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

IN RE:	§	
	§	
SCHLOTZSKY'S, INC., *et al.*,	§	**CHAPTER 11**
	§	
	§	**Case No. 04-54504 (lmc)**
Debtors.	§	**Jointly Administered**
	§	
	§	**Hearing Date: November 24, 2004**
	§	**Hearing Time: 9:30 a.m.**
	§	**Hearing Location: Austin, Courtroom #1**

DEBTORS' AMENDED MOTION FOR ORDERS (A) APPROVING AUCTION PROCEDURES IN CONNECTION WITH THE PROPOSED SALE OF SUBSTANTIALLY ALL OF THE DEBTORS' ASSETS AND (B)(i) AUTHORIZING AND APPROVING THE SALE OF SUBSTANTIALLY ALL OF THE DEBTORS' ASSETS FREE AND CLEAR OF ALL LIENS, CLAIMS AND ENCUMBRANCES, (ii) AUTHORIZING THE ASSUMPTION AND ASSIGNMENT OF CERTAIN EXECUTORY CONTRACTS AND UNEXPIRED LEASES, AND (iii) GRANTING RELATED RELIEF

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"), each a debtor and debtor-in-possession (collectively, "Schlotzsky's," the "Debtors," or the "Sellers"), by and through their undersigned counsel, hereby submit this amended motion (the "Amended 363/365 Motion" or the "Amended Motion") and respectfully represent as follows:

SUMMARY OF RELIEF REQUESTED

1. Debtors and their financial advisors have been exploring third-party interest in a sale of substantially all of the Debtors' assets. Following extensive marketing efforts, and in

consultation with the Debtors' primary creditor constituencies, the Debtors have concluded that an auction (the "Auction") of certain of the Debtors' assets (the "Sale Assets") pursuant to the procedures outlined herein will generate the highest and best value to the Debtors' estates.

2. Time is of the essence. Debtors have limited use of cash collateral. Establishing a date and a process for the Auction will provide certainty regarding the Debtors' survival as a going concern and will aid in reducing employee and franchisee attrition.

3. Accordingly, by this Amended 363/365 Motion, the Debtors seek the entry of two orders, pursuant to Sections 105, 363, 365 and 1146 of the Bankruptcy Code (as defined below) and Rule 6004 of the Federal Rules of Bankruptcy Procedure, as follows:

a. an order (the "Auction Procedures Order"), a copy of which is annexed hereto as ***Exhibit A***:

i. establishing and approving auction procedures and requirements for interested parties to submit competing bids for the Assets, other than credit bids made pursuant to 11 U.S.C. § 363(k);

ii. approving a proposed discretionary break-up fee of $250,000 for the benefit of a potential bidder who in the judgment of the Debtors and the Unsecured Creditors' Committee has proposed to bid at the Auction an amount and on terms that the Debtors and the Unsecured Creditors' Committee jointly determine would enhance the bidding at the Auction;

iii. establishing procedures to fix amounts necessary to cure defaults, if any, due under the Debtors' executory contracts and unexpired leases that are to be assumed and assigned in connection with the sale; [1]

iv. scheduling a hearing (the "Sale Hearing") to consider approval of the proposed sale to the person making the highest and best bid at the Auction (the "Successful Bidder") and the related relief requested in this Amended 363/365 Motion;

v. approving the form and manner of notice of the sale contemplated by this Amended 363/365 Motion and the related relief requested herein; and

[1] By order entered on November 18, 2004, the Court approved cure notice procedures.

vi. fixing a date for the filing of objections, if any, to the relief requested in this Amended 363/365 Motion; and

b. an order (the "Sale Order"), a copy of which is annexed hereto as ***Exhibit B***:

i. authorizing the sale of the Assets to the Successful Bidder, free and clear of all liens, claims and encumbrances, except for liabilities expressly assumed;

ii. finding, determining and approving the Cure Amounts identified by Debtors on ***Exhibit C*** hereto;

iii. authorizing the assumption and assignment of certain executory contracts and unexpired leases to the Successful Bidder; and

iv. authorizing the Debtors to take any and all other actions necessary to consummate the proposed transactions.

JURISDICTION

4. This Court has jurisdiction over this Amended 363/365 Motion pursuant to 28 U.S.C. §§ 157 and 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2). Venue of the Debtors' Chapter 11 cases and this Amended 363/365 Motion is proper in this district pursuant to 28 U.S.C. §§ 1408 and 1409. The statutory predicates for the relief sought herein are Sections 105, 363, 365 and 1146 of Title 11, United States Code, 11 U.S.C. §§ 101 et seq. (the "Bankruptcy Code"), as complemented by Rules 2002 and 6004 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules").

BACKGROUND

5. On August 3, 2004, (the "Petition Date"), the Debtors filed petitions for relief under Chapter 11 of the Bankruptcy Code. The Debtors continue to operate their business and manage their assets as debtors in possession pursuant to 11 U.S.C. §§ 1107(a) and 1108. Pursuant to an Order of this Court, the Debtors' estates are being jointly administered solely for procedural purposes.

6. No trustee or examiner has been appointed in these bankruptcy cases. An Official Committee of Unsecured Creditors was appointed in the Debtors' cases on August 11, 2004 (the "Committee").

7. 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.

8. 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.

9. 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.

10. 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. As of the Petition Date, the Debtors employed approximately 776 individuals in the United States.

OVERVIEW OF PROPOSED TRANSACTION

A. General

11. As noted above, the Debtors have, since shortly after the commencement of these Chapter 11 cases, explored third-party transactions. Pursuant to an order dated September 21, 2004, the Debtors retained BWK Trinity Capital Securities, LLC ("Trinity") as financial advisors to the Debtors to, among other services, identify third parties interested in pursuing plan or sale transactions. During the course of the Debtors' cases, Trinity and the Debtors pursued all such proposals received from parties that were in the range of reasonableness (and discussed same with the Debtors' primary creditor constituencies). In furtherance of such efforts, Trinity assisted the Debtors in preparing financial projections and other data and in developing a confidential offering memorandum and contacting approximately 59 parties. In connection therewith, the Debtors executed approximately 45 confidentiality agreements and ultimately received 11 serious proposals from interested parties regarding possible sale and/or plan transactions.

12. The Debtors, with assistance from Trinity, contacted the parties who had made offers respecting sale or plan transactions to explore whether such parties had any continuing interest. Debtors initially believed that negotiating and presenting a "stalking horse" contract to the creditors and the Court would maximize the sales process. After further analysis, and with input from certain creditors, the Debtors now believe that the estates' value will be maximized if the Sale Assets are sold in the Auction pursuant to the Auction Procedures set forth on ***Exhibit F***.

B. Description of the Proposed Asset Purchase Agreement[2]

13. As a precondition to the Auction, bidders must sign and, if they become the Successful Bidder in the Auction, be bound by the terms and conditions of an Asset Purchase Agreement (the "Asset Purchase Agreement") in substantially the form of ***Exhibit D*** annexed hereto.

14. The following is a brief summary of certain of the key provisions of the Asset Purchase Agreement:

A. **Parties**. The parties to the Asset Purchase Agreement are SI, Restaurants, Real Estate, Franchisor, Franchise Operations, and Brand Products, DFW, 56th and 6th, RAD, and San Felipe, as seller and the Successful Bidder, as buyer.

B. **Purchased Assets**. Pursuant to Section 1.2 of the Asset Purchase Agreement, the assets to be sold consist of a substantial part of the assets of the Debtors including:

1. The Schlotzsky's System and the Schlotzsky's Concept;
2. All of the Sellers' interest in and to the Assumed Agreements designated on Schedule 1.2(b) (the "***Assumed Agreements***"),[3] including, but not limited to, all of the Sellers' interest under the following agreements to the extent they are identified or listed on Schedule 1.2(b): (i) the Franchise Agreements, certain Master License Agreements and certain branding agreements entered into by any Seller; (ii) certain Real Property Leases and Subleases; (iii) certain Equipment Leases; and (iv) certain Material Contracts;
3. The Owned Real Property as may be agreed between Bidder and Debtors;
4. The equipment and leasehold improvements installed in the subject Leased Real Property and the Subleases, and all of the Equipment;

[2] In the event of any inconsistency between this Motion and the Asset Purchase Agreement, the terms of the Asset Purchase Agreement shall control.

[3] At any time up to the commencement of the Auction, Debtors may add or remove contracts from Schedule 1.2(b), the schedule of Assumed Agreements.

5. All Licenses (only to the extent transferable) and all rights to use existing restaurant telephone numbers and rights arising under equipment warranties;

6. All inventory, intellectual property, accounts receivable and notes receivable of the business and all goodwill; and

7. All corporate, financial and tax records of the Sellers, including, without limitation, the Sellers' corporate charters, corporate minute and stock books and records, and other documents and instruments relating solely to the organization, maintenance and existence of the Sellers as corporations and limited liability companies or the Taxes of the Sellers; provided, however, that Buyer shall afford reasonable access to Seller after the Closing Date.

C. **Excluded Assets.** Pursuant to Section 1.3 of the Asset Purchase Agreement, assets of the Debtors not being sold to Buyer include:

1. All Owned Real Property, Leased Real Property, or other owned or leased personal property that is not to be specifically assumed and thus is excluded;

2. All cash deposits related to the Business, including, without limitation, those securing the Real Property Leases and the Assumed Liabilities;

3. All claims (including, without limitation, any litigation or arbitration claims and any refunds and deposits), rights, rights of offset or causes of action that the Sellers or their Affiliates may have against or from any person or entity relating to (i) any of the Excluded Assets or the Excluded Liabilities, (ii) those arising under and relating to the Bankruptcy Code; and (iii) the directors and officers of the Sellers, the Official Committee of Unsecured Creditors appointed in the Cases, and officers, directors and professional advisors, as applicable, of each of the foregoing;

4. All refunds, net operating losses and claims relating to federal, state or municipal income taxes of the Sellers for periods prior to the Closing Date;

5. The capital stock of the Sellers and each of their subsidiaries and all equity securities owned or held by any of the Sellers;

6. Cash receipts related to sales made prior to Closing;

7. The proceeds from the sale of the assets that are not being sold;

8. All insurance proceeds relating to the Excluded Liabilities or the Excluded Contracts;

9. All causes of action and claims that may be asserted against the Buyer and/or any of its Affiliates and all rights of the Sellers under this Agreement or any other agreements or instruments otherwise delivered in connection with this Agreement;

10. All bond collateral, collateral for letters of credit and the like and any other collateral posted for the operation of the Business, including vendor deposits;

11. Any contracts and unexpired leases that are not expressly identified as Assumed Contracts; and

12. All artwork of the Sellers listed on Schedule 1.3(m);

D. **Tax Liabilities**. Buyer will assume certain designated ad valorem tax liabilities on the Sale Assets.

E. **Purchase Price**. As full consideration for the Assets, the Buyer shall pay to the Debtors at closing, a cash purchase price of $_______[No less than $25 million] (subject to a customary working capital adjustment), plus the assumption of certain liabilities as set forth in the Asset Purchase Agreement (the "Assumed Liabilities").

F. **Assumption and Assignment of Contracts; Cure Costs**. Pursuant to Section 2.6 of the Asset Purchase Agreement (a) the Sellers will seek to assume and assign to Buyer the Assumed Agreements identified on Schedule 1.2(b), and the Sale Order shall authorize such assumption and assignment; and (b) to the extent that any Assumed Agreements are subject to a cure (pursuant to Section 365 of the Bankruptcy Code and described in any Order of the Bankruptcy Court relating to such cure liability), the Buyer shall be responsible and agree to pay certain designated Cure Costs at the Closing.

G. **Deposit.** As a condition to participating the Auction, each potential bidder in the Auction shall post a $500,000 deposit (the "Initial Deposit") that shall be nonrefundable upon the potential bidder's becoming the Successful Bidder. The Successful Bidder will make an Additional Deposit (herein so called) of $1 million immediately upon becoming the Successful Bidder. The Initial Deposit and the Additional Deposit shall be deposited into a segregated account designated by the Sellers. If the Closing takes place as provided herein, then the Deposits shall be credited against the Cash Consideration and shall be paid to the Sellers at the Closing. If the Agreement is terminated because of the Seller's breach or the inability to satisfy the conditions to closing, then the Deposit shall be returned to the Buyer. If the Agreement is terminated because of a breach

of the Asset Purchase Agreement by Buyer, then the Deposits shall be retained by the Sellers as liquidated damages.

H. **Closing.** Consummation of the transactions contemplated by this Agreement shall occur on or before December 31, 2004 (the "***Closing Date***"), at the offices of Schlotzsky's, Inc., 203 Colorado Street, Suite 600, Austin, Texas, 78701, or at such time and place as the Buyer and the Sellers may otherwise agree (the "***Closing***").

DISCRETIONARY BREAK-UP FEE

15. If the Debtors and the Creditors' Committee mutually agree prior to the Auction that a person has proposed to purchase the Sale Assets on terms that will enhance the results of the Auction, then the Debtors are authorized to enter into an Asset Purchase Agreement with such person (which Asset Purchase Agreement will be subject to higher and better bids at the Auction) and such Asset Purchase Agreement may provide such person be paid a break-up fee in the amount of $250,000 payable by the Sellers from the proceeds at the closing of a higher and better offer.

MOTION FOR AUTHORITY TO ASSUME AND ASSIGN EXECUTORY CONTRACTS AND LEASES AND TO ESTABLISH PROPOSED PROCEDURES FOR FIXING CURE AMOUNTS

16. **Relief Requested**. ***Exhibit C*** contains a listing of all contracts and leases (the "Assumed Contracts") that the Debtors propose to assume and assign to Buyer in the Sale Order. Through this Amended 363/365 Motion, Schlotzsky's requests that the Court grant it authority to assume and assign the Assumed Contracts and to establish procedures for fixing cure amounts. In Schlotzsky's business judgment, the assumption and assignment of the Assumed Contracts is in the best interest of Schlotzsky's estates.

17. **Basis for Relief.** Section 365(a) of the Bankruptcy Code provides that a debtor "subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor." 11 U.S.C. § 365(a). Section 365(b)(1) of the Bankruptcy Code, in turn, provides

that if there has been a default on an executory contract or unexpired lease, the debtor may not assume such contract or lease unless, at the time of assumption, the debtor (a) cures, or provides adequate assurance that it will promptly cure, such default, (b) compensates, or provides adequate assurance that it will promptly compensate, the non-debtor party to the agreement for any pecuniary loss resulting from such default, and (c) provides adequate assurance of future performance under the agreement. 11 U.S.C. § 365(b)(1).

18. The assignment of executory contracts and unexpired leases is governed by Section 365(f) of the Bankruptcy Code, which provides, in pertinent part, that:

> (2) The trustee may assign and executory contract or unexpired lease of the debtor only if --
>
> (A) the trustee assumes such contract or lease in accordance with the provisions of this section; and
>
> (B) adequate assurance of future performance by the assignee of such contract or lease is provided whether or not there has been a default in such contract or lease.

11 U.S.C. § 365(f)(2).

19. "[G]enerally an agreement is considered executory 'if at the time of the bankruptcy filing, the failure of either party to complete performance would constitute a material breach of the contract, thereby excusing the performance of the other party.'" *Stewart Title Guar. Co. v. Old Republic Nat'l Title Ins. Co.*, 83 F.3d 735, 741 (5th Cir. 1996) (quoting *In re Murexco Petroleum, Inc.*, 15 F.3d 60, 62-63 (5th Cir. 1994)).

20. The Debtors believe that the Assumed Contracts constitute executory contracts within the meaning of section 365 of the Bankruptcy Code because both Debtors and the parties to the Assumed Contracts have material unperformed obligations.

21. The standard governing bankruptcy court approval of a debtor's decision to assume or reject executory contracts or unexpired leases of nonresidential real property is whether the debtor's reasonable business judgment supports assumption or rejection. *See*

Official Comm. of Unsecured Creditors of Mirant Corp. v. Potomac Elec. Power Co. (In re Mirant Corp.), 378 F.3d 511, 524 n.5 (5th Cir. 2004); *Lifemark Hospitals, Inc. v. Liljeberg Enters. (In re Liljeberg Enters.)*, 304 F.3d 410, 438 (5th Cir. 2002); *Richmond Leasing Co. v. Capital Bank, N.A.*, 762 F.2d 1303 (5th Cir. 1985) ("It is well established that 'the question [of] whether a lease should be rejected . . . is one of business judgment") (quoting *Group of Institutional Investors v. Chicago, Milwaukee, St. Paul & Pac. R.R. Co.*, 318 U.S. 523, (1943)).

22. The Debtors have determined that the assumption and assignment of the Assumed Contracts represents an exercise of sound business judgment. Moreover, the Debtors are able to satisfy the requirements of Section 365(b) and (f) of the Bankruptcy Code with respect to the assumption and assignment of the Assumed Contracts because, pursuant to the Asset Purchase Agreement, all amounts required to cure pre- and post-petition defaults under the Assumed Contracts will be assumed and paid by Buyer and the Buyer will be prepared to demonstrate at the Sale Hearing that the requirement of adequate assurance of future performance by the Buyer is satisfied. Therefore, the assumption of the Assumed Contracts will place no financial burden on the Debtors' estate. In addition, assumption and assignment of the Assumed Contracts will facilitate the continuation of the Debtors' businesses and add value to the Sale Assets as a going concern. For these reasons, assumption and assignment of the Assumed Contracts is in the best interest of Schlotzsky's estates and should be approved.[4]

23. Pursuant to § 365(b)(1)(A) of the Bankruptcy Code, the Debtors' cannot assume the Assumed Contracts unless (i) all existing defaults in respect of the Assumed Contracts are cured, or (ii) adequate assurance of a prompt cure of such defaults is provided. 11 U.S.C. § 365(b)(1)(A). In order to facilitate an orderly sale of the Assets and the prompt payment of cure

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[4] At any time up to the commencement of the Auction, Debtors may add or remove contracts from Schedule 1.2(b), the schedule of Assumed Agreements.

amounts in accordance with Section 365(b) of the Bankruptcy Code, the Debtors request that the Court approve procedures for fixing the amounts (the "Cure Amounts"), if any, necessary to cure defaults under the Debtors' executory contracts and unexpired leases to be assumed by Debtors and assigned to Buyer pursuant to the Asset Purchase Agreement (previously defined herein as the "Assumed Contracts"). The Debtors are aware of certain accrued and unpaid amounts under certain of the Assumed Contracts and believe that the Cure Amounts in respect of those Assumed Contracts are as set forth on ***Exhibit C*** annexed hereto. If no amount, or "$0.00" or "zero" is designated for an Assumed Contract on **Exhibit C**, then Debtors believe no Cure Amount is due. By way of example, Debtors propose to assume and assign to Buyer all of their Franchise Agreements. Because Debtors do not believe any Cure Amounts are due in respect of any Franchise Agreements, such Agreements are listed as having a zero cure amount on ***Exhibit C.*** The Debtors request that the Court require any non-Debtor party to an Assumed Contract who objects to the Cure Amount set forth in ***Exhibit C*** to file and serve[5] upon: Schlotzsky's, Inc., 203 Colorado Street, Suite 600, Austin, Texas 78701, with a copy to Haynes and Boone, LLP, 901 Main Street, Suite 3100, Dallas, Texas 75202-3789, Attn: Robert D. Albergotti, Esq., counsel for the Debtors **by no later than 12:00 p.m. noon (Central Time) on December 6, 2004**, an objection to the Cure Amount and evidence of any claim that a Cure Amount other than the designated amount is due under the Assumed Contracts. The Debtors will serve this Amended 363/365 Motion on all non-Debtor parties to the Assumed Contracts as well as a notice ("Cure Notice") advising such parties of their deadline to object and to serve evidence disputing the Cure Amounts. The Cure Notice shall be in a form approved by this Court pursuant to the Bid Procedures Order and attached hereto as ***Exhibit E***. If a non-Debtor party to an Assumed

[5] Service may be by facsimile addressed to Robert D. Albergotti; Counsel to the Detbtors, Facsimile No. (214)-200-0350.

Contract does not file and serve an objection as described above, the Debtors and Buyer shall be entitled to rely solely on the Cure Amounts as set forth on ***Exhibit C***, and such non-Debtor party to an Assumed Contract shall be forever barred from claiming (or asserting as to the Buyer or the Debtors' estates) a different Cure Amount, or from asserting any additional Cure Amounts with respect to any Assumed Contract. The Debtors submit that the above procedures are fair, reasonable and necessary and do not impose an undue burden on the non-Debtor parties to the Assumed Contracts. Accordingly, the Debtors respectfully submit that approval of the proposed procedures for fixing Cure Amounts is warranted and appropriate.

PROPOSED AUCTION PROCEDURES

24. In order for the Auction to generate the highest and best bid and to assure fairness to all potential bidders, the Debtors hereby seek to have this Court establish certain uniform auction procedures (herein so called) as set forth on ***Exhibit F*** attached hereto. The Auction Procedures are proposed to govern the submission of competing bids (each, a "Bid") for the Assets by bidders (each, a "Bidder"), other than credit bids made under Section 363(k) of the Bankruptcy Code.

25. The Debtors submit that the Auction Procedures are fair, reasonable and necessary and do not impose undue obstacles to the competitive bid process. Accordingly, the Debtors respectfully submit that approval of the proposed Auction Procedures is warranted and appropriate. The Debtor shall send notice as described in the Auction Procedures, which will include the Auction Date ("Notice of Auction Date"). The Notice of Auction Date shall be in the form approved by this Court pursuant to the Auction Procedures Order.

BASIS FOR APPROVAL OF THE PURCHASE
AGREEMENT AND RELATED TRANSACTIONS

A. Sale of the Assets is Authorized Pursuant
to Section 363 of the Bankruptcy Code

26. Section 363(b)(1) of the Bankruptcy Code provides that "[t]he trustee, after notice and a hearing, may use, sell or lease, other than in the ordinary course of business, property of the estate." 11 U.S.C. § 363(b)(1). Courts have uniformly held that approval of a proposed sale of property pursuant to Section 363(b) of the Bankruptcy Code is appropriate if a court finds that the transaction represents a reasonable business judgment on the part of the debtor. *See Institutional Creditors of Cont'l Air Lines, Inc. v. Cont'l Air Lines, Inc. (In re Cont'l Air Lines, Inc.),* 780 F.2d 1223, 1226 (5th Cir. 1986) ("for the debtor-in-possession or trustee to satisfy its fudiciary duty to the debtor, creditors and equity holders, there must be some articulated business justification for using, selling, or leasing the property outside the ordinary course of business.") (citing *In re Lionel Corp.*, 722 F.2d 1063, 1071 (2d Cir. 1983)); *In re Abbotts Dairies of Pa., Inc.,* 788 F.2d 143 (3d Cir. 1986); *Pension Benefit Guaranty Corp. v. Braniff Airways, Inc. (In re Braniff Airways, Inc.)*, 700 F.2d 935, 940 (5th Cir. 1983); *Sullivan Cent. Plaza I Ltd., v. Bancboston Real Estate Capital Corp.*, 106 B.R. 934, 938 (N.D. Tex. 1989) (approving the *Abbots Dairies* fairness standard for the sale of assets); *In re Property Co. of Am. Joint Venture*, 110 B.R. 244, 247 n.5 (Bankr. N.D. Tex. 1990) ("a judge determining a § 363 application must expressly find that the evidence presents a good business reason to grant the application"); *In re Terrace Gardens Park Partnership*, 96 B.R. 707, 713-14 (Bankr. W.D. Tex. 1989) (recognizing the debtor-in-possession's potential necessity of selling some of its assets to "'slim down' as part of the reorganization process preliminary to a plan" and the business justification required to do so); *In re Phoenix Steel Corp.*, 82 B.R. 334, 335 (Bankr. D. Del. 1987) (stating that the elements

necessary for approval of a section 363 sale in a chapter 11 case are "that the proposed sale is fair and equitable, that there is a good business reason for completing the sale and the transaction is in good faith").

27. The Debtors believe that, for the reasons set forth herein, the Auction of the Sale Assets pursuant to the Auction Procedures represents a prudent and proper exercise of their business judgment and is supported by articulated business reasons.

B. Sale of the Assets Free and Clear of Liens, Claims and Encumbrances Should be Authorized

28. As required pursuant to Section 1.2 of the Asset Purchase Agreement, the Debtors request authority to transfer the Assets free and clear of any and all liens, claims and encumbrances, except those expressly assumed by Buyer pursuant to the Asset Purchase Agreement. Section 363(f) of the Bankruptcy Code permits such sales if one of the following conditions is satisfied:

> A. applicable non-bankruptcy law permits sale of such property free and clear of such interest;
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> B. such entity consents;
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> C. such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
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> D. such interest is in bona fide dispute; and
>
> E. such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

11. U.S.C. § 363(f).

29. The Debtors anticipate that they can satisfy one or more of these requirements. In addition, the Sale Order will provide that, except to the extent paid and released at the closing, all liens, claims and encumbrances (other than those assumed by Buyer) will attach to the proceeds of the sale transaction with the same force and effect as such liens previously had on the Sale

Assets. Accordingly, the Debtors submit that the transfer of the Assets free and clear of any liens, claims and encumbrances (other than those assumed by Buyer) satisfies the statutory prerequisites of Section 363(f).

C. Approval of the Discretionary Breakup Fee is Warranted

30. A breakup or termination fee is an incentive payment to a prospective purchaser, which is made to the prospective purchaser in the event that the transaction between the prospective purchaser and the seller is not consummated. *Calpine Corp. v. O'Brien Envtl. Energy, Inc. (In re O'Brien Envtl. Energy, Inc.),* 181 F.3d 527 (3d Cir. 1999). Breakup fees may take several forms, including the payment of the costs associated with pursuing the transaction, including professional fees and due diligence costs, and compensation for lost opportunity costs. Outside of bankruptcy, breakup fees are presumptively valid under the business judgment rule, and are often authorized by bankruptcy courts if they serve to encourage rather than discourage bidding. *See In re O'Brien Envtl. Energy, Inc.*, 181 F.3d at 535. Thus, bankruptcy courts will generally authorize a break-up fee if it serves one of three purposes: "(1) to attract or retain a potentially successful bid, (2) to establish a bid standard or minimum for other bidders to follow, or (3) to attract additional bidders." *See In re Integrated Res., Inc.,* 147 B.R. 650, 662 (S.D.N.Y. 1992), *appeal dismissed*, 3 F.2d 49 (2d Cir. 1993).

31. The Debtors and the Creditors' Committee will confer prior to the commencement of the Auction. If the Debtors and the Committee mutually agree, a person who has signed the Asset Purchase Agreement and provided the Initial Deposit may be entitled to receive a breakup fee of $250,000 that would be payable only out of the proceeds of a sale to the Successful Bidder. Given the sale process articulated herein, the Breakup Fee would only be payable if the Debtors and the Creditors' Committee mutually agreed that it was reasonably

calculated to establish a minimum bid and to encourage other bidders to submit bids within the range of reasonably anticipated values. The Debtors submit that the Breakup Fee is reasonable under the circumstances and that the Court should authorize the Debtors and the Creditors' Committee to agree to a Breakup Fee of $250,000 if, in their reasonable business judgment, it meets the standard articulated above.

D. Application of Section 1146(c) is Warranted

32. Section 1146(c) of the Bankruptcy Code provides that "[t]he issuance, transfer, or exchange of a security, or the making or delivery of an instrument of transfer under a plan confirmed under section 1129 of [the Bankruptcy Code], may not be taxed under any law imposing a stamp or similar tax." 11 U.S.C. § 1146(c). It is well settled that a transfer which is "necessary to consummation of a plan" is a transfer made under a plan within the meaning of Section 1146(c) of the Bankruptcy Code. *See Dir. of Revenue, State of Del. v. CCA P'ship (In re CCA P'ship)*, 70 B.R. 696 (Bankr. D. Del.), aff'd 833 F.2d 304 (3d Cir. 1987); *see also City of N.Y. v. Jacoby-Bender Inc. (In re Jacoby-Bender, Inc.)*, 758 F.2d 840, 842 (2d Cir. 1985).

33. It has been held that although the term "under a plan confirmed" is best interpreted to mean "authorized" by such plan, this is not the only plausible interpretation of that term. *See In re Hechinger Inv. Co. of Del., Inc.,* 335 F.3d 243, 252 (3d Cir. 2003) (holding that under such a reading, "under a plan confirmed" might also mean a sale of real estate, although actually carried out under the authority of some other provision of law such as Section 363 or 365, which is later listed as part of a plan that is confirmed); *see also, City of N.Y. v. Smoss Enters. Corp. (In re Smoss Enters. Corp.),* 54 B.R. 950, 951 (E.D.N.Y. 1985) (sale occurring three months before confirmation was "under plan," and therefore tax exempt, when transfer of property was essential to confirmation of plan).

34. Here, the Debtors submit that the transactions contemplated by the Auction should be considered a transfer "under a plan" within the meaning of Section 1146(c) of the Bankruptcy Code. The Debtors expect to distribute all proceeds received from the sale of Assets pursuant to a plan of liquidation to be filed shortly after the closing of the transactions under the Asset Purchase Agreement. The consideration received by the Debtors under the Asset Purchase Agreement will be used by the Debtors to fund remaining administrative, priority and other claims under the plan and therefore the sale of Assets is essential to consummation of such plan. Given these circumstances, the Debtors respectfully submit that the sale transaction contemplated herein is a transfer that should be deemed an exempt transfer within the meaning of Section 1146(c) of the Bankruptcy Code.

E. A Finding of Buyer's Good Faith is Warranted

35. Pursuant to Section 363(m) of the Bankruptcy Code, a good faith purchaser is one who purchases assets for value and in good faith. The Debtors submit that the Auction will be negotiated in good faith and at arm's length. Accordingly, the Auction and a signed Asset Purchase Agreement are proposed in good faith.

F. Waiver of Bankruptcy Rule 6004(g)

36. The Debtors request that the Court direct that the Sale Order become effective immediately upon its entry, notwithstanding the automatic stay provisions set forth in Rule 6004(g) of the Bankruptcy Rules, such that the stay provisions will not apply to the Sale Order.

37. Bankruptcy Rule 6004(g) provides that "an order authorizing the use, sale or lease of property other than cash collateral is stayed until expiration of 10 days after entry of the order, unless the court orders otherwise." See Bankruptcy Rule 6004(g). The Buyer and the Debtors desire to close as soon as possible on the sale of the Assets and consider time to be of the

essence. Indeed, as noted above, the Asset Purchase Agreement is conditioned upon the closing of the sale occurring prior to December 31, 2004. Absent waiver of the provisions of Bankruptcy Rule 6004(g), the Debtors believe that it may not be possible to consummate the sale of the Assets prior to the deadline required by the Asset Purchase Agreement thus causing serious harm to the Debtors, their creditors and their estates.

THE SALE OF ASSETS DOES NOT CONSTITUTE
A SUB ROSA PLAN OF REORGANIZATION

38. The proposed sale of Sale Assets does not constitute a sub rosa plan of reorganization as contemplated by *Pension Benefit Guar. Corp. v. Braniff Airways, Inc. (In re Braniff Airways, Inc.)*, 700 F.2d 935, 939-940 (5th Cir. 1983). The sale of Assets simply proposes to sell all of the Debtors' assets without altering the rights of the Debtors' creditors. The sale of Sale Assets does not specify the terms under which a plan of reorganization is to be adopted and does not bind any parties or creditor constituencies under any future plan of reorganization proposed by the Debtors. *See In re Naron & Wagner, Chartered*, 88 B.R. 85, 88 (Bankr. D. Md. 1988) (stating, "the sale proposed here is not a sub rosa plan because it seeks only to liquidate assets, and the sale will not restructure rights of creditors, as in the Braniff case."); *see also E. Airlines, Inc. v. Shugrue (In re Ionosphere Clubs, Inc.)*, 184 B.R. 648, 654 n.6 (S.D.N.Y. 1995) (distinguishing *Braniff*).

39. Further, case law from other circuits has clearly established that a sale of substantially all of the assets of a debtor prior to confirmation, or even prior to filing, of a plan of reorganization, is permissible. *See In re Ionosphere*, 184 B.R. at 653 ("[C]ourts consistently have acknowledged that assets of an estate can be sold prior to the confirmation, or even filing of a plan."); *see also In re Chateaugay Corp.,* 973 F. 2d. 141 (2d Cir. 1992) (proceeds of a sale placed in escrow pending distribution through a plan); *In re Naron & Wagner*, 88 B.R. at 88

("[A] 363 sale] may even be made, as here, prior to filing a plan of reorganization."); *In re WHET, Inc.,* 12 B.R. 743, 750 (Bankr. D. Mass. 1981) ("[T]he case law again is clear that there is nothing objectionable about a sale of all of the assets outside of a chapter 11 plan.... A trustee may, in appropriate circumstances, first liquidate the assets of a debtor and then propose a plan for distributing the proceeds to creditors."). Here, after the sale of the Debtors' Assets and the satisfaction of certain secured claims at closing, to the extent authorized by the Bankruptcy Court pursuant to the Sale Order, the proceeds from the sale shall remain with the Debtors' estates. The Debtors contemplate that shortly after consummation of the sale, the Debtors will file a liquidating Chapter 11 plan and proceed to expeditiously close their estates. Accordingly, the Debtors submit that the sale of Assets does not constitute a *sub rosa* plan of reorganization.

PROPOSED NOTICE PROCEDURES

40. The Debtors propose to serve by first-class U.S. mail, a copy of the Amended 363/365 Motion (with exhibits), and a notice of the hearing on the Debtors' request that the Court approve the Auction Procedures upon (a) Winstead Sechrest & Minick, counsel to the Official Committee of Unsecured Creditors, 401 Congress Ave., Suite 2100, Austin, TX 78701, Attn: Berry Spears, Esq., (b) the United States Trustee, (c) the Debtors' Secured Creditors (as identified in the Auction Procedures), (d) the District Director of the Internal Revenue Service; (e) the Security and Exchange Commission; and (f) any entity entering a notice of appearance in these cases.

41. Upon entry of the Auction Procedures Order, the Debtors further propose to serve by first-class U.S. mail, a conformed copy of (i) the Amended 363/365 Motion (with exhibits), (ii) the Auction Procedures Order, and (iii) the Notice of Auction Procedures and Deadlines and Notice of Hearing to Approve Sale of Substantially All of the Debtors' Assets to Highest and

Best Bidder and Notice of Hearing on Assumption and Assignment of Executory Contracts and Leases upon (a) Winstead Sechrest & Minick, counsel to the Official Committee of Unsecured Creditors, 401 Congress Ave., Suite 2100, Austin, TX 78701, Attn: Berry Spears, Esq., (b) the United States Trustee, (c) all applicable federal, state and local taxing authorities; (d) the District Director of the Internal Revenue Service; (e) the Secured Creditors, and any other party, that to the best of the Debtors' knowledge as of the Petition Date, asserts a lien, mortgage, or security interest in the Sale Assets, (f) any entity which has expressed an interest in purchasing the Sale Assets or that the Debtors believe may have an interest in the Sale Assets; (g) all counter parties to the Assumed Contracts listed on ***Exhibit C***, including all franchisees, and (h) any entity entering a notice of appearance in these cases. In addition, Debtors will provide notice of the Auction and of the sale of the Sale Assets to all equity security holders.

42. In addition, any interested party may obtain complete copies of the Amended Motion, the Asset Purchase Agreement (with the exhibits and schedules attached thereto), the notice of the sale hearing, the notice of the auction procedures hearing, the Auction Procedures Notice, and the Cure Notice by visiting the Schlotzsky's website at www.haynesboone.com/schlotzskys or by calling Ms. Jennifer Villarreal at 210-978-7000.

43. Under all of the relevant facts and circumstances herein and the nature of the relief requested herein, the Debtors respectfully submit that the foregoing notice should be deemed adequate and sufficient notice of the sale of Sale Assets, the Sale Hearing, the Auction Procedures, and the Amended 363/365 Motion.

CONCLUSION

44. The Debtors believe that the relief requested herein will maximize the value of the Sale Assets and facilitate a sale process that best accomplishes, under the circumstances, the

Debtors' goal of ensuring that the highest and best offer is obtained for the Sale Assets. Accordingly, based upon the foregoing, the Debtors respectfully submit that approval of the sale of the Assets pursuant to Section 363(b) of the Bankruptcy Code and in accordance with the Asset Purchase Agreement is in the best interest of the Debtors, their creditors and their estates.

WHEREFORE, the Debtors respectfully request that the Court enter the Auction Procedures Order and the Sale Order, substantially in the forms annexed hereto as ***Exhibits A*** and ***B*** respectively, and grant such other relief as the Court may deem just and proper.

RESPECTFULLY SUBMITTED this 18th day of November, 2004.

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ATTORNEYS FOR DEBTORS

CERTIFICATE OF SERVICE

The undersigned certifies that a copy of the foregoing instrument was served on those parties listed below via e-mail, and on the parties referenced in the Amended 363/365 Motion and the Master Service List via first class United States Mail, postage prepaid, on the 18th day of November, 2004.

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