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

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| *In re* | : | Chapter 11 |
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| FUHU, INC., *et al.*[1] | : | Case Number 15-12465(CSS) |
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| | : | **Hearing Date: December 30, 2015 at 9:30 a.m.** |
| Debtors | : | **UST Objection Deadline: December 29, 2015 at noon** |

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**ACTING UNITED STATES TRUSTEE'S OBJECTION TO MOTION OF DEBTORS FOR ORDER: (A) APPROVING BIDDING PROCEDURES FOR THE SALE OF SUBSTANTIALLY ALL OF THE DEBTORS' OPERATING ASSETS, (B) SCHEDULING AN AUCTION AND SALE HEARING, (C) APPROVING BID PROTECTIONS, AND (D) APPROVING PROCEDURES FOR THE ASSUMPTION AND ASSIGNMENT OF CERTAIN EXECUTORY CONTRACTS AND EXPIRED LEASES (D.I. 4 & 50)**

In support of his Objection (the "Objection") to the Motion Of Debtors For Order: (A) Approving Bidding Procedures For The Sale Of Substantially All Of The Debtors' Operating Assets, (B) Scheduling An Auction And Sale Hearing, (C) Approving Bid Protections, And (D) Approving Procedures For The Assumption And Assignment Of Certain Executory Contracts And Expired Leases (D.I. 4 & 50, "the "Bid Procedures Motion"), Andrew R. Vara, Acting United States Trustee for Region Three (" U. S. Trustee"), states as follows:

1. This Court has jurisdiction to hear the above-referenced Objection.

2. Pursuant to 28 U.S.C. § 586, the U. S. Trustee is charged with the administrative oversight of cases commenced pursuant to chapter 11 of title 11 of the United States Code (the "Bankruptcy Code"). This duty is part of the U. S. Trustee's overarching responsibility to enforce the bankruptcy laws as written by Congress and interpreted by the courts. *See United*

[1] The Debtors together with the last four digits of each Debtor's tax identification number are: Fuhu, Inc. (7896), Fuhu Holdings, Inc. (9761); Fuhu Direct, Inc. (2180); and Nabi, Inc. (4191). The location of the headquarters is 1700 E. Walnut Avenue, Suite 500, El Segundo, CA 90245.



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*States Trustee v. Columbia Gas Sys., Inc. (In re Columbia Gas Sys., Inc.)*, 33 F.3d 294, 295-96 (3d Cir. 1994) (noting that UST has "public interest standing" under 11 U.S.C. § 307, which goes beyond mere pecuniary interest); *Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 500 (6th Cir. 1990) (describing the U. S. Trustee as a "watchdog").

3. Pursuant to 11 U.S.C. § 307, the U. S. Trustee has standing to be heard with regard to this Objection.

## INTRODUCTION

4. The Debtors seek entry of an order approving bid procedures. The U.S. Trustee objects to several aspects of the bidding procedures order.[2]

5. First, the bidding protections accorded to the Stalking Horse are excessive and inappropriate. These include a Break-Up Fee of $300,000, an Expense Reimbursement of $200,000, and the repayment of a $300,000 pre-petition loan made by the Stalking Horse to the Debtors (the "Pre-Petition Mattel Loan"). Each of these protections also would be improperly accorded super-priority status if an alternative transaction closes. In addition, the Purchase Price paid by the Stalking Horse, if it is the successful bidder, will be paid, in part, by a credit bid of the Pre-Petition Mattel Loan.

6. Second, while all other potential bidders may be declared the "Back-Up Bidder," and, as such must keep their bid open until the closing of the sale with the Successful Bidder, the Stalking Horse is not required to act as a back-up bidder.

7. Third, the bidding procedures ignore even the most basic requirements to

[2] The U.S. Trustee submits this objection to the Bid Procedures Motion. The U.S. Trustee has concerns regarding the Stalking Horse Agreement itself, which will be heard at the sale hearing. These concerns include, but are not limited to, the sale of causes of action against Debtors' directors and officers, and the treatment of warranty claims and customer programs post-sale.

provide due process to counterparties to "Additional Assumed Contracts" and "Additional Assumed Leases" or to parties of contracts or leases to be assumed and assigned that are subject to "Amended Cure Amounts."[3] These parties will be served, at the earliest, with the first notice that their contracts or leases may be assumed and assigned, or their cure amounts amended, after the auction on January 25, 2016. The sale hearing is proposed to be held just three days later, on January 28, 2016. Assuming the notices were actually mailed on January 25, 2016, the likelihood that the counterparties will actually receive the notices before the sale hearing is slim.

## FACTUAL BACKGROUND

8. On December 7, 2015, the Debtors Fuhu, Inc. and Fuhu Holdings, Inc., each filed voluntary petitions for relief under chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware. On December 11, 2015, the Debtors Fuhu Direct, Inc., and Nabi, Inc., filed voluntary petitions for relief under Chapter 11. These cases are administratively consolidated for procedural purposes. The Debtors continue to operate their businesses and properties as debtors-in-possession. No trustee or examiner has been appointed in these cases.

9. On December 16, 2015, the U.S. Trustee appointed an Official Committee of Unsecured Creditors.

10. The Debtors are parties to a credit facility with Obsidian Agency Services, Inc., as agent for Tennenbaum Special Situations Fund IX, LLC and Tennenbaum Special Situations IXO, L.P. (collectively, "Tennenbaum") dated May 27, 2015 (the "Prepetition Credit

[3] The U.S. Trustee has provided additional comments to the Debtors concerning the Bid Procedures Motion. The Debtors and the U.S. Trustee continue to work to resolve these issues. To the extent any of these issues are not resolved prior to the hearing, the U.S. Trustee reserves its right to raise these issues at the hearing.

Agreement"). The Debtors maintain that the obligations under the Prepetition Credit Agreement are secured by a first priority security interest in substantially all of the assets of the Debtors other than accounts receivable, as well as a second priority security interest in the Debtors' accounts receivable. As of November 25, 2015, Tennenbaum asserted that approximately $6.5 million was outstanding under the Prepetition Credit Agreement, comprised of approximately $5.4 million in principal, approximately $65,000 in accrued interest, a yield-enhancement fee of $400,000 and an early termination fee of $700,000.

11. LSQ Funding Group, L.C. ("LSQ") factored certain of the Debtors' accounts receivable under a Factoring and Security Agreement dated April 21, 2015. According to the Debtors, LSQ holds a first priority security interest in all of the Debtors' receivables, although it factored only a limited subset of those receivables. As of the Petition Date, approximately $1.3 million was owed to LSQ on account of the factored receivables.

12. On or about December 4, 2015, Mattel, Inc. (the Stalking Horse) made the Pre-Petition Mattel Loan to the Debtors. According to the Debtors, $300,000 is owed on account of this loan, which is secured by substantially all of the Debtors' assets. Upon information and belief, the Mattel Loan is junior in priority to the debt held by Tennenbaum and LSQ.

13. On or about December 15, 2015, the Debtors and the Stalking Horse entered into the Stalking Horse Agreement, whereby the Debtors seek to sell substantially all of their operating assets to Mattel, subject to higher and/or better offers.

## ARGUMENT

### The Bid Protections Are Unreasonable and Will Chill Bidding

14. The Debtor proposes to provide a break-up fee to the Stalking Horse equal

to $800,000 ($300,000 break-up fee, $200,000 expense reimbursement, and repayment of the $300,000 Pre-Petition Mattel Loan). Assuming a $9.5 million purchase price, this is an 8.4% break-up fee. As pointed out by the Committee in its objection, this percentage is even higher when you include all of the purchase price reductions, and factor in that the Assets being sold include cash. This break-up fee is excessive and will seek to chill bidding.

15. Break-up fees must be carefully scrutinized in light of the circumstances of the case. *See, e.g., In re Am. West Airlines, Inc.*, 166 B.R. 908, 912 (Bankr. D. Ariz. 1994) (stating that "the proposed break-up fee must be carefully scrutinized to insure that the [d]ebtor's estate is not unduly burdened and that the relative rights of the parties in interest are protected.") (internal citation omitted). Break-up fees are permissible upon a demonstration that the fees are actual, necessary costs for preserving value to the estate. *See, e.g., Calpine v. O'Brien Envtl. Energy, Inc. (In re O'Brien Environmental Energy, Inc.)*, 181 F.3d 527, 535 (3d Cir. 1999) ("the allowability of break-up fees, like that of other administrative expenses, depends upon the requesting party's ability to show that the fees were actually necessary to preserve the value of the estate").

16. In this case, a break-up fee in excess of 8% of the purchase price, without factoring in other aspects of the asset purchase agreement, is excessive. When the purchase price adjustments and other considerations are factored in, the proposed break-up fee would act to chill bidding, not enhance the auction.

17. In addition, providing that the repayment of the Pre-Petition Mattel Loan is part of a break-up fee accorded administrative expense status, elevates a pre-petition claim that may be unsecured or undersecured to that of an administrative expense claim. The Pre-Petition Mattel Loan should be accorded whatever status it is entitled to under the Bankruptcy Code and

applicable non-bankruptcy law. If the claim is not unsecured, Mattel is entitled to have its lien attach to the sale proceeds. Any portion of the Pre-Petition Mattel Loan that is unsecured must be treated equally with other unsecured claims in this estate.

18. This break-up fee is also accorded superpriority administrative status. This is impermissible. The Bankruptcy Code limits superpriority administrative status to (a) entities providing post-petition financing, *see* 11 U.S.C. § 364(c)(1); and (b) adequate protection for diminution in value of collateral by way of the use of the secured parties' cash collateral. *See* 11 U.S.C. §§ 361(2) and 507(b). The break-up fee, if permissible, is only entitled to administrative expense status under 11 U.S.C. §507(a)(2).

19. The Debtors further propose that, if the Stalking Horse is the successful purchaser, then the purchase price will be paid, in part, by a credit bid of the Pre-Petition Mattel Loan. It is unclear that the Pre-Petition Mattel Loan is fully secured. Under the circumstances of this case, the Stalking Horse should not be entitled to credit bid a pre-petition loan that may be wholly or partially unsecured. Rather, to the extent that the lien is valid, it should attach to the proceeds of the sale.

20. Finally, the Stalking Horse should be required to act as the Back-Up Bidder if it provides the second highest or otherwise best bid at the auction. The favorable treatment of the Stalking Horse in this regard may chill bidding, and would potentially leave the estate without a sale should the Successful Bidder be unable or unwilling to close the transaction.

**The Assignment Procedures**

21. The proposed procedures for the assumption and assignment of executory contracts fail to provide *any* meaningful notice to counterparties to "Additional Assumed

Contracts/Leases" or for "Amended Cure Amounts."

22. The proposed bid procedures provide that, if the successful bidder is an entity other than the Stalking Horse, then the Auction Results Notice will include notice to any counterparty to any additional executory contract or unexpired lease that the successful bidder wishes to purchase that the Stalking Horse did not so designate. These counterparties likely will have received no notice that their contracts or leases were the possible subject of the sale, prior to the Auction Results Notice.

23. Likewise, if the successful bidder other than the Stalking Horse proposes an Amended Cure Amount to those contracts/leases that were designated by the Stalking Horse, the Auction Results Notice will include such amended cure amount.

24. The Auction Results Notice will be served "promptly" after the auction concludes. The Auction is scheduled to take place on January 25, 2016.

25. The Auction Results Notice will be served "at the last known address available to the Debtors." This notice will likely be served late in the day on January 25, 2016.

26. The proposed hearing date is January 28, 2016, just three days later. It is unlikely that the Auction Results Notice will even be received by the counterparties prior to the sale hearing, let alone in sufficient time to respond. *See* Federal Rule of Bankruptcy Proc. 9006(f) (requiring additional three days' notice if service is accomplished by mail).

27. Likewise, any amended cure amount notice sent on January 25, 2016 likely will not be received by the counterparty prior to the sale hearing.

28. Such notice is insufficient to meet the most basic requirements of due

process.[4] The assignment procedures must be amended to provide sufficient due process. This can be accomplished, for example, (a) by providing notice to those contract/lease counterparties to contracts that *are* being assumed and assigned by the Stalking Horse, which would include a notice that the cure amount may be amended if there is a successful bidder other than the stalking horse, and providing a means by which the counterparties can get email or fax notification of the amended cure amount promptly after the auction; and (b) by providing notice to *all* other counterparties to executory contracts or unexpired leases that are not designated by the Stalking Horse within three days of the bid procedures order is entered that their contracts/leases *may* be assumed, providing a means by which such parties can provide email or fax numbers for prompt, immediate notice on January 25, 2016 if the successful bidder selects their contract/lease. In both cases (a) and (b), the counterparties should be permitted to provide, in writing or in person, before the sale hearing, any objection to the cure amount. The Debtors must then reserve the cure amount and a cure amount hearing will take place at least 14 days after the notice. Adequate assurance of future performance objections may be raised and heard at the sale hearing. This procedure would properly balance the need of the Debtors and the successful purchaser to be flexible regarding what contracts/leases are being assigned while protecting the counterparties' due process rights.

[4] The procedures also include dates that simply do not work. The proposed objection deadline for filing written objections to the assumption and assignment of Additional Assumed Contracts/Lease or to Amended Cure Amounts is January 28, 2016 at 4:00 p.m. The proposed sale hearing is to be held on January 28, 2016. Thus, the objection deadline for submitting written objections is *after* the actual sale hearing will likely commence.

WHEREFORE the U. S. Trustee requests that this Court issue an order denying the Motion as written and/or granting such other relief as this Court deems appropriate, fair and just.

Respectfully submitted,

**Andrew R. Vara**
**UNITED STATES TRUSTEE**

**By:** /s/ Linda J. Casey

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