

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE**

In re

SUGARFINA INC., et al.,¹

Debtors.

Chapter 11

Case No. 19-11973 (MFW)

(Jointly Administered)

Hearing: Oct. 24, 2019 at 10:30 a.m. (ET)

Obj. Due: Oct. 21, 2019 at 4:00 p.m. (ET)

Related to Docket Nos. 62, 268

OBJECTION AND RESERVATION OF RIGHTS OF FEDERAL REALTY INVESTMENT TRUST AND THE RELATED COMPANIES TO DEBTORS' MOTION FOR ENTRY OF AN ORDER: (I) (A) APPROVING BID PROCEDURES AND PROTECTIONS IN CONNECTION WITH A SALE OF SUBSTANTIALLY ALL OF DEBTORS' ASSETS FREE AND CLEAR OF LIENS, CLAIMS, ENCUMBRANCES, AND INTERESTS; (B) SCHEDULED AN AUCTION AND SALE HEARING; (C) APPROVING 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

Federal Realty Investment Trust and The Related Companies (collectively, the “Landlords”) hereby file this objection and reservation of rights (the “Objection”) to the *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,*

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 location of the Debtors' corporate headquarters is 1700 E. Walnut Ave., 5th Floor, El Segundo, California 90245

Claims, Interests, and Encumbrances; (B) Authorizing and Approving the Assumption and Assignment of Certain Contracts and Leases; and (C) Granting Related Relief [D.I.62] (the “Sale Motion”),² and respectfully represent as follows:

I. BACKGROUND FACTS

1. Sugarfina Inc., and affiliated co-debtors (collectively, the “Debtors”), filed voluntary petitions for relief under Chapter 11 of Title 11 of the United States Code on September 6, 2019 (the “Petition Date”). Debtors continue to operate their business and manage their properties as debtors-in-possession pursuant to 11 U.S.C. §§ 1107(a) and 1108.³

2. The Debtors lease retail space (the “Premises”) from the Landlords pursuant to unexpired leases of nonresidential real property (individually, a “Lease,” and collectively, the “Leases”) at the locations (the “Centers”) set forth in detail on the attached **Schedule A**.

3. The Leases are leases “of real property in a shopping center” as that term is used in Section 365(b)(3). *See In re Joshua Slocum, Ltd.*, 922 F.2d 1081, 1086-87 (3d Cir. 1990).

4. On May 14, 2019, the Debtors filed the Sale Motion, seeking, *inter alia*, to sell substantially all of the Debtors’ assets to Sugarfina Acquisition Corp. (the “Stalking Horse Bidder”), or another successful bidder at auction. The Order approving bidding procedures to govern the Sale of all or some of the Debtors’ Assets was approved on October 15, 2019 [D.I. 268].

5. In connection with the Sale Motion, on October 14, 2019, the Debtors filed that certain *Amended Notice of Assumption and Cure Cost with Respect to Executory Contracts or Unexpired Leases Potentially to be Assumed and Assigned in Connection with a*

² Terms not otherwise defined here shall have the meanings ascribed to them in the Sale Motion (defined below), the Cure Notice and accompanying documents.

³ Unless otherwise specified, all statutory references to “Section” are to 11 U.S.C. §§ 101 et seq. (the “Bankruptcy Code”).

Sale of Debtors' Assets [D.I. 257] (the "Cure Notice"), and the Landlords have separately filed their objection to the Cure Notice.

II. OBJECTION TO SALE AND RESERVATION OF RIGHTS

A. The Debtors must demonstrate adequate assurance of future performance to assume and assign the Leases to Buyer.

6. The Debtors may not assume and assign the Leases unless they demonstrate adequate assurance of future performance. 11 U.S.C. § 365(b)(1)(C); *see also* 11 U.S.C. § 365(f)(2). The provision of adequate assurance of future performance is an affirmative duty of the Debtors, and the Debtors bear the ultimate burden of persuasion as to issues under Section 365. *See In re Rachels Indus., Inc.*, 109 B.R. 797, 802 (Bankr. W.D. Tenn. 1990); *see also Richmond Leasing Co. v. Capital Bank, N.A.*, 762 F.2d 1303, 1309 (5th Cir. 1985). The obligation to comply with Section 365(b) and Section 365(f) is unaffected by the assumption and assignment process taking place through a sale under Section 363. Courts require a specific factual showing through competent evidence to determine whether adequate assurance of future performance has been provided. *See, e.g., Matter of Haute Cuisine, Inc.*, 58 B.R. 390 (Bankr. M.D. Fla. 1986) (even though experts presented cash flow projections, the court found that insufficient documentary evidence had been presented).

7. In this case, the Leases are shopping center leases and, as such, the Bankruptcy Code requires more than the basic adequate assurance of future performance of the Leases under Section 365(b)(1)(C). *In re Sun TV and Appliances, Inc.*, 234 B.R. 356, 359 (Bankr. D. Del. 1999). In order to assume and assign shopping center leases, the Debtors must satisfy the heightened requirements set forth in 11 U.S.C. § 365(b)(3)(A) - (D). *See Joshua Slocum*, 922 F.2d at 1086; *see also L.R.S.C. Co. v. Rickel Home Centers, Inc. (In re Rickel Home Centers, Inc.)*, 209 F.3d 291, 299 (3d Cir. 2000). The heightened adequate assurance requirements that Debtors must satisfy under Section 365(b)(3) include the following:

- the source of rent and that the financial condition and operating performance of the proposed assignee and its guarantors, if any, must be similar to the financial condition and operating performance of the debtor and its guarantor(s), if any, as of the time the debtor became the lessee. *See* 11 U.S.C. § 365(b)(3)(A);

- that any percentage rent due under the lease will not decline substantially. *See* 11 U.S.C. § 365(b)(3)(B);
- that assumption and assignment of the lease is subject to all provisions thereof, including (but not limited to) provisions such as a radius, location, use, or exclusivity provision, and will not breach of any such provision in any other lease, financing agreement, or master agreement relating to such shopping center. *See* 11 U.S.C. § 365(b)(3)(C); and
- that assumption and assignment of the lease will not disrupt the tenant mix or balance in the shopping center. *See* 11 U.S.C. § 365(b)(3)(D).

8. This heightened adequate assurance of future performance determination must be satisfied in connection with an assumption and assignment under Section 365(f)(2)(B). *Sun TV and Appliances, Inc.*, 234 B.R. at 370. In connection with the heightened adequate assurance requirement for shopping center leases, courts also require a specific factual showing through competent evidence to determine whether the Debtors have provided adequate assurance of future performance. *Matter of Haute Cuisine, Inc.*, 58 B.R. at 394.

9. To date, the Debtors and the Stalking Horse Bidder have provided limited adequate assurance of future performance information to the Landlords. In addition, since the auction will occur after the deadline to object to the Stalking Horse Bidder, the Landlords do not know what, if any, other bids will be received for the assets, and as a result, reserve their rights to file further objections to any other bidder.

10. With respect to the Stalking Horse Bidder, the adequate assurance information does not seem to make it clear whether it intends to assign all Leases to a single entity or whether it will designate leases to multiple entities. In addition, while the adequate assurance information provides some unsubstantiated figures for going forward working capital, it does not provide any support for these amounts. In addition, because it is not clear how many leases the Stalking Horse Bidder will keep, Landlords have no way to determine the sufficiency of such working capital to fund ongoing store operations. The Landlords intend to continue working with the Stalking Horse Bidder to resolve the adequate assurance questions prior to the hearing should they prevail at the auction.

B. Any assumption and assignment must comply with terms of the Leases.

11. Through the BAPCPA amendments, “Section 365(f)(1) is amended to make sure that all of the provisions of Section 365(b) are adhered to and that 365(f) of the code does not override Section 365(b).” Floor Statement of Senator Orrin Hatch, 151 Cong. Rec. S. 2459, 2461-62 (daily ed. March 10, 2005). In explaining the change to Section 365(f)(1), Senator Hatch stated:

The bill helps clarify that an owner should be able to retain control over the mix of retail uses in a shopping center. When an owner enters into a use clause with a retail tenant forbidding assignments of the lease for a use different than that specified in the lease, that clause should be honored. Congress has so intended already, but bankruptcy judges have sometimes ignored the law.

151 Cong. Rec. S. 2459, 2461 (daily ed. March 10, 2005).

12. The changes embodied in the BAPCPA specifically preserve a landlord’s right to enforce use and other lease provisions. Again, Senator Hatch’s remarks in the Congressional Record clarify the intent behind Section 365(b) and 365(f):

A shopping center operator . . . must be given broad leeway to determine the mix of retail tenants it leases to. Congress decided that use or similar restrictions in a retail lease, which the retailer cannot evade under nonbankruptcy law, should not be evaded in bankruptcy. It is my understanding that some bankruptcy judges have not followed this mandate. Under another provisions of the Code, Section 365(f), a number of bankruptcy judges have misconstrued the Code and allowed the assignment of a lease even though terms of the lease are not being followed. (emphasis added).

151 Cong. Rec. S. 2459, 2461-62 (daily ed. March 10, 2005).

13. BAPCPA clarified Section 365 to reflect the Congressional intent that Debtors cannot use Section 365(f)(1) to void lease provisions, and to overrule those prior court decisions that did not strictly enforce lease terms. The predicate to the limited ability to assign a lease over a landlord’s objection under Section 365(f) is that such assignment must be subject to the protections of Section 365(b)(1) and (3).

14. Section 365(f)(1) does not modify or override Section 365(b). *Trak Auto Corp. v. West Town Ctr. LLC (In re Trak Auto Corp.)*, 367 F.3d 237, 243-44 (4th Cir. 2004) (bankruptcy courts could not use the general anti-assignment provision of Section 365(f)(1) to

trump the specific protections granted to landlords in Section 365(b)(3)(C)). Any assignment must remain subject to all provisions of the Leases, including those provisions concerning use, radius, exclusivity, tenant mix and balance. Landlords need to understand whether the Stalking Horse Bidder intends to continue to operate to operate as Sugarfina under the Leases, and the Landlords have no information on the potential proposed use by any other potential bidder. The Stalking Horse Bidder has other store concepts that may violate the use, tenant mix, or exclusivities of other tenants in the Centers, and, therefore, Landlord objects to any such change in the use or other terms of the Leases.

C. Any sale cannot be free and clear of the obligations to pay all charges due under the Leases, including unbilled year-end adjustments and reconciliations.

15. The Sale Motion seeks authority for the sale of the Leases free and clear of liens, claims, interests, and encumbrances. The Landlords object to any sale free and clear of the obligations to satisfy unbilled taxes, reconciliations, percentage rent, or other year-end adjustments or unbilled charges that may have accrued under the Leases prior to the assignment of the Leases, but which have not yet been billed. The Debtors continue to be responsible for all such unbilled charges as they come due under the Leases, and the Debtors, or an assignee, must continue to satisfy all charges due under the Leases, including charges which have not yet been billed, reconciled and/or adjusted from pre-petition (or even post-petition) periods. Any assumption and assignment of the Leases cannot cut off the Landlords' right to recover unbilled charges that have accrued, or are accruing, under the Leases. If the sale is not subject to these reconciliation and adjustment claims, it is unlikely that these legitimate lease charges will ever be paid to the Landlords.

16. Finally, the Leases provide that the Debtors must indemnify and hold the Landlords harmless with respect to any existing claims which may not become known until after the assumption and assignment of the Leases, examples of which may include such claims as personal injuries at the Premises and damage to the Premises or Centers by the Debtors or their agents. Any order approving the assumption and assignment of the Leases must provide that the assumption and assignment is pursuant to the terms of the Leases, including that any assignee

continues to be responsible for all such indemnification obligations, regardless of when they arose. In the alternative, the Debtors must provide (by insurance or otherwise) that it can satisfy the indemnification obligations under the Leases for any such claims that relate to the period prior to any assumption and assignment of the Leases.

D. An undercapitalized assignee should provide the Landlords additional security.

17. If the Stalking Horse Bidder (or any other proposed assignee) does not possess sufficient operating experience or capitalization to satisfy the Landlords' requirements, the assignee should provide some type of credit enhancement as part of its adequate assurance of future performance demonstration, such as: (i) a guaranty of future performance from a financially capable parent entity; (ii) a letter of credit; or (iii) a cash security deposit. At this time, the Landlords do not have any information on the actual tenant entity that will take an assignment of the Leases, either from the Stalking Horse Bidder or with respect to any other potential bidder. Pursuant to Section 365(l), the Landlords will require a security deposit, parent guaranty or letter of credit as security for the performance of the assignee's obligations under the Leases in the event that the assignee fails to perform on a going-forward basis. This is a reasonable condition of demonstrating adequate assurance of future performance where the Debtors are seeking approval of an ultimate assignee with no operating history, and certain of the Landlords already possess security deposits from the Debtors.

E. Assumption and Amendment Agreement

18. Landlords request that, as a condition to any order approving assumption and assignment of any of Landlords' Leases, the assignee shall be required to enter into a short form Assumption and Amendment Agreement whereby the assignee shall become directly obligated to Objecting Landlords and the provisions of Objecting Landlords' Leases regarding notice addresses will be modified. The form of Assumption and Amendment Agreement will be made available upon request.

III. RESERVATION OF RIGHTS TO RAISE FURTHER OBJECTIONS AND JOINDER

18. Landlords reserve their rights to amend or modify the Objection once Landlords receive information about any other bidders, as well as any additional adequate assurance of future performance information related to the Stalking Horse Bidder or any other bidder for any of the Debtors' assets. This Objection is without prejudice to Landlords' ability to raise further objections, including at the Sale Hearing, and the Landlords reserve all rights to: (i) object to any request to assume and assign the Leases on any grounds, including objections based upon adequate assurance of future performance and the proposed use for any Premises; (ii) object to the form of any asset purchase agreement, sale order, or other document proposed by the Debtors and the successful bidder; (iii) object to any attempt by the Debtors to designate any of the Leases; (iv) require any attempted assignment to comply with all terms of the Leases; and (v) seek to continue the Sale Hearing.

19. To the extent not inconsistent herewith, the Landlords hereby join in the objections raised by other landlords.

IV. CONCLUSION

In order to protect the interests of the Landlords, any order approving the sale to the Buyer should protect the Landlords as set forth above, and the Court should grant such other relief that the Court finds just and proper.

Dated: October 21, 2019
Wilmington, Delaware

Respectfully submitted,

/s/ Leslie C. Heilman

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