IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF TEXAS
SAN ANTONIO DIVISION

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| **IN RE:** | § | |
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| **SCHLOTZSKY'S, INC.** | § | **CASE NO. 04-54504** |
| | § | |
| **SCHLOTZSKY'S RESTAURANTS, INC.** | § | **CASE NO. 04-54506** |
| | § | |
| **SCHLOTZSKY'S REAL ESTATE, INC.** | § | **CASE NO. 04-54507** |
| | § | |
| **SCHLOTZSKY'S FRANCHISOR, LLC** | § | **CASE NO. 04-54508** |
| | § | |
| **SCHLOTZSKY'S FRANCHISE OPERATIONS, LLC** | § | **CASE NO. 04-54509** |
| | § | |
| **SCHLOTZSKY'S BRAND PRODUCTS, LLC** | § | **CASE NO. 04-54510** |
| | § | |
| **DFW RESTAURANT TRANSFER CORP.** | § | **CASE NO. 04-54511** |
| | § | |
| **56TH AND 6TH, INC.** | § | **CASE NO. 04-54512** |
| | § | |
| **RAD ACQUISITION CORP.** | § | **CASE NO. 04-54513** |
| | § | |
| **SAN FELIPE, LLC,** | § | **CASE NO. 04-54514** |
| | § | |
| **Debtors.** | § | |
| | § | **CHAPTER 11** |
| | § | |
| | | (Motion for Joint Administration Pending) |

# DEBTORS' EMERGENCY MOTION FOR AUTHORITY TO GRANT ADMINISTRATIVE EXPENSE PRIORITY STATUS TO DEBTORS' OBLIGATIONS ARISING FROM THE POSTPETITION DELIVERY OF GOODS AND SERVICES ORDERED PRIOR TO BANKRUPTCY AND TO PAY SUCH OBLIGATIONS IN THE ORDINARY COURSE OF BUSINESS

**TO THE HONORABLE UNITED STATES BANKRUPTCY JUDGE:**

Schlotzsky's, Inc. ("SI"), Schlotzsky's Restaurants, Inc. ("Restaurants"), Schlotzsky's Real Estate, Inc. ("Real Estate"), Schlotzsky's Franchisor, LLC ("Franchisor"), Schlotzsky's

Franchise Operations, LLC ("Franchise Operations"), and Schlotzsky's Brand Products, LLC ("Brand Products"), DFW Restaurant Transfer Corp. ("DFW"), 56th and 6th, Inc. ("56th and 6th"), RAD Acquisition Corp. ("RAD"), and San Felipe, LLC ("San Felipe") (collectively, "Schlotzsky's" or the "Debtors"), files this their Debtors' Emergency Motion for Authority to Grant Administrative Expense Priority Status to Debtors' Obligations Arising from the Postpetition Delivery of Goods and Services Ordered Prior to Bankruptcy and to Pay Such Obligations in the Ordinary Course of Business (the "Motion"), and respectfully represent as follows:

## I. INTRODUCTION

1. The Debtors regularly incur obligations to vendors that provide the Debtors with goods and services. The failure of these vendors to continue providing goods and services would disrupt the Debtors' operations and jeopardize their ability to reorganize. Thus, the Debtors are requesting authority to grant administrative expense priority status to all obligations arising from postpetition delivery of goods and services ordered prepetition and to pay these obligations in the ordinary course of business.

## II. JURISDICTION

2. This Court has jurisdiction over this Motion pursuant to 28 U.S.C. §§ 157 and 1334. This is a core proceeding pursuant to 28 U.S.C. § 157. Venue is proper in this District pursuant to 28 U.S.C. §§ 1408 and 1409. The statutory predicate for the relief sought herein is 11 U.S.C. §§ 105, 363(c) and 503(b).

## III. BACKGROUND

3. The Bankruptcy Cases. On August 3, 2004 (the "Petition Date"), the Debtors filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code (the "Bankruptcy Code") in the United States Bankruptcy Court for the Western District of Texas, San Antonio Division.

4. Since the Petition Date, the Debtors have managed their affairs and conducted their businesses as debtors-in-possession, pursuant to sections 1107 and 1108 of the Bankruptcy Code. No trustee has been appointed in the Debtors' Chapter 11 cases.

5. The Debtors' Businesses. SI, through its wholly-owned subsidiaries, is a franchisor and operator of restaurants in the fast casual sector under the Schlotzsky's brand. Schlotzsky's restaurants offer a current menu of hot sandwiches and pizza served on their proprietary buns and crusts as well as wraps, chips, salads, soups, desserts and beverages.

6. As of August 2, 2004, the Schlotzsky's system included 471 domestic franchised restaurants, twenty-one (21) company-owned restaurants ("Company Restaurants") and twenty-one (21) international franchised restaurants located in thirty-six (36) states, the District of Columbia, and six (6) foreign countries.

7. In 2003, the Schlotzsky's system generated revenues of approximately $56.2 million through two business segments: franchise operations and restaurant operations. The Franchise Operations segment is a key source of revenues for Schlotzsky's through royalties that Franchisor collects from its franchisees for the use of trademarks and operating systems and license fees that Brand Products receives from manufacturers and supply chain managers of

Schlotzsky's brand products. Several brand products, including chips, cheeses and meats, are available for retail sale in grocery and other retail stores. The Restaurant Operations segment operates the Company Restaurants.

8. Schlotzsky's, Inc. SI is a Texas corporation with executive offices located at 203 Colorado Street, Suite 600, Austin, Texas 78701. SI is the parent corporation of Franchisor, Restaurants, Real Estate, Franchise Operations, DFW and RAD. SI has approximately one hundred nine (109) employees, including the corporate office staff and the restaurant managers of the Company Restaurants.

9. Schlotzsky's Franchisor, LLC. Franchisor is a Delaware limited liability company wholly owned by SI and is the parent company of Brand Products. Franchisor is the "Franchisor" or "Grantor" under all franchise agreements, area developer agreements and master license agreements, owns Schlotzsky's intellectual property, including the trademarks, and also licenses Brand Products the right to sublicense private label use of the Schlotzsky's brand. Franchisor has no employees.

10. Schlotzsky's Brand Products, LLC. Brand Products is a Delaware limited liability company wholly owned by Franchisor. Brand Products receives license fees from licensed third party manufacturers and supply chain managers based on their sales of Schlotzsky's brand products to distributors who in turn sell to the Schlotzsky's restaurant system and to retail outlets. Brand Products has no employees.

11. Schlotzsky's Restaurants, Inc. Restaurants is a Texas corporation wholly-owned by SI and is the parent corporation of 56th and 6th. Restaurants operates the twenty-one (21)

Company Restaurants. Fifteen (15) of these Company Restaurants are in Schlotzsky's long-term portfolio that Schlotzsky's intends to operate for the purposes of leadership of the franchise system and, in certain cases, to stimulate the redevelopment of certain markets. These stores also are used to demonstrate sales potential and key operating metrics, to build brand awareness, and to serve as laboratories for product development, concept refinement, product and process testing, and training. In addition, Schlotzsky's operates six (6) Company Restaurants that were developed for or acquired from franchisees and are expected to be operated until those stores are re-franchised or otherwise divested. Restaurants has approximately 625 employees.

12. Schlotzsky's Franchise Operations, LLC. Franchise Operations is a Delaware limited liability company wholly owned by SI. Franchise Operations is party to a management agreement pursuant to which it manages, services and administers certain assets owned by Franchisor, Brand Products, and two SI affiliates, Schlotzsky's N.A.M.F., Inc. and Schlotzsky's NAMF Funding, LLC, including all franchise agreements, area developer agreements and master license agreements, all Schlotzsky's intellectual property, including trademarks, and also all licensing by Brand Products of private label use of the Schlotzsky's brand. Franchise Operations has approximately 22 employees.

13. Schlotzsky's Real Estate, Inc. Real Estate is a Texas corporation wholly-owned by SI. Real Estate is party to a number of real estate mortgage and lease contracts and documentation for the Company Restaurants that are operated by Restaurants. Real Estate has no employees.

14. DFW Restaurant Transfer Corp. DFW is a Texas corporation wholly-owned by SI. DFW serves as the Area Developer under certain Area Developer Agreements that were re-purchased by Schlotzsky's through DFW and holds certain real estate and equipment leases and contracts associated with several recently closed Company Restaurants in Georgia, Mississippi and Utah. Pursuant to these Area Developer Agreements, DFW performs certain ongoing services for franchisees in its area developer territories and receives a percentage of the gross sales from those franchisees. DFW has no employees.

15. RAD Acquisition Corp. RAD is a Texas corporation wholly-owned by SI. RAD serves as the Area Developer under certain Area Developer Agreements that were re-purchased by Schlotzsky's through RAD and holds certain real estate and equipment leases and contracts associated with recently closed Company Restaurants in Tennessee and New Mexico. Pursuant to these Area Developer Agreements, RAD performs certain ongoing services for franchisees in its area developer territories and receives a percentage of the gross sales from those franchisees. RAD has no employees.

16. 56th & 6th, Inc. 56th & 6th is a Texas corporation wholly-owned by Restaurants. 56th & 6th is party to certain Franchise Agreements and other agreements related to the operation of three now closed Schlotzsky's restaurants in New York and Tennessee. 56th & 6th no longer has employees.

17. San Felipe, LLC San Felipe is a Texas limited liability company that is owned 50% by SRI and 50% by a third party named Uptown Restaurants, Inc. Restaurants has sole right and authority to control the operations of San Felipe. As a Special Member, Uptown

Restaurants, Inc.'s sole right is to receive a Special Member Cash Distribution to be paid in monthly installments through September 2006. San Felipe, LLC operates one Schlotzsky's restaurant in Texas and has approximately twenty (20) employees.

## IV. RELIEF REQUESTED AND THE BASIS THEREFOR

18. To obtain delivery and performance of the goods and services subject to prepetition outstanding orders that are critical to ongoing operations, the Debtors seek an order (i) granting their vendors administrative expense priority status under 11 U.S.C. § 503(b) for undisputed obligations arising from the Debtors' prepetition orders that are delivered or performed after the Petition Date, and (ii) authorizing the Debtors to satisfy those undisputed obligations to and vendors for such post petition deliveries in the ordinary course of business under 11 U.S.C. § 363(c).

19. Section 503(b) provides that "the actual, necessary costs and expenses of preserving the estate" shall be allowed as administrative expense claims. 11 U.S.C. § 503(b)(1)(A).

20. The relief requested in this Motion will ensure a continued supply of goods and services indispensable to the continued operations of the Debtors. Moreover, the Debtors submit that all obligations arising from the postpetition delivery of goods and services, including those ordered before the Petition Date, are in fact administrative expense priority claims pursuant to 11 U.S.C. § 503(b)(1)(A). Therefore, the granting of the relief sought in this Motion will not provide the Debtors' vendors with any greater priority than they already have under applicable law. Absent the requested relief, however, the Debtors may be required to expend substantial

time and effort reissuing the outstanding orders to provide the vendors with the assurance of an administrative priority status. The attendant disruption to the continuous flow of current goods and services could result in the inability to continue operations without interruption, which could cause irreparable harm to the Debtors' operations and jeopardize the prospects for a successful reorganization.

21. The relief requested in this Motion has been authorized in other larger Chapter 11 cases, in unreported decisions such as *In re JIT Holdings, Inc., et al.*, Case No. 02-21102 (Bankr. S.D. Tex. May 24, 2002) (Schmidt, J.) (Order Granting Emergency Motion For Authority to Grant Administrative Expense Priority to Debtors' Obligations Arising From the Postpetition Delivery of Inventory, Supplies and Other Materials Ordered Prepetition and to Pay Those Obligations in the Ordinary Course of Business); *In re PWS Holding Corp., Bruno's, Inc., et al.*, Case Nos. 98-212 (SLR) through 98-223 (SLR) (Bankr. D. Del. 1998); *In re Edison Stores, Inc., et al.*, Case No. 95-1354 (PJW) (Bankr. D. Del. 1995); *In re Weiners's Stores, Inc.*, Case No. 95-417 (PJW) (Bankr. D. Del. 1995); *In re Heileman Brewing Co., Inc., et al.*, Case Nos. 96-501 (PJW), 96-503) (PJW) through 96-513 (PJW) (Bankr. D. Del. 1996); *In re UDC Homes, Inc., et al.*, Case No. 95-558 (HSB) (Bankr. D. Del. 1995).

22. Based on the foregoing, it is clear that the relief requested in this Motion is essential and appropriate, and in the best interests of the Debtors' bankruptcy estates and their creditors.

## V. NOTICE

9. Pursuant to the Standing Order on First Day Motions in Chapter 11 Cases dated May 3, 2001, the Debtors have served notice of this hearing on the United States Trustee's Office for the Western District of Texas, the twenty largest unsecured creditors, known secured creditors, and counsel for Commercial National Bank, NS Associates I, Ltd., and Jeff and John Wooley via hand-delivery, telephone, telecopier, or email. In light of the nature of the relief requested, the Debtors respectfully submit that the Court may enter an Order granting the relief requested without further notice or hearing.

WHEREFORE, the Debtors respectfully request that this Court enter an order (i) granting the relief requested in this Motion, and (ii) granting such other and further legal and equitable relief to which they are entitled.

**RESPECTFULLY SUBMITTED THIS 3RD DAY OF AUGUST, 2004.**

HAYNES AND BOONE, LLP

By: /s/ Robert D. Albergotti

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