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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	:	Chapter 11
	:	
THE GREAT ATLANTIC & PACIFIC TEA COMPANY, INC., *et al.*,	:	Case No. 10-24549 (RDD)
	:	
Debtors.	:	Jointly Administered

OBJECTION TO DEBTORS' MOTION FOR AN ORDER AUTHORIZING THE DEBTORS TO (A) ENTER INTO CERTAIN SECURITIES PURCHASE AGREEMENTS FOR A $490 MILLION NEW CAPITAL INVESTMENT AND (B) PAY CERTAIN FEES IN CONNECTION THEREWITH, EACH TO SUPPORT DEBTORS' PLAN OF REORGANIZATION

ASM Capital LP ("**ASM**"), as holder of approximately $10 million in face amount of the 9.375% senior quarterly interest bonds due August 1, 2039 (the "**Quarterly Interest Bonds**") issued by The Great Atlantic & Pacific Tea Company, Inc. ("**A&P**" and together with its debtor affiliates, the "**Debtors**" or the "**Company**"), hereby objects to the Debtors' motion (the "**Motion**") [Dkt. No. 2797] for an order authorizing, among other things, entry into certain securities purchase agreements (the "**Securities Purchase Agreements**") with certain affiliates of The Yucaipa Companies LLC ("**Yucaipa**"), one of the Debtors' controlling shareholders, and with certain select holders of the Debtors' unsecured notes (the "**Supporting Noteholders**" and together with Yucaipa, the "**Investors**"), providing for an infusion of $490 million in new debt and equity financing (the "**New Money Commitment**").[1] In support of its objection, ASM respectfully represents as follows:

PRELIMINARY STATEMENT

1. The Debtors, without having marketed the Company to any parties other than the Investors and with no intention of undertaking an additional marketing process (and actually being prohibited from doing so), seek approval of what amounts to a private sale of the Company (in violation of the absolute priority rule) to a group that includes one of the Debtors' largest shareholders (Yucaipa). The Motion raises a host of serious problems. If the Debtors have their way, the Motion will be heard on an expedited basis, with no opportunity to take discovery, and with little or no evidence presented. There will be no market test – past or future – of the Company's value. Valuation, it appears, will be dispensed with entirely, as the Debtors have not deigned even to state what the Company might be worth. And this Court will be asked to approve a transaction, the basic economic terms of which have not been fully disclosed, including terms necessary to ascertain whether Yucaipa is receiving preferential, and therefore prohibited, treatment.

2. The Debtors may argue that such "details" can await a hearing on confirmation of the Debtors' plan of reorganization (the "**Plan**"), because the Motion does not seek the final approval of any sale but merely locks in the principal terms of the Plan. We respectfully submit, however, that it would be a mistake to defer these crucial matters to a later time. Doing so would squander precious months (time that, as the Debtors emphasize, they cannot afford to waste), deplete the estates' resources, and further limit the Debtors' options. The time to scrutinize the adequacy and fairness of the proposed sale is now – when it is not too

[1] In addition to its holdings of the Quarterly Interest Bonds, ASM holds certain other small general unsecured claims.

late for the Debtors to take the necessary steps to market the Company properly and to ensure that they are receiving the highest and best price.

3. A further reason why the matters raised by the Motion should not be deferred to confirmation is that several aspects of the Plan mandated by the Motion raise serious legal issues that, we believe, could bar confirmation of the Plan as a matter of law:

- Most importantly, the Plan discriminates unfairly against those noteholders who are not part of the Supporting Noteholders' group by excluding them from participation in the New Money Commitment contemplated by the Securities Purchase Agreements.
- In addition, as explained in more detail below, the Plan appears to violate the absolute priority rule by giving significant value to Yucaipa on account of its equity interests – including potentially substantial value under a proposed Management Services Agreement, the terms of which have not been disclosed.

The Court need not – and, we submit, should not – wait until confirmation to address these crucial legal issues. Rather, the Court should rule on these issues now, so that the Debtors can fix these fundamental Plan defects while they still have time, rather than proceeding further down a path that will only end in failure.

4. For these reasons, we ask the Court to deny the Motion. Alternatively, if the Court believes that an evidentiary hearing is needed to properly address the issues before it, we ask the Court to adjourn the hearing so as to afford objecting parties an adequate opportunity to take discovery of factual issues raised by the Motion, including (i) the undisclosed terms of the proposed transaction, (ii) the potential additional value that the Debtors could realize through

a marketing process or an auction of the Company, and (iii) the composition of, and steps taken by, the "independent restructuring committee" formed by the Debtors in connection with this transaction.

BACKGROUND

5. The Debtors filed the Motion on November 3, 2011. Pursuant to an ex parte order entered the next day [Dkt. No. 2805], the Motion is scheduled to be heard on shortened notice on November 14, 2011. The objection deadline is November 11, eight days after the Motion was filed.[2]

6. Through the Motion, the Debtors seek authority to enter into the Securities Purchase Agreements with Yucaipa and the Supporting Noteholders. Yucaipa is one of the Debtors' largest shareholders, holding 4% of the Company's common stock and 100% of its Series A-Y preferred stock as of the petition date, and controlling the appointment of two members of the board. *See* Chapter 11 Petition [Dkt. No. 1]. The Supporting Noteholders hold approximately 80% of the Company's unsecured convertible notes and 15% of the Quarterly Interest Bonds. Motion at n.5.

7. If approved, the Securities Purchase Agreements would supposedly "commit" the Investors to purchase (subject to certain conditions) $210 million in face amount of new second lien notes, $210 million in face amount of third lien notes, and $80 million in shares of the reorganized company's common stock (representing all of the equity of the reorganized company). Motion ¶ 6. The "commitment" is subject to numerous contingencies, providing the Investors with optionality while effectively binding the Debtors. The Debtors have disclosed the

[2] Under ordinary circumstances, motions seeking approval of a proposed use, sale or lease of property of the estate other than in the ordinary course of business require at least 21 days' notice. FED. R. BANKR. P. 2002(a)(2).

percentage commitments of Yucaipa, on the one hand, and the Supporting Noteholders, on the other, but have not provided the details of the split between the Supporting Noteholders.[3]

8. In addition to its share of the securities purchased under the New Money Commitment, Yucaipa would receive certain additional consideration under the contemplated transaction. First, Yucaipa would receive warrants to purchase new common stock of the reorganized company representing 7.0% of the new common stock on a fully-diluted basis on the effective date of the plan (the "**Investment Warrants**"), with an exercise price struck at an assumed equity value of the reorganized company of $725 million, exercisable for a period of ten years from the date of issuance. Securities Purchase Agreements § 1.12. Second, upon confirmation Yucaipa would enter into a management services agreement (the "**Management Services Agreement**") with the reorganized company. The terms of the Management Services Agreement are not disclosed.

9. The $490 million New Money Commitment would be made in connection with a plan of reorganization containing the terms specified in Exhibit A to the three Securities Purchase Agreements (a "**Conforming Plan**"). The Securities Purchase Agreements would commit both the Debtors and the Investors to support confirmation of a Conforming Plan. *See* Securities Purchase Agreements §§ 1.10, 4.1.[4] Among other things, a Conforming Plan would provide for the sale of the Company to the Investors for the consideration set forth in the Securities Purchase Agreements (the "**Proposed Sale**").

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[3] Yucaipa would get approximately 22.7% of the new common stock (plus the warrants described *infra*), one-fifth of one percent of the second lien notes, and 27% of the convertible third lien notes. *See* Securities Purchase Agreements, Schedule I.

[4] The three agreements are substantially identical.

10. The Securities Purchase Agreements contemplate payment of a break-up fee of $20 million and a commitment fee of $40 million (the latter payable in third lien notes), each upon occurrence of specified events. *See* Securities Purchase Agreements §§ 1.6, 1.8.[5]

11. Participation in the New Money Commitment is limited to the Investors. Other unsecured noteholders are not given the right to take part.

OBJECTION

I.
There is no Evidence that the Investors' Offer Maximizes Value for the Estates

12. The Motion proposes a sale of the Company to the Investors based on nothing more than the Debtors' bald assertion that the Investors' offer represents the best option to maximize value for their estates. *See* Motion ¶ 5. The proposed sale has not been tested by a pre-Motion marketing process, nor is any provision made for an auction or other form of post-Motion marketing; to the contrary, there is a strict "no-shop" clause that prohibits the Debtors from undertaking a marketing process. One might have expected the Debtors to explain why they have chosen not to explore other alternatives – but they have not. In the absence of any meaningful market test or any indication whatsoever that the Investors are paying fair value for the Company, the Motion must be denied.

A. The Company Has Not Been and Will Not Be Marketed

13. As far as can be gleaned from the Motion, the Debtors have discussed the sale of the Company with only two potential purchasers: the Supporting Noteholders and Yucaipa. *See* Motion ¶ 3, 4. Nothing in the Motion suggests that the Debtors have approached

[5] The Motion states that the commitment fee is $40 million. As drafted, however, the fee would actually be three times that amount, or $120 million, because each Securities Purchase Agreement independently provides for payment of a $40 million commitment fee. *See* Securities Purchase Agreements § 1.6. To the extent this is a drafting error, it must be corrected. To the extent it is not, the fee is patently unreasonable.

any other parties to determine their interest in a potential transaction. In short, there is no way to tell whether a better offer might be obtainable. This limited marketing process is patently inadequate. *See, e.g., In re Innkeepers USA Trust,* 442 B.R. 227, 231-32 (Bankr. S.D.N.Y. 2010) (denying assumption of plan support agreement where the deal embodied in the term sheet had not been shopped); *see also Bank of Am. Nat'l Trust & Savs. Ass'n v. 203 N. LaSalle St. P'ship,* 526 U.S. 434, 457 (1999) ("[T]he best way to determine value is exposure to a market.").

14. In some circumstances, a debtor's failure to actively market its assets prior to the filing of a sale motion may be corrected by an open post-motion auction process. In this case, however, the Debtors have not offered even this protection. Instead, the Debtors have done the opposite, agreeing to a "no-shop" clause under which they "will not, directly or indirectly, take any action to solicit, initiate, encourage or assist the submission of, or enter into any discussions, negotiations or agreements regarding, any proposal, negotiation or offer relating to an Alternative Transaction . . ." Securities Purchase Agreement § 4.11. The Debtors can consider an unsolicited "Alternative Transaction" (as defined in the Securities Purchase Agreements) in certain limited circumstances, but this is no substitute for active marketing.[6]

15. The Motion, moreover, fails to satisfy the basic requirements of this Court's local rules. The rules require, among other things, that a sale motion "demonstrate facts that support a finding that the property to be sold has been marketed adequately." *See* General Order M-383, p. 7. And, in the case of a private or no-auction sale, the rules further require a Debtor to explain why the sale as structured "is likely to maximize the sale price." *Id.*, p. 9.

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[6] It bears noting, moreover, that an Alternative Transaction can be considered only if the Company's board of directors determines that it may be a "Superior Transaction." Securities Purchase Agreement § 4.11(b). Because the proposed transaction is with an insider, to be truly effective, section 4.11(b) must delegate to the *Restructuring Committee* (as defined in the Motion), as opposed to the full board, the duty of considering Alternative Transactions.

Here, the Debtors have not even attempted to address these requirements, giving no explanation or justification for their failure to solicit alternative offers for the Company.[7]

16. In sum, the lack of a marketing process is fatal to the Debtors' Motion, particularly in light of the fact that one of the proposed purchasers of the Company's assets is an insider. *In re Bidermann Indus. U.S.A., Inc.*, 203 B.R. 547 (Bankr. S.D.N.Y. 1997) is instructive. There, the court denied approval of the debtors' entry into a letter agreement that would have set in motion a leveraged buyout of the debtors by, among others, an insider, finding that the transaction had been inadequately marketed. The letter agreement in *Bidermann*, like the Securities Purchase Agreements here, contained a no-shop clause. *See id.* at 550. Also, as in this case, the debtors in *Bidermann* had committed to the transaction at issue without "even testing the waters to see if a more favorable arrangement were available." *Id.* The court called the lack of a marketing process "astounding" under the circumstances, and noted that the sale process "should have followed an intensive effort to drum up the best price obtainable for the creditors." *Id.* at 551-52. The exact same criticisms apply to the Debtors' marketing process in this case, and the exact same result – denial of the Motion – should obtain.

B. There is No Evidence That The Purchase Price is Fair

17. The failure to market the Company alone warrants denial of the Motion – regardless of the standard under which the Court reviews the proposed transaction. But the Motion must be denied for an additional reason as well: the Debtors have not established the fairness of the consideration to be paid by the Investors.

[7] The General Order applies directly only to sales pursuant to section 363 of the Bankruptcy Code. While the Debtors may argue that this sale will not finally be consummated until a plan of reorganization is confirmed, this does not excuse compliance. The current Motion – which commits the Debtors to a sale through a plan process – is couched as a motion pursuant to section 363 of the Bankruptcy Code. Motion ¶ 15. There is no reason, moreover, that a sale pursuant to a chapter 11 plan should be subjected to less stringent requirements relating to marketing and maximization of value than a sale pursuant to section 363.

18. The use of property under section 363 of the Bankruptcy Code, under ordinary circumstances, is governed by the business judgment standard. *See In re Lionel Corp.*, 722 F.2d 1063, 1071 (2d Cir. 1983). Transactions with insiders, however, are subjected to the more stringent "entire fairness" standard. *See In re Innkeepers USA Trust*, 442 B.R. 227, 231 (Bankr. S.D.N.Y. 2010); *In re Wingspread Corp.*, 92 B.R. 87, 93 (Bankr. S.D.N.Y. 1988). Under this standard, courts consider the "integrity and entire fairness of the transaction," focusing, among other things, on whether the process and price of a transaction "not only *appear* fair, but *are* fair." *Innkeepers*, 442 B.R. at 231 (emphasis added).

19. Here, a key participant in the transaction embodied in the Securities Purchase Agreements – Yucaipa – is an insider and, indeed, a controlling shareholder. As such, the Debtors must establish the entire fairness of the Proposed Sale, including, among other things, the fairness of the consideration to be paid by the Investors. Despite having this burden, however, the Debtors have submitted no evidence – and, indeed, have made no assertions – concerning the value of the Company. Without this information it is impossible to determine whether the price to be paid by the Investors is a fair one.

20. The Debtors, to avoid the obligation to prove the fairness of the Proposed Sale, assert that the sale was vetted by an independent restructuring committee formed for that purpose. Motion ¶ 3. They provide no details, however, concerning the composition of this committee or its dealings. The Debtors' bare assertion that the restructuring committee followed appropriate protocols is not enough to avoid application of the entire fairness doctrine, because the truth of that assertion cannot be tested. Thus, the Court must subject the Proposed Sale to the searching inquiry required of sales to insiders (which requires, among other things, that the Debtors show that the price is fair). Without information concerning the restructuring

committee's composition and activities, creditors and the Court cannot ascertain whether the members of this committee were indeed independent; whether they exercised independent and adequate oversight – for example, whether they were advised by independent legal and financial professions; or what steps they and their advisors took to satisfy themselves that the Debtors had obtained the best available price for the Company.

C. Consideration of the Propriety of the Sale Cannot Await Confirmation

21. The Debtors may argue that marketing and valuation issues should not be considered now, but instead should be put off until a later confirmation hearing. Any such argument is unfounded. Approval of the Motion will commit the Debtors to pursuit of a Conforming Plan. In the absence of a proper test of the value of the assets, however, a Conforming Plan will never be confirmable. Rather than commit the estates to pursuit of an unconfirmable plan, the Debtors should amend their process now so as to foster a competitive, market-tested valuation of the Company.

22. This course of action is particularly prudent in light of the time constraints under which the Debtors are operating. The Debtors make much of these constraints, pointing to their postpetition financing milestones, the expiration of section 365(d)(4) deadlines, and the negative impact of lingering in bankruptcy. Motion ¶ 4. But this is no reason to dispense with proper procedure. Indeed, quite the opposite: it is a reason to get the sale process right the first time so that the Debtors and their estates are not confronted with a much more serious time crunch several months down the road. *Cf. Bidermann,* 203 B.R. at 554 (acknowledging delay that would result from denial of approval of letter agreement regarding leveraged buyout, but denying it nonetheless in light of the flawed process).

II.
Approval of the Motion Would Commit the Debtors to Pursuit of a Legally Deficient Plan

23. The Securities Purchase Agreements commit the Debtors to pursue confirmation of a Conforming Plan. Securities Purchase Agreements § 4.1. As set forth below, however, the plan the Investors are insisting upon may be unconfirmable. The Court, therefore, should deny the Motion and spare the Debtors' estates the cost and delay associated with spending the next several months in prosecution of a patently unconfirmable plan.

A. The Plan Would Discriminate Unfairly

24. To be confirmable, a chapter 11 plan must "provide the same treatment for each claim or interest of a particular class." 11 U.S.C. § 1123(a)(4). This means, among other things, that "all class members must receive equal value." *In re Quigley Co.*, 437 B.R. 102, 146 (Bankr. S.D.N.Y. 2010).

25. Here, the plan that the Debtors intend to pursue would violate this basic tenet of bankruptcy law by offering preferential treatment to a select group of noteholders and equity holders, while denying it to others. Specifically, only the Supporting Noteholders and Yucaipa are being offered the opportunity to participate in the New Money Commitment. This opportunity has real value. *See 203 North LaSalle Street*, 526 U.S. at 455 (noting that an exclusive opportunity to purchase equity in a reorganized debtor is "an item of property in its own right"); *Coltex Loop Central Three Partners, L.P. v. BT/SAP Pool C Assocs., L.P.*, 138 F.3d 39, 43 (2d Cir. 1998) (same). The Supporting Noteholders, in addition to the payments they will receive under the plan (and which all other unsecured noteholders will also receive), will also receive new debt and equity interests in the reorganized company, both on favorable terms. Other noteholders are not given this option. Similarly, Yucaipa will receive new debt and equity interests in the reorganized company, while other old equity holders will not.

26. A recent decision from the Delaware Bankruptcy Court struck down just such a discriminatory rights offering. In *In re Washington Mutual, Inc.*, 442 B.R. 314 (Bankr. D. Del. 2011), plan proponents had proposed a plan of reorganization that offered some claimants (those with claims over $2 million) but not others the opportunity to participate in a rights offering. The plan supporters argued that the proposed discrimination was necessary for purposes of administrative convenience. The court rejected this argument, holding that under section 1123(a)(4) of the Bankruptcy Code, the debtor was required to make the rights offering available to *all* members of the unsecured creditors' class. *See id.* at 360-61 (noting that "the right to buy into a company does have inherent value"). The same is true here.

27. It is anticipated that the Debtors may argue that the Supporting Noteholders and Yucaipa are not receiving anything extra "on account of" their claims and interests; rather, any benefit they receive is attributable entirely to the new money they are committing. The argument might have merit in the context of a third party (i.e., non-creditor) investor. But any such argument must fail with respect to existing creditors and interest holders such as the Investors. Such existing creditors and interest holders receive value "on account of" their claims and interests when they receive value "because of" such existing rights. *See Dish Network Corp. v. DBSD North America, Inc. (In re DBSD North America, Inc.),* 634 F.3d 79, 96 (2d Cir. 2011).

28. Here, it is clear that the Supporting Noteholders and Yucaipa have been offered the exclusive right to participate in the transaction embodied in the Securities Purchase Agreements "because of" their status as major creditors and interest holders in these cases. Indeed, as noted, the Debtors' "marketing process" focused exclusively on such creditors. There is, moreover, a quid pro quo at work: in exchange for the opportunity to participate in the New

Money Commitment, the Supporting Noteholders and Yucaipa have agreed to support and vote their claims and interests in favor of a Conforming Plan. Under the circumstances, it cannot be said that any value that flows from the Investors' participation in the transaction is attributable entirely to their new money commitment and not to their claims. *See Coltex Loop*, 138 F.3d at 41, 44 (holding that where debtor did not retain any mortgage brokers or outside consultants to help locate other sources of equity or financing and did not consider bringing in new equity partners as an alternative means of obtaining money to fund a plan, "it [was] apparent that the Partners could not have gained their new position but for their prior equity position").

B. The Plan Would Violate the Absolute Priority Rule

29. A Conforming Plan would also violate the absolute priority rule. The rule – codified in section 1129(b)(2)(B)(ii) of the Bankruptcy Code – provides that, absent consent of all impaired classes, "a confirmable plan must ensure either (i) that the dissenting class receives the full value of its claim, or (ii) that no classes junior to that class receive any property under the plan on account of their junior claims or interests." *Dish Network Corp. v. DBSD North America, Inc. (In re DBSD North America, Inc.),* 634 F.3d 79, 95 (2d Cir. 2011).

30. The phrase "on account of," in this context, does not mean "in exchange for," but rather means "some form of 'because of.'" *Id.* at 96; *see Bank of Am. Nat'l Trust & Savs. Ass'n v. 203 N. LaSalle St. P'ship,* 526 U.S. 434, 451 (1999) (noting that "the better reading of subsection (b)(2)(B)(ii) recognizes that a causal relationship between holding the prior claim or interest and receiving or retaining property is what activates the absolute priority rule"). For purposes of this rule, moreover, "a transfer *partly* on account of factors other than the prior interest is still partly 'on account of' that interest" – i.e., "receipt of property *partly* on account of the existing interest [is] enough for the absolute priority rule to bar confirmation of the plan." *DBSD,* 634 F.3d at 96 (emphasis added).

31. Here, a Conforming Plan would of necessity violate the absolute priority rule, because under such a plan unsecured noteholders would not be paid in full and Yucaipa would receive value, at least in part, "on account of" its equity interests. This is true for several reasons. *First*, as explained above, (i) it is only because Yucaipa is a significant equity holder that it was given the opportunity to participate, and (ii) the participation of Yucaipa is conditioned on its agreement to support a Conforming Plan. *See DBSD*, 634 F.3d at 96 ("The 'continued cooperation' of the existing shareholder was useful only because of the shareholder's position as equity holder and 'the rights emanating from that position.'"). *Second*, the Supreme Court has held that a plan that provides for an *exclusive* opportunity to junior interest holders free from competition and without the benefit of a market valuation – as here – violates the absolute priority rule. *203 N. LaSalle*, 526 U.S. at 458 ("[A]ssuming a new value corollary . . . plans providing junior interest holders with exclusive opportunities free from competition and without benefit of market valuation fall within the prohibition of § 1129(b)(2)(B)(ii)."). *Third*, Yucaipa may be receiving significant value over and above any new money contribution it is making under the terms of the proposed Management Services Agreement.[8] *Finally*, without evidence of the value of the Investment Warrants, it is impossible to determine whether Yucaipa is paying fair value for their receipt.[9]

[8] Without knowing the terms of the Management Services Agreement, this question cannot be definitively addressed. It is widely recognized, however, that in the private equity context, such "management services agreements" are often a mechanism for compensating large shareholders without the receipt of commensurate value in return.

[9] In this regard, it bears noting that the Investment Warrants are exercisable at an assumed equity value of $725 million. Motion ¶ 9. Given that this equity value is approximately *nine times* as much as the Investors are paying to acquire *all* the common stock of the reorganized company at confirmation, it raises the question whether the warrants may be intended to compensate Yucaipa for the loss of equity value in the old Company in the event that the business prospects of the reorganized company greatly exceed current expectations. In such circumstances, Yucaipa would clearly be receiving the warrants on account of its old equity position.

III.
At Minimum, The Court Should Defer Consideration
of The Motion and Order Expedited Discovery

32. In view of the foregoing, if the Court does not deny the Motion outright, it should adjourn the November 14 hearing on the Motion for two weeks so that ASM and any other objecting parties can take discovery. The matters on which ASM requires discovery include, without limitation: (i) the undisclosed terms of the proposed transaction (including unredacted copies of the Securities Purchase Agreements, the Management Services Agreement, and the side letter among the Investors); (ii) negotiations with the Investors; (iii) the potential additional value that the Debtors could realize through a marketing process or an auction of the Company; and (iv) the composition of, and steps taken by, the "independent restructuring committee" formed by the Debtors in connection with this transaction.

33. A short delay should not interfere with the Debtors' efforts to conclude these cases as expeditiously as possible. To the contrary, it may facilitate the expeditious resolution of this case, by affording the Court the opportunity to examine now, on a fully developed factual record, the important issues raised by the Motion, rather than deferring a full examination of these issues to a confirmation hearing months down the road.

CONCLUSION

WHEREFORE, for the foregoing reasons, ASM respectfully requests that the Court deny the Motion or defer consideration of the relief sought therein until such time as ASM has had the opportunity to take discovery.

Dated: November 11, 2011
New York, New York

Respectfully submitted,

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