IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF SOUTH CAROLINA

In re:	)	Chapter 11
	)	
CAFÉ HOLDINGS CORP., et al,	)	Case No.: 18-05837 (hb)
	)	
Debtors.	)	

OFFICIAL COMMITTEE OF UNSECURED CREDITORS' OBJECTION TO THE DEBTORS' MOTION FOR ENTRY OF INTERIM AND FINAL ORDERS (I) AUTHORIZING THE DEBTORS TO OBTAIN POSTPETITION FINANCING, (II) AUTHORIZING THE DEBTORS TO USE CASH COLLATERAL, (III) GRANTING LIENS AND PROVIDING SUPERPRIORITY ADMINISTRATIVE EXPENSE STATUS, (IV) GRANTING ADEQUATE PROTECTION TO THE PREPETITION LENDERS, (V) MODIFYING THE AUTOMATIC STAY, (VI) SCHEDULING A FINAL HEARING, AND (VII) GRANTING RELATED RELIEF

The Official Committee of Unsecured Creditors (the "Committee") of Café Holdings Corp., *et al*. (the "Debtors") hereby objects to the *Debtors' Motion for Entry of Interim and Final Orders (I) Authorizing the Debtors to Obtain Postpetition Financing, (II) Authorizing the Debtors to Use Cash Collateral, (III) Granting Liens and Providing Superpriority Administrative Expense Status, (IV) Granting Adequate Protection to the Prepetition Lenders, (V) Modifying the Automatic Stay, (VI) Scheduling a Final Hearing, and (VII) Granting Related Relief* [Docket No. 15] (the "Motion")[1]. In support of this objection, the Committee respectfully represents as follows:

INTRODUCTION

1. The Debtors seek approval of a $3.2 million debtor-in-possession financing facility (the "DIP Facility") provided by Atalaya Capital Management, LP or its

[1] Capitalized terms used but not otherwise defined herein shall have the meanings ascribed to them in the Motion.

affiliates ("Atalaya," the "DIP Lender," or the "Prepetition First Lien Lender"), the latest holder of the Debtors' prepetition first lien debt, of which $1 million has already been approved on an interim basis. As part of the DIP Facility's collateral package, the Debtors propose to grant postpetition liens, adequate protection liens, and superpriority claims in favor of Atalaya on all of the estates' unencumbered assets, including (a) store-level cash that was not in bank accounts as of the Petition Date; (b) commercial tort claims; (c) leasehold interests; and (d) avoidance actions arising under chapter 5 of the Bankruptcy Code. Further, the DIP Facility would have the effect of eliminating the effect of section 552 of the Bankruptcy Code, which cuts off the Prepetition First Lender's liens on proceeds of postpetition assets.

2. This is a restaurant case and most of the value to be derived from the Debtors' business comes not from the inventory sitting on the Debtors' shelves when these cases were filed, but rather through the ongoing efforts and services of the Debtors' approximately 1,671 employees. As such, any revenues generated by the Debtors from postpetition sales, net of the cost of inventory, constitute proceeds of postpetition assets (*i.e.*, fruits of the labor of the Debtors' employees), and not proceeds of the prepetition collateral of Atalaya or any other secured creditor. Hence, any DIP Facility must recognize and preserve the value of any such unencumbered assets for the benefit of unsecured creditors. As currently proposed, however, the DIP Facility is merely a means for Atalaya to effectuate a "bargain basement" acquisition of the Debtors' assets through a credit bid of the amounts owed under the DIP Facility, plus $1 million of the prepetition first lien debt, while leaving nothing at all for unsecured creditors.

3. Atalaya stepped into the first lien debt position against the Debtors only days prior to commencement of these cases,[2] and apparently with the intent to acquire the Debtors' assets through an expedited chapter 11 process that disfavors a competitive environment for overbids. To a large extent, approval of the DIP Facility will dictate the outcome of these cases in that the Debtors are required to commit to extremely tight milestones in connection with a 60-day sale process or face the onerous consequences of an Event of Default under the DIP Facility, which itself matures only within 60 days following the Petition Date (as defined below). Notwithstanding the prepetition marketing effort that took place, the Debtors must be given an adequate time period on a postpetition basis to market their assets, which now can be sold free and clear of liens, claims and encumbrances, and based on the circumstances that exist now (not prepetition) to maximize the value of their assets. The currently proposed 60-day sale process is too short of a window to allow a full and fair opportunity for potential competing bidders to evaluate possible overbids, especially as it occurs over the end-of-year holiday season. At a minimum, all milestones under the DIP Facility, including the Maturity Date, should be postponed by at least one month.

4. Further, the DIP Facility is objectionable by proposing to grant complete waivers of estate marshalling rights and surcharge claims under section 506(c) of the Bankruptcy Code in favor of Atalaya. Unless and until all budgeted and accrued administrative expenses, including unpaid section 503(b)(9) claims, postpetition stub rent, and any other obligations that may be entitled to priority status, have been adequately provided for (such as by inclusion in the

[2] Upon information and belief, the predecessor to Atalaya, Shrayne Capital, LLC, purchased the first lien secured debt position of $9.7 million against the Debtors for $2.2 million in September 2018. We presume that Atalaya acquired its position from Shrayne Capital, LLC approximately one month later at approximately the same or lesser amount.

Carve-Out), there should be no waivers of marshalling or surcharge rights against Atalaya or anyone else.

5. In sum, the DIP Facility, as currently proposed, needlessly prejudices the rights and recoveries of unsecured creditors. Although the Committee has no objection in principle to the DIP Facility and securing additional funding that will be necessary to fund the Debtors' operational and administrative needs in these cases, unsecured creditors should not bear the brunt of such obligations. The rights of the Committee and unsecured creditors must be preserved so that they can fully benefit from any unencumbered estate assets and play a pivotal role in determining the outcome of these cases.

BACKGROUND

6. On November 15, 2018 (the "Petition Date"), each of the Debtors filed a voluntary petition with this Court under chapter 11 of the Bankruptcy Code. The Debtors are operating their businesses and managing their properties as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code. No trustee or examiner has been appointed in these cases.

7. On November 28, 2018, the Office of the United States Trustee appointed the Committee pursuant to section 1102 of the Bankruptcy Code.

8. The Debtors' prepetition capital structure is set forth in detail in the Motion, and is summarized in the chart below:

DEBT FACILITY	LENDER	COLLATERAL	AMOUNT OUTSTANDING (IN MILLIONS)
First Priority Secured Facility	Atalaya Capital Management, LP or its affiliates	Senior first lien on substantially all assets.	$9.7[3]
Second Priority Secured Facility	Benefit Street Partners L.L.P. and other lenders[4]	Subordinated second lien on substantially all assets.	$2.0
Mezzanine Facility	Benefit Street Partners L.L.P. and other lenders	None.	$17.5
Subordinated Note	Old Mills Stream, LLC	None.	$1.9
Total			**$31.1**

9. In addition, the Debtors owe at least $20 million to trade vendors, current and former landlords, and other general unsecured creditors.

PROPOSED DIP FACILITY

10. A summary of certain material terms of the DIP Facility is set forth in the chart below:

BORROWERS	The Debtors, jointly and severally
DIP LENDER	ACM Fatz VII LLC, as lender (an affiliate of Atalaya) Atalaya Administrative LLC, as agent
BORROWING LIMITS	A senior, secured, priming delayed draw term loan of up to $3.2 million ($1 million on an interim basis).
INTEREST RATE	9% per annum
EXPENSES AND FEES	Payment of all reasonable and documented out-of-pocket fees, costs, and expenses of the DIP Lender within 12 days of delivery of the fee request.
MATURITY DATE	60 days after the Petition Date unless a Termination Date occurs earlier.
EVENTS OF DEFAULT	The failure of the Debtors to meet any of the below case milestones will trigger an Event of Default, among many other potential default triggers.
SECTIONS 506(C)/552 WAIVERS	Upon entry of the Final Order, a waiver of the Debtors' rights under section 506(c) to surcharge the DIP Lender's collateral, marshal any of the DIP obligations, or argue the "equities of the case" waiver under section 552.

[3] The Debtors stipulated that they owe not less than $10.5 million under the Interim Order, an amount that is $800,000 more than what is specified in the Motion.

[4] Benefit Street Partners L.L.P. and such other lenders are referred to herein as the "Prepetition Second Lien Lenders."

CHALLENGE PERIOD	Unless challenged by the Committee within 45 days after the Petition Date, the prepetition liens and security interests granted to the Prepetition Lender (the lenders under the first lien credit facility). The Committee is only provided an investigation budget of $15,000. Total fees in the Budget for the Committee are limited to $130,000, while the Debtors' budgeted professionals fees are over $1.4 million, or stated another way, the Committee's budgeted professional fees are less than 10% of the Debtors' budgeted professional fees.

11. The failure to meet any of the below milestones will trigger an Event of Default under the DIP Facility:

EVENT	**DEADLINE**
Motion for Approval of Bid Procedures Filed	November 22, 2018
Bid Procedures Order Entered	December 10, 2018
Auction Held and Successful Bidder Selected	January 15, 2019
Sale Order Entered	January 16, 2019
Sale Closed	January 19, 2019

12. On November 20, 2018, this Court entered the Interim Order approving the DIP Facility on an interim basis. A final hearing on the Motion is currently set for December 18, 2018.

OBJECTION

13. A court should approve a proposed debtor in possession financing only if such financing "is in the best interest of the general creditor body." *In re Roblin Indus., Inc.,* 52 B.R. 241, 244 (Bankr. W.D.N.Y. 1985) (*citing In re Vanguard Diversified, Inc.,* 31 B.R. 364, 366 (Bankr. E.D.N.Y. 1983); *see also In re Tenney Village Co., Inc.*, 104 B.R. 562, 569 (Bankr. D. N.H. 1989) ("The debtor's prevailing obligation is to the bankruptcy estate and, derivatively, to the creditors who are its principal beneficiaries"). Moreover, the proposed financing must be "fair, reasonable, and adequate." *In re Crouse Group, Inc.*, 71 B.R. 544, 546 (Bankr. E.D. Pa. 1987).

14. Postpetition financing also should not be authorized if its primary purpose is to benefit or improve the position of a particular secured lender. *See, e.g., In re Aqua Assocs.,* 123 B.R. 192, 195-98 (Bankr. E.D. Pa. 1991) ("[C]redit should not be approved when it is sought for the primary benefit of a party other than the debtor."); *In re Ames Dep't Stores, Inc.,* 115 B.R. 34, 37 (Bankr. S.D.N.Y. 1990) ("[A] proposed financing will not be approved where it is apparent that the purpose of the financing is to benefit a creditor rather than the estate."); *Tenney Village,* 104 B.R. at 568 (debtor in possession financing terms must not "pervert the reorganizational process from one designed to accommodate all classes of creditors and equity interests to one specially crafted for the benefit of the secured creditor").

15. Indeed, the law has long acknowledged the unequal bargaining power inherent in negotiations leading to proposed postpetition financing, as well as the very significant harm that can befall creditors if the proposed financier is enabled to exploit its leverage position. *See, e.g., In re FCX, Inc.,* 54 B.R. 833, 838 (Bankr. E.D.N.C. 1985) ("[T]he court should not ignore the basic injustice of an agreement in which the debtor, acting out of desperation, has compromised the rights of unsecured creditors.").

16. The DIP Facility, as currently proposed, is a textbook example of an over-reaching postpetition financing that is designed primarily to benefit Atalaya, as the DIP Lender and the Prepetition First Lien Lender, while casting aside unsecured creditors and stripping them of any value associated with unencumbered assets. As of the Petition Date, several significant sources of recovery were available to satisfy claims of unsecured creditors, including (a) store-level cash that was not in bank accounts as of the Petition Date; (b) commercial tort claims; (c) leasehold interests; and (d) avoidance actions arising under chapter 5 of the Bankruptcy Code. In

addition, most of the Debtors' receipts from postpetition sales, net of inventory costs, are unencumbered by any prepetition liens by virtue of section 552 of the Bankruptcy Code. Yet, as proposed, the DIP Facility would encumber such unencumbered assets in favor of Atalaya and the Prepetition Second Lien Lenders, and thereby leave unsecured creditor recoveries in jeopardy. The DIP Facility also imposes onerous milestones on the estates and limitations on the Committee's ability to investigate potential claims against Atalaya or its predecessor lenders. Finally, the DIP Facility waives the estates' potentially valuable surcharge and marshalling rights without adequate provision for the payment of all administrative claims, including 503(b)(9) claims, postpetition stub rent, and any other obligations that may be entitled to priority status (such as budgeted administrative obligations that may be accrued but unpaid as of the occurrence of an Event of Default). Under these circumstances, the DIP Facility is not in the best interests of these estates and should be denied.

A. The Prepetition Lenders' Interests in Postpetition Revenues are Limited <u>Pursuant to 11 U.S.C. § 552</u>

17. Section 552(a) of the Bankruptcy Code states that, except as otherwise provided in subsection (b) of that section, "property acquired by the [bankruptcy] estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case." 11 U.S.C. § 552(a). The purpose of this provision is "to allow a debtor to gather into the estate as much money as possible to satisfy the claims of all creditors." *Arkison v. Frontier Asset Mgmt., LLC (In re Skagit Pac. Corp.)*, 316 B.R. 330, 335 (B.A.P. 9th Cir. 2004) (quoting *In re Bering Trader, Inc.*, 944 F.2d

500, 502 (9th Cir. 1991)). Section 552(b)(1) provides an exception to the rule that prepetition liens extend to postpetition property:

> if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds, products, offspring, or profits of such property, then such security interest extends to such proceeds, products, offspring, or profits acquired by the estate after the commencement of the case … except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.

11 U.S.C. § 552(b)(1). Section 552(b) is intended to "balance[] the [Bankruptcy] Code's interest in freeing the debtor of pre-petition obligations with a secured creditor's rights to maintain a bargained-for interest in certain items of collateral" and provides only a "*narrow* exception to the general rule of 552(a)." *Bering Trader*, 944 F.2d at 502 (emphasis in original).

18. Therefore, in order "[f]or a pre-petition security agreement to attach to after-acquired property, **a creditor must show** the following: 1) the security agreement extends to the after-acquired property upon which the creditor seeks the lien, and 2) the after-acquired property is proceeds, product, offspring, rents, or profits of pre-petition property subject to the lien." *In re Cafeteria Operators, L.P.*, 299 B.R. 400, 405 (Bankr. N.D. Tex. 2003) (citation omitted; emphasis added); *see* 11 U.S.C. § 363(p)(2) ("[T]he entity asserting an interest in property has the burden of proof on the issue of the validity, priority, or extent of such interest."). However, based on a "plain reading of § 552, **revenues generated post-petition solely as a result of the debtor's labor are not subject to a pre-petition lender's security interest**." *Cafeteria Operators*, 299 B.R. at 405 (emphasis added).

19. Restaurants are among the types of businesses in which revenues are derived largely from employee labor and, as a consequence, a prepetition lender's security interest

does not extend to all revenues generated postpetition. For example, in *Cafeteria Operators*, the United States Bankruptcy Court for the Northern District of Texas assessed the extent of prepetition lenders' interests in postpetition cash and cash equivalents generated by a multi-state chain of family-style restaurants and a food preparation, processing and distribution center, in the context of a contested motion for use of cash collateral. The debtors, with the support of the creditors' committee, asserted that all of the restaurant chain's postpetition revenues were derived from services and, consequently, were not subject to the prepetition liens and security interests of any lienholder pursuant to section 552 of the Bankruptcy Code. *Id.* at 403. The bank group sought to analogize restaurant revenues to hotel rents and cited to cases that extended hotel financiers' liens to postpetition revenues.

20. The court in *Cafeteria Operators* first examined the definition of "proceeds" in the Uniform Commercial Code (as enacted in Massachusetts), which includes "(A) whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral; (B) whatever is collected on, or distributed on account of, collateral; (C) rights arising out of collateral," noting that "[o]n its face, the … definition … does not include revenues generated by a service-oriented business since services are not tangible collateral." *Id.* at 405. The court also distinguished case law involving hotels on the grounds that revenues derived from hotels are primarily from sheltering guests in rooms, with any other services rendered to guests incidental to providing them with such rooms. *Id.* at 406-7.

21. The court agreed with the debtors, finding that restaurant revenues were derived largely from labor, not simply from the purchase of food and beverage inventory: "If consumers were solely purchasing the food component, they would look to the local grocery

store, for example, to make such a purchase. Clearly, restaurant customers are paying some premium to have the food prepared prior to consumption and served to them." *Id.* at 409. Accordingly, the court determined that only **"that portion of the revenues acquired as a result of the disposition of the food and beverage inventory constitutes proceeds of such inventory,"** and, consequently, **"only that portion of the revenues, then, constitutes the Bank Group's cash collateral.**" *Id.* (emphasis added); *see also In re Everett Home Town Ltd. Partn.*, 146 B.R. 453, 456 (Bankr. D. Ariz. 1992) (restaurant revenues not proceeds of real property but the result of services provided by the business); *In re Zeeway Corp.*, 71 B.R. 210, 211 (B.A.P. 9th Cir. 1987) (restaurant income not proceeds of real property but the result of services provided by the business).

22. The *Cafeteria Operators* court discussed the decision *In re Inman*, 95 B.R. 479 (Bankr. W.D. Ky. 1988), which also involved efforts by a secured creditor to avail itself of the exception contained in section 552(b) of the Bankruptcy Code to assert that fast-food restaurant deposits were proceeds subject to its security interest. The debtor objected to the creditor's claim, arguing that its deposits were not derived from sales of its inventory "since revenue generated from the operation of a restaurant is primarily from the sales of services and not inventory …." *Inman*, 95 B.R. at 480. Rejecting the secured creditor's argument that fast-food customers "don't expect, nor do they pay for, 'service'," and sustaining the claim objection, the court held:

> We agree with the creditor that a consumer would hope and expect to receive more personalized service at a full-service restaurant than at a fast-food restaurant. However, the degree of service is not the significant factor for our consideration. Rather, the meritorious fact we should note is that the restaurant industry, in

> general, is a service-oriented industry. In comparison with food wholesalers and retailers who sell food products in their natural or packaged state, restaurants expend a great deal of time and energy preparing individual food orders by transforming these natural or packaged foods into menu items. As in any business, the cost of preparing such foods for human consumption is without a doubt passed on to the consumer.
>
> For the above stated reasons, we find that the restaurants involved in this case were primarily engaged in the selling of services and therefore, any revenues generated from the operation of the businesses were not from the sale of inventory.

Id. at 480-81.

23. Three years after the *Cafeteria Operators* decision, the court in *Timothy Dean's, Inc. v. White (In re Timothy Dean Restaurant & Bar)*, 342 B.R. 1 (Bankr. D.C. 2006), evaluated a bank's creative efforts to utilize section 552(b) in litigation it commenced against the chapter 7 trustee of the debtor's estate and the debtor's former landlord, the St. Regis Washington Hotel, where the debtor had operated a restaurant. Through the litigation, the bank sought a determination of the extent, priority and validity of its liens in various property, including guest charges owed to the debtor by the hotel for room service. The bank argued that the guest charges were postpetition proceeds of food served by the debtor. Calling the bank's position a "strained interpretation of the term 'proceeds' [that] does not accord with the applicable statutory language or with the case law on this point" and citing to both *Cafeteria Operators* and *Inman*, the court stated:

> The room *service* charges here fall within the service industry to an even greater extent than a typical restaurant bill. Patrons of room service pay for a meal prepared and served by another that is delivered to their hotel room. Guests of the Hotel that patronized the restaurant and charged their meal to their room also received a service: a customer in the restaurant industry pays a premium for having a chef prepare a meal in a manner in which the customer might be unable to prepare it.

Timothy Dean's, 342 B.R. at 24 (emphasis in original; footnote omitted). Because the bank failed to produce any evidence that a portion of the guest charges were identifiable as proceeds of inventory in which it held a lien as of the petition date, the court granted judgment in favor of the hotel. *Id.; see United States Bank Nat'l Ass'n v. Venice Md LLC,* 92 Fed. Appx. 948, 953, 2004 U.S. App. LEXIS 5134, *12 (4th Cir. 2004) ("The depletion of the hotel's food and beverage inventory did not generate revenue by direct sale, as would, for example, selling groceries from a store. Hotel and restaurant establishments are service-oriented businesses; customers pay not just for the food itself, but also for the preparation, atmosphere and service.").

24. In *Bank of N. Ga. v. Strick Chex Columbus Two, LLC (In re Strick Chex Columbus Two, LLC)*, 542 B.R. 914 (Bankr. N.D. Ga. 2015), the Bank of North Georgia moved for adequate protection (or, alternatively, relief from stay) soon after the commencement of a chapter 11 bankruptcy case filed by a franchisee of a "Checkers" fast food restaurant in Columbus, Georgia. The bank gave a loan to the debtor and received a security interest in substantially all of the debtor's property and its proceeds, among other collateral. In its motion, the bank asserted that its collateral was depreciating and that, because it held a blanket security interest in all of the debtor's personal property, all of the debtor's post-petition revenue constituted proceeds of the bank's collateral. The debtor disagreed, stating that because its revenues were not proceeds of the bank's collateral, they did not constitute its "cash collateral."

25. Like the *Inman*, *Skagit*, and *Timothy Dean's* courts that previously addressed the identical issues in the restaurant debtor context, the *Strick* court (citing all three prior decisions) concluded:

> The Debtor owns and operates a restaurant, selling its inventory of food and drink in exchange for payment. However, the Court cannot conclude that *all* of the revenue brought in from food sales is proceeds of the food inventory. Unlike grocery stores or other food wholesalers, restaurants are service oriented. [Thus,] (1) a portion of a restaurant's revenue is received in return for the services provided, (2) a portion of the revenue is received as payment for the food itself, and (3) it is only that portion received in exchange for the inventory that constitutes proceeds of inventory, and thus cash collateral …. Applying that reasoning to the case at bar, that portion of the Debtor's revenue received in exchange for its food inventory constitutes proceeds of the Bank's collateral, and thus is "cash collateral" that requires protection … Because the Bank's interest in the Debtor's post-petition property is exclusively an interest in the proceeds of pre-petition inventory, rather than an interest in all of the Debtor's revenue, this case does not warrant the grant of a blanket replacement lien on all of the Debtor's pre- and post-petition assets. Instead, the Court finds that granting a replacement lien on the Debtor's post-petition inventory will be sufficient to protect the Bank's interest.

Strick, 542 B.R. at 919-21.

26. The Debtors propose in the Motion to provide the Prepetition First Lien Lender and the Prepetition Second Lien Lenders with adequate protection in the form of adequate protection liens on substantially all of their assets, including proceeds of postpetition sales.

27. However, because the Debtors are engaged in the restaurant business, even assuming that the Prepetition First Lien Lender and the Prepetition Second Lien Lenders are able to establish that their prepetition liens satisfy the criteria set forth in section 552(b)(1), at most, such lenders are entitled to a replacement lien in the Debtors' postpetition inventory at cost, and not any revenues derived therefrom in excess of cost. The remaining amount of the Debtors' revenues do not constitute proceeds of the lenders' prepetition collateral and therefore are not subject to such lenders' liens.

B. The Debtors' Unencumbered Assets Should Remain Unencumbered
<u>For the Benefit of the Estates and Unsecured Creditors</u>

28. These are not cases where unencumbered assets do not exist to help satisfy the claims of general unsecured creditors. As noted above, a substantial portion of the Debtors' postpetition receipts should be unencumbered by the Prepetition First Lien Lender's and the Prepetition Second Lien Lenders' liens. In addition, the Committee has preliminarily identified several buckets of potentially unencumbered assets as of the Petition Date that warrant investigation, including, without limitation: (a) store-level cash that was not in bank accounts as of the Petition Date; (b) commercial tort claims; (c) leasehold interests; and (d) avoidance actions arising under chapter 5 of the Bankruptcy Code.

29. Under the DIP Facility, the Debtors propose to grant the Prepetition First Lien Lender and the Prepetition Second Lien Lenders a lien on every previously unencumbered asset of the estates, along with superpriority administrative claims that would be payable from the proceeds of any unencumbered assets. *Id.* Through both devices, the lenders propose to take for themselves all unencumbered assets to repay their claims at the expense of unsecured creditors.

30. Avoidance actions, in particular, are uniquely for the benefit of general creditors of the estate, not secured creditors, and are rarely encumbered in favor of secured lenders. The intent behind avoidance powers and a debtor's power to bring causes of actions is to allow the debtor in possession to gain recoveries for the benefit of all unsecured creditors. *See Buncher Co. v. Official Comm. of Unsecured Creditors of GenFarm Ltd. Partn. IV*, 229 F.3d 245, 250 (3d Cir. 2000); *In re Sweetwater*, 55 B.R. 724, 735 (D. Utah 1985) (avoiding powers

are meant to benefit creditors generally and promote equitable distribution among all creditors). The overwhelming purpose of avoidance actions is to "facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor." H.R. Rep. No. 595, 95th Cong., 1st Sess. 177-78, reprinted in 1978 U.S. Code Cong. & Admin. News 5787, 5963, 6138. To advance this policy of equal distribution, courts have held that proceeds of avoidance actions cannot be collateral of a secured creditor. *See In re Sun Island Foods*, 125 B.R. 615, 618-19 (Bankr. Haw. 1991) ("It is well settled that a Trustee's right to pursue a preference action does not become collateral to any party's security interest . . . Indeed, it is illogical to allow a secured creditor to attach the proceeds of recoveries, while at the same time preventing it from compelling a trustee to pursue a preference action."); *see also Frank v. Michigan*, 263 B.R. 538, 542 (E. D. Mich. 2000) ("The majority of courts considering [this] question have found that preference actions are unique bankruptcy devices designed specially to increase the dividend for unsecured creditors and that therefore secured creditors, even those with rights in the proceeds, can have no interest in a trustee's preference recovery.") (internal citations omitted).

31. Moreover, avoidance actions with respect to preferences, fraudulent transfers, and setoffs, are quintessential unencumbered assets because they do not exist before the commencement of a bankruptcy case. As such, avoidance actions are uniquely for the benefit of general unsecured creditors of the estate, not secured creditors, and should not be encumbered in favor of secured lenders. Bankruptcy Rule 4001(c)(1)(B)(xi) and SC LBR 4001-4(b)(1)(H) recognize the importance of avoidance actions to unsecured creditors by requiring special disclosures in motions to obtain postpetition financing that involve liens on avoidance actions. This Court should not permit the Debtors to deplete valuable unencumbered assets in

the bankruptcy estates or condone an end-run by granting the Prepetition First Lien Lender and the Prepetition Second Lien Lenders a superpriority administrative claim payable from such assets.

32. The same logic that applies to avoidance actions applies equally to other unencumbered assets. The entire purpose of the Bankruptcy Code and its distribution scheme is to ensure that creditors share ratably in unencumbered assets. Unencumbered assets may be the sole source of recovery for unsecured creditors in these cases. The "best interest of creditors" test requires unsecured creditors to receive as much through a "reorganization" as they would in a hypothetical chapter 7 liquidation. 11 U.S.C. § 1129(a)(7) (The "best interest of creditors" test reflects the fundamental policy that chapter 11 should not be conducted in a manner that prejudices creditors beyond the result achieved in a chapter 7 liquidation.). Under a liquidation, unencumbered assets would remain unencumbered for the benefit of unsecured creditors. There is no reason why unsecured creditors should be treated worse in chapter 11 through the Final Order.

33. To allow the Debtors, as fiduciaries, to use their powers to effectively assign the benefits of certain causes of action and related estate claims and proceeds to the Prepetition First Lien Lender and the Prepetition Second Lien Lenders, as opposed to behaving as true representatives of the estates for the benefit of unsecured creditors, turns bankruptcy law on its head. The lenders are granted replacement and adequate protection liens on all unencumbered assets, including avoidance actions. Even though Atalaya is extending new financing under the DIP Facility, the scope of the adequate protection liens and superpriority claims is too broad. *See In re Tenney Village Co., Inc.*, 104 B.R. 562, 568 (Bankr. D. N.H. 1989) (financing terms

must not "pervert the reorganizational process from one designed to accommodate all classes of creditors and equity interests to one specially crafted for the benefit" of the secured creditor).

34. The Final Order should make clear that the adequate protection liens and superpriority claims shall not attach to unencumbered assets and that none of the Prepetition First Lien Lender's and the Prepetition Second Lien Lenders' claims shall be payable from the proceeds thereof.

C. The Case Milestones and Lien Validation and Challenge Provisions Should Be Stricken

35. The DIP Facility imposes a number of sale-related milestones that are very short and unnecessarily act as potential hair triggers for an event of default. First of all, the sale milestones are designed to chill bidding and are unreasonably short for a restaurant case. Below is a chart of sale milestones in recent restaurant bankruptcy cases:

Case	**District**	**Time between filing Bid Procedures and Bid Due Date**	**Time between filing of Bid Procedures and the Auction Date**	**Time between filing of Bid Procedures and the Sale Hearing**
Café Holdings Corp.(proposed)	SC	42 days	45 days	46 days
Garden Fresh Restaurant Intermediate Holding, LLC	DE	60 days	62 days	69 days
Ignite Restaurant Group, Inc. (Joe's Crab Shack)	S.D. Tx.	58 days	62 days	72 days
Cosi Inc.	D. Mass.	52 days	54 days	61 days
RM Holdco LLC(Real Mex)	DE	46 days	59 days	67 days
PGHC Holdings, Inc.(Papa Gino's)	DE	67 days	72 days	79 days

As the Court can see, the proposed sale milestones for the instant case set forth in the DIP Facility are tighter than the milestones in other recent restaurant cases. In a case where Atalaya acquired its first lien position only days prior to the Petition Date, there is no rational basis for allowing this new creditor (and stalking horse buyer) to determine the course that these cases will take. The DIP Facility, as currently proposed, is clearly designed to minimize the chance of competitive bidding for the Debtors' assets (in addition to attempting to encumber virtually all of the Debtors' assets as explained above). Rather, the Committee and unsecured creditors, who stand the most to lose or to gain, should be the primary decision makers here. At a minimum, all milestones under the DIP Facility, including the Maturity Date, should be postponed by at least one month.

36. The DIP Facility also attempts to handcuff the Committee's ability to exercise its statutory duties. The Committee is given a mere 45 days from the Petition Date to investigate the validity of the Prepetition First Lien Lender's liens and claims and any possible affirmative claims against such lender or its predecessors, on the basis of a nominal investigation budget of $15,000. If the Committee does not obtain standing and assert a challenge by this deadline, the Debtors' waivers, acknowledgements, and releases in favor of the Prepetition First Lien Lender become valid and binding on all parties, including the Committee.

37. Given that Atalaya proposes to use its first lien position to credit bid for the Debtors' assets, it is imperative that the Committee should be permitted to thoroughly investigate the prepetition relationships between the Debtors and the Prepetition First Lien Lender and to determine whether any defects exist in the Prepetition First Lien Lender's asserted lien position. At a minimum: (a) the challenge deadline should be extended to 90 days after Committee formation, (b) the Committee's investigation budget should be increased to $75,000,

and (c) the Committee should be granted immediate standing, on behalf of the Debtors' estates, to pursue any and all claims that may be subject to the deadline to assert a challenge.

38. Further, Atalaya should not be permitted to credit bid on any unencumbered assets or any encumbered assets during the pendency of the challenge period. To the extent that this Court is inclined to allow Atalaya to credit bid on its purported collateral, and there is ultimately a successful challenge asserted against Atalaya that determines its liens on such collateral are defective, Atalaya should be required to pay cash for those assets, regardless of whether such determination is made post-closing. Similarly, to the extent a cash bidder is the successful bidder for the Debtors' assets, such cash proceeds should be held in escrow by the Debtors until the Committee is able to complete is statutory duties of investigating Atalaya's purported liens.

D. The Proposed Section 506(c) and Other Waivers are Inappropriate Unless All Administrative Expenses are Adequately Provided For

39. The Debtors propose to grant a section 506(c) surcharge waiver and eliminate any marshaling requirements as to the DIP Lender and the Prepetition First Lien Lender. Through the 506(c) waiver, the Debtors irrevocably waive the estates' rights to charge certain costs or expenses incurred in the administration of these cases, including claims arising under section 503(b)(9) of the Bankruptcy Code, against the Prepetition First Lien Lender's collateral. The waiver of any marshalling requirements is prejudicial because it could allow the DIP Lender/Prepetition First Lien Lender to marshall recoveries, first from the new DIP collateral, such as avoidance claims, and then their prepetition collateral, potentially leaving nothing for unsecured creditors. These provisions should be stricken from any Final Order

unless and until the DIP Lender and the Prepetition First Lien Lender commit to fund all accrued and unpaid budgeted administrative expenses in these cases (such as by inclusion in the Carve-Out).

40. The effect of the proposed section 506(c) waivers is to eliminate a further avenue of recovery for the Debtors' estates and to create the risk of an administratively insolvent estate. This result contravenes the essential purpose of section 506(c). *See Precision Steel Shearing v. Fremont Fin. Corp. (In re Visual Indus.)*, 57 F.3d 321, 325 (3d Cir. 1995) ("[S]ection 506(c) is designed to prevent a windfall to the secured creditor . . . The rule understandably shifts to the secured party . . . the costs of preserving or disposing of the secured party's collateral, which costs might otherwise be paid from the unencumbered assets of the bankruptcy estate . . .") (internal citation omitted); *see also In re Codesco, Inc.*, 18 B.R. 225, 230 (Bankr. S.D.N.Y. 1982) ("The underlying rationale for charging a lienholder with the costs and expenses of preserving or disposing of the secured collateral is that the general estate and unsecured creditors should not be required to bear the cost of protecting what is not theirs.").

41. Neither the Committee nor this Court has any assurance that there will be sufficient DIP availability or unencumbered assets to pay all administrative claims against the Debtors' estates, and under the current construct – *i.e.*, the DIP Facility liens up all assets and the stalking horse purchases all assets leaving the estates with virtually nothing -- it will be impossible to wind down these cases properly and confirm a plan. As other bankruptcy courts have recognized, DIP financing that contains an inadequate budget coupled with a surcharge waiver should not be approved unless modified to provide for payment of administrative claims. *See NEC Holdings Corp.*, Case No. 10-11890 (PJW) (Bankr. D. Del. Jul 13, 2010) [Docket No.

223] and Hearing Tr. at 108:1-5 [Docket No. 224] ("I need some evidence that there's a probability that admin claims are going to be paid in full, including 503(b)(9) claims or I won't approve the financing."); *Hartford Fire Ins. Co. v. Northwest Bank Minn. (In re Lockwood Corp.)*, 223 B.R. 170, 176 (8th Cir. B.A.P. 1998) (holding that provision in financing order purporting to immunize the postpetition lender from section 506(c) surcharge was unenforceable); *In re Colad Group, Inc.*, 324 B.R. 208, 224 (Bankr. W.D.N.Y. 2005) (refusing to approve postpetition financing agreement to the extent that the agreement purported to modify statutory rights and obligations created by the Bankruptcy Code by prohibiting any surcharge of collateral under section 506(c)).

42. The waiver of section 506(c) rights and the no-marshalling provisions are inappropriate where, as here, there is no certainty that adequate provision has been made for payment of all administrative expenses against the Debtors. Therefore, the surcharge and other waivers should be stricken in their entirety.

E. <u>Other Objections</u>

43. The Committee has various additional objections to the DIP Facility, as set forth below:

a. ***Committee's Consent Rights***. The Committee must be granted consent rights on new budgets and provided with all financial reporting delivered to the DIP Lender and the Prepetition First Lien Lender at substantially the same time as such reporting is delivered to the lenders.

b. ***Economics of the DIP Facility Must Be Evaluated Under a Market Test.*** The Committee reserves all rights to consider the economics of the DIP Facility, including the interest that the DIP Lenders intend to charge the Debtors' estates, compared to the market for debtor-in-possession financing facilities of this type *vis-a-vis* the specific circumstances of these cases.

c. ***Carve-Out for Committee Professionals***. The budget attached to the Interim Order specifies only $130,000 for the Committee's professionals (legal and financial), as compared to almost $900,000 for the Debtors' bankruptcy counsel only and $300,000 for counsel to the DIP Lender. Factoring in the other Debtor professionals, the total amount budgeted for the Debtors' professional fees is over $1.4 million, which means that the budgeted amount for the Committee's professionals' fees are less than 10% of the Debtors' professionals fees -- this clearly is not equitable and it is not market. The Committee respectfully submits that the Committee's budgeted line items for its professionals must be set at a reasonable amount in proportion to the Debtors' professionals. *See, e.g., Ames Dep't Stores, Inc.*, 115 B.R. at 38 (Bankr. S.D.N.Y. 1990) (it is appropriate for court to insist on reasonable carve-out designed to provide for payment of fees of debtor and committee counsel in order to preserve adversary system; absent this protection, collective rights and expectations of all parties-in-interest are sorely prejudiced). The Committee proposes that the budget for its professionals should be increased to $600,000, which would total roughly 37.5% of the Debtors' professional fees. The Committee has statutory duties that it must serve, and this Court should not condone Atalaya's attempt to block the Committee with an inequitable and unreasonable budget for its professional fees.

d. ***Post-Termination Carve-Out is Too Small***. The Interim Order provides for a post-termination Carve-Out of $40,000 for the chapter 11 case and $10,000 in the event of conversion to chapter 7. These amounts are woefully deficient for purposes of an orderly wind-down of these Debtors and means that these estates could be left administratively insolvent. The post-termination Carve-Out should be increased to no less than $250,000.

e. ***Deemed Lifting of the Automatic Stay Upon Expiration of Remedies Notice Period; No Provision for Payment of Accrued Operating Expenses***. The Final Order contemplates that, upon the occurrence of an Event of Default under the DIP Facility and after a short Remedy Notice Period of five (5) business days, the automatic stay will be deemed lifted and the DIP Lender will be fully entitled to exercise any and all remedies against its collateral. The onus then will be on the Debtors and the Committee to obtain an order of this Court during the Remedy Notice Period to forestall the DIP Lender from foreclosing on substantially all of the Debtors' assets. Rather than imposing such a Draconian remedy on these estates, it is the DIP Lender that should be required to seek relief from stay if that is the remedy that it seeks, and the estates' representatives should have an opportunity to challenge such requested relief. At the same time, there is no provision in the Final Order for payment of accrued but unpaid budgeted expenses that exist as of the delivery of a Default Notice, aside from professional fees covered by the Carve-Out. What happens to all of the other operating expenses, including postpetition payroll and vendor obligations, that are certain to have been incurred under the Budget, but that have not yet been paid when an Event of Default has been declared? These obligations also should be covered by the Carve-Out. Otherwise, the Debtors' estates would face administrative insolvency to the detriment of their employees, vendors, and landlords.

RESERVATION OF RIGHTS

44. The Committee expressly reserves all rights, claims, defenses, and remedies, including, without limitation, to supplement and amend this objection, to raise further and other objections to the Motion and the form of Final Order, and to introduce evidence prior to or at any hearing regarding the Motion in the event that the Committee's objections are not resolved prior to such hearing.

CONCLUSION

45. For all of the foregoing reasons, the Committee respectfully requests that the Court deny final approval to the DIP Facility in the form presented.

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Dated: December 11, 2018

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Proposed Attorneys for the Official Committee of Unsecured Creditors

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF SOUTH CAROLINA

In re:	)	Chapter 11
CAFÉ HOLDINGS CORP., *et al.*,[1]	)	Case No. 18-05837 (hb)
Debtors.	)	Jointly Administered

CERTIFICATE OF SERVICE

I the undersigned administrative assistant with the law offices of Nelson Mullins Riley & Scarborough LLP, proposed counsel of record for the Official Committee of Unsecured Creditors of the above-captioned debtors, do hereby certify that I have served all parties in this action with a copy of the pleading(s) hereinbelow specified by either mailing a copy of the same by United States Mail, postage prepaid, or electronic service through the court's CM/ECF case filing system to the following:

Pleadings: **Official Committee of Unsecured Creditors' Objection to the Debtors' Motion for Entry of Interim and Final Orders (I) Authorizing the Debtors to Obtain Postpetition Financing, (II) Authorizing the Debtors to Use Cash Collateral, (III) Granting Liens and Providing Superpriority Administrative Expense Status, (IV) Granting Adequate Protection to the Prepetition Lenders, (V) Modifying the Automatic Stay, (VI) Scheduling a Final Hearing, and (VII) Granting Related Relief**

Parties Served: See Attached Mailing Matrix

s/Stephanie Arnold
Stephanie Arnold
Administrative Assistant

December 11, 2018

[1] The Debtors in these cases, along with the last four digits of each Debtor's federal tax identification number, are: Cafe Holdings Corp. (7910); Cafe Enterprises, Inc. (4946); CE Sportz LLC (2009); and CES Gastonia LLC (0863). The location of the Debtors' corporate headquarters is 4324 Wade Hampton Blvd., Suite B, Taylors, South Carolina 29687.

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Case 18-05837-hb
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Spartanburg
Mon Dec 10 15:37:33 EST 2018

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(u)Old Mill Stream, LLC

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Bypassed recipients	5
Total	69