IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	)	Chapter 11
FRIENDLY ICE CREAM CORPORATION, *et al.*,[1]	)	Case No. 11-13167 (KG)
Debtors.	)	(Jointly Administered)
	)	**Re: Court Docket Nos. 140, 142, 150, 151, 153, 155, 170, 172, 173, 191, 193, 233, 241, 242**

DEBTORS' OMNIBUS REPLY TO OBJECTIONS TO (I) DEBTORS' MOTION FOR ENTRY OF AN ORDER APPROVING BIDDING PROCEDURES; AND (II) DEBTORS' MOTION FOR APPROVAL OF DIP FINANCING AND USE OF CASH COLLATERAL

The above-captioned debtors and debtors in possession (collectively, the "Debtors") hereby file this reply (this "Reply") to the objections (collectively, the "Objections"), including the objection [Docket No. 242] (the "Committee Objection") of the official committee of unsecured creditors (the "Committee") to the Debtors' motions [Docket Nos. 15, 16] for entry of (1) an order approving the Debtors' proposed bidding procedures and authorizing the sale of substantially all of the Debtors' assets (the "Bidding Procedures Motion")[2] and (2) an order approving the Debtors' proposed postpetition debtor-in-possession financing (the "DIP Motion"

[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, include: Friendly Ice Cream Corporation (3130); Friendly's Restaurants Franchise, LLC (3693); Friendly's Realty I, LLC (2580); Friendly's Realty II, LLC (2581); and Friendly's Realty III, LLC (2583). The location of the Debtors' corporate headquarters and the Debtors' service address is: 1855 Boston Road, Wilbraham, Massachusetts 01095.

[2] Objections (or joinders to Objections) to the Bidding Procedures Motion were filed by: Holyoke Mall Company, L.P., Aviation Mall NewCo, LLC, and PCK Development Company, L.L.C. [Docket No. 140]; The Macerich Company [Docket No. 142]; Simon Property Group, Inc. [Docket No. 150]; Kimco Westmont 614, Inc., Potomac Run, LLC, and Garden State Pavilions Center, LLC [Docket No. 155]; S.R. Weiner & Associates Inc., Brookside (E&A) [Docket No. 170]; Brixmor Property Group, Inc. and GGP Limited Partnership [Docket No. 172]; Darnestown Road Associates LP [Docket No. 173]; the United States Trustee (the "U.S. Trustee") [Docket No. 191]; AGNL Ice Cream, DST [Docket No. 193]; Continental Illinois Holding Corporation [Docket No. 233]; the Pension Benefit Guaranty Corporation [Docket No. 241]; and the Committee (collectively, the "Bidding Procedures Objectors").

and, together with the Bidding Procedures Motion, the "Motions").[3] As discussed in detail in this Reply, the Objections lack merit and should be overruled. In support of the Motions and this Reply, the Debtors respectfully state as follows:

PRELIMINARY STATEMENT

Prior to filing these chapter 11 cases, the Debtors negotiated a $71.3 million postpetition debtor-in-possession financing facility—including approximately $35 million of new money to fund operations in chapter 11—and a stalking-horse purchase agreement for the sale of substantially all of the Debtors' assets as a going concern. As was previously disclosed, affiliates of Sun Capital Partners, Inc. ("Sun Capital") are the Debtors' ultimate majority equity holders, are lenders under a prepetition second lien facility, are providing the new money portion of the debtor-in-possession financing facility, and are the proposed stalking-horse purchaser. Without the new-money financing commitment (which is predicated, in part, on the stalking-horse purchase agreement) and without the stalking-horse purchase agreement itself, the Debtors would likely not be able to continue operations, and all parties in interest, including general unsecured creditors, contract counterparties, landlords, secured creditors, priority claimants, vendors, customers, and the Debtors' approximately 10,000 employees, would all suffer serious harm. The Committee would have this Court believe that it is somehow inherently improper for affiliates of Sun Capital to hold debt and equity positions in the Debtors and to also want to acquire the Debtors' assets. However, while "insider" transactions may be subject to heightened scrutiny, the Debtors have made clear from the outset of these chapter 11 cases that the sale of their assets will be subject to a full marketing and auction process, and that the Committee will

[3] Objections to the DIP Motion were filed by: National Industrial Portfolio Borrower, LLC [Docket No. 151]; Huntington National Bank [Docket No. 153]; the Pension Benefit Guaranty Corporation [Docket No. 241]; and the Committee (collectively, together with the Bidding Procedures Objectors, the "Objecting Parties").

have the opportunity to challenge the validity or priority of the debt claims held by Sun Capital affiliates. The Committee has also repeatedly asserted that these chapter 11 cases are being run for the sole benefit of affiliates of Sun Capital. In reality, these chapter 11 cases will benefit all creditors. Affiliates of Sun Capital are making a significant new-money investment into the Debtors and are proposing to acquire the Debtors' assets and operations as a going-concern. In the process, the Debtors, with the new money provided by an affiliate of Sun Capital, have been able to stabilize their operations, to finance their chapter 11 cases, and have the ability to pay numerous prepetition unsecured claims, including employee obligations, priority vendor and supplier claims, certain advertising claims, customer obligations, and various tax and licensing claims. Furthermore, the proposed sale process is expected to result in the purchaser assuming many of the Debtors' contracts, continuing to operate most of the Debtors' restaurant locations, providing an ongoing customer for many of the Debtors' suppliers, and providing ongoing employment for most of the Debtors' employees. Contrary to the Committee's allegations, affiliates of Sun Capital are participating in these chapter 11 cases in a manner that is providing clear benefits to the Debtors' many stakeholders, including the unsecured creditors represented by the Committee.

At the time of the filing of this Reply, the Debtors remained in active settlement dialogue with numerous Objecting Parties, including the Committee. At or before the November 1, 2011, hearing on these matters, the Debtors expect to present revised proposed forms of orders approving the DIP Motion and the Bidding Procedures Motion, which orders, the Debtors hope, will resolve many if not all outstanding Objections. Nonetheless, the Debtors submit this Reply to refute certain allegations set forth in the Committee Objection and to support the entry of orders granting the Motions.

BACKGROUND

1. Prior to commencing these chapter 11 cases on October 5, 2011 (the "Petition Date"), the Debtors negotiated with their existing secured creditors and their ultimate equity sponsor to develop the framework for their restructuring. The Debtors' restructuring will be financed through their proposed postpetition debtor-in-possession financing facility (the "DIP Facility"), and is expected to result in the sale of the Debtors' assets and operations as a going concern pursuant to a stalking-horse purchase agreement (the "Purchase Agreement") between the Debtors and the stalking-horse bidder (the "Stalking-Horse Bidder"), or pursuant to such higher and better offer as may be received through the proposed bidding procedures attached as an exhibit to the Bidding Procedures Motion (the "Bidding Procedures"). On the Petition Date, the Debtors filed the Bidding Procedures Motion and the DIP Motion.[4]

2. Since the Debtors filed the Motions, certain parties in interest have raised concerns regarding the DIP Facility and the Bidding Procedures. Prior to the Motions' general objection deadline (which was extended for certain parties, including the Committee), certain Objecting Parties filed Objections. In efforts to consensually resolve all such concerns, the Debtors have engaged in discussions with the Committee and other parties in interest regarding all aspects of their chapter 11 cases, including the DIP Facility and the Bidding Procedures.

3. On October 28, 2011, the Committee filed the Committee Objection, asserting that neither the DIP Facility nor the Bidding Procedures should be approved, and that the

[4] In support of the DIP Motion and the Bidding Procedures Motion, the Debtors submitted the *Declaration of Steven C. Sanchioni, Executive Vice President, Chief Financial Officer, Treasurer, and Assistant Secretary of Friendly Ice Cream Corporation, in Support of the Debtors' Chapter 11 Petitions and First Day Motions* [Docket No. 3] (the "Sanchioni Declaration"). Additionally, in further support of the DIP Motion, the Debtors filed the *Declaration of Ryan S. Bouley in Support of Debtors' Motion for Entry of Interim and Final Orders (I) Authorizing Debtors to Obtain Postpetition Financing, (II) Authorizing Use of Cash Collateral, (III) Granting Adequate Protection to Prepetition Secured Parties, and (IV) Granting Liens and Superpriority Claims* [Docket No. 26] (the "Bouley Declaration").

affiliates of Sun Capital should be denied reasonable and customary protections routinely granted to DIP lenders, and should further be penalized and subjected to extraordinary and onerous conditions, including having to fund an unlimited amount of money for the Committee to investigate and prosecute claims against Sun Capital. In an effort to address the issues raised by the Objectors, including the Committee, the Debtors have revised the proposed Bidding Procedures and expect to present a proposed order approving the Bidding Procedures, as amended (the "Amended Bidding Procedures") at or prior to the November 1, 2011, hearing.

4. Notably, the Amended Bidding Procedures extend the marketing and sale approval process from a period of approximately 60 days (the Bidding Procedures Motion originally requested a hearing to approve the sale in the first week of December) to a period of approximately 90 days (the Amended Bidding Procedures contemplate a late-December sale hearing) to ensure a sufficiently lengthy marketing process and to allow the Committee to conduct and complete its investigation of the Sun Capital stalking-horse credit bid, and to litigate any challenges to the credit bid.[5] Additionally, the Debtors continue to negotiate modifications to the proposed final order approving the DIP Facility, and expect to present a revised order at the hearing on November 1, 2011.

ARGUMENT

I. Approval of the Amended Bidding Procedures and the DIP Facility Is Integral to the Successful Reorganization of the Debtors' Businesses.

5. Prior to the Petition Date, the Debtors successfully negotiated with their existing secured creditors, including Sun Capital, the approximately $71.3 million DIP Facility—

[5] Other changes incorporated into the Amended Bidding Procedures include, among other things, the addition of certain consultation rights in favor of the Committee and certain bid requirements related to adequate assurance of future performance under executory contracts and unexpired leases and other landlord concerns.

including approximately $35 million of new money to fund operations in chapter 11. At the same time, the Debtors engaged in negotiations regarding the marketing and sale of substantially all their assets and obtained a stalking-horse bid from a Sun Capital affiliate. The DIP Facility, coupled with cash flow from operations, is designed to fund the administration of these chapter 11 cases and implement an efficient, public process through which the Debtors will sell their businesses as a going concern.

6. As set forth in detail in the DIP Motion, the Sanchioni Declaration, and the Bouley Declaration, approval of the DIP Facility is necessary to avoid erosion of value and to maintain ordinary-course operations in chapter 11 and, ultimately, to transition to a new ownership structure through the public sale process contemplated by the Amended Bidding Procedures. Without access to the DIP Facility, the Debtors would be subject to a liquidity shortfall and would lack the capital necessary to continue operations. The DIP Facility also allows the Debtors to minimize disruption to their businesses and instill confidence in their various creditor constituencies, including customers, employees, vendors, and service providers. To facilitate the continued operation of the Debtors' businesses and an orderly restructuring and sale through chapter 11, the DIP Facility should be approved.

7. Similarly, approval of the Amended Bidding Procedures is necessary to maximize the value of the Debtors' estates (for the benefit of all constituencies in these chapter 11 cases) by establishing the process by which the Debtors will solicit and obtain competing bids for their businesses. As set forth in the Sanchioni Declaration, the Debtors believe that Bidding Procedures (which were only improved by the changes reflected in the Amended Bidding Procedures) will promote active bidding from interested parties and will dispel any doubt as to the highest or best offer reasonably available for the Debtors' assets. In fact, in response to

marketing efforts to date and in anticipation of the approval of the Amended Bidding Procedures, the Debtors have already received a number of indications of interest from potential bidders and have negotiated (or currently are negotiating) over two dozen confidentiality agreements to allow these bidders to commence due diligence. This degree of bidding is exactly the sort of activity effective bidding procedures are intended to foster—and a strong indication that the Stalking-Horse Bidder's credit bid will not chill bidding, as the Committee Objection suggests.

8. Contrary to the argument set forth in the Committee Objection, the Amended Bidding Procedures are fair and will encourage bidding, thereby giving the Debtors the opportunity to obtain the highest and best offer reasonably available for the Debtors' businesses. Indeed, the concessions agreed to by the Debtors and the Stalking-Horse Bidder—including the extension of the marketing and sale process far beyond the time periods often used in section 363 sales in this jurisdiction—reflect the fairness of the Amended Bidding Procedures and the Debtors' efforts (as fully supported by Sun Capital) to accommodate concerns of the Committee and other parties in interest.

9. The Amended Bidding Procedures are consistent with procedures routinely approved by courts in this and other jurisdictions, and all aspects of the Amended Bidding Procedures are appropriate under the standards governing auction proceedings and bidding incentives in bankruptcy proceedings. *See, e.g.*, *In re Reliant Energy Channelview LP*, 594 F.3d 200, 204 (3d Cir. 2010); *Calpine Corp. v. O'Brien Environmental Energy, Inc. (In re O'Brien Environmental Energy, Inc.)*, 181 F.3d 527, 537 (3d Cir. 1999). Accordingly, and for the reasons set forth herein and in the Motions, the Court should disregard the Objections, including the Committee Objection, and approve the DIP Facility and the Amended Bidding Procedures.

II. The Debtors' Sale of Assets Pursuant to the Amended Bidding Procedures and Entry into the DIP Facility Are Consistent with the Debtors' Fiduciary Duties.

10. The Debtors are the only parties in these chapter 11 cases that owe fiduciary duties to each and every creditor—including their vendors, landlords, customers, and more than 10,000 employees. *See LaSalle Nat'l Bank v. Perelman*, 82 F. Supp. 2d 279, 292 (D. Del. 2000). The Debtors' request for approval of the DIP Facility and the Amended Bidding Procedures is consistent with their fiduciary obligations.

11. There is a clear record in these chapter 11 cases that the Debtors followed an appropriate process to secure the most favorable DIP financing available in the exercise of their fiduciary duties. The Debtors determined that financing from their existing prepetition secured lenders was the most viable (and perhaps only viable) alternative, and, following negotiations and with the aid of their advisors, the Debtors, in consultation with the independent member of Debtor Friendly Ice Cream Corporation's board of directors, who oversees all transactions in which Sun Capital is an interested party, determined that the proposed DIP Facility offered the best financing package available to the Debtors. The proposed sale process similarly ensures that the Debtors are able to fulfill their fiduciary obligations to their constituencies. Specifically, the proposed process appropriately balances the Debtors' desire for a full and robust sale process against the need for a quick and efficient emergence from chapter 11. Indeed, the Debtors already are in the process of negotiating confidentiality agreements with more than 24 potential bidders.

12. Mindful of their relationship with Sun Capital, prior to commencing these cases the Debtors appointed Alan B. Miller as an independent director to supplement the current slate of directors. Mr. Miller voted to authorize the Debtors' entry into the DIP Facility and to approve the Purchase Agreement and contemplated marketing and sale process (including recent changes to DIP Facility, the Purchase Agreement, and the Amended Bidding Procedures).

13. Remarkably, in its nearly 80 pages, the Committee Objection fails to acknowledge even once the existence of Mr. Miller or the corporate formalities observed by the Debtors. The Debtors' advisors have been fully transparent with the Committee's advisors, and have explained the Debtors' governance process. The Committee's convenient failure to acknowledge the procedural and governance protocols that the Debtors have adopted belies the Committee's credibility and exposes the Committee's true intention: to disrupt the process proposed by the Debtors in order to leverage a settlement for its constituencies, placing in harm's way all other parties in interest. The record is clear that in seeking approval of the DIP Facility and the Amended Bidding Procedures, the Debtors are exercising their fiduciary duties to preserve estate value and maximize recoveries for all creditor constituencies.

III. The Debtors' Restructuring Efforts (as Supported by Sun Capital) Are in the Best Interests of the Estates and Have Benefitted All Constituencies in These Chapter 11 Cases.

14. There is nothing inherently wrong with a bankruptcy transaction involving an insider. Here, Sun Capital—an insider equity sponsor and the Debtors' largest secured creditor—has consistently provided the support necessary to maintain the Debtors' operations and maximize value. The Debtors and Sun Capital negotiated the DIP Facility and the Amended Bidding Procedures to maximize value (consistent with the Debtors' fiduciary duties) to all stakeholders in these chapter 11 cases. In spite of the Committee's attempts to invent a bad-faith motivation behind the Debtors' and Sun Capital's efforts, these efforts have preserved value and will serve to maximize creditor recoveries (including those of the Committee's constituents) in these chapter 11 cases. Throughout the Debtors' pre- and postpetition restructuring efforts, Sun Capital has offered critical support that has inured to the benefit of the Debtors' estates and other creditors.

15. As the Committee correctly points out, courts have subjected bankruptcy transactions involving insiders to additional scrutiny. *See* Committee Objection ¶ 40 (citing *Brouwer v. Ancel & Dulap (In re Firstmark Corp.)*, 46 F.3d 653, 656 (7th Cir. 1995), *on subsequent appeal*, 132 F.3d 1179 (7th Cir. 1997); *Shuck v. Seminole Oil & Gas Corp. (In re Seminole Oil & Gas Corp.)*, No. 91-1636 (HEW), 1992 WL 110720, at *6 (4th Cir. May 22, 1992); *Citicorp Venture Capital, Ltd. v. Comm. of Creditors Holding Unsecured Claims (In re Papercraft Corp.)*, 211 B.R. 813, 823 (W.D. Pa. 1997), *aff'd*, 160 F.3d 982 (3d Cir. 1998); *Crown Vill. Farm, LLC v. Arl. L.L.C. (In re Crown Vill. Farm, LLC)*, 415 B.R. 86, 93 (Bankr. D. Del. 2009)).

16. The Committee Objection errs, however, in its implication that insider transactions are inherently flawed or otherwise should not be approved. To the contrary, transactions involving insiders—potential investors already having positions in debtors' capital structures and familiar with debtors' businesses—are very common and are often approved by courts in this and other jurisdictions. *See, e.g.*, *Firstmark*, 46 F.3d at 656, 660 (noting district court's upholding sale approval and concluding that insider sale is not "bad faith per se" before dismissing interlocutory appeal for lack of jurisdiction); *Seminole Oil & Gas*, No. 91-1636 (HEW), 1992 WL 110720, at *6 (upholding district court approval of sale to insiders); *Papercraft*, 211 B.R. at 821–22 (reversing bankruptcy court's adoption of per se rule prohibiting certain insider transactions); *Crown Vill. Farm*, 415 B.R. at 93 (noting close scrutiny afforded insider sale and explaining that extended public sale timeline should permit debtor to maximize value).

17. In fact, courts have rejected the type of per se rule or presumption against insider transactions espoused by the Committee Objection. *See, e.g.*, *In re Dexter Distrib. Corp.*, No.

10–15910, 2011 WL 1979855, (9th Cir. May 23, 2011) (explaining, "a sale to an insider is not per se bad faith" (citing *Paulman v. Gateway Venture Partners III, L.P. (In re Filtercorp. Inc.)*, 163 F.3d 570, 577 (9th Cir. 1998))); *Hower v. Molding Systems Engineering Corp.*, 445 F.3d 935, 939 (7th Cir. 2006) (explaining that, "in order to encourage insolvent debtors to continue operating and generating revenue for the creditors, bankruptcy debtors are permitted to do exactly that [sell assets to insiders]"(citing *Firstmark*, 46 F.3d at 656)); *In re Brook Valley IV*, 347 B.R. 662, 675 (8th Cir. B.A.P. 2006); *Papercraft*, 211 B.R. at 821–22 (reversing bankruptcy court's adoption of per se rule prohibiting certain insider transactions). An insider-supported restructuring transaction may offer the most viable alternative for a chapter 11 debtor. *See Hower*, 445 F.3d at 939 ("[T]here may be circumstances where an effective repurchase of assets [by an insider] is the most efficient business outcome.") Allowing such transactions fosters the fundamental purpose of chapter 11—enabling a company in financial distress to restructure its balance sheet and reorganize its business operations successfully. *See NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984); *B.D. Int'l Disc. Corp. v. Chase Manhattan Bank (In re B.D. Int'l Disc. Corp.)*, 701 F.2d 1071, 1075 n.8 (2d Cir. 1983) (stating "the two major purposes of bankruptcy [are] achieving equality among creditors and giving the debtor a fresh start"). ***More importantly***, though, and as stated above, here the Debtors appointed an independent director to ensure a fair process in these cases.

18. To be clear, there is nothing inherently wrong with insider connections like those between the Debtors and Sun Capital. Indeed, the facts of these chapter 11 cases demonstrate that Sun Capital has played a key role ***preserving*** the Debtors' ongoing operations and ***protecting*** value for the benefit of other constituencies. For example, in the weeks leading up to the Petition Date, an affiliate of Sun Capital invested $6 million to fund the Debtors' operational losses and

to prevent the Debtors from running out of cash. An affiliate of Sun Capital has also provided a commitment to fund approximately $35 million in new financing, a portion of which already has been utilized to satisfy prepetition general unsecured claims. To date, approximately $8 million has been paid to employees, customers, vendors, and other creditors on account of the authority granted in the orders approving the Debtors' "first-day" motions. Moreover, the Debtors have negotiated an open and fair sale process through which an affiliate of Sun Capital, or some other potential bidder, will purchase substantially all assets of the Debtors, ensuring that, in large degree, the Debtors' employees continue to be employed, their landlords continue to have a paying tenant for the Debtors' many leased restaurant locations, and that their vendors and suppliers continue to have an important customer.

19. Here, the Debtors and their advisors considered all available restructuring alternatives and took steps to ensure the survival of the Debtors' businesses; a transaction with affiliates of Sun Capital offered the most viable avenue for the Debtors' restructuring. With their fiduciary duties in mind, the Debtors appointed an independent director to ratify any and all dealings with affiliates of Sun Capital to ensure that negotiations and transactions were fair, at arm's length, and for the benefit of the Debtors' estates and stakeholders.

20. Contrary to the Committee's allegation that these chapter 11 cases are being run for the sole benefit of Sun Capital, the DIP Facility and the Amended Bidding Procedures will have direct, tangible benefits for scores of other creditors. Sun Capital's involvement has benefitted the Debtors and all of the Debtors' stakeholders.

IV. The DIP Facility and the Amended Bidding Procedures Address the Concerns of All of the Objecting Parties.

21. As noted above, the Debtors have endeavored to consensually resolve the Objections (as well as certain informal objections raised by certain parties in interest) with

certain changes to the DIP Facility and the Amended Bidding Procedures that have been discussed with the Objecting Parties.

A. Landlord Objections Have Been Resolved or Should Be Overruled.

22. Perhaps not surprisingly given that the Debtors, as of the Petition Date, operate approximately 490 restaurants across 16 states, the majority of the Objections were filed by landlords concerned about the timing of the sale contemplated by the Bidding Procedures, especially as it implicated the assumption and assignment of the Debtors' leases.

23. The Amended Bidding Procedures incorporate certain changes requested by landlord Objecting Parties and, the Debtors believe, appropriately address all landlord concerns. Specifically, the Amended Bidding Procedures (a) require all bidders to provide adequate assurance information that will be shared with interested landlords and (b) provide that, if the Stalking-Horse Bidder is not the successful bidder and if any landlord objects to the proposed assignment of its lease, the sale hearing shall be only a status conference with respect to the proposed lease assignment, and the Debtors, the objecting landlord, and the successful bidder will request a new hearing date to consider the proposed lease assignment.

24. The Debtors believe that the changes set forth in the Amended Bidding Procedures address all appropriate landlord concerns, and certain landlord Objecting Parties have agreed that the changes resolve their Objections. To the extent any landlord continues to object to the Amended Bidding Procedures, the Debtors submit that such Objection should be overruled.

B. Objections to the DIP Motion Should Be Overruled.

25. As indicated above, in addition to the Committee Objection to the DIP Facility, Objecting Parties Huntington National Bank ("Huntington") and National Industrial Portfolio Borrower, LLC ("National") also filed Objections to the proposed DIP Facility. Though the

Debtors have strived to reach a resolution with both parties, a consensus has not been reached as of the time of the filing of this Reply.

26. As set forth in Huntington's Objection, Huntington acquired a loan secured by five franchised Friendly's locations in Dayton, Ohio. Prior to the commencement of these chapter 11 cases, the franchisees had ceased operations at these Huntington locations. As is ordinary course for the Debtors in these instances, the Debtors have been operating the stores on a going-forward basis and negotiating with Huntington to reach a resolution on its pending loans with the franchisees. Huntington objects to the DIP Facility to the extent that it seeks to prime Huntington's security interest in the collateral at the relevant Dayton, Ohio area Friendly's locations, and additionally is seeking adequate protection for the Debtors' continued use of the collateral.

27. The Debtors do not object to the addition of language in the final DIP Facility order clarifying that Huntington's security interest is a "Permitted Prior Lien" (i.e., that even if the Debtors have an interest in the collateral of the Huntington locations, the DIP Facility liens will not prime Huntington's interest in the collateral.

28. In addition, the Debtors have proposed that their agreement to continue operating the Huntington locations serve as the requisite adequate protection to Huntington.[6] If the Debtors had not stepped in to continue operations at the Huntington locations, those restaurants would not be conducting business operations, which likely would materially reduce the value of the collateral securing Huntington's claim. In contrast, by continuing to operate the Huntington

---

6 Huntington's Objection actually seeks adequate protection under section 364(d)(1) of the Bankruptcy Code, which relates to priming postpetition credit facilities. Given that the Debtors are agreeing with Huntington that its collateral will not be primed by the DIP Facility, section 364(d)(1) is moot. Nonetheless, the Debtors address the adequate protection issues for the continued use of the collateral securing Huntington's claim.

locations, the Debtors are preserving the value of Huntington's collateral on a going-forward basis. Courts generally have found that secured creditors are adequately protected and have authorized a debtor's continued use of collateral where the proposed continued use will preserve the value of the collateral. *See In re Jim Kelly Ford of Dundee, Ltd.*, 14 B.R. 812 (N.D. Ill. 1980) (lender was adequately protected and debtor was authorized to use cash collateral to fund operations because the lender benefited from the difference between the average sale price of car sold at retail and the average sale price if the same vehicle was sold at a wholesale auction). As of the time of the filing of this Reply, the Debtors have not heard back from Huntington on the second point; however, the Debtors are hopeful that their proposed adequate protection will resolve this aspect of Huntington's Objection.

29. National is a landlord of warehouse utilized by the Debtors in the operation of their businesses. As set forth in National's Objection, National is seeking a host of assurances that more accurately go towards the potential sale of any collateral from the warehouse. *See* National Objection ¶ 16. As the Court is aware, the Debtors' ability to sell or otherwise dispose of assets is governed by a prior order of the Court [Docket No. 218]. As the Debtors have indicated to National, National's rights against the Debtors are governed by the terms of the unexpired lease currently existing between the parties. To the extent the assurances sought by National's Objection are provided for under that lease, the Debtors do not oppose the request; however, the Debtors will not agree to expand National's rights from those provided under the lease. Simply put, National's rights are what they are, and the Debtors will determine at a later date whether to assume those obligations or reject National's lease.

30. Finally, both Huntington and National object to the proposed section 506(c) waiver in the final DIP Facility order. The proposed DIP Facility is the product of extensive,

good faith and arm's-length negotiations between the Debtors and the DIP lenders (with significant input from the Committee). It is well within the Debtors' business judgment to waive its rights under section 506(c) of the Bankruptcy Code in connection with those negotiations, especially given the circumstances present here—where the prepetition secured lenders are funding these chapter 11 cases for the benefit of all constituencies. Moreover, courts in this jurisdiction routinely grant section 506(c) waivers on a final basis. *See In re Perkins & Marie Callender's, Inc.*, No. 11-11795 (Bankr. D. Del. July 12, 2011); *In re NEC Holdings Corp.*, No. 10-11890 (Bankr. D. Del. July 26, 2010); *In re U.S. Concrete, Inc.*, No. 10-11407 (Bankr. D. Del. May 21, 2010); *In re Point Blank Solutions, Inc.*, No. 10-11255 (Bankr. D. Del. May 12, 2010); *In re Eigen, Inc.*, No. 10-11061 (Bankr. D. Del. May 7, 2010); *In re Orleans Homebuilders, Inc.*, No. 10-10684 (Bankr. D. Del. Apr. 16, 2010).

C. The Proposed Sale Does Not Require a Consumer Privacy Ombudsman.

31. The Debtors have a written corporate policy regarding the protection of personally identifiable information (the "General Privacy Policy"). The General Privacy Policy provides strict technology standards and safeguards for personally identifiable information of all of the Debtors' employees and customers.

32. The General Privacy Policy is in turn supplemented by two website-specific policies (one for adults, one for children). The adult website policy provides for protection of electronic information and promotion and sweepstakes entries. The children's website policy provides that children's personally identifiable information is never to be shared except "in connection with the winning of a prize or when we need to send the information to companies that work on our behalf to provide a product or service that has been requested by a parent on behalf of a child" or "in order to respond to subpoenas, court orders or legal process, to the

extent permitted by law, or when any future subsidiaries, affiliated companies or successor companies (resulting from a merger or acquisition) have a need for such information."

33. By virtue of the foregoing, the Debtors disagree with the U.S. Trustee's assertion that a consumer privacy ombudsman should be appointed. The General Privacy Policy and the website policies will remain in full force and effect throughout the Debtors' sale process, and the Debtors fully intended to adhere to such policies in connection with the proposed sale. Because the Debtors' businesses are to be sold as a going concern, the Debtors expect that the privacy policies remain in place post-closing, as well. Accordingly, the Debtors submit that the sale will in all respects be "consistent with" the privacy policies, such that no consumer privacy ombudsman is required under section 332 or section 363(b)(1) of the Bankruptcy Code.

34. Section 363(b)(1) of the Bankruptcy Code provides in pertinent part,

> if the debtor . . . discloses to an individual a policy prohibiting the transfer of personally identifiable information about individuals to persons that are not affiliated with the debtor and if such policy is in effect on the date of the commencement of the case, then the trustee may not sell or lease personally identifiable information to any person unless—
>
> (A) such sale or such lease is consistent with such policy; ***or***
>
> (B) after appointment of a consumer privacy ombudsman in accordance with section 332, and after notice and a hearing.

11 U.S.C. § 363(b)(1)(A) (emphasis added). Contrary to the argument set forth in the U.S. Trustee's Objection, section 363(b)(1) makes clear that a sale may be approved as consistent with a debtor's existing privacy policy under subparagraph (A) without the need for a consumer privacy ombudsman as provided by subparagraph (B). Similarly, section 332 of the Bankruptcy Code requires the appointment of a consumer privacy ombudsman only "[i]f a hearing is required ***under section 363(b)(1)(B)***." *Id.* § 332(a) (emphasis added). Accordingly, here, since the proposed sale will be entirely consistent with the Debtors' privacy policies, neither section

332(a) nor subparagraph (b) of section 363(b)(1) are implicated, and no ombudsman is required. *Id.* §§ 332(a), 363(b)(1).

D. The Expense Reimbursement Should Be Approved.

35. The $1 million expense reimbursement provided by the Purchase Agreement is reasonable and was negotiated in good faith and at arm's length (and was approved by the debtors' independent director). In addition since the Stalking-Horse Bidder's obligations under the Purchase Agreement are conditioned on its approval, the expense reimbursement provides an actual benefit to the estate in the form of a stalking-horse bid around which the Debtors' marketing and sale process will be built. *See In re Reliant Energy Channelview LP*, 584 F.3d 200 (3d Cir. 2010); *Calpine Corp. v. O'Brien Envtl. Energy, Inc. (In re O'Brien Envtl. Energy, Inc.)*, 181 F.3d 527 (3d Cir. 1999). No Objecting Party other than the U.S. Trustee has raised any concern with the expense reimbursement.

36. The Debtors successfully negotiated a stalking-horse bid in the form of the Purchase Agreement without any "breakup" or similar fee. The expense reimbursement was negotiated at arm's length and in good faith, and is necessary to secure the Stalking-Horse Bidder's commitment under the Purchase Agreement. Moreover, the amount of the expense reimbursement is eminently reasonable (and, in fact, is considerably smaller relative to the size of the transaction than similar reimbursements routinely approved by this and other courts). *See, e.g.*, *In re Dura Auto. Sys., Inc.*, No. 06-11202 (Bankr. D. Del. July 14, 2007); *In re New Century TRS Holdings, Inc.*, No. 07-10416 (Bankr D. Del. Apr. 20, 2007); *In re Three A's Holdings, L.L.C.*, No. 06-10886 (Bankr. D. Del. Sept. 7, 2006). Accordingly, the Debtors submit that the expense reimbursement should be approved.

V. The Amended Bidding Procedures and the DIP Facility Will Enable the Debtors' Proposed Restructuring and Will Benefit the Debtors' Estates and All of Their Creditors.

37. In light of the foregoing, the Debtors submit that the DIP Facility and the Amended Bidding Procedures will benefit their estates and all creditors and should be approved. In fact, the proposed restructuring (as built on the DIP Facility and the Amended Bidding Procedures) offered prior to the Petition Date and continues to offer the only viable alternative.

38. As set forth in the Sanchioni Declaration and the Bouley Declaration, given the Debtors' declining performance and significant financial obligations, a restructuring was absolutely necessary. For instance, prior to the Petition Date, the Debtors' adjusted EBITDA declined to only $8.6 million for the first eight months of 2011. The Debtors recognized that their revenue stream would be insufficient to continue to support their significant lease obligations, interest expense, and other operational liabilities. Given this financial reality, the Debtors were faced with two practical alternatives: (a) restructure with the support of their existing secured creditors (including Sun Capital, their largest secured creditor and equity sponsor); or (b) attempt to go into chapter 11 without significant creditor support, without any exit strategy, and without committed postpetition financing (or with financing from a new lender source that would require a priming fight with their existing secured lenders).

39. After considering these alternatives, the Debtors determined that a consensual restructuring (comprised of elements including the DIP Facility and the Amended Bidding Procedures) supported by their existing secured creditors, but subject to a marketing and competitive auction process, and subject to the right of parties in interest to investigate and object to the claims of the prepetition secured lenders, was in the best interests of the Debtors and all parties in interest. Accordingly, the Debtors commenced negotiations to develop a restructuring strategy that ultimately begat the sale process contemplated by the Amended

Bidding Procedures. The DIP Facility and the Amended Bidding Procedures contemplate an orderly and value-maximizing restructuring of the Debtors' business that, in truth, offers the ***only*** responsible choice for the Debtors in the satisfaction of their fiduciary duties. Accordingly, the Court should overrule the Objections and should approve the DIP Facility and the Amended Bidding Procedures.

Dated: October 31, 2011
Wilmington, Delaware

PACHULSKI STANG ZIEHL & JONES LLP

/s/ Kathleen P. Makowski

Laura Davis Jones (DE Bar No. 2436)
Timothy P. Cairns (DE Bar No. 4228)
Kathleen P. Makowski (DE Bar No. 3648)
919 North Market Street, 17th Floor
P.O. Box 8705
Wilmington, Delaware 19899-8705 (Courier 19801)
Telephone: (302) 652-4100
Facsimile: (302) 652-4400
Email: ljones@pszjlaw.com
tcairns@pszjlaw.com
kmakowski@pszjlaw.com

- and -

James A. Stempel (admitted *pro hac vice*)
Ross M. Kwasteniet (admitted *pro hac vice*)
Jeffrey D. Pawlitz (admitted *pro hac vice*)
KIRKLAND & ELLIS LLP
300 North LaSalle
Chicago, Illinois 60654
Telephone: (312) 862-2000
Facsimile: (312) 862-2200
Email: james.stempel@kirkland.com
ross.kwasteniet@kirkland.com
jeffrey.pawlitz@kirkland.com

Proposed Co-Counsel to the Debtors and Debtors in Possession