IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	Chapter 11
SUGARFINA INC., *et al.*,	Case No. 19-11973 (MFW)
Debtors.[1]	(Jointly Administered)
	Ref No. 62

OBJECTION TO DEBTORS' MOTION FOR ENTRY OF AN ORDER: (I) (A) APPROVING BIDDING PROCEDURES AND PROTECTIONS IN CONNECTION WITH A SALE OF SUBSTANTIALLY ALL OF DEBTORS' ASSETS FREE AND CLEAR OF LIENS, CLAIMS, ENCUMBRANCES, AND INTERESTS; (B) SCHEDULING AN AUCTION AND SALE HEARING; (C) APPROVING THE FORM AND MANNER OF NOTICE THEREOF; (D) APPROVING PROCEDURES FOR THE ASSUMPTION AND ASSIGNMENT OF CONTRACTS AND LEASES; AND (E) GRANTING RELATED RELIEF AND (II) (A) AUTHORIZING AND APPROVING THE SALE OF SUBSTANTIALLY ALL THE DEBTORS' ASSETS FREE AND CLEAR OF ALL LIENS, CLAIMS, INTERESTS, AND ENCUMBRANCES; (B) AUTHORIZING AND APPROVING THE ASSUMPTION AND ASSIGNMENT OF CERTAIN CONTRACTS AND LEASES; AND (C) GRANTING RELATED RELIEF

Bristol Investment Fund, Ltd. ("Bristol") hereby submits this objection to the Debtors' motion (a) approving the Bidding Procedures (as defined in the Bidding Procedures Order) in connection with the sale of substantially all of the Debtors' assets (the "Sale") and approval of the Termination Fee (as defined herein); (b) scheduling the related auction and hearing to consider approval of the sale (the "Sale Hearing"); (c) approving the form and manner of notice thereof; (d) approving the procedures related to the assumption and assignment of certain of the Debtors' executory contracts and unexpired leases, including notice of proposed cure costs; and

[1] The Debtors in these Chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number or Canadian Revenue Agency, as applicable, are (1) Sugarfina, Inc., a Delaware corporation (4356), (2) Sugarfina International, LLC, a Delaware limited liability company (1254), and (3) Sugarfina (Canada), Ltd. (4480). The Debtors' corporate headquarters is located at 1700 E. Walnut Avenue, 5th Floor, El Segundo, California 90245.

(e) granting related relief [D.I. 62] ("Sale Motion"). In support of this Objection, Bristol respectfully states as follows:

INTRODUCTION

1. The Sale Motion and the proposed asset purchase agreement ("APA") should not be approved, as they are illusory in value, chill bidding, and contain inappropriate "credit bid" features which would allow the proposed staking horse buyer (a minority $1 million participant in the DIP Facility) to credit bid up to $11 million in second lien debt that it does not own but may take by "assignment" for credit bidding purposes and for no consideration. This feature is designed, not to maximize value, but rather to freeze out other bidders. It also evades any investigation and challenge periods that are required by the Local Bankruptcy Rules.

2. On September 19, 2019, just one day prior to the objection deadline, the heretofore secret "Sale Support Agreement" was filed on the docket [D.I. 103]. The 356 page agreement raises many more questions than answers and appears at best, designed to freeze out bidders, and at worse, a collusive and anti-competitive agreement that should result in the denial of the proposed bidding procedures, the Stalking Horse Agreement and the Termination Fee.

3. The Sale Support Agreement and its accompanying schedules contemplate that, *inter alia*, after Goldman receives net sale proceeds from the auction, a plan of reorganization shall (i) transfer to Goldman 100% of the reorganized equity of the Debtors, (ii) grant releases and exculpations to the agreement's parties (i.e. SFCC, Candy Cube and Goldman); (iii) preserve significant NOL's that would be transferred to Goldman, as the 100% owner of the reorganized "shell;" (iv) establish a "Minimum Recovery Note" between Candy Cube and Goldman, which contemplates a convoluted formula to guaranty Goldman a minimum cash payment after the dust settles. Sale Support Agreement, pp. 348-356.

A. Background

4. On September 9, 2019, (the "Petition Date"), the Debtors commenced the above-captioned bankruptcy cases.

5. An Official Committee of Unsecured Creditors was appointed by the Office of the United States Trustee on September 17, 2019.

6. Under the pending DIP financing motion [D.I. 21] (the "DIP Motion"), the Debtors seek final authority to obtain a senior secured, super-priority revolving credit facility in the aggregate amount of $4.0 million, inclusive of a $600,000 roll up of pre-petition debt (the "DIP Facility") from SFCC Loan Investors, LLC, ("SFCC") and Candy Cube Holdings, LLC ("Candy Cube" or "Stalking Horse Buyer"), and together with SFCC, individually and collectively, "DIP Lender"). SFCC is providing 75% of the DIP Facility and Candy Cube, the proposed stalking horse purchaser, is allegedly providing 25% of the DIP Facility.

B. The Illusory Value Being Paid to the Estate.

7. On September 11, 2019, the Debtors filed the Sale Motion seeking to approve, among other things, bidding procedures, bidding protections and a sale transaction to the Stalking Horse Bidder for a headline value of $13 million (minus seven categories of price deductions), plus the Buyer's issuance of "Equity Consideration."

8. Much of the consideration being offered by the Stalking Horse Bidder comes in the form of dubious credit bid rights and other purported value ascribed in the "Equity Term Sheet" annexed to the APA. Under the Equity Term Sheet, in lieu of cash, the Stalking Horse Bidder has offered to pay part of the purchase price with equity from the Newco acquiring the acquired assets, in the form of Senior Preferred Membership Units and 20% of all Common Membership Units in the Stalking Horse Bidder, which equity interests the Debtors

presumptively value at $1 million (the "Minority Common Membership Interests"). It is unclear what the Debtors intend to do with the Minority Common Membership Interests after they have sold all of their assets (there is insufficient money in the budget to confirm a plan). The remaining equity in the Stalking Horse Bidder is being issued to TerraMar Capital LLC ("TerraMar"), the owner of Candy Cube. Terra Marr has the option to purchase the estates' Minority Common Membership Units "for a price equal to the prevailing fair market value of the Minority Common Membership Units". The Equity Term Sheet transactions look more like Chapter 11 Plan transactions than a section 363 sale transaction; even more so, when one reviews the Sale Support Agreement.

C. The Credit Bid

9. In addition to the non-cash "Equity Consideration," much of the remainder of the purchase price may be paid by credit bid. See, APA at section 2.5(a)(i) ("Buyer shall pay to Seller an amount equal to the Purchase Price (which shall be paid by a credit bid of any secured debt of Seller that Buyer owns as of the Closing Date that reduces the Purchase Price dollar for dollar and, for any remaining amounts of the Purchase Price, by wire transfer of immediately available funds)…".

10. Paragraph 15 of the proposed Sale Order provides as follows:

> **Credit Bidding**. For purposes of any bid by the Stalking Horse Bidder, including any Overbid, the Stalking Horse Bidder shall be entitled to credit bid up to the full amount of the Termination Fee and the full amount of any secured debt of the Debtors for which the Stalking Horse Bidder is the lender by assignment **or otherwise** (but only so long as such bid provides for the payment in full in cash of any secured debt senior in priority to such secured debt being credit bid). The Stalking Horse Bidder shall have the right to credit bid the full amount of (a) the pro rata portion of the DIP Obligations (as defined in the DIP Credit Facility) of the DIP Credit Facility based on the portion of the DIP Credit Facility that it has funded compared with the aggregate

> amount of the DIP Credit Facility that has been funded by each Lender plus (b) the amount of the obligations under the Goldman Prepetition Loan Agreement (the "Second Lien Loan") that Goldman (the "Second Lien Lender") has assigned to the Stalking Horse Bidder at any time (which includes (a) $2,000,000 … and (b) additional amounts that may be assigned by the Second Lien Lender at the Auction as agreed to between the Buyer and the Second Lien Lender)…. (emphasis added)

11. As explained below, in violation of applicable law, the Stalking Horse Bidder seeks to credit bid debt that it is owned by Goldman, as well as the right to further credit bid a requested $1 million Termination Fee.

D. The Expedited Timeline that Seeks to Evade the Challenge Period

12. The Sale Motion seeks a sale process to occur in approximately 30 days and contemplates the following expedited dates:

- Bid Deadline on October 4, 2019 (10 days after the Bidding Procedures Hearing, and 25 days from Petition Date),
- Auction on October 8th (14 days after the Bidding Procedures Hearing, and 29 days from Petition Date), and
- Sale hearing on October 10th (16 days after Bidding Procedures Hearing, and 31 days from Petition Date).

The Sale Motion does not seek shortened notice for the Sale Hearing, although Bankruptcy Rule 2002 requires twenty-one days' notice. The Debtors have advised that the hearing on the Bidding Procedures has been adjourned to the October 3rd hearing date – but there has been no indication that the foregoing deadlines would be extended.

OBJECTION

I. The Sale Does Not Satisfy Section 363(b)

13. Bankruptcy Code section 363(b)(1) allows a debtor to "use, sell, or lease, other than in the ordinary course of business, property of the estate" after notice and a hearing. 11 U.S.C. § 363(b)(1). Typically, a sale may be authorized under Bankruptcy Code section 363(b) if a "good business reason exists to support it." Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063, 1071 (2d Cir. 1983). The sale must be consistent with the overarching objective of maximizing value to the estate and further "the diverse interests of the debtor, creditors, and equity holders, alike," not the interests of a single creditor constituency. See In re Lionel Corp., 722 F.2d at 1071; In re Metaldyne Corp., 409 B.R. 661, 667-70 (Bankr. S.D.N.Y. 2009).

14. A pre-plan sale of all or substantially all of a debtor's assets "requires a bankruptcy court's careful review." In re Exaeris, Inc., 380 B.R. 741, 744 (Bankr. D. Del. 2008). Given that the protections afforded under the plan confirmation process are absent, a proposed pre-plan sale of substantially all of a debtor's assets must be closely scrutinized. See In re CGE Shattuck, LLC, 254 B.R. 5, 12 (Bankr. D. N.H. 2000) ("The closer a proposed transaction gets to the heart of the reorganization process, the greater scrutiny the Court must give to that matter."). As set forth herein, given the deal structure, timing, onerous terms, and proposed credit bidding of debt not owned, as well as payment of the purchase price with equity in Newco, the transfers are more akin to "plan transactions" and do not comply with the above standards.

II. The Court Should Not Allow Credit Bidding unless Such Bidding is Subject to Challenge and Bankruptcy Code Section 363(k)

15. The transactions by and between SFCC, the Stalking Horse Bidder and Goldman have not been adequately disclosed. In fact, the Debtors advised that they had not seen

the final "Sale Support Agreement" until it was filed with this Court, even though it has a material effect on the Debtors' auction process, dictate the terms of distribution of sale proceeds, and "lock-up" the collective parties thereunder's rights in the sale process to only support the Stalking Horse Bid, and provide for a complex plan transaction. They raise many unanswered questions, some of which were raised by the Court at the first day hearing.

16. Delaware Local Bankruptcy Rule 4001-2 provides a standard investigation period for a creditors committee of 60 days from the date of formation of such committee, and 75 days from the date of entry of an interim order on DIP financing for all other parties in interest in the case. Local Rule 4001-2(a)(i)(B) would make November 16, 2019 the end of the Committee's investigation period. As to all other parties in interest, as the Interim DIP Financing Order in this case was entered on September 11, 2019, the Local Rules would give all parties in interest other than the Committee until at least December 1, 2019 to investigate Goldman's (or Candy Cube's) or SFCC's pre-petition liens.

17. The Debtors proposes October 8th as the sale auction date at which the Stalking Horse Bidder would be allowed to credit bid. If the Debtors' proposed schedule is approved, it would **shorten the investigation period by 39 days** from what the Local Rules provides for the Committee, **and 55 days** from what the Local Rules provide for all other parties in interest.

18. Notably, the proposed Bidding Procedures Order gives the Stalking Horse Bidder a blanket right to credit bid "the full amount of any secured debt of the Debtors for which the Stalking Horse Bidder is the lender ***by assignment or otherwise.***" Bidding Procedures Order, ¶15 (emphasis added). It does not condition the right to credit bid pursuant to Bankruptcy Code section 363(k) (*i.e.* a holder of an allowed claim) nor does it make it subject to any challenge.

The Court should not permit such an end-run around long-established protections on the use of credit bidding as currency and should require that any bidding at the October 8th auction be in cash, and not permit bids in the form of impossible-to-value equity in a Newco, and not in credit bids of debt the Buyer does not own.

19. Section 363(k) provides as follows:

> (k) At a sale under subsection (b) of this section of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the **holder** of such claim may bid at such sale, and, if the **holder** of such claim purchases such property, **such holder** may offset such claim against the purchase price of such property. (emphasis added)

20. As a threshold matter, as the statutory language makes clear, a party seeking to credit bid must first be "the holder of the debt." Here, the Stalking Horse Bidder indisputably is not the holder of the debt[2], but rather the beneficiary of a side agreement that purports to allow it to be "assigned" credit bid rights at an auction, in exchange for what appears to be a minimum payment to Goldman of $2 million.

21. The Sale Support Agreement does not transfer title or liens to the debt. In fact, it ensures that Goldman keeps its debt so that it can be the 100% equity owner of the reorganized Debtors' shell. It only furthers a potentially collusive, bid chilling scheme for the benefit of the Stalking Horse Bidder and Goldman.

III. Credit Bidding by the Stalking Horse Bidder or Goldman Sachs will Chill Bidding

22. A secured creditor's ability to credit bid is not an absolute, unfettered right. In Re Philadelphia Newspapers, LLC, 599 F.3d 298, 316, n.14 (3d Cir. 2010) ("[T]he right to credit bid is not absolute."). The term "cause" in §363(k) is not defined by the Bankruptcy Code and a court must apply its discretion on a case-by-case basis to determine whether cause to

[2] As the Interim DIP Financing Order makes clear, "the current outstanding principal balance of the obligations owed to Goldman (the "Second Lien Obligations") is not less than $10,900,000" (emphasis added).

deny or restrict the right to credit bid exists. See, In re Aéropostale, Inc., 555 B.R. 369, 414-15 (Bankr. S.D.N.Y. 2016).

23. A court may deny a lender the right to credit bid in the interest of any policy advanced by the Code, such as to remedy against inequitable conduct, to ensure the success of the reorganization or to foster a competitive bidding environment. Philadelphia Newspapers, LLC, 599 F.3d at 315-16); see also, In re The Free Lance-Star Publishing Co. of Fredericksburg, VA, 512 B.R. 798, 805 (Bankr. E.D. Va. 2014) (collecting cases).

24. One primary "cause" that justifies denying a credit bid is well-established: where the validity of the lien securing the creditor's claim is subject to dispute, thus throwing into doubt whether the creditor has an "allowed" claim, as is required under Bankruptcy Code section 363(k). See In re Aéropostale, Inc., 555 B.R. at 415 ("Courts have . . . limited the right to credit bid when the validity of a creditor's lien is in dispute."); In re SubMicron Sys. Corp., 432 F.3d 448, 458 (secured lenders must "present[] valid secured claims" under state law to credit-bid); In re Fisker Auto. Holdings, Inc., 510 B.R. at 61 ("The law leaves no doubt that the holder of a lien, the validity of which has not been determined, as here, may not bid its lien."). **In other words, a buyer cannot bid with currency (secured debt) that it does not validly hold or is in dispute. This is the case here.**

25. As the sale procedures must "facilitate an open and fair public sale designed to maximize value for the estate" while at the same time "enhancing competitive bidding," Sale Motion at para 36 (citing Calpine Corp. v. O'Brien Envtl. Energy, Inc. (In re O'Brien Envtl. Energy, Inc.), 181 F.3d 527, 536-37 (3d Cir. 1999), cause exists to deny or significantly curtail Candy Cube's ability to credit bid any debt that it does not own or that was obtained under the Sale Support Agreement, which agreement, until demanded by Bristol, was

not even disclosed to the Court or creditors, and which is the subject of a current investigation. This includes, at a minimum, the denial of the right to credit bid Goldman's debt, as well as the right to credit bid the Termination Fee. Anything short will likely mean no bidders show up at the auction. See In re President Casinos, Inc., 314 B.R. 784, 786 (Bankr. E.D. Mo. 2004) (the Court denied "approval of the bid procedures [as they] would not enhance the bid process and may in fact chill bidder interest").

IV. The Termination Fee Does Not Meet O'Brien Standards

26. The Debtors also seek approval of a $1 million termination fee, as described in Section 5.5 of the Agreement, which provides for a $500,000 Break-Up Fee plus the actual, reasonable, and documented expenses of the Candy Cube, totaling $1,000,000 ("Termination Fee").

27. In In re O'Brien Envtl. Energy, Inc, the Third Circuit reviewed the following nine factors in deciding whether to award a break-up fee:

a. the presence of self-dealing or manipulation in negotiating the break-up fee;

b. whether the fee hampers, rather than encourages, bidding;

c. the reasonableness of the break-up fee relative to the purchase price;

d. whether the unsuccessful bidder placed the estate property in a "sale configuration mode" to attract other bidders to the auction;

e. the ability of the request for a break-up fee to serve to attract or retain a potentially successful bid, establish a bid standard or minimum for other bidders or attract additional bidders;

f. the correlation of the fee to a maximum value of the debtor's estate;

g. the support of the principal secured creditors and creditors' committees of the break-up fee;

h. the benefits of the safeguards to the debtor's estate; and

i. the substantial adverse impact of the break-up fee on unsecured creditors, where such creditors are in opposition to the break-up fee

See O'Brien, 181 F.3d at 536.

28. The Termination Fee is objectionable for many reasons. First, the proposed Stalking Horse Agreement has not set the floor for other bidders. Bristol has advised the Debtors that it will enter into an asset purchase agreement with a cash purchase price that exceeds the headline number offered in the APA. Second, for the reasons cited herein, the Termination Fee does not satisfy the O'Brien standards given the collusive agreements among the Debtors' first and second lien lenders and the Stalking Horse Purchaser, and would only chill bidding and detract them from participating at an auction. Third, the Termination Fee is excessive, and is 7.6% of the $13 million headline purchase price. If allowed, the Termination Fee should be no more than 2-3 %, which is consistent with Delaware precedent and practice. Fourth, to the extent any Termination Fee is approved, it should be only be paid out of sale proceeds following the closing of an Alternative Transaction, should not be a super-priority administrative claim nor granted any priority lien status. See, Bidding Procedures Order, ¶¶9-12. Finally, the Court should not allow the Termination Fee to be credit bid at the auction.

In addition to the foregoing, the following provisions of the Bidding Procedures should be deleted or modified:

- Purchase Price: Potentially purchasers should not be required to bid more than the consideration provided by the Stalking Horse Bidder. Thus, the Debtors must value the seven (7) purchase price reductions and deduct that from the $13 million purchase price. Likewise, there should be no value given to the equity

consideration unless the Stalking Horse Purchaser provides credible pro forma documents that shows a value of $1 million. Bidding Procedures, pp. 3-4.

- Consultation Parties: Given the lock-up in the Sale Support Agreement neither SFCC, Candy Cube (in its capacity as lender), nor Goldman should be permitted to be consultation parties. They have given up their right to approve any other transaction and should not be permitted to funnel confidential information to the Stalking Horse Bidder (who is also a minority DIP Lender). Bidding Procedures, p. 1
- No Assignment of Additional Debt. The Stalking Horse Bidder should not be permitted to buy or have assigned to them any additional debt at the Auction.
- Minimum Overbid Increment. The Minimum Overbid Increment should only be cash consideration. Bidding Procedures, p. 6. Likewise, each Qualified Bidder should be required to show its financial ability to close on each incremental bid.

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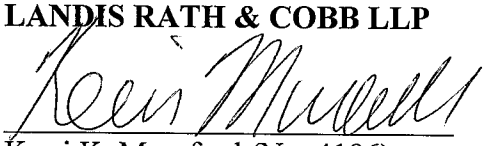
CONCLUSION

For the reasons set forth above, Bristol respectfully requests that this Court enter an order: (i) denying the approval of the Stalking Horse Agreement, (ii) denying the Termination Fee, (iii) modifying the Bidding Procedures as set forth herein and, and (iv) granting such further relief as the Court deems just and proper.

Dated: September 23, 2019
Wilmington, Delaware

LANDIS RATH & COBB LLP



Kerri K. Mumford (No. 4186)
Matthew R. Pierce (No. 5946)
919 Market Street, Suite 1800
Wilmington, Delaware 19801
Telephone: (302) 467-4400
Facsimile: (302) 467-4450
Email: mumford@lrclaw.com
pierce@lrclaw.com

-and-

OLSHAN FROME WOLOSKY LLP
Adam H. Friedman
Thomas J. Fleming
1325 Avenue of the Americas
New York, New York 10019
Tel: 212 451-2300
Fax: 212 451-2222

Counsel to Bristol Investment Fund, Ltd.