

IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE EASTERN DISTRICT OF TENNESSEE  
SOUTHERN DIVISION

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IN RE:

PROPEX INC.,  
PROPEX HOLDINGS INC.,  
PROPEX CONCRETE SYSTEMS  
CORPORATION,  
PROPEX FABRICS INTERNATIONAL  
HOLDINGS I INC.,  
PROPEX FABRICS INTERNATIONAL  
HOLDINGS II INC.,

Debtors.

\*  
\*  
\* Case No. 08-10249  
\* Case No. 08-10250  
\* Case No. 08-10252  
\* Case No. 08-10253  
\* Case No. 08-10254  
\*  
\* Chapter 11  
\*  
\* Jointly Administered Under  
\* Case No. 08-10249  
\*  
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Chattanooga, Tennessee

BE IT REMEMBERED, that the above-styled  
cause came on to be heard on the 25th day of June, 2008,  
before the Honorable John C. Cook, Judge of said Court, when  
all parties announced ready to proceed, and the following  
proceeding was had, to wit:)

\* \* \*

Donna F. Segars, CCR  
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6255 Dayton Boulevard  
Chattanooga, Tennessee 37343-2710  
(423) 843-3114

DEBTORS' INDEX OF EXHIBITS

1  
2  
3  
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8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
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No.	Description	Page
1	Summary calculation of consideration being provided by the sale; Tax basis of the inventory; Tax basis of the fixed assets; Form 1120 for 2006 Propex tax return and attached schedule to the 2006 return.....	10

\* \* \*

INTERNAL REVENUE SERVICE'S  
INDEX OF EXHIBITS

(There were no exhibits tendered.)

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UNSECURED CREDITORS COMMITTEE  
INDEX OF EXHIBITS

(There were no exhibits tendered.)

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THE COURT: Be seated please.

Clerk, call the case.

THE CLERK: This is the Chapter 11, Propex Inc., Propex Holdings Inc., and associated cases, several matters on the agenda this morning. Motion for approval of settlement agreement with American Fibers & Yarns Company. There is an expedited motion for entry of an order approving the sale of assets.

THE COURT: All right. Let's have an announcement of appearances, please.

MR. WEGE: Good morning, Your Honor. Mark Wege and Shelley Rucker for the Debtors.

THE COURT: All right.

MR. ROCHESTER: Good morning, Your Honor. Shaya Rochester, with Akin Gump Strauss Hauer & Feld, for the initial committee of unsecured creditors.

THE COURT: All right.

MS. SWAFFORD: Kim Swafford, for the office of the United States Trustee.

THE COURT: All right.

MR. CLINTON: Shayne Clinton, for BNP Paribas.

THE COURT: All right.

1 MR. ANDERSON: Kent Anderson, Assistant  
2 U.S. Attorney, for the Internal Revenue Service.

3 THE COURT: Okay. All right. You may  
4 proceed.

5 MR. WEGE: Your Honor, we have two matters  
6 this morning. The first one is unopposed, that is the  
7 motion for approval of the 9019 settlement with American  
8 Fibers & Yarns.

9 Your Honor, the settlement is --  
10 essentially, what the settlement provides is that the  
11 Debtors would get paid the amount that they are due in March  
12 and April of '08, which had not been paid yet at the time of  
13 this settlement document. There would be more or less a  
14 clear allocation under the common site services agreement so  
15 that, that agreement would change to be consistent with the  
16 terms of the settlement agreement, and then the lease  
17 agreement, essentially, would be unchanged. There would be  
18 a payment in full of all the obligations that would be owed  
19 under the common site services agreement as amended to the  
20 Debtor, and the lawsuit would be dismissed, and there would  
21 be releases upon the parties, so, essentially, it's a  
22 settlement that would provide full payment of all the monies  
23 that the Debtor believes it's due.

24 THE COURT: All right. And I assume the  
25 Committee was aware of the particulars of this litigation

1 and has no objection to it?

2 MR. ROCHESTER: That's correct, Your Honor,  
3 there is no objection by the Committee.

4 THE COURT: All right. I will grant the  
5 motion.

6 MR. ROCHESTER: Very good, Your Honor.

7 MR. WEGE: Your Honor, the second matter  
8 that is set for hearing today is the motion for the sale of  
9 the manufacturing operations in Alto, Georgia, which is also  
10 known as the Yonah facility. And there is an objection to  
11 one aspect I believe of the sale, which is the IRS  
12 objection. There is no -- to my knowledge, there is no  
13 objection to the substance of the sale, which is the amount  
14 of money that is being paid, the transaction itself, the  
15 nature of the transaction, or the settlement agreement -- I  
16 mean the sale agreement, and so, to my knowledge, I think,  
17 all parties have agreed to that aspect of it. I'm only  
18 aware of the IRS objection, and as I understand it, their  
19 objection is a desire to have -- set aside or some  
20 recognition in the order that would recognize the proceeds  
21 in that sale as it relates to a capital gain. I mean I'll  
22 let them, obviously, speak for themselves. But, that  
23 doesn't go to the substance, and I think they have no  
24 objection to the substance of the sale.

25 Your Honor, one thing I also wanted to

1 cover with respect to the motion, we did file an amendment  
2 to the asset purchase agreement, that made a minor change in  
3 the assets that were assets being sold and then assets being  
4 excluded as well as a modification to the list of executory  
5 contracts that were being assumed and assigned. There were  
6 two new parties that were included on that list of assumed  
7 contracts, that was only filed Monday, and those two parties  
8 are Purity Water and Docuteam. And so in order to deal with  
9 that, that late inclusion of the parties and the contracts  
10 to be assumed and assigned, what we did is, of course,  
11 provide a notice to those parties, and we included in the  
12 order, a proposed order that we uploaded, which is an  
13 amended order, that those parties would have ten days after  
14 today if they filed -- if they desired to object to the  
15 assumption of assignments. So it gives them, those two  
16 parties additional notice time, in case they have any  
17 issues.

18 As to the magnitude of those particular  
19 contracts, they are what I would consider relatively minor  
20 contracts, in that they deal with water coolers and copiers,  
21 so it's not a significant portion of the sale itself and it  
22 will definitely go to a significant matter. But,  
23 nonetheless, we wanted to protect their rights, and so the  
24 order that we submitted was amended to give that additional  
25 notice time.

1 THE COURT: All right. What about the  
2 deletion of certain assets, the inclusion of others? You  
3 characterize that as minor?

4 MR. WEGE: Very minor, Your Honor.

5 THE COURT: And can you tell me the  
6 definition of minor, how you are using that? Because I  
7 couldn't really tell what -- the significance of that.

8 MR. WEGE: Your Honor, basically, a  
9 substitution of a couple of looms. And if you ask me to  
10 tell you in detail what that means, I can't. But, they're a  
11 minor portion of the equipment that's being sold. There  
12 were two that were excluded and two that were included, so.

13 THE COURT: It would not impact the value  
14 of the overall sale at all?

15 MR. WEGE: It does not. It does not. The  
16 terms of the sale itself is unaffected, the 3.4 million  
17 dollar consideration is completely unaffected, it's merely  
18 clarifying the schedules, of identifying the correct looms.

19 THE COURT: I see.

20 MR. WEGE: So, Your Honor, that is the  
21 nature of the amendment, the proposed order that we have  
22 deals with that change, as well as the notice language to  
23 the parties that are the counter-parties to the contracts,  
24 as well as the language that the committee asked for,  
25 providing notice to them of any amendments, of course, which

1 we have done by virtue of the filing of the amendment. So  
2 that is the nature of the sale, the amendment, and will be  
3 done with the proposed order.

4 Your Honor, we still, as I understand it,  
5 have an unresolved objection with the IRS. And I have a  
6 witness here that is prepared to provide testimony, but I  
7 can do that by proffer, and I understand the IRS just don't  
8 have any objection to proffer.

9 THE COURT: All right.

10 MR. ANDERSON: That's correct, Your Honor,  
11 all we're talking about is proffering financial information,  
12 and we have no counter-evidence as to that, and we are  
13 comfortable with that, with his proffering at this point.

14 THE COURT: All right. And I assume your  
15 proffer will include the necessary information as to satisfy  
16 the burden, that this was a sale within the business  
17 judgment of the Debtors, so you can also include that since  
18 I make certain findings in my order related to that, and I  
19 will let you proffer that as well.

20 MR. WEGE: Very good, Your Honor.

21 Your Honor, if I may approach.

22 I have two exhibits, which I've also  
23 provided.

24 THE COURT: All right. We'll mark those as  
25 collective Exhibit 1.

1 (Whereupon, the summary calculation of  
2 consideration being provided by the sale;  
3 Tax basis of the inventory; Tax basis  
4 of the fixed assets; Form 1120 for 2006  
5 Propex Tax Return and attached schedule  
6 to the 2006 Return was marked as  
7 Exhibit No. 1.)

8 MR. WEGE: Very good.

9 Your Honor, this would be the testimony of  
10 Stan Spraker who is the Director of the Tax Compliance for  
11 Propex. He is familiar with Exhibit 1. Exhibit 1 consists  
12 of three sheets. The first is a summary calculation of,  
13 first, a consideration being provided by the sale, which is  
14 3.1 million dollars. And then, the second two sets of rows  
15 deal with the tax basis of the inventory, which is being  
16 sold under the sale, and then the tax basis of the fixed  
17 assets, which are also being sold pursuant to the sale.

18 The resulting tax result for this sale  
19 would be, approximately, a 10.8 million dollar tax loss from  
20 as a result of the sale. And, in fact, all of the assets,  
21 they're being -- they're being solely reflected in the  
22 inventory, the fixed assets.

23 The inventory schedule is consistent with  
24 the schedule that's attached to the asset and purchase  
25 agreement, and the numbers that are contained on the summary

1 are based on the books and records of the company.  
2 Mr. Spraker would also testify that these numbers are  
3 accurate and truly correct in they're -- the company's basis  
4 for the tax effect of the sale on its books.

5 Your Honor, the second two pages of  
6 Exhibit 1 are the first page of the Form 1120 for the 2006  
7 Propex tax return, which was filed with the IRS. The second  
8 page is an attached schedule to the 2006 return, which  
9 summarizes the existing net operating losses of the company  
10 as of 12/31/06.

11 The circled number or figure on the  
12 detailed schedule is the net operating loss of 48.675  
13 million dollars. And Mr. Spraker would testify that this  
14 is, in fact -- Exhibit 1 is, in fact, the Form 1120 that was  
15 filed with the IRS; that, in fact, there was, as of  
16 12/31/06, approximately, 48.6 million dollars in net  
17 operating loss.

18 Mr. Spraker would also testify that any  
19 preliminary estimates of the net operating loss for 2007  
20 were, approximately, 48 million dollars, and that in excess  
21 of 90 million dollars in net operating loss on the tax basis  
22 would exist as of 12/31/07.

23 I mean those figures, 407, would not vary  
24 within a million dollars on a tax basis. And so, as of  
25 12/31/07, there would be over 90 million dollars available

1 for the company to use, to offset the potential gain that  
2 might exist. And that is the testimony that Mr. Spraker  
3 would offer. If the IRS wishes to cross-examine him, they  
4 can do so.

5 All right. Your Honor, with respect to the  
6 sale itself, Mr. Lee McCarter would testify that the sale  
7 was negotiated at arm's length, that it was the best  
8 available sale, that they made the sale, that the assets  
9 were available to any party that was interested, including  
10 following both before and following the filing of the  
11 petition, that the parties that are purchasing the assets  
12 are unrelated to the Debtor presently.

13 There is, in fact, one of the equity  
14 owners, of the buyer, that was formally a sales manager of  
15 the Debtor but is no longer with the company and is -- was  
16 never an officer or director of the company, and that they  
17 dealt with the parties at arm's length, they negotiated and  
18 came up with the sale's price, and the sale's price is the  
19 best available option for the Debtor, and that the value of  
20 the consideration is more than the value on the assets on a  
21 financial basis, and, therefore, the company made the  
22 decision to sell in its best business judgment.

23 THE COURT: All right.

24 MR. WEGE: And that will be the testimony  
25 that we would proffer in support of this.

1 THE COURT: And I assume the committee has  
2 no objection to the sale?

3 MR. ROCHESTER: That's correct, Your Honor.  
4 Of course, we would have liked to have seen a higher  
5 purchase price, but we do believe that, under the  
6 circumstances, this is a reasonable exercise of the Debtor's  
7 position.

8 THE COURT: All right.

9 MR. WEGE: Your Honor, that's the evidence  
10 that we would put forth in support of the motion. We would,  
11 obviously, reserve our arguments with respect to anything  
12 that the IRS wishes to raise.

13 THE COURT: All right.

14 MR. ANDERSON: Good morning, Your Honor.

15 Let me clear up one factual matter, first,  
16 if I could, Mr. Wege. I didn't hear anything in your  
17 proffer about depreciation recapture. I assume that your  
18 proffer was to include that these numbers include all of  
19 these depreciation recaptures, which could potentially  
20 result in capital gains. Is that correct?

21 MR. WEGE: Your Honor, the testimony would  
22 reflect that even if the depreciation were captured, were  
23 included, that there would still be a net loss of,  
24 approximately, 11 million dollars from the sale.

25 MR. ANDERSON: Your Honor, our motion, in

1 this case, is based on the concept found In re Scott Cable  
2 Communications, and the line of cases that follow it, that a  
3 capital gains tax incurred in the administration of a  
4 Chapter 11 state creates an administrative claim which needs  
5 to be provided for.

6 We ask in our motion that the order provide  
7 that any capital gains resulting in this transaction be paid  
8 from the proceeds.

9 Obviously, if there are no capital gains,  
10 then there's no way that I could -- that we could have  
11 determined that at the time this motion was filed, then  
12 there would be nothing to pay. But, what we are trying to  
13 prevent here is the situation where, down the line, when  
14 this plan comes up for confirmation, there's a large capital  
15 gains tax which has not been provided for, it's an  
16 administrative claim, and it causes the IRS to lose its  
17 value in that situation. We think that's supported by the  
18 case law.

19 The cases that discuss this are not that  
20 many. They're collected at a case called In re Dawes, at  
21 382 B.R. 509, footnote number 37, collects those cases. And  
22 we think that the law is clear, that the capital gains tax  
23 should be paid from these proceeds, because it is an  
24 administrative claim in the cost of administering this  
25 Chapter 11 stay.

1 All that we've asked for, in this case, is  
2 that the order provide that the capital gains tax, if any,  
3 be paid from the closing, at the closing, from the sale's  
4 proceeds. If there are none, obviously, there's nothing to  
5 be paid. But, we've been unable to agree on any language  
6 that would result in what we believe is the correct result  
7 in that situation.

8 THE COURT: Well, I haven't seen any  
9 language. Apparently, the evidence indicates that they have  
10 a loss that offset any capital gains, and that's what the  
11 evidence reveals, so there could be none.

12 MR. ANDERSON: Yes, sir. And all we wanted  
13 was the order made clear, that if there was any, that it  
14 would be provided for. If there is none, then, obviously,  
15 there would be none to be paid from that closing. But,  
16 there was an objection to that language, and we were not  
17 willing to stipulate, at this point, that this is the  
18 correct tax treatment, because we don't have -- have not had  
19 the ability to audit these results or to review these  
20 returns, because the returns haven't been filed yet because  
21 the year is not closed.

22 And this is a situation where to agree that  
23 there is no capital gains and then walk away from that would  
24 be, in essence, to agree to a 505 determination without the  
25 ability of the Service to audit those documents. So we're

1 not prepared to do that, and we take the position that in a  
2 Chapter 11 these do have to be paid. If there are none to  
3 be paid, then, obviously, to some degree, as I've indicated  
4 to Mr. Wege, when we first started talking about this, we  
5 may be arguing over air. But, we feel like that that  
6 language should be in the order, because it should protect  
7 the Internal Revenue Service if there were a capital gains  
8 tax.

9 THE COURT: Well, is there any problem  
10 including that in the order, if there is no capital gains?  
11 Apparently, there are. Or does the loss not offset any  
12 capital gains? What is the harm in including that in the  
13 order?

14 MR. WEGE: Your Honor --

15 THE COURT: I mean it does have to be paid  
16 if there are, in fact, capital gains and no loss, or the  
17 loss isn't sufficient to offset them. Correct?

18 MR. WEGE: Your Honor, the Service,  
19 certainly, has the ability to file any claim they wish to  
20 file. We object to that language for a number of reasons,  
21 or any, we haven't seen the language, in that respect. But,  
22 the order, itself, provides what the Debtor is obligated to  
23 do, pursuant to Debtors' provision on that, which is pay the  
24 net proceeds down on the DIP loan, and the order sets that  
25 out. The DIP, you know, the D-I-P, credit agreement, that

1 the Debtor is governed by and must live up to, sets forth  
2 how the proceeds are dealt with, and we intend to live by  
3 that, and that's what the order provides.

4 Your Honor, the problem with what the IRS  
5 is espousing, of course, number one, is that there are no  
6 capital gains from the sale. We are arguing about a  
7 hypothetical that doesn't exist. The other problem with the  
8 argument that's been asserted is really twofold. One of the  
9 cases that they've cited, in which they believe collected  
10 the cases, is the Dawes case, which is a Chapter 12 case.

11 Your Honor, there is a provision in the  
12 Code, in Chapter 12, that actually allows, as the Court, I'm  
13 sure, is aware, to -- for an agricultural Debtor or,  
14 officially, a Debtor to sell assets and then discharge any  
15 capital gain. It's a unique provision. It's in Chapter 12.  
16 It's not, obviously, in Chapter 11. And we would,  
17 certainly, stipulate that the provisions of Chapter 12 don't  
18 apply to 11. But, that's the case that they cite, that  
19 collect of cases.

20 The other case that they cite is a case  
21 which deals with 1129(d), which is one of the tests that go  
22 into confirmation of the plan. I think, as the Court is  
23 aware, the determination of the payment of administrative  
24 claims is made at the time of the plan of obligation, under  
25 1129(a), 1129(a)(9), which requires payment in full of all

1 administrative claims. 1129 also has a provision which  
2 deals with denial of confirmation of the plan, if the  
3 Service can prove, and they bear the burden, under the Code,  
4 of proof, that the purpose of the plan was to somehow avoid  
5 taxes.

6           Your Honor, none of that's relevant today.  
7 We're talking about the 363 sale of insubstantial assets of  
8 the case, where the evidence before the Court is clearly  
9 that there's going to be a gigantic tax loss, well in excess  
10 of the value. And we're not talking about the plan of  
11 confirmation stage, we're simply in the middle of the case,  
12 where we're selling assets, we're paying the proceeds to the  
13 DIP lenders, pursuant to the agreement that has been  
14 approved by the Court. And so to interject language that  
15 talks about hypothetical capital gains, hypothetical  
16 administrative claims, when we don't even have the time set  
17 for filing a return and any determination of what tax  
18 liability exists, it's just inappropriate at this time and  
19 we don't think that should be included in the order, because  
20 it confuses matters.

21           The other aspect of it is that the IRS in  
22 this situation is, actually, similarly situated to a trade  
23 creditor, if they even have a claim, which they don't, as a  
24 result of this sale, but they would be situated like a  
25 post-petition trade creditor, that would come in and say,

1 gosh, I may sell some product to the debtor, I may incur an  
2 obligation, and I want something in the sale order that  
3 guarantees that I'll be paid administrative claim.

4 Your Honor, that's just not appropriate in  
5 a sale order, that's not the type of thing that the Court  
6 should be doing. The administrative claim should be dealt  
7 with and a plan of confirmation. If there are arguments  
8 about 1129(d), the IRS bears the burden of that at the plan  
9 of confirmation time. And so we believe that the arguments  
10 of the Service are inapposite and they should be rejected by  
11 the Court.

12 THE COURT: All right.

13 MR. ANDERSON: Your Honor, as to one  
14 matter, we are not like a trade creditor, we are an  
15 involuntary creditor, the case law is very clear that as an  
16 involuntary creditor the Service is different than a trade  
17 creditor, so that argument is suspicious, or at least in  
18 apposite.

19 The matter in a Chapter 11 is that the  
20 capital gains tax on a sale of assets in Chapter 11 should  
21 be provided for, paid for in Chapter 11, and we feel that  
22 our request is not inaccurate.

23 The problem here is that there may well be  
24 no capital gains tax, but we could not make that calculation  
25 at the time the order of sale was called for, and I think

1 the Service is fully justified in seeking the Court to have  
2 the order provide that the capital gains tax be paid as part  
3 of the closing; otherwise, the Service, as an involuntary  
4 creditor, is left without a remedy.

5 THE COURT: All right. Well, based on the  
6 argument presented, I am more persuaded by the Debtors'  
7 argument, and I will not include that in the sale order.

8 If you do have a claim, an administrative  
9 claim, of course, it can be filed. But, I will not include  
10 or insist that that language be included in the sale order.  
11 I did have a couple of items that I wanted to bring up in  
12 connection with the proposed order that's been submitted,  
13 and I know you are going to be -- have already uploaded an  
14 amended order this morning, that I have not looked at. But,  
15 if you go to Paragraph C, you can upload an order, where  
16 you, actually, fill in the blanks of the order, the  
17 certificate of service, filed on June blank of 2008.

18 MR. WEGE: Your Honor, we, actually -- the  
19 order --

20 THE COURT: Have you already done that?

21 MR. WEGE: The order that we uploaded did,  
22 in fact, include the dates, but I will confirm that. One  
23 other cleanup point, including that point, was we are, of  
24 course, aware of the decision by the Supreme Court with  
25 respect to 1146.

1 THE COURT: That's been amended?

2 MR. WEGE: So that -- that portion of the  
3 order has been amended --

4 THE COURT: All right.

5 MR. WEGE: -- to comply with the Supreme  
6 Court's decision.

7 THE COURT: And I did have some concerns  
8 about Paragraph D, about the reasonable opportunity to  
9 object, namely, because of the amendment that was filed on  
10 Monday, but I think you have taken care of that by allowing  
11 these parties to the executory contracts an additional ten  
12 days to object to the order. So I think you have taken care  
13 of that problem.

14 In Paragraph E, I would suggest that you  
15 add that all parties who were served with notice of the  
16 motion and who did not file and serve or otherwise object,  
17 there is no language in there that talks about that the  
18 parties that you are referring to in Paragraph E are the  
19 parties who were served with notice.

20 MR. WEGE: Your Honor, we can reflect that.

21 THE COURT: Okay. And the only other  
22 question that I had, had to do with jurisdiction.

23 Paragraph 21, where it says, The Court  
24 shall retain exclusive jurisdiction, I didn't quite  
25 understand why you had the word "exclusive," especially,

1 when you talk about exclusive jurisdiction to resolve any  
2 disputes, controversies, or plans arising out of or relating  
3 to the agreement, which could happen, I assume, after this  
4 case is closed. The word "exclusive," which is stricken,  
5 does that make any real difference?

6 MR. WEGE: Your Honor, I would say, I would  
7 request the Court that during the pendency of the case that  
8 the Court --

9 THE COURT: That will be fine, that will be  
10 fine, just add that language.

11 Anything further?

12 MR. WEGE: Your Honor, that's it.

13 THE COURT: You can make those changes then  
14 and upload the amended order. I will approve the motion.

15 MR. WEGE: Thank you, Your Honor.

16 THE COURT: All right. Anything further in  
17 connection with the case today? If not, I will ask the  
18 Clerk to adjourn court.

19 (Proceedings adjourned.)

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STATE OF TENNESSEE )  
: SS.  
COUNTY OF HAMILTON )

I, DONNA F. SEGARS, Court Reporter and  
Notary Public in and for the State of Tennessee, do hereby  
certify that I reported in machine shorthand the proceedings  
had in the above-styled cause on the 25th day of June, 2008;

That the attached pages, numbered 1 through  
23, inclusive, were reduced to typewriting under my personal  
supervision; and that the foregoing is a true and accurate  
transcript of said proceedings.

This 26th day of June, 2008.

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Donna F. Segars, Notary  
Public in and for the  
State of Tennessee.  
My commission expires:  
March 10, 2012.