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7 Steakhouse Partners, Inc.,
Paragon Steakhouse Restaurants, Paragon of Michigan, Inc.
8

9 UNITED STATES BANKRUPTCY COURT
10 SOUTHERN DISTRICT OF CALIFORNIA

11 In re: *
12 STEAKHOUSE PARTNERS, INC., a Delaware
corporation,
13 Debtor.
14

Case No. 08-04147-11
Chapter 11

15 In re:
16 PARAGON STEAKHOUSE RESTAURANTS, a
Delaware corporation,
17 Debtor.
18

Case No. 08-04152-11
Chapter 11

19 In re:
20 PARAGON OF MICHIGAN, INC., a Wisconsin
corporation,
21 Debtor.
22

Case No. 08-04153-11
Chapter 11

23 **DECLARATION OF JOSEPH L. WULKOWICZ IN
24 SUPPORT OF DEBTORS' FIRST DAY
25 MOTIONS**

26 Date: TBD
27 Time: TBD
28 Courtroom: 218
Judge: The Honorable James W. Meyers

1 I, Joseph L. Wulkowicz, do hereby declare:

2
3 1. I am the Vice President, Chief Financial Officer and Assistant Secretary of Steakhouse
4 Partners, Inc. and have served in that capacity since December 2003. Since November 1999 I have served
5 as the Chief Financial Officer and Assistant Secretary of Paragon Steakhouse Restaurants, Inc. Paragon of
6 Michigan, Inc. is a wholly owned subsidiary of Paragon Steakhouse Restaurants, Inc. (collectively, the
7 "Debtors"). My current duties for the for the Debtors include supervision of the areas of accounting, treasury,
8 budgeting, risk management, payroll, management information systems and internal auditing. I am generally
9 familiar with the day-to-day operations, business and financial affairs and books and records of the Debtors.

10 2. I submit this declaration in support of the various "first day" motions filed by the Debtors (the
11 "Declaration") in connection with our filing of voluntary petitions for reorganization under chapter 11 of title 11
12 of the United States Code (the "Bankruptcy Code") on May 15, 2008 (the "Petition Date"). Except as
13 otherwise indicated, I have personal knowledge of the facts set forth herein and, if called upon to testify, could
14 and would testify competently thereto.

15 3. Section I of this Declaration describes the business of the Debtors and the developments
16 which led to the Debtors' filing of the voluntary chapter 11 petitions. Section II sets forth the relevant facts in
17 support of the various first-day motions and applications filed by the Debtors concurrently herewith.

18
19 **SECTION I: BACKGROUND REGARDING THE DEBTORS**

20
21 **History of the Debtors**

22 4. The three Debtors are related corporations engaged in the operation of 21 full service
23 steakhouse restaurants located in the seven states of Arizona, California, Indiana, Michigan, North Carolina,
24 Ohio and Utah. These restaurants principally operate under the brand names of Hungry Hunter, Hunter
25 Steakhouse, Mountain Jack's and Carvers.

26 5. Debtor Steakhouse Partners, Inc. ("Steakhouse Partners") is publicly traded over the counter
27 under the symbol "STKP." In December, 1998, Steakhouse Partners acquired its wholly owned subsidiary,
28 Debtor Paragon Steakhouse Restaurants, Inc. ("Paragon Steakhouse"), which owns and operates the

1 restaurant businesses. Paragon Steakhouse has one wholly owned subsidiary, Debtor Paragon of Michigan,
2 Inc., ("Paragon of Michigan") through which it conducts its restaurant operations in the state of Michigan and
3 holds its intellectual property and trade names. The structural maintenance of Paragon of Michigan is dictated
4 by state alcohol laws; however, the subsidiary operations and financial results are consolidated at the
5 Paragon Steakhouse level.

6 6. The Debtors' business income is generated from food and beverage sales from each of the
7 21 restaurants, which during the Debtors' Fiscal Year 2007 (ending December 25, 2007) generated
8 approximately \$45,000,000 in gross revenue (as of the first quarter 2008, two restaurants are no longer
9 operated by the Debtors). Like other restaurant businesses, the Debtors' operations are seasonal, with the
10 overall performance peaking in the 4th quarter.

11 7. The Debtors' 21 steakhouses specialize in complete steak and prime rib meals, and also
12 offer fresh fish and other lunch and dinner dishes. The average restaurant check is \$27.30 per guest
13 (including alcoholic beverages) and the 21 restaurants serve approximately two million meals annually. Most
14 restaurants are open daily from 4:30 to 9:30 p.m. on weekdays and from 4:00 to 11:00 p.m. on the weekends.
15 Some restaurants are also open for lunch, typically beginning at 11:00 a.m.

16 8. Paragon Steakhouse and Paragon of Michigan, as of January 8, 2008 employ in excess of
17 1,325 full and part time employees, approximately 1,200 of which perform services during any two-week
18 period, and of which approximately 55% are part-time.

19 9. Paragon manages six restaurants known as Sirloin Saloon and Dakota Steakhouses in the
20 states of Vermont, Massachusetts, Connecticut and New York pursuant to a Management and Services
21 Agreement between Paragon and the restaurant owners, DWH, I, Pittsfield DWH and Saloon beverages, Inc.,
22 entered into effective November, 2007. This Management Agreement provides for termination of Paragon's
23 management services in the event that Paragon's acquires the membership interests in the referenced
24 corporations pursuant to a Membership Purchase Agreement or terminates the transaction pursuant to its
25 terms.

26 10. The Debtors maintain an internet website at www.paragonsteak.com. This website offers
27 free access to the Debtors' press releases and Steakhouse Partners' filings with the U.S. Securities and
28 Exchange Commission (the "SEC"), including its annual report on Form 10-K, quarterly reports on Form 10-Q,

1 current reports on Form 8-K and amendments to those reports, as soon as reasonably practicable after these
2 reports are filed with or furnished to the SEC.

3 **The Debtors' Prior Bankruptcy Cases**

4 11. On February 15, 2002, Steakhouse Partners filed a voluntary petition for relief under Chapter
5 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Central District of California (the
6 "Bankruptcy Court"). On February 19, 2002, Paragon Steakhouse and Paragon of Michigan also filed
7 voluntary petitions for relief under Chapter 11 of the Bankruptcy Code in the Bankruptcy Court (together, the
8 "Initial Filing"). Effective December 31, 2003, the Debtors confirmed a Joint Plan of Reorganization (the "2003
9 Plan"), and on December 28, 2007 the Court entered an Order Regarding Final Report, Accounting and Final
10 Decree.

11 12. The Initial Filing was made in response to the maturing of certain notes aggregating
12 \$1,734,285, which the Debtors were unable to pay. Throughout the course of the Reorganization, the Debtors
13 sought to retain core locations, eliminate non-competitive leases, restructure their debt, and withdraw from
14 under-performing markets.

15 13. The 2003 Plan provided for the creation of the Class 4 Creditor Trust (the "Trust") for general
16 unsecured claimants with claims in excess of \$4,000 with a trustee (the "Trustee") for the purpose of
17 collecting, maintaining and distributing the Steakhouse Partners Class 4 Creditors Trust Assets. As part of
18 the Plan, the Trust was granted a lien on the Debtors' leasehold interests. Today, the Trust is the principle
19 secured creditor of the Debtors.

20 **Post Plan Confirmation**

21 14. Since confirmation of the 2003 Plan, the Debtors have experienced difficulty generating
22 sufficient cash to cover operating expenses, deferred maintenance and the extraordinary costs to satisfy
23 reorganization commitments. This inability remained an impediment to implementing long term strategic
24 changes required to enhance the Debtors' intrinsic value, to increase top line revenue and resulting profit, and
25 to pay long-term debt. As a result, the Debtors' post-confirmation business plans focused on generating
26 increased revenue and profit, but directed attention to programs producing a longer-term focus through debt
27 restructuring and acquisition. Post confirmation, the Debtors sought and reached agreements with both public
28

1 and private financial institutions to complete certain acquisitions and private equity placements in order to
2 strengthen the core business and provide capital for debt repayment.

3 15. Although the Debtors had originally made total payments of approximately \$1,200,000 to the
4 Trust, we failed to make certain further payments as required by the 2003 Plan. As a result, the Trustee and
5 the Debtors negotiated a settlement agreement approved by the Court on August 10, 2006 (the "Settlement
6 Agreement"). Under the Settlement Agreement, the Debtors became obligated to make an alternative
7 payment of \$5,200,000 (the "Alternative Payment") of which \$1,100,000 was to be paid immediately.

8 16. In early 2007, the Debtors began a real estate liquidation plan designed to make structured
9 payments on their debt to the Trust. However, because the Debtors had not made the \$1,100,000 payment,
10 on or about May 18, 2007, the Debtors received the Trustee's notice of default as to the Alternative Payment.
11 As a result, the Debtors agreed to enter into a forbearance agreement (the "Forbearance Agreement") with
12 the Trust, which formalized the real estate sale plan already being marketed. We discuss our efforts and the
13 status of the sales with the Trustee of the Trust on a regular basis.

14 **The Debtors' Situation in 2008**

15 17. Although the Debtors have attempted to complete all of the sales contemplated by our
16 agreement with the Trust, a combination of variables causing deteriorating financial performance and third-
17 party reticence to consent to transfers have stymied our efforts to live up to our commitments to the Trust.

18 18. Since mid-2007, the Debtors' financial results have deteriorated as a result of a combination
19 of rising costs and declining sales and guest frequency. By the end of March 2008, the deterioration rapidly
20 accelerated. Specifically, cost increases have been unprecedented. By way of example:

- 21 • The price of prime rib alone has increased by around 4%, chiefly as a result of the
22 Midwest diversion of corn products from the cattle feed market to the production of
23 alternate fuel sources such as ethanol. Thus, the feed available to ranchers has spiked
24 in price, forcing them to charge more per pound of beef. Further, in response to their
25 own cost pressures, the ranchers have reduced herd sizes, further driving up commodity
26 costs due to lack of available product. The Debtors only serve corn fed beef as it is the
27 over whelming preference of their core guests.
28

- Similarly, the nationwide oil and gas price increases have forced purveyors to assess “fuel charges” on all products (whether produce, dairy, staples or alcohol), adding almost \$500,000 annually to the Debtors’ operating cost.
- During 2007, the Debtors incurred increased payroll costs of around \$400,000 as a direct result of state minimum wage increases. During first quarter 2008, an additional \$100,000 in increased wages were paid as new minimum wage increases took effect.

19. Administrative and accounting costs necessary to comply with new federal regulations, public company filing requirements and the increases in medical benefit and workman’s compensation costs added another \$100,000 to the costs of business.

20. Unfortunately, the above cost increases come in the middle of an economic downturn in which Americans are spending less on “elective items” such as dining out, making it near impossible to raise menu prices. According to the restaurant industry reports, unemployment, economic uncertainty and instability in the housing market are the greatest contributors to declining restaurant revenue in all segments.

21. As a result of this reduced revenue-increased cost environment, the Debtors have been unable to generate sufficient cash to timely pay our bills on an ongoing basis and still sell real estate to satisfy the Trust obligations. As the spiral has accelerated, landlords are unwilling to consent to transfers when payments are not current, and state authorities will not allow transfer of single units until all state obligations are current.

22. As such, we seek to complete our liquidation commitments within the protection of chapter 11 cases to gain sufficient time to sell assets for their highest and best price as going concerns. In the past six years, the Debtors have sold and assigned more than 20 restaurants. In each case, the Debtors were able to sell its leasehold interest, alcohol license, personal property and inventory for cash. In contrast, two restaurants have been closed and offered for sale. In each case, no sale has been consummated because the building offers no “going concern” value. A restaurateur does not want the property, because the inventory and operating licenses (including liquor) are not available, and the “dark building” offers no built in customer base. Alternate use buyers have shied away from purchase, because a restaurant building requires extensive remodeling (especially with approximately 40% of the square footage allocated to the kitchen) or razing to be suitable for alternative use.

1 23. Beginning in the week of May 11, 2008, the Debtors have started to receive 3-day notices
2 from some of their landlords. Other landlords have made statements to the Debtors that they may commence
3 eviction proceedings but have not yet served formal 3-day notices.

4 24. I believe that we can maximize cash available for distribution to creditors by offering for sale
5 our assets as operating "going concerns" while under the court's protection. I believe this can be
6 accomplished expeditiously and efficiently given the sales programs and leads already in place. However, it
7 cannot be accomplished without this Court's protection from parties seeking to block sales by seeking
8 preferential payment in front of senior creditors.

9 25. I believe the remaining units will produce sufficient cash to support operations until sold. In
10 my opinion, during the coming ninety days, the restaurants we will continue to operate until sales are
11 consummated should produce a positive EBITDA.

12 **FACTUAL SUPPORT FOR THE DEBTORS FIRST DAY MOTIONS**

13 26. I have reviewed the facts set forth in the motions, and they are accurate to the best of my
14 knowledge, information and belief. Set forth below are facts in support of those motions, highlighted for the
15 convenience of the Court.

16 **First Day Motion No. 1: Motion For Order Directing Joint Administration Of Related Cases Pursuant**
17 **To Federal Rule Of Bankruptcy Procedure 1015(b) And Local Bankruptcy Rule 1015-1**

18 27. The Debtors have related cases before this Court and we intend to file numerous motions
19 and applications that apply to all of our cases and which involve the same nucleus of facts. The Debtors are
20 all affiliates of one another and share common management. I believe the joint administration of these
21 bankruptcy cases, including the combining of notices to creditors of the respective estates and the calling and
22 hearing of all matters related to the Debtors at the same time, will promote economical and efficient
23 administration of the Debtors' estates.

24 28. I believe that the rights of the respective creditors of each of the Debtors will not be adversely
25 affected by joint administration of these cases since the relief sought in the motion is purely procedural and in
26 no way intended to affect substantive rights.

27
28

1 **First Day Motion No. 2: Motion For Order Limiting Scope Of Notice**

2 29. The Debtors cases involve approximately 7,000 creditors and potential creditors and other
3 interested parties, the overwhelming majority of whom are owed less than \$1,000. Unless this Court issues
4 an order streamlining the notice and service requirements applicable under the Bankruptcy Code, Bankruptcy
5 Rules and Local Bankruptcy Rules, the Debtors and our outside professionals will be required to expend an
6 undue amount of time, effort and money in copying documents for, and serving them upon, parties who in
7 many instances either do not desire to receive such documents or who have no genuine interest in receiving
8 them.

9 **First Day Motion No. 3: Motion For Order Authorizing Payment Of Non-Insider Prepetition Accrued**
10 **Wages, Salaries, Commissions, Employee Expenses, Workers' Compensation And Employee Benefits**
11 **And Payment Of Related Taxes And Tax Deposits And Authorizing And Directing Banks To Honor**
12 **Payroll Account Checks And Expense Reimbursement Checks**

13 ***The Debtors' Employees***

14 30. As of May 15, 2008, Debtor Steakhouse Partners employs three persons, each of whom is
15 salaried and an executive officer of the Debtor. The compensation of these three persons is not the subject of
16 this Motion as they are insiders of the Debtor within the meaning of 11 U.S.C. § 101(31). As of the May 15
17 2008, Debtor Paragon Steakhouse employs approximately 950 employees, of which approximately 70 are
18 salaried and the remainder are paid wages at an hourly rate. As of May 15, 2008 Debtor Paragon of Michigan
19 employs approximately 147 employees, of which approximately eight are salaried and the remainder are paid
20 wages at an hourly rate.

21 31. The Debtors, for purposes of payroll and benefit issues, place our employees into two
22 different categories: (i) Production Employees; and (ii) Administrative Employees. Production Employees
23 include any and all non-managerial restaurant employees and Administrative Employees include all other
24 employees. Restaurant Management (approximately 67 of the Administrative Employees) receives
25 compensation in two forms, a base salary and performance based compensation, more fully described below.

26 32. Prior to the Petition Date, and in the ordinary course of the Debtors' business, employees
27 were owed or had accrued various sums for wages, salaries and commissions in their rendition of services. In
28 addition, some of the employees were entitled to reimbursement of business expenses. Furthermore, the

1 Debtors have always and remain obligated to pay federal, state and local withholding and employer payroll
2 taxes due on prepetition employee wages and salaries.

3 33. The Debtors also subsidize certain employee benefits such as medical, dental and vision
4 insurance, disability insurance, accidental death and dismemberment, and life insurance. To maintain these
5 benefits, the Debtors are required to make contributions to insurance providers and plan administrators, as
6 discussed in more detail below. In addition, well before the Petition Date, the Debtors adopted a Paid Time
7 Off plan pursuant to which employees may take vacation and sick days.

8 34. The Debtors believe that in order to achieve success in these chapter 11 cases, they must
9 honor our obligations to employees. Without loyal employees who know and understand the business, the
10 Debtors will be at a serious disadvantage with respect to ensuring the maximization of the value of our assets
11 in these chapter 11 cases.

12 35. The Debtors believe that without the relief requested its employees would be faced with
13 tremendous hardship. A failure to pay accrued employee wages, salaries, expenses, benefits, and other
14 employee-related obligations, or even a delay in such payment, would have a significant negative impact on
15 employee morale. The Debtors' employees could not reasonably be expected to continue their employment
16 and assist with the Debtors' efforts to maximize their value while at the same time enduring personal financial
17 difficulties.

18 36. I believe that the requested relief will enable them to maintain our current business
19 operations without interruption and, at the same time, maintain employee morale until our assets can be
20 liquidated. The Debtors' employees are vital to the Debtors' efforts and provide essential services, without
21 which the Debtors would be unable to function. Without the relief requested, the Debtors' ability to preserve
22 our assets for the benefit of all creditors and equity security holders will be impaired, and the goals of these
23 chapter 11 cases will be thwarted.

24 37. The amount of compensation (including wages, salaries, commissions, vacation, severance
25 and sick leave pay and applicable benefits) to be paid to the Debtors' employees for their accrued prepetition
26 services will average less than \$10,950 per employee. At the present time, the Debtors are not seeking
27 authority to pay our officers and directors (or any other insiders) for their accrued prepetition services.
28

1 **Salary, Wages and Commissions**

2 38. Under the Debtors' standard payroll procedure, we pay our salaried and hourly employees on
3 a bi-weekly basis by check drawn on a payroll account at Union Bank, as processed by the Debtor's third-
4 party payroll processing Company, RealTime Computer Systems ("RealTime"). Employees are paid the
5 wages or salaries earned during a bi-weekly period one week after the end of the pay period. Therefore, on
6 any given payday, there will still be one week of accrued and unpaid wages and salaries outstanding. All of
7 the Debtors' employees are paid by check (except for certain terminating restaurant employees (less than 10
8 per pay period) who are paid cash upon termination in compliance with state wage & hour laws.) The most
9 recent payroll was made on May 13, 2008 for the pay period ending May 6, 2008. This payroll totaled
10 \$334,694.11 and we believe that, at most, approximately 50% of this payroll will not have cleared the bank
11 and will remain owing to our employees for wages and salaries earned prepetition (including overtime). The
12 next payroll will occur May 27, 2008 for wages and salary earned through May 20, 2008.

13 39. In addition, Paragon Steakhouse and Paragon of Michigan provide restaurant leadership with
14 compensation tied to performance. This compensation, payable to less than 70 persons, is based upon
15 achieving certain sales and profit goals during the respective four-week accounting period. Under the
16 program, employees are paid one part of their performance compensation with the fourth payroll following the
17 respective accounting period an another piece on a quarterly basis. On average, Paragon and its subsidiaries
18 pay approximately \$25,000 in performance compensation to these employees each period based on the
19 results ended two periods ago (in other words, there would typically be as much as a two month lag period).
20 However, the Debtors have not paid these wages for periods 12/2007 and periods 1, 2, 3 and 4 / 2008, each
21 of which is currently due and/or payable. The quarterly compensation for Period 1, 2008 is also unpaid.
22 Paragon Steakhouse and Paragon of Michigan, however, estimate that no more than the numbers below are
23 owed in the future for results that arose from prepetition services rendered:

24	Period 12, 2007	\$53,734
25	Period 1, 2008	\$16,754
26	Period 2, 2008	\$28, 775
27	Period 3, 2008	\$29,293
28	Period 4, 2008	\$18,194

40. We pay our employees by check. As a result of the timing of the filing of these chapter 11 cases, employee paychecks previously issued may not yet have been presented for payment or may not yet have cleared the banking system and, accordingly, may be dishonored unless the Court authorizes and directs the bank in which we maintain our payroll account to honor these checks. The Debtors believe that in addition to the payroll released May 13, 2008, approximately \$40,000 of paychecks may be outstanding as of the Petition Date (dating to 2005).

Reimbursable Expenses

41. Many of the Debtors employees regularly incur certain out-of-pocket, business-related expenses, such as necessary and authorized travel expenses (i.e. airfare, lodging, rental cars, meals, etc.). Employees are reimbursed upon the submission of expense reports and supporting documentation. Such reports are normally submitted within two weeks after the employee incurs the expense and, after review and approval of the expense report, the Debtors reimburse the employee by check drawn on the Union Bank Concentration Account. The Debtors estimate that they have no more than \$10,000 (other than to Executive Officers) of accrued prepetition employee expenses that were not reimbursed prior to the Petition Date. (All have been paid, but not all checks have been presented to the issuing banks). However, because some employees submit reimbursement requests up to one month after incurring the expense, there may be significantly more employee expenses that the Debtors are unable to quantify at the present time.

Withholding Taxes

42. Attendant to the payment of employee wages, salaries, commissions and expenses is the Debtors' obligation to pay federal, state and, in some instances, city withholding taxes and employer payroll taxes such as FICA, FUTA, SUTA and state/local disability taxes/insurance ("Withholding Taxes"). Such taxes accrue as wages are earned and are calculated based upon a statutorily mandated percentage of gross wages employees earn.

43. The Debtors currently use the services of a third-party payroll service, RealTime, to process all of its payroll obligations and uses Payroll Tax Management Company ("PTM") to process and remit its Withholding Taxes nationwide. For each pay period, the Debtors remit a list of employees to RealTime, and RealTime then sends an electronic report to PTM and the Debtors reflecting our Withholding Tax obligation for

1 that pay period. The Debtors, based on this report, thereafter remit funds for the Withholding Taxes to PTM,
2 who in turn remits the Withholding Taxes to the applicable taxing authority after the disbursement of funds to
3 employees.

4 44. Through the Petition Date, to the best of my knowledge, the Debtors were current on all
5 Withholding Tax obligations relating to disbursed prepetition payrolls. The Withholding Tax to be transmitted
6 relating to the May 13, 2008 payroll was paid as required by wire transfer.

7 ***Employee Benefits***

8 45. The Debtors provide employees with certain benefits, including medical, dental and vision
9 insurance coverage, disability insurance, accidental death and dismemberment, and life insurance, for which
10 the Debtors makes certain contributions. The Debtors also pay compensation for certain periods of its
11 employees' vacation and sick leave.

12 46. The Debtors subsidize some of these benefits, which are an integral and important part of
13 each employee's total compensation package. I believe that interruption of such benefits caused by the filing
14 of the Debtors' voluntary petitions would affect the morale of the employees adversely and would undermine
15 the Debtors' business operations.

16 ***Medical, Dental and Vision Insurance***

17 47. Each Debtor provides medical and dental insurance to its full time employees and its full time
18 employees' dependents, if they elect to subscribe to the plan offered. The Debtors' medical and dental plan is
19 a standard HMO or PPO medical and dental health plan provided through Blue Shields (medical) and Cigna
20 (dental) and their affiliates in seven states, covering a percentage of medical costs (with such dollar amounts
21 varying based on choice of HMO or PPO). The monthly premium for the medical health insurance plans
22 varies, depending on the number of employees enrolled and the number of dependents covered, and
23 averages \$37,000 per month, of which approximately 50% represents withholdings from employee wages to
24 cover the cost of their portion of the premium. The monthly premium for the dental plan is approximately
25 \$3,300, half of which is obtained through withholdings from employee wages. The Debtors offer Vision Case
26 through VSP Insurance to our administrative employees only, at an annual cost of approximately \$9,000, half
27 of which premium is paid by the employees. We have paid for our medical, dental and vision insurance plans,
28 including the employee withholdings portion, through April 2008.

1 ***Disability Insurance, Life Insurance and AD&D Policies***

2 48. Long term-disability insurance is made available to all administrative full-time employees;
3 employees pay 75% of the premium costs of \$15,768 annually. Pursuant to these policies, the employee may
4 receive 60% of their earnings if the employee is unable to perform material duties of their position due to
5 disability. Unum underwrites the long-term disability policies.

6 49. The Debtors provides life insurance and accidental death and dismemberment for its
7 administrative employees and its employees' dependents. In conjunction with the Debtors' medical policy,
8 one times base salary of term life insurance is provided to the employees at no cost. Additionally, the Debtors
9 provide term life insurance benefits up to five times an employee's salary. United Health Care underwrites
10 benefits for these programs. At the employee's option, additional term life insurance can be purchased from
11 United Health Care via payroll deduction. Employees may also purchase accidental death and
12 dismemberment from UNUM Insurance. The annual premium for life insurance and accidental death and
13 dismemberment is approximately \$24,588, all of which is employee paid except as stated above.

14 ***Paid Time Off***

15 50. The Debtors have established a VEBA Trust for the purpose of providing vacation related
16 benefits, by which, depending upon the length of service, employees are eligible to earn paid time off for
17 purposes of vacation.

18 51. For administrative employees, after one year of service, an employee with may be paid for
19 one week off annually, increasing as the length of the employee's service increases, up to a maximum of four
20 weeks days per year after 15 years of service. For production employees, after one year of service,
21 employees receive a check equal to 30 hours of pay in the event that they work at least 1,560 hours in one
22 year.

23 52. All administrative employees also have the opportunity to earn paid "sick days". After being
24 employed for one year, employees earn one-half day of paid sick time per month. Employees are not paid at
25 termination for any unused sick days.

26 53. Almost all administrative employees may have accrued "paid time off" based upon work
27 performed prior to the Petition Date. The aggregate obligation for Debtors' "paid time off" policy is
28 approximately \$592,167.92 for "sick days" and \$346,665.24 for vacation pay.

1 54. It is critically important that the Debtors be permitted to pay our non-insider employees the
2 prepetition wages, salaries, commissions, personal/sick leave, vacation and other pay that has accrued, and
3 to honor existing employee benefits policies in the ordinary course of business. Not only will this assist in
4 maintaining the continuity of the Debtors' businesses and preserve the morale of our labor force, but a
5 potential loss (or delay in receipt) of benefits or earned wages would work a hardship on the Debtors'
6 employees. Our ability to preserve our businesses and assets will be affected adversely if we are unable to
7 retain the support and loyalty of our employees.

8 55. In addition, the authority to continue to pay the Debtors' employees and to maintain the
9 current employee benefits programs is necessary to ensure that the Debtors can retain employees
10 knowledgeable about the Debtors' businesses, to provide an incentive for the Debtors' employees to continue
11 to provide quality services to the Debtors at a time when they clearly are needed and to allow the Debtors to
12 remain competitive in the job markets in which they maintain operations. The Debtors operate in a very
13 competitive market for certain of our employees, and, in the ordinary course, there tends to be a lot of
14 movement of employees. The Debtors continue to try to keep this to a minimum and I believe that the relief
15 requested in the First Day Motion is critical to that objective.

16 56. The adequate staffing of the Debtors' operations without excessive turnover is essential to
17 the Debtors' ability to conduct business and obtain the highest value for the sale of our assets. If the Debtors
18 are unable to assure our employees that they will be paid timely, or if employees are not immediately assured
19 of uninterrupted critical benefits payments to which they are entitled, the Debtors' operations could suffer
20 immediate and irreparable harm due to employee resentment, resignations and loss of goodwill.

21 57. I believe that the failure to honor accrued obligations and benefits and to maintain the
22 Debtors' employee benefits package would create great concern and discontent among our employees and
23 adversely affect our ability to retain them. This, in turn, would likely cause a slowdown or cessation of the
24 Debtors' operations, which would severely hinder our efforts to maximize the value of our operations and
25 assets.

26 58. Moreover, I believe for the Debtors to identify whether and to what extent individual
27 employees hold priority or general unsecured claims for employee benefits, and to modify benefit policies to
28

1 enforce these distinctions, would be disruptive, time-consuming and expensive. This would lead to further
2 discontent among the Debtors' employees and hamper business operations.

3 59. I believe the payment of the prepetition employee-related obligations, described above, and
4 the continuation of employee compensation and benefits is essential to the Debtors' efforts.

5 **First Day Motion No. 4: Motion For Order (1) Authorizing Continued Use Of Existing Business Forms**
6 **And Records and (2) Authorizing Maintenance Of Existing Corporate Bank Accounts And Cash**
7 **Management System**

8 ***The Debtors' Existing Business Forms***

9 60. In the ordinary course of our business, the Debtors use many checks, invoices, stationery
10 and other business forms. Additionally, the Debtors have a computerized record-keeping system that is
11 supported by various reporting and detailed ledger packages. By virtue of the nature and scope of the
12 business in which we are engaged, and the numerous other parties with whom we deal, we need to be
13 permitted to use our existing business forms without alteration or change. A substantial amount of time and
14 expense would be required in order to print new checks and other business forms. In addition, many of the
15 forms that are used by the Debtors are preprinted from a computer draft copy. Although it would be possible
16 to change these forms, I believe that this would create confusion and delay among our employees, customers
17 and other third parties.

18 ***The Debtors' Existing Bank Accounts***

19 61. The Debtors maintain sixteen active bank accounts to fund our operations as well as certain
20 other bank accounts. Attached as exhibit "A" to the "First Day Motion No. 4: Motion For Order (1)
21 Authorizing Continued Use Of Existing Business Forms And Records and (2) Authorizing Maintenance Of
22 Existing Corporate Bank Accounts And Cash Management System" (the "Cash Management Motion") is a
23 true and correct list of all of our active bank accounts which was prepared at my direction and which I have
24 reviewed.

25 62. Our bankruptcy counsel have explained to me what the United States Trustee requirements
26 entail regarding a debtor-in-possession's deposit accounts. I believe that compliance with these requirements
27 would unnecessarily disrupt our business and impair our efforts to preserve the value of these companies and
28

1 frustrate one of our main objectives, which is to preserve the morale of their employees and, correspondingly,
2 the value of their operations .

3 63. I believe that only if their accounts are continued in their current form can the chapter 11
4 process be smooth and orderly, thereby creating a minimum amount of interference with continuing
5 operations.

6 64. To the extent there are any prepetition obligations that are processed for payment
7 postpetition, I am confident that our personnel can readily distinguish between prepetition and postpetition
8 obligations without closing the Debtors' bank accounts and opening new ones. This capability is an
9 unintended benefit of our electronic accounting and reporting systems, which includes special notation fields
10 which identify the dates in which a liability is incurred, processed and, if applicable, paid. Our accounting
11 system automatically records a written notation on checks, and more importantly, put notations on electronic
12 vouchers created when an invoice is entered into the accounts payable system.

13 65. In the ordinary course of our business we utilize the "Positive Pay" system for all of our
14 disbursement accounts, which requires us to send a file of issued checks to the bank each day checks are
15 written. When those issued checks are presented for payment at the bank, they are compared electronically
16 against the list of transmitted checks. The check-issue file sent to the bank contains the check number,
17 account number, issue date, and dollar amount. When a check is presented that does not have a "match" in
18 the file, it becomes an "exception item". The bank sends a fax or an image of the exception item to us. We
19 review the image and have the opportunity to instruct the bank to pay or return the check. I believe this
20 system will ensure that no prepetition debts are paid postpetition except for those specifically authorized by
21 this Court.

22 ***The Debtors' Existing Cash Management System***

23 66. We also need the ability to continue to utilize their cash management system so that we may
24 continue the uninterrupted operation of our business. Attached as exhibit "B" to the Cash Management
25 Motion is a true and correct flow chart of our cash management system which was prepared at my direction
26 and which I have reviewed. As the flow chart demonstrates, we maintain a centralized cash management
27 system, involving well established banking relationships and accounts, to manage and control receipts and
28 disbursements. Generally, our corporate accounts are maintained in the name of Paragon Steakhouse

1 Restaurants, Inc. at Union Bank Concentration Account No. 4000153015. This Concentration Account
2 receives deposits from the many sources described below, and funds the disbursements, which is also
3 described below.

4 67. Deposits to the Concentration Account are received daily from the following sources:

- 5 • Modest direct deposits made by the corporate office, consisting of checks in
6 payment of gift certificates, refund checks, employee paid insurance and the like;
- 7 • Paragon Steakhouse Restaurant Inc.'s Bank of America Deposit Account via
8 daily wires; this account is used primarily for West Coast restaurant cash
9 receipts. No disbursements are made from this account;
- 10 • Direct transfers from Heartland Payment Systems for Visa, MasterCard and
11 Diners Club transactions;
- 12 • Direct transfers from American Express and Discover Card transactions; and
- 13 • Five other banks throughout the country (Chase / Bank One, Comerica Bank,
14 Lafayette Bank and Trust, Wells Fargo Bank and Zions Bank); these accounts
15 are used by the Midwest and eastern restaurants for cash receipt deposits only
16 and are not disbursement accounts. Deposits made to these accounts are wired
17 nightly to the Concentration Account at Union Bank.

18 68. The Concentration Account serves as the funding account for the Accounts Payable
19 Accounts at Union Bank (account numbers 4000153112, 9081001118 and 4000154119), the Payroll Accounts
20 at Union Bank (account numbers 9081001126 and 4000154100), the Field Disbursement Account at Union
21 Bank (account number 9081001134), a Liquor Payment Account at Bank of America (account number
22 000697028275) and for Vendor Payments and Wire Transfers . The Concentration Account automatically
23 funds the disbursement accounts.

24 69. Regular Payroll is also paid out of the Concentration Account. Additionally, the Concentration
25 Account automatically funds the payroll disbursement account at Union Bank (account number 4000153023)
26 to fund vacation payments for Debtor Paragon Steakhouse Restaurants, Inc. and Debtor Paragon of
27 Michigan, Inc.

28

1 70. The obligations of each of the Debtors are paid by Debtor Paragon Steakhouse Restaurants
2 and accounted for through intercompany receivables / payables accounts which are reconciled monthly.

3 71. Our cash management system enables us to effectively and efficiently run our business. I
4 believe that the success of our chapter 11 cases demands that there be minimal disruption and that the
5 maintenance of our current cash management system is essential to limiting the disruptions to our business.

6
7 **First Day Motion No. 5: Motion For Order (1) Authorizing Payment Of Prepetition Accrued Utility**
8 **Services, (2) Prohibiting Utilities From Altering, Refusing Or Discontinuing Service On Account Of**
9 **Prepetition Invoices And (3) Establishing Procedures For Determining Requests For Additional**
10 **Adequate Assurance**

11 72. In order to operate our restaurants and maintain our headquarters, the Debtors receive water,
12 electricity, telephone, Internet, gas and similar utility services from 127 utility companies (each a "Utility
13 Company" and collectively the "Utility Companies").

14 73. The services provided by the Utility Companies to our operations are absolutely essential to
15 the continuation of our business. We cannot operate the 21 restaurants without the utility services provided
16 by the Utility Companies. Attached as exhibit "A" to the "First Day Motion No. 5: Motion For Order (1)
17 Authorizing Payment Of Prepetition Accrued Utility Services, (2) Prohibiting Utilities From Altering, Refusing
18 Or Discontinuing Service On Account Of Prepetition Invoices And (3) Establishing Procedures For
19 Determining Requests For Additional Adequate Assurance" is a true and correct list of the Debtors' Utility
20 Companies which was prepared at my direction and which I have reviewed.

21 74. That exhibit sets forth, among other things, the names of the Utility Companies, the particular
22 utility service provided, the Debtors' account numbers with those companies, the amount paid to the Utility
23 Companies on the last full month for which a bill is available, the amount which is 50% of the last full month's
24 bill and (where applicable or known) the amounts of the existing deposits held by each Utility Company.

25 75. As of this date, we are generally current with all Utility Companies, except to the extent that
26 we have not yet been billed for prepetition utility services or we have been billed but payment for such utility
27 services was not yet due, or checks on account of such utility services were issued but will not be honored
28 because of the commencement of these cases. I anticipate that we will pay all utility bills for postpetition utility

1 services as billed and when due subject to the Debtors' rights, if any, in the ordinary course, to contest,
2 among other things, the amount of a bill or the services rendered.

3 **First Day Motion No. 6: Motion For Order Authorizing Payment Of Installments Under Prepetition**

4 **Insurance Premium Agreement**

5 76. In the ordinary course of the Debtors' business, we are either required by law or compelled
6 by sound business judgment to maintain various forms of insurance, including workers' compensation,
7 property, automobile, fiduciary liability, directors and officers liability, and umbrella insurance. Certain
8 insurance policies obtained by the Debtors to provide such coverage require us to prepay the full premium for
9 the applicable coverage period. Because all of these insurance policies cover policy periods of one year, the
10 requirement to prepay the full premium may impose a significant financial burden on the Debtors. To lessen
11 this burden, prior to the Petition Date, we entered into the Premium Finance Agreement with AFCO
12 Acceptance Corporation ("AFCO"). I executed the Premium Finance Agreement on behalf of the Debtors and
13 a true and correct copy of that agreement is attached as exhibit "A" to the "First Day Motion No. 6: Motion
14 For Order Authorizing Payment Of Installments Under Prepetition Insurance Premium Agreement."

15 77. The Premium Finance Agreement requires the Debtors to pay total premiums of \$532,190, of
16 which we chose to finance \$425,752 pursuant to the terms stated in the attached Premium Finance
17 Agreement. We paid a down payment of \$106,438. Those financing terms require the Debtors to pay
18 \$48,116.44 per month with the first installment coming due on June 1, 2008.

19 78. The Policies are extremely valuable policies and it is essential to maintain them in the
20 interest of the preservation of the property, assets and business of the Debtors. The Policies could not have
21 been obtained unless the premiums were financed. We have been unable to locate any source of unsecured
22 premium financing and, at the time we entered into the Premium Finance Agreement with AFCO, we granted
23 AFCO a security interest in the gross unearned premiums (the "Security Interest") which would be payable in
24 the event of cancellation of the Policies and which further authorizes AFCO to cancel the financed Policies
25 and obtain the return of any unearned premiums in the event of a default in the payment of any installment
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1 due. The Security Interest granted to AFCO is limited to that money which will be given to the Debtors by
2 AFCO. Therefore, I do not believe that the Security Interest affects the interests of our other creditors.

3 79. As of the Petition Date, the Debtors are current in our obligations to AFCO under the
4 Premium Financing Agreement but will owe \$48,116.44 on June 1, 2008. To ensure that the insurance
5 coverage provided under the financed insurance policies is not interrupted and to avoid the risk that the
6 Debtors could be forced to procure replacement insurance coverage on less favorable terms and conditions, I
7 believe we must be able to continue to perform their obligations under the Premium Finance Agreements.

8
9 I declare, under penalty of perjury under the laws of the United States of America, that the foregoing
10 is true and correct.

11
12 Dated this ____ day of May 2008 at San Diego, California.

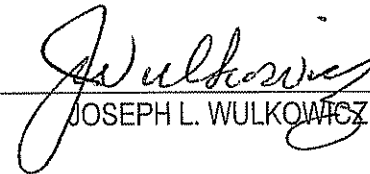
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2 AFCO. Therefore, I do not believe that the Security Interest affects the interests of our other creditors.

3 79. As of the Petition Date, the Debtors are current in our obligations to AFCO under the
4 Premium Financing Agreement but will owe \$48,116.44 on June 1, 2008. To ensure that the insurance
5 coverage provided under the financed insurance policies is not interrupted and to avoid the risk that the
6 Debtors could be forced to procure replacement insurance coverage on less favorable terms and conditions, I
7 believe we must be able to continue to perform their obligations under the Premium Finance Agreements.

8
9 I declare, under penalty of perjury under the laws of the United States of America, that the foregoing
10 is true and correct.

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12 Dated this 15 day of May 2008 at San Diego, California.

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16 JOSEPH L. WULKOWICZ
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