests that this Court convert bankruptcy case nos.: 06-61794, 06-61796, and 06-61797 from chapter 11 cases to chapter 7 cases, with all rights preserved for the Chapter 7 Trustee as provided under the Bankruptcy Code and grant such other relief as this Court deems to be just and appropriate.

Dated: September 21, 2006 **McGuireWoods LLP**

By: *__/s/ Mark E. Freedlander___*

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