

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH CAROLINA**

In re:

CAFÉ HOLDINGS CORP., *et al.*

Debtors.

Case No. 18-05837-hb
Chapter 11

OBJECTION OF UNITED STATES TRUSTEE TO DEBTORS' MOTION, PURSUANT TO BANKRUPTCY CODE SECTIONS 105(a), 363, 365, AND BANKRUPTCY RULES 2002, 6004, AND 6006, FOR ENTRY OF ORDERS (I) APPROVING SALE, BIDDING, NOTICE, AND AUCTION PROCEDURES IN CONNECTION WITH THE SALE OF SUBSTANTIALLY ALL OF THE ASSETS OF THE DEBTORS; (II) APPROVING ASSUMPTION AND ASSIGNMENT OF CERTAIN EXECUTORY CONTRACTS AND UNEXPIRED LEASES; (III) AUTHORIZING THE SALE OF THE DEBTORS' ASSETS FREE AND CLEAR OF ALL LIENS, CLAIMS, ENCUMBRANCES, AND OTHER INTERESTS, AND (IV) GRANTING RELATED RELIEF

The United States Trustee (the "UST"), by and through his counsel, hereby files this objection to the Motion, pursuant to Bankruptcy Code Sections 105(a), 363, and 365, and Bankruptcy Rules 2002, 6004, and 6006, for Entry of Orders (I) Approving Sale, Bidding, Notice, and Auction Procedures in Connection with the Sale of Substantially All of the Assets of the Debtors; (II) Approving Assumption and Assignment of Certain Executory Contracts and Unexpired Leases; (III) Authorizing the Sale of the Debtor's Assets Free and Clear of All Liens, Claims, Encumbrances, and Other Interests, and (IV) Granting Related Relief, filed on November 30, 2018 on an expedited basis (the "Bidding Procedures Motion"). *See* ECF Doc. No. 106. The UST files this objection pursuant to the authority granted to him by 28 U.S.C. § 586 and 11 U.S.C. § 307.¹ In support of the Objection, the UST respectfully states:

SUMMARY

The Debtors have made clear that they are not in a position to reorganize, and that the focus of these Chapter 11 cases will be on the liquidation of the Debtors' assets. Atalaya Capital Management, LP and some of its affiliates (collectively, "Atalaya"),² which bought the first lien debt on November 13, 2018 – two days before the cases filed bankruptcy – will be the primary beneficiary of the liquidation. Atalaya is now owed approximately \$10 million and has offered to lend the Debtors \$3.2 million to fund the bankruptcy proceedings, while acting as stalking horse bidder for the Debtors' assets.

The case is moving at a fast pace with a sale of substantially all of the Debtors' assets to its secured lender. The agreement between the Debtors and Atalaya, as set forth in the Bidding Procedures Motion, contemplates: (a) the sale of substantially all of the assets of the Debtors; (b) consideration from the Stalking Horse bidder consisting of a credit bid of \$1 million of the Debtor's obligation to the Stalking Horse Bidder under the First Priority Secured Facility and (ii) assumption of the outstanding principal and accrued interest owed by the Debtors under the DIP Facility; and (c) assumption of certain of the Debtors' liabilities.

The UST objects to the Bidding Procedures Motion and Sales Motion for, among others, three main reasons:

- First, while the proposed sale process appears to propose the sale or transfer of personally identifiable information, the bidding procedures omit any analysis of privacy concerns or the need for a consumer privacy ombudsman as contemplated by 11 U.S.C. § 363(b)(1) and § 332. Based on the terms of the asset purchase agreement, however, it appears that the appointment of a consumer privacy ombudsman may be warranted in this case or, at a

¹ Further reference to Title 11 U.S.C. § 101, *et. seq.* will be by section number only.

² The affiliate that is proposed to act as the stalking horse bidder is ACM Fatz VII, LLC (the "Stalking Horse Bidder" or "First Lien Secured Party").

minimum, that the purchase agreement provide for the purchaser of the assets to be bound by the Debtors' privacy policy in place as of the Petition Date.³

- Second, the Bidding Procedures Motion fails to contain necessary and relevant information that would normally be provided in a disclosure statement, despite the fact that selling substantially all the assets is a significant event in the bankruptcy cases. What is clear is that the \$4.2 million stalking horse credit bid does not even come close to paying the secured debt in full. As currently drafted, the motion fails to provide important information to creditors and parties in interest, including that unsecured creditors are unlikely to receive anything from the sale; and, to the extent that a pot of funds is created for them, how Atalaya's deficiency claim will be treated.
- Third, the bidding procedures provide the Debtors with unfettered decision-making authority with respect to the bids provided and gives them broad discretion to make substantive decisions without further notice or order of the Court.

GENERAL BACKGROUND

1. On November 15, 2018 (the "Petition Date"), the Debtors each filed a voluntary petition in this Court for relief under Chapter 11 of the Bankruptcy Code. The Debtors continue to manage and operate their businesses as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code. The Chapter 11 cases are being jointly administered for procedural purposes.

2. On November 28, 2018, the Office of the UST appointed a committee of general unsecured creditors.

3. As set forth in more detail in the First Day Declaration of Eric Easton, as of the Petition Date, the Debtors' capital structure is comprised of outstanding funded-debt obligations in the aggregate principal amount of approximately \$31 million, consisting of the following four separate loan facilities:

³ The UST and Debtors' counsel have been in discussions regarding the Debtors' privacy policy and, given the wording in the policy the Debtors have presented, it appears that the sale of customer's data was contemplated. Accordingly, the parties are attempting to resolve this issue amicably and are hopeful that they will be in a position to propose a resolution at the hearing on

Debt Facility	Balance Outstanding (Millions)
First Priority Secured Facility	\$9.7
Second Priority Secured Facility	\$2.0
Mezzanine Facility	\$17.5
Subordinated Note	\$1.9
Total	\$31.1

See Declaration of Eric Eason In Support of Chapter 11 Petitions and Certain First Day Motions, ECF Doc. No. 17 (the “First Day Declaration”) at ¶ 32. In addition to their \$31 million of funded debt liabilities, as of the Petition Date, the Debtors owe approximately \$20 million to trade vendors, current and former landlords, and other general unsecured creditors. *Id.* at ¶ 48.

4. On the Petition Date, the Debtors filed the DIP Motion, seeking entry of an order authorizing the Debtors to obtain secured post-petition financing from Atalaya in the aggregate amount of \$3.2 million. The DIP financing appears to be structured to provide the Debtors with just enough funding to permit them to consummate a quick sale of their assets under 11 U.S.C. § 363 – with Atalaya acting as the stalking horse bidder and credit bidding all or a portion of its debt.

5. On November 30, 2018, the Debtors filed the Bidding Procedures Motion, seeking to sell substantially all of their assets to the Stalking Horse Bidder for approximately \$4.2 million in the aggregate, consisting of a non-cash credit bid of prepetition senior indebtedness and assumption of post-petition indebtedness. *See* Bidding Procedures Motion, Exhibit 2, ECF Doc. No. 106-2 (Form of Sale Notice). As the notice of the sale provides, Duff & Phelps, who is acting as the Debtors’ investment banker, will receive compensation of 4% of

December 18, 2018.

sale consideration up to \$10,000,000.00 and 6% of sale consideration in excess of \$10,000,000, subject to a minimum of \$450,000.00.⁴ *Id.*

ARGUMENT

A. Privacy Policy Concerns

Section 363(b)(1) of the Bankruptcy Code provides:

(b)(1) The trustee, after notice and a hearing, may use, sell, or lease other than in the ordinary course of business, property of the estate, except that if the debtor in connection with offering a product or a service discloses to an individual a policy prohibiting the transfer of personally identifiable information about individuals to persons that are not affiliated with the debtor and if such policy is in effect on the date of the commencement of the case, then the trustee may not sell or lease personally identifiable information to any person unless –

- (A) such sale or such lease is consistent with such policy; or
- (B) after appointment of a consumer privacy ombudsman in accordance with section 332, and after notice and a hearing, the court approves such sale or such lease –
 - (i) giving due consideration to the facts, circumstances, and conditions of such sale or such lease; and
 - (ii) finding that no showing was made that such sale or such lease would violate applicable nonbankruptcy law.

See 11 U.S.C. §363(b)(1). In turn, 11 U.S.C. § 332 provides, in pertinent part:

If a hearing is required under section 363(b)(1)(B), the court shall order the United States trustee to appoint, not later than 7 days before the commencement of the hearing, a disinterested person (other than the United States Trustee) to serve as the consumer privacy ombudsman in the case and shall require that notice of such hearing be timely given to such ombudsman.

See 11 U.S.C. §332(a).

⁴ The UST objects to the commission of the investment bankers on a credit bid, but believes that the issue is not ripe at this time and better left to be argued at the retention application stage.

The proposed Asset Purchase Agreement by and among the Debtors and the Stalking Horse Bidder seeks to sell, among other things, what appears to be “personally identifiable information,” as such term is defined in 11 U.S.C. § 101(41A). “Acquired Asset” to be purchased by the Stalking Horse Bidder, includes: “(c) all Intellectual Property related to or used in connection with the Business . . . (k) to the extent assignable under applicable Law, any customer data used and/or collected by the Business, including information collected in connection with any catering business conducted at the Restaurants.” *See Bidding Procedures Motion, Exhibit 4, ECF Doc. No. 106-4, pp. 7-8.* In turn, “Intellectual Property” is defined as including, among other things, “(d) trade secrets, know-how, technology, improvements, inventions, confidential business information, formulas, research and development, *customer and supplier lists . . .*”. *Id.* at p. 15 (emphasis added).

Upon his request, the Debtors provided the UST with a copy of its privacy policy. While it is not entirely clear if the privacy policy was in place as of the Petition Date and whether the policy provided was subsequently amended, the policy includes language, among other things, detailing the Debtors’ commitment to data security and how various customers’ personal information would be used. Among other things, the policy provides:

We may share the information we collect with our affiliated companies and with third parties that assist us with our Services and other Properties. These companies may assist us in such activities as processing menu orders, conducting sweepstakes and contests, promoting our Services through marketing and advertising, conducting quality assurance testing, providing technical support, running customer loyalty or rewards programs and otherwise improving our third party service providers and other Properties. We also may share this information in connection with or during negotiation of any merger, financing, acquisition or dissolution transaction involving the sale, transfer, divestiture, or disclosure of all or a portion of our business or assets. *In the event of an insolvency, bankruptcy, or receivership, your information may also be transferred as a business asset. If our company, business or assets are acquired by another company, that company*

will possess the information collected by us and it will assume the rights and obligations regarding your personal information as described in this Policy.

Accordingly, to the extent that the privacy policy provided to the UST was in place as of the Petition Date, the UST requests that the proposed bidding procedures order be revised to provide that the transfer of personally identifiable information proposed in the Asset Purchase Agreement shall not be effective until either, (a) a consumer privacy ombudsman is appointed pursuant to 11 U.S.C. § 332(a), issues its findings, and the Court has an opportunity to review the findings, or (b) to the extent the Court agrees that the appointment of an ombudsman is not necessary, at a minimum, the Stalking Horse Bidder Asset Purchase Agreement and any Qualified Bid should provide that the purchaser will comply with the Debtors' customer data privacy policy, restricting the transfer or use of personally identifiable information as set forth therein, and that the purchaser of any personally identifiable information shall be the successor-in-interest as to any such information and use the customer information solely in accordance with the privacy policy of the Debtors.

B. The Bidding Procedure Motion Lacks Any Information As to The Benefit of the Sale and the Debtors' Ability to Confirm A Plan if the Sale Is Authorized

The Debtors are seeking to sell substantially all their assets prior to confirmation of a plan of reorganization to Atalaya as the Stalking Horse Bidder for a credit bid of \$4.2 million or to a successful higher bidder. While pre-confirmation sales have been allowed prior to confirmation, the Debtors have the burden of proving: (a) a sound business reason or emergency justifies the pre-confirmation sale; (b) the sale has been proposed in good faith; (c) adequate and reasonable notice of the sale has been provided to interested parties; and (4) the purchase price is fair and reasonable. *In re Daufuskie Island Properties, LLC*, 431 B.R. 626, 638 (Bankr. D.S.C.

2010). Based on prior evidence submitted in these cases as well as the information provided in the Bidding Procedures Motion, it is doubtful the Debtors can meet this burden.

The sole creditor that stands to benefit from the sale of the assets – Atalaya – has controlled the timing of the sale, approval of the sale, post-petition financing, and numerous other aspects of these cases to date. The bankruptcy cases and sale have proceeded in a quick fashion with no evidence of the benefit to the estate and other creditors resulting from the proposed sale. If the Debtors had filed a liquidating plan, it would have been accompanied by a disclosure statement including adequate information to all creditors and parties in interest. Normally included in the disclosure statement is a listing of a debtor's assets, a classification of the debtor's creditors and the proposed distribution to each class, a discussion of claims and causes of action the debtor may have, a discussion of the debtor's financial history and why the proposed plan is in the creditors' best interest, and similar information. Here, the creditors are asked to consider the proposed sale and bidding procedures in a vacuum.

The form of Sale Notice the Debtors seek approval of is deficient in that it lacks important information for the creditors to evaluate the sale being proposed. The Sale Notice vaguely sets forth the liens/mortgages/security interest encumbering the property, but does not disclose all the liabilities of the Debtors that will remain outstanding after the sale of substantially all the Debtors' assets. In fact, the Sale Notice provides:

LIENS/MORTGAGES/SECURITY INTERSTS ENCUMBERING PROPERTY:
Various parties assert liens on the Debtors' assets including ACM Fatz VII LLC (asserts first lien security interest) and Benefit Street Partners L.L.P. (asserts second lien security interest). *The non-cash bid of approximately \$4.2 million will be insufficient to satisfy the first lien security interest on the Debtors' assets.*

See Form of Sale Notice, ECF Doc. No. 106-2. The Sale Notice is completely silent as to proceeds available for administrative expense claims and unsecured creditors, providing solely

the following vague and inconclusive information: “PROCEEDS ESTIMATED TO BE PAID TO ESTATE: Current Bid is a combination of non-cash credit bid and indebtedness assumption only.” *Id.* The Sale Notice is also silent as to whether the Debtors have appraisals on any of their assets (“APPRAISAL VALUE: N/A”). Lastly, it does not discuss what effect any deficiency by Atalaya will have on any distribution to administrative expense claims and/or unsecured creditors – and more importantly whether there will be any distribution to them at all.

In short, the Sale Notice for which the Debtors seek approval provides insufficient information to creditors and parties in interest to assess the Debtors’ business judgment in selling substantially all of their assets. By trying to sell those assets prior to confirmation, the Debtors are attempting to deprive the creditors and parties in interest from the protections provided to them under the Bankruptcy Code.

C. The Proposed Bidding Procedures Provide the Debtors Unfettered Decision-Making Authority

In the Bidding Procedures Motion, the Debtors are requesting broad discretion to make substantive decisions without further notice or order of the Court. More specifically, the proposed bidding procedures contemplate various requirements that an “Initial Overbid” must meet to become a “Qualified Bidder,” but they give the Debtors the unfettered discretion to decide which “Initial Overbid” is a “Qualified Bidder” allowed to participate in the auction. The bidding procedures also contemplate that “the Debtors reserve the right, in their reasonable business judgment to adjourn the Auction one or more times” and that “the Debtors shall retain full discretion and right to determine, in the exercise of their business judgment, which bid constitutes the highest or otherwise best offer for the purchase of the Purchased Assets, and which bid should be selected as the Prevailing Bid, if any, all subject to final approval by the

Court.” *See* Bidding Procedures Motion at ¶ 22 (iii) and (iv)(1); *see also* id. at ¶ 22 (iv)(n) (“the Auction shall be governed by such other Auction Procedures as may be announced by the Debtors, after consultation with their advisors, from time to time on the record at the Auction.”).

Thus, the Debtors request that the Court allow them to determine Qualified Bidders, whether to adjourn the auction, the highest and/or best bid, and other procedures for the auction – solely in their discretion. The proposed bidding procedures, however, do not provide a mechanism for the Debtors to report what events occurred, seek Court approval of the events, or an opportunity for creditors and parties in interest to raise any issues regarding the events. The Debtors should not be granted such unfettered discretion on decisions which have a profound impact on the estate.

D. Miscellaneous Issues

The UST also objects to the following provisions or procedures mentioned in the Bidding Procedures Motion, and requests that the Bidding Procedures Motion be denied in its current form:

1. The Bidding Procedures Motion are silent as to when the Debtors propose to send out the Sale Notice.
2. The marketing period that is proposed – consisting of less than a month for bids to be submitted – is simply too short for any significant marketing of the Debtors’ assets to take place to ensure the highest possible value for the Debtors’ estates.
3. As previously discussed and negotiated as part of the Order Authorizing the Debtors to (I) Prepare a Consolidated List of Creditors in Lieu of a Mailing Matrix, (II) File a Consolidated List of the Thirty Largest Unsecured Creditors, (III) Mail Initial Notices, and (IV) Shorten the Mailing List, ECF Doc. No. 57, any sale motion would be served on ***all*** creditors as set forth in Bankruptcy Rule 2002. While the Debtors provide an extensive list as to the parties they propose to serve with the Sale Notice, it remains unclear to the UST whether ***all*** creditors and interest holders will be served with notice of the proposed sale. *See* Bidding Procedures Motion at ¶¶ 38-39.

4. It is not clear why, in order to qualify as a “Qualified Bidder,” the overbid must include a commitment that the overbidder will consummate the purchase of the assets by January 18, 2019, when the Stalking Horse Bidder’s closing date can be extended to January 30, 2018.
5. As set forth in more detail in the Objection to the DIP Financing and Cash Collateral Motion that the UST filed with the Court, the UST objects to the Debtors selling any “Avoidance Actions”, as currently contemplated in the Asset Purchase Agreement. *See* ECF Doc. No. 106-4 at Art. I, Sec. 1.1 (definition of “Acquired Assets” includes “Avoidance Actions”).
6. The term “Excluded Assets” in the Asset Purchase Agreement includes “all Causes of Action other than the Transferred Causes of Action,” but the latter term is not defined anywhere. *Id.* at Art. I, Sec. 1.1 (definition of “Excluded Assets”).
7. The bidding procedures contemplate that Qualified Bidders, including the Stalking Horse Bidder, shall appear in person or through duly-authorized representatives at the Auction. The term “Representative” means, when used with respect to the Stalking Horse Bidder, “Falcon Holdings Management, LLC.” The UST requests additional information regarding the relationship between Falcon Holdings Management, LLC and Atalaya.⁵
8. The Asset Purchase Agreement makes multiple references to Disclosure Schedules, but those schedules are not attached as an exhibit, and it is not clear when the Debtors intend to file them.

CONCLUSION

The UST acknowledges that the Debtors are negotiating with various constituencies, and that the prospective bidding and sale process is still fluid. To that end, the UST reserves his rights to object to other deficiencies at the hearings on the Bidding Procedures Motion.

WHEREFORE, the UST respectfully requests that this Court entered an order denying the approval of the Bidding Procedures Motion unless the Debtors cure the objections presented herein, and for any and all further relief as may be equitable and just.

⁵ The Debtors have provided the UST with general information regarding their understanding of the relationship between Falcon Holdings Management, LLC and Atalaya, but the UST requests that additional information be provided at the hearing on the issue and on the Notice of Sale to provide parties in interest with the knowledge on the connections that Falcon

JOHN P. FITZGERALD, III
ACTING UNITED STATES TRUSTEE REGION FOUR
By: /s/ Elisabetta G. Gasparini
Elisabetta G. Gasparini, Id. 11548
Trial Attorney
1835 Assembly Street, Ste. 953
Columbia, SC 29201
(803) 765-5227
(803) 765-5260 (facsimile)
Elisabetta.g.gasparini@usdoj.gov

Date: 12/13/2018

Holdings Management, LLC has with the stalking horse bidder.

CERTIFICATE OF SERVICE

I, Elisabetta G. Gasparini, do hereby certify that on December 13, 2018, I served the below-named documents upon the parties listed below by electronic mail.

OBJECTION OF UNITED STATES TRUSTEE TO DEBTOR'S MOTION, PURSUANT TO BANKRUPTCY CODE SECTIONS 105(a), 363, 365, AND BANKRUPTCY RULES 2002, 6004, AND 6006, FOR ENTRY OF ORDERS (I) APPROVING SALE, BIDDING, NOTICE, AND AUCTION PROCEDURES IN CONNECTION WITH THE SALE OF SUBSTANTIALLY ALL OF THE ASSETS OF THE DEBTORS; (II) APPROVING ASSUMPTION AND ASSIGNMENT OF CERTAIN EXECUTORY CONTRACTS AND UNEXPIRED LESAES; (III) AUTHORIZING THE SALE OF THE DEBTORS' ASSETS FREE AND CLEAR OF ALL LIENS, CLAIMS, ENCUMBRANCES, AND OTHER INTERESTS, AND (IV) GRANTING RELATED RELIEF

Haynes and Boone, LLP
Ian T. Peck
J. Frasher Murphy
2323 Victory Avenue, Suite 700
Dallas, TX 75219

McNair Law Firm, P.A.
Robin Stanton
Michael Weaver
104 South Main Street, Suite 700
Greenville SC 29601

Holland & Knight LLP
Brent McIlwain
200 Crescent Court, Suite 1600
Dallas, TX 75201

Fox Rothschild, LLP
Kevin McCarrell
2 W. Washington St., Suite 1100
Greenville, SC 29601

Bradford J. Sandler
Pachulski Stang Ziehl & Jones LLP
919 North Market Street, 17th Floor
Wilmington, DE 19801

Keith Poston
Nelson Mullins
1320 Main Street
Columbia, SC 29201

By: /s/ Elisabetta G. Gasparini
Elisabetta G. Gasparini, Id. 11548
Trial Attorney
1835 Assembly Street, Ste. 953
Columbia, SC 29201
(803) 765-5227
(803) 765-5260 (facsimile)
Elisabetta.g.gasparini@usdoj.gov

Date: 12/13/2018