

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:) Chapter 11
)
KONA GRILL, INC., et al., ¹) Case No.: 19-10953 (___)
)
Debtors.) Joint Administration Requested
)

**DECLARATION OF CHRISTOPHER J. WELLS
IN SUPPORT OF FIRST DAY MOTIONS**

I, Christopher J. Wells, hereby declare that the following is true and correct to the best of my knowledge, information, and belief:

1. I am the Chief Restructuring Officer ("CRO") of Kona Grill, Inc. ("KGI") and each of its affiliated debtors in the above captioned chapter 11 cases (collectively, the "Debtors" or "Company"). I joined the Company as the CRO in April of 2019.

2. I am also a Managing Director with Alvarez & Marsal North America, LLC ("A&M") and have extensive experience in operational and financial analysis, financial forecasting, cash management, insolvency work, and debt restructuring. I have been employed with A&M since April 2002 and was promoted to Managing Director in December 2013.

¹ The Debtors and the last four digits of their respective taxpayer identification numbers include: Kona Grill, Inc. (6690); Kona Restaurant Holdings, Inc. (6703); Kona Sushi, Inc. (4253); Kona Macadamia, Inc. (2438); Kona Texas Restaurants, Inc. (4089); Kona Grill International Holdings, Inc. (1841); Kona Baltimore, Inc. (9163); Kona Grill International, Inc. (7911); and Kona Grill Puerto Rico, Inc. (7641). The headquarters and service address for the above-captioned Debtors is 15059 North Scottsdale Road, Suite 300, Scottsdale, Arizona 85254.

3. I have a bachelor's degree with majors in finance, accounting, and entrepreneurship from the University of Arizona. I am a Certified Public Accountant in the State of Arizona, a Chartered Financial Analyst, and a Certified Insolvency and Restructuring Advisor.

4. Jonathan Tibus, my colleague at A&M, serves as the Company's Chief Executive Officer. Together, we are responsible for managing the Company's day-to-day business operations.

5. On April 30, 2019, the Company commenced the above-captioned chapter 11 cases (the "Chapter 11 Cases") by filing voluntary petitions for relief under chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code"). The Chapter 11 Cases were filed in order to preserve the value of the Debtors' business and maintain continued operations pending the Debtors' implementation of a financial and operational restructuring through a sale of the Company's business. To minimize the adverse effects of commencing these Chapter 11 Cases, the Debtors have filed a number of pleadings requesting various kinds of "first day" relief (collectively, the "First Day Motions").

6. I am familiar with the Debtors' books and records, day-to-day operations, business affairs, and financial condition. I am also familiar with the facts and circumstances surrounding the First Day Motions and the commencement of these Chapter 11 Cases, the Company's debtor-in-possession financing commitment, and the recent key operational and strategic decisions made by the Debtors' senior management. However, no one individual has personal knowledge of all the facts in this Declaration. The facts set forth herein are based upon (a) my personal knowledge of and familiarity with the Debtors' operations and finances,

(b) information learned from my review of the relevant documents, and information supplied to me by other members of the Debtors' management, the Debtors' professionals and employees of the Debtors working under my supervision, and (c) my opinions based upon experience, knowledge and information concerning the Debtors and the industry in which the Debtors operate. If called upon to testify, I would and could testify competently to the facts set forth herein.

7. I submit this declaration in support of the First Day Motions. Any capitalized terms not expressly defined herein shall have the meaning ascribed to them in the relevant First Day Motion. Part I of this declaration describes the Debtors' business and the circumstances surrounding the commencement of these Chapter 11 Cases. Part II sets forth the relevant facts in support of the First Day Motions filed concurrently herewith.

PART I

BACKGROUND

A. The Company's Business

8. The Debtors currently own and operate 27 casual dining restaurants in 18 states, as well as one location in Puerto Rico. Each restaurant location seats an average of 290 customers. In addition, the Debtors have one international restaurant located in Canada and another international restaurant located in the United Arab Emirates that both operate under franchise agreements. The Debtors operate their restaurants under the name Kona Grill™.

9. KGI opened its first restaurant in Scottsdale, Arizona in 1998. The Company's restaurants offer freshly prepared food, attentive service, and an upscale

contemporary ambience that creates an exceptional, yet affordable dining experience. The restaurants feature contemporary American favorites, award-winning sushi and an extensive selection of alcoholic beverages. The Debtors' menu items are prepared from scratch at each restaurant location using original recipes, signature sauces and dressings, memorable flavor profiles, and creative presentations that appeal to a wide-range of customers. The Debtors' diverse menu is complemented by a full-service bar offering a broad assortment of beers, wines, and craft cocktails. The Debtors believe that their innovative menu items, generous portions, and flexible price points provide customers with a compelling value proposition and allow them to attract a diverse customer base.

10. The Debtors' competitive strengths include (a) innovative menu selections with mainstream appeal; (b) multiple dining areas with a variety of atmospheres; (c) significant bar and happy hour business; (d) personalized customer service to make every guest experience exceptional and; (e) locations in high-activity areas and a multiple daypart model to attract customers throughout the day beyond traditional meal times.

11. Currently, the Company is focused on key initiatives designed to drive traffic, increase sales, and enhance the customer experience. For example, in the third quarter of 2018, the Company launched the *Konavore Rewards* loyalty program that encourages customers to visit its restaurants more frequently. In November 2018, the Company revitalized its legendary happy hour with expanded food and liquor offerings at reduced prices and expanded hours. In April 2019, the Company revamped its core menu to bring back certain items that

made them successful in the past and right-sized the menu to boost exceptional guest experiences.

12. Despite the Company's efforts to improve sales, the Company's revenue for the twelve months ended December 31, 2018 was \$156.9 million, down 12.4% from the prior year. As of the Petition Date, the Company has approximately \$1.2 million of cash on hand.

13. As of April 30, 2019, the Debtors employ approximately 2,400 people of whom 32 are employed at the Company's corporate offices in Scottsdale, Arizona. None of the Debtors' employees are covered by a collective bargaining agreement.

B. Corporate and Capital Structure of the Company

14. KGI was incorporated on April 10, 2002. KGI went public on August 16, 2005, and was publicly traded on the NASDAQ Global Market (ticker: KONA) until its recent delisting on April 25, 2019.

15. KGI owns 100% of the common stock of Debtor Kona Restaurant Holdings, Inc. which, in turn, wholly owns Debtors Kona Sushi, Inc., Kona Macadamia, Inc., Kona Texas Restaurants, Inc. and Kona Grill International Holdings, Inc. Debtor Kona Grill Baltimore, Inc. is wholly owned by Kona Macadamia, Inc. Kona Grill International Holdings, Inc. wholly owns Kona Grill International, Inc. and Kona Grill Puerto Rico, Inc. A Corporate Entity Organizational Chart is attached hereto as Exhibit A.²

16. KGI is the borrower under a *Second Amended and Restated Credit Agreement* dated October 12, 2016 (the "Credit Agreement") with KeyBank National

² KGI's subsidiaries are referred to herein collectively as the "Subsidiary Debtors."

Association (“KeyBank”) as co-lender and administrative agent, along with ZB N.A. d/b/a Zions First National Bank (“Zions”) as co-lender. The credit facility under the Credit Agreement (the “Credit Facility”) consists of a revolving loan (the “Revolver”) and term loan (the “Term Loan”) as well as availability for other facilities such as letters of credit. KGI’s obligations under the Credit Agreement are guaranteed pursuant to an *Amended and Restated Subsidiary Guaranty* dated October 12, 2016 given to KeyBank by the Subsidiary Debtors (the “Guaranty”). The Debtors’ obligations under the Credit Agreement and the Guaranty are secured by a pledge of certain of their assets pursuant to an *Amended and Restated Pledge and Security Agreement* dated as of October 12, 2016.

17. On March 29, 2017, KGI entered into *Amendment No. 1* to the Credit Agreement to, among other things, increase the leverage ratio applicable at March 31, 2017 to 4.85 from 4.25.

18. On July 7, 2017, KGI entered into *Amendment No. 2* to the Credit Agreement which (a) provided additional flexibility with financial covenants, (b) decreased the available credit on the Revolver, and (c) shortened the maturity date from October 12, 2021 to October 12, 2019.

19. On October 30, 2017, KGI entered into *Amendment No. 3* to the Credit Agreement which (a) required the Debtors to provide monthly reporting and (b) placed a limitation on capital expenditures.

20. On March 9, 2018, KGI entered into *Amendment No. 4* to the Credit Agreement (the “Fourth Credit Amendment”) which (a) reduced borrowing availability on and

required certain payments with respect to the Revolver, (b) increased the interest rate depending on the Debtor's leverage ratio, (c) revised certain covenants and ratios, and (d) extended the maturity date to January 13, 2020.

21. As of December 31, 2018, the Debtors had \$33.2 million in outstanding secured borrowings under the Credit Agreement, consisting of \$20.0 million outstanding under the Revolver and \$13.2 million outstanding under the Term Loan. As of December 31, 2018 there was no availability under the Credit Facility.

22. As of the Petition Date, the Company owes various vendors, suppliers, and other unsecured trade creditors approximately \$8 million.

C. Events Leading to the Commencement of the Chapter 11 Cases

23. Over the past several years, the Debtors made several operational decisions that increased borrowings and restricted cash, leading to the need to commence these Chapter 11 Cases.

24. The Debtors aggressively doubled their restaurant base from 2013 to 2017, increasing its footprint from 23 restaurants to 46 restaurants by the end of 2017. This rapid expansion required a significant amount of capital, as the average restaurant investment exceeded \$4 million.

25. Beginning in 2015, after five years of increased traffic, the Company began to experience negative traffic and declining average unit volume of its restaurants. In an attempt to build brand awareness and increase traffic, the Debtors spent over \$1 million in media

and advertising in 2017. Despite the Company's marketing efforts, same-store sales continued to weaken.

26. The Company's liquidity position deteriorated further when the Company utilized \$15 million in capital for its stock repurchase program in 2016 and 2017.

27. In July 2017, the Company decided to discontinue developing new restaurants and to focus its efforts on improving the sales and profitability of its existing restaurants. The slowdown in new unit growth was also intended to conserve cash resources, while also allowing the Company to focus on discussions with its landlords for rent abatement and to evaluate certain unprofitable restaurants for closures. To that end, the Debtors decided not to move forward with the development of two restaurants previous planned to open in 2017 and 2018. The Company also decided to close four unprofitable restaurants.

28. In addition to restaurant closures in 2018, the Debtors engaged in rapid cost-cutting efforts Company-wide to offset the effects of declining revenues. Corporate headcount was reduced, which decreased restaurant level support, training programs, and culinary innovation. Store management staffing levels were also reduced, which negatively impacted guest experiences and restaurant-level standard operating procedures. Additionally, the Debtors significantly decreased their marketing efforts and presence in the community. Although store-level profitability improved in the short-term, the reductions in staffing, marketing, and customer-focused initiatives were unsustainable to counterbalance decreasing revenue trends.

29. The Fourth Credit Amendment, executed in March 2018, placed further restrictions on the Company's borrowing ability and tightened certain financial covenants, effectively limiting the Company's available liquidity to properly invest in remodeling aging units or spend capital expenditures beyond maintenance levels.

30. By March 2019, liquidity was so severely impacted by declining trends that the Debtors decided to engage Piper Jaffray as their investment banker to assist in the evaluation of strategic alternatives, including the sale of the Company, refinancing, or other alternatives, including the closure of additional restaurants. Shortly thereafter, the Debtors also engaged A&M to provide Jonathan Tibus to serve as Chief Executive Officer and Christopher Wells to serve as Chief Restructuring Officer effective April 17, 2019.

31. Beginning in 2019 through the Petition Date, the Debtors closed an additional 15 locations after being unsuccessful in their negotiations with landlords concerning rent concessions. Considering all the events previously detailed, ongoing litigation costs, lease termination and exit costs for shuttered restaurants, and limited liquidity to pursue strategic alternatives outside of the bankruptcy process, the Company decided to seek protection under chapter 11 of the Bankruptcy Code and commenced these Chapter 11 Cases.

D. Goals of the Chapter 11 Cases

32. The Company commenced these Chapter 11 Cases to preserve value for its stakeholders, including its employees and creditors. Prior to the Petition Date, the Debtors engaged Piper Jaffray as its investment banker. After its engagement, Piper Jaffray prepared a

marketing teaser and confidential information memorandum that it used to market the sale of the Debtors' assets.

33. After the Petition Date, the Debtors and Piper Jaffray will continue to market the Debtors' assets with a goal of entering into an asset purchase agreement with a stalking horse buyer, which will be subject to higher and better offers in the event the Debtors receive competing bids. In the event a stalking horse buyer submits an acceptable offer, the Debtors will file a sale and sale procedure motion for purpose of establishing a formal sale timeline, which will include an auction in the event the Debtors receive additional competing offers.

34. The Debtors believe that a marketing and sale process through these Chapter 11 Cases is in the best interests of the Company's creditors and will maximize the value of these estates.

PART II

FIRST DAY MOTIONS

35. In order to enable the Debtors to minimize the adverse effects of the commencement of the Chapter 11 Cases, the Debtors have requested various types of relief in the First Day Motions filed simultaneously with this Declaration. A summary of the relief sought in each First Day Motion is set forth below.

36. I have reviewed each of the First Day Motions. The facts stated therein are true and correct to the best of my knowledge, information, and belief. I believe that the type of relief sought in each of the First Day Motions (a) is necessary to enable the Debtors to operate

in chapter 11 with minimal disruption and (b) is essential to maximizing the value of the Debtors' assets for the benefit of their estates and creditors.

37. With respect to each First Day Motion which seeks authority to pay all or part of a claim that arose before the Petition Date within the first 21 days of the Petition Date, for the reasons stated herein and in such First Day Motion, such relief is necessary to avoid immediate and irreparable harm.

A. Motion of Debtors for Entry of an Order (I) Directing Joint Administration of Chapter 11 Cases and (II) Granting Related Relief (the "Joint Administration Motion")

38. Through the Joint Administration Motion, the Debtors seek the entry of an order authorizing and directing the joint administration of the Debtors' related chapter 11 cases for procedural purposes only.

39. Joint administration is warranted in these chapter 11 cases because (a) the Debtors' financial affairs and business operations are closely related and (b) such administration will ease the administrative burden on the Court and other parties.

40. With respect to the proximity of relations, as discussed above, the Debtors are under common ownership and management. They also share certain creditors and parties in interest. As a result, joint administration will prevent duplicative efforts and unnecessary expenses, without any risk of prejudice.

41. The Debtors anticipate that numerous notices, applications, motions, other pleadings, hearings, and orders in these cases will affect all of the Debtors. With nine affiliated debtors, each with its own case docket, the failure to administer these cases jointly

would result in numerous duplicative pleadings filed for each issue and served upon separate service lists.

B. Motion of Debtors for Entry of Order Authorizing Debtors to File a Consolidated List of Creditors in Lieu of Submitting a Separate Mailing Matrix for Each Debtor (the “Consolidated Matrix Motion”)

42. Through the Consolidated Matrix Motion, the Debtors seek the entry of an order authorizing the Debtors to file a consolidated list of creditors in lieu of submitting a separate mailing matrix for each Debtor.

43. The Debtors presently maintain various computerized lists of the names and addresses of their respective creditors that are entitled to receive the obligatory notices and other documents in these chapter 11 cases. The Debtors believe that the information, as maintained in computer files (or those of their agents), may be consolidated and utilized efficiently to provide interested parties with the Notices and other similar documents, as contemplated by Local Rule 1007-2. Requiring the Debtors to segregate and convert their computerized records to an entity-specific creditor matrix format would be an unnecessarily burdensome task and would result in duplicate mailings. Accordingly, by the Consolidated Matrix Motion, the Debtors seek authority to file the lists on a consolidated basis, identifying their creditors in the format or formats currently maintained in the ordinary course of the Debtors' businesses.

44. I believe that such relief is not only appropriate under the circumstances, but necessary for the efficient and orderly administration of these chapter 11 cases.

C. Motion of Debtors for Interim and Final Orders Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, and 364 and Rules 2002, 4001, and 9014 of the Federal Rules of Bankruptcy Procedure (I) Authorizing Incurrence by the Debtors of Postpetition Senior Secured Indebtedness, (II) Authorizing Use of Cash Collateral By the Debtors, (III) Granting Adequate Protection to Prepetition Secured Parties, (IV) Modifying the Automatic Stay, and (V) Scheduling A Final Hearing (the “DIP Financing Motion”)

45. As mentioned above, the Debtors commenced these cases to preserve value for their stakeholders including their employees and creditors. The Debtors plan to conduct a marketing and sale process through these chapter 11 cases that will preserve jobs and yield distributions to their creditors. The Debtors’ goal through the filing of these cases is to maximize the value of these estates through a going concern sale of the Debtors’ assets. The Debtors now seek approval of financing that is necessary to facilitate such sale process.

46. As of the Petition Date, the Debtors had approximately \$33.2 million in outstanding secured borrowings under the Prepetition Credit Agreement (defined below). By the DIP Financing Motion, the Debtors seek authority to consummate a new senior secured debtor-in-possession financing facility (the “DIP Facility”) with the DIP Lender on the terms set forth in the DIP Credit Agreement (as defined below), consisting of term loans in an amount up to \$6 million. The proceeds of the DIP Facility will be used to roll-up the Prepetition Loans (as defined below) and to pay (a) postpetition operating expenses and other working capital requirements of the Debtors, (b) costs and expenses incurred in administering the cases; and (c) interest and fees (including professional fees and expenses) due under the DIP Loan Documents (as defined below).

47. The DIP Facility presents these estates with the best economic terms available and provides the Debtors with adequate liquidity to maintain operations in the ordinary

course and satisfy ongoing administrative expenses associated with these cases. Accordingly, the Debtors seek the entry of an Interim Order and a Final Order, *inter alia*:

(a) authorizing Kona Grill (the “Borrower”) to obtain postpetition financing of up to \$39,218,750.00 (the “DIP Facility” and the loans made thereunder, the “DIP Loans”) on the terms and conditions set forth in the Interim Order and the *Senior Secured Superpriority DIP Credit Agreement* (substantially in the form attached to the DIP Financing Motion as **Exhibit B** (without schedules), and as hereafter amended, restated, amended and restated, supplemented, or otherwise modified from time to time in accordance with the terms thereof and hereof, the “DIP Credit Agreement,”³ together with all agreements, documents, certificates, and instruments delivered or executed from time to time in connection therewith, each as hereafter amended, restated, amended and restated, supplemented, or otherwise modified from time to time in accordance with the terms thereof and hereof, collectively, the “DIP Documents”), among the Debtors, KeyBank National Association, acting as the administrative and collateral agent (in such capacities, the “DIP Agent”), and KeyBank National Association as a “new money” lender (in such capacity, the “DIP Lender”), and ZB, N.A., d/b/a Zions First National Bank, as a Roll Up Loan Lender (as defined in the DIP Credit Agreement), secured by the Collateral (as defined below), and authorization for each Debtor other than the Borrower to guarantee Borrower’s obligations under the DIP Facility as a guarantor (collectively, with the Borrower, the “Credit Parties,” as that term is defined in the DIP Credit Agreement) and for each Debtor to grant security interests in the Collateral;

³ Capitalized terms used but not defined herein shall have the meanings given to them in the DIP Financing Motion or the DIP Credit Agreement, as applicable.

(b) authorizing the Debtors to use the proceeds of the DIP Facility extended to the Borrower as expressly provided in the DIP Documents and consistent with the Budget (as defined below) (I) to pay certain costs, fees, and expenses related to the Cases as provided for in the Interim Order and the DIP Documents, (II) following entry of the Interim Order, for \$2,500,000 in aggregate principal amount of Prepetition Loans (as defined below) to be “rolled-up” into the DIP Obligations and to allow a “creeping roll up” of additional Prepetition Loans outstanding under the Prepetition Credit Agreement pursuant to the procedures set forth below and, upon entry of the Final Order, to convert the entire outstanding amount balance of the Prepetition Loans into DIP Obligations, (III) to provide working capital and for other general corporate purposes of the Debtors, and (IV) to pay administration costs, fees and expenses of these Cases and claims or amounts approved by this Court;

(c) authorizing the Debtors to execute and deliver the DIP Credit Agreement and the other DIP Documents and to perform such other and further acts as may be necessary or appropriate in connection therewith;

(d) granting to the DIP Lender and the DIP Agent in respect of the DIP Loans, for the benefit of the DIP Agent, the DIP Lender and any other parties referred to in the DIP Credit Agreement with respect to the respective DIP Obligations (as defined below), in accordance with the relative priorities as set forth more fully below, and subject and subordinate to the Carve Out (as defined below), the following: (I) pursuant to Bankruptcy Code section 364(c)(1), joint and several superpriority allowed administrative expense claim status in the Cases; (II) pursuant to Bankruptcy Code section 364(c)(2), a first priority lien on all assets of the

Debtors, including all property of their respective estates in the Cases, whether real or personal, tangible or intangible, now owned or hereafter acquired and all proceeds, profits, rents, accessions, and substitutes thereof, that is not subject to (i) valid, perfected, and non-avoidable liens in existence as of the Petition Date or (ii) valid liens in existence as of the Petition Date that are perfected thereafter to the extent permitted by Bankruptcy Code section 546(b); and (III) pursuant to Bankruptcy Code section 364(d), a first priority, senior priming lien on and security interest in all of the Debtors' assets, including all property of their respective estates in the Cases, whether real or personal, tangible or intangible, now owned or hereafter acquired, and all proceeds, profits, rents, accessions, and substitutions thereof, that is subject to (y) valid, perfected and non-avoidable liens in existence as of the Petition Date or (z) valid liens in existence as of the Petition Date that are perfected thereafter to the extent permitted by Bankruptcy Code section 546(b), *provided, however*, the priming lien shall prime only the liens granted pursuant to the Prepetition Credit Agreement (defined below) and shall be subject to (i) Permitted Liens, and (ii) the Carve Out (each as defined in the DIP Documents or herein);

(e) authorizing the DIP Agent to terminate the DIP Credit Agreement and to terminate the Debtors' use of Cash Collateral (defined below) upon the occurrence and continuance of an Event of Default (as defined in the DIP Credit Agreement) on terms specified herein and in the DIP Credit Agreement;

(f) subject to entry of the Final Order, authorizing the Debtors to grant liens to the DIP Lender on the proceeds of the Debtors' claims and causes of action arising under

Bankruptcy Code sections 544, 545, 547, 548, 549 and 550 (collectively, the “Avoidance Actions”);

(g) authorizing the Debtors to use, among other things, in accordance with the Budget, any cash collateral (as that term is defined in Bankruptcy Code section 363(a) and described below, the “Cash Collateral”) in which the Prepetition Secured Parties (as defined below) may have an interest and granting adequate protection to the Prepetition Secured Parties with respect to any diminution in value of their interests in the Prepetition Collateral (as defined below) arising from, *inter alia*, the Debtors’ use of the Prepetition Collateral (including Cash Collateral), the imposition of the automatic stay of Bankruptcy Code section 362, and the priming of the liens of the Prepetition Secured Parties by the DIP Facility;

(h) subject to, and only effective upon, the entry of a Final Order granting such relief, approving the waiver by the Debtors of any right to surcharge against the Collateral pursuant to Bankruptcy Code section 506(c) or otherwise;

(i) modifying the automatic stay imposed by Bankruptcy Code section 362 to the extent necessary to implement and effectuate the terms and provisions of the DIP Documents and the Interim Order;

(j) waiving any applicable stay (including under Bankruptcy Rule 6004) and providing for immediate effectiveness of the Interim Order;

(k) authorizing that during the period (the “Interim Period”) commencing on the date of this Court’s entry of the Interim Order and ending on the earlier of (a) the date this Court enters the Final Order and (b) the occurrence of the Maturity Date, a portion of the

Commitments shall be borrowed by Borrower, subject to compliance with the terms, conditions, and covenants contained in the DIP Documents, in an amount equal to \$2,500,000; and

(l) scheduling a final hearing (the “Final Hearing”) to consider entry of the Final Order granting the relief requested in the Motion on a final basis and authorizing the balance of the borrowings under the DIP Documents on a final basis, as set forth in the Motion and the DIP Documents filed with this Court and approving the Debtors’ notice with respect to the Motion.

48. The Debtors are an operating restaurant business with thousands of employees, vendors, and customers that depend on the Debtors’ continuing performance of their ongoing business obligations. The Debtors have an urgent and immediate need to obtain financing and use Cash Collateral subject to the terms of the DIP Financing Motion in order to, among other things: (a) continue to operate their business in an orderly manner through a going concern sale process; (b) maintain their valuable relationships with employees, vendors, and customers; (c) pay various administrative professionals’ fees to be incurred in the cases; and (d) support the Debtors’ working capital, general corporate and overall operational needs. The foregoing expenditures are critically necessary to preserve and maintain the going concern value of the Debtors’ business. Without access to funding under the DIP Facility and use of Cash Collateral, the Debtors would be forced to cease operations and liquidate their assets. With the DIP Facility in place, the Debtors intend to continue operations with their ordinary course prepetition practices, without material interruption or alteration.

Background to Proposed DIP Facility

49. The Debtors recognized a need for further outside financing and began the process of considering potential funding sources. The Debtors approached various third parties regarding the opportunity to provide financing to the Debtors, but no alternative funding proposals were provided to the Debtors.

50. Separately, the Debtors performed due diligence regarding the reasonableness of the terms proposed for the DIP Facility by the DIP Lender, including by comparing such terms to other debtor-in-possession credit facilities provided in the marketplace. Based on such analysis, the Debtors believe that the DIP Facility is provided on reasonable market terms. The DIP Lender is unwilling to provide financing to the Debtors on an unsecured or subordinated basis.

51. After careful review of their financing options, the Debtors concluded that the DIP Lender's proposed terms would allow the Debtors to meet their goals and provide the Debtors with sufficient liquidity on the best available economic terms. Through the DIP Documents, the Debtors will continue to have access to sufficient liquidity for their ongoing operations as well as to provide confidence to vendors and employees that the Debtors will be able to consummate a going concern sale. All negotiations with the DIP Lender were conducted at arms' length and in good faith. The outcome of such negotiations is the DIP Credit Agreement pending before this Court.

52. The Debtors now seek to move forward with the proposed DIP Facility on the terms set forth in the DIP Documents. Subject to this Court's approval, the Debtors intend to

draw on the DIP Facility in order to satisfy the Debtors' ongoing working capital needs through a going concern sale process.

53. The Debtors have an urgent and immediate need for access to funds available under the DIP Facility and the use of the Cash Collateral. Such funding is necessary in order for the Debtors to have sufficient liquidity to operate their business, satisfy their vendor and customer obligations, and pay their employees. Without immediate access to the DIP Facility and Cash Collateral, the Debtors would be forced to terminate operations and liquidate their assets, which would put numerous employees out of work and irreparably damage the Debtors' efforts to maintain going concern value. Accordingly, the Debtors strongly urge the Court to authorize the DIP Facility and continued use of Cash Collateral on the terms contemplated herein, initially on an interim basis and, following a final hearing, on a final basis.

D. Debtors' Motion for Order Under Sections 105, 345, 363, 364, 503, 1107 and 1108 of the Bankruptcy Code Authorizing (I) Maintenance of Existing Bank Accounts; (II) Continuance of Existing Cash Management System, Bank Accounts, Checks and Related Forms; (III) Continued Performance of Intercompany Transactions; (IV) Limited Waiver of Section 345(b) Deposit and Investment Requirements and (V) Granting Related Relief (the "Cash Management Motion")

54. The Company's Cash Management System facilitates the timely and efficient collection, management, and disbursement of funds used in the Debtors' business. The Cash Management System currently consists of, as more fully outlined below, three primary bank accounts and 38 linked depository sub-accounts, all located at Wells Fargo Bank, N.A. ("Wells Fargo").⁴ A list of the Company's bank accounts (collectively, the "Bank Accounts") is

⁴ The Company is in the process of closing certain restaurant locations. To the extent sub-accounts relating to these restaurants are no longer necessary, the Debtors request authority to close such sub-accounts without further order of the Court.

set forth on Exhibit A to the Cash Management Motion. A schematic diagram of the Cash Management System is annexed to the Cash Management Motion as Exhibit B.

55. As more fully explained below, the Cash Management System is designed to effectuate the collection of revenue from customers, pay operating expenses, and maintain payroll obligations. Any disruption to the Cash Management System would jeopardize the Company's ability to timely satisfy postpetition obligations.

i. The Operating Account

56. The Debtors maintain an operating account (Account No. 9811, the "Operating Account") at Wells Fargo. The Operating Account is utilized for both receipts and disbursements. The approximate balance in the Operating Account as of the Petition Date is \$1.2 million.

57. The Company typically makes the following deposits to the Operating Account:

- **Restaurant Cash Deposits:** Each sub-account is maintained for a separate restaurant location. Cash deposits from the restaurants are transported on a weekly basis to and deposited into the applicable sub-account at a Wells Fargo branch by armored car. Deposits are automatically swept from the sub-accounts to the Operating Account such that the end of day balance of the sub-accounts is always \$0.
- **Credit Card Deposits:** Credit card deposits (collectively the "Credit Card Deposits") in the United States are received from (a) American Express and (b) Total Systems Services, Inc. ("TSYS"). Credit card deposits in Puerto Rico are received from Global Payments Inc. ("Global Payments"). The Credit Card Deposits are made by the applicable credit card processor directly into the Operating Account.
- **Other Deposits:** Checks may be received at the Company's corporate office for vendor rebates, refunds, and for other miscellaneous reasons. These checks are logged by the Senior Accountant into a summary journal entry when received. The physical checks are stored in a

locked drawer until deposited. The checks are deposited into the Operating Account either electronically or at a physical Wells Fargo branch location. In addition, the Debtors receive Automated Clearing House (“ACH”) deposits from other vendors or consumers that are deposited into the Operating Account.

58. The Company also utilizes the Operating Account as a centralized disbursement account. Specifically, the Company uses the Operating Account to fund the zero-balance payroll and accounts payable accounts, as described more fully below. The Debtors also utilize the Operating Account to (i) fund certain credit card processing fees, (ii) send wires to third parties when ACH is not available, and (iii) fund the on premise cash requirements of individual restaurants.

ii. Accounts Payable Account

59. The Debtors make the majority of accounts payable disbursements and some minor payroll-related disbursements (e.g., *de minimis* prepaid payroll debit cards) from a zero balance account (Account No. 0072, the “Accounts Payable Account”) maintained at Wells Fargo. Disbursements from the Accounts Payable Account are made via automated and manual checks and ACH transfers. Check runs typically occur on a weekly basis while ACH transfers occur on a daily basis or as needed. The Accounts Payable Account is funded on an as-needed and zero balance basis from the Operating Account.

iii. Payroll Account

60. The Debtors make the majority of payroll disbursements from a zero balance account (Account No. 9829, the “Payroll Account”) maintained at Wells Fargo. To meet their weekly payroll obligations, the Debtors utilize the services of Paycom, a third party payroll

processor. Payments to fund payroll disbursements are made to Paycom from the Payroll Account. The Payroll Account is funded on an as-needed and zero balance basis from the Operating Account. The Debtors do not make any non-payroll-related disbursements from the Payroll Account.

61. By the Cash Management Motion, the Debtors seek (a) authority to (i) maintain their existing bank accounts and to pay any prepetition routine banking fees imposed by the financial institutions where the Debtors' bank accounts are maintained and to continue to use their existing business forms and check stock; (ii) continue to use their existing Cash Management System, as provided herein; (iii) continue to perform intercompany transactions among the Debtors; (iv) obtain a limited waiver of the requirements pursuant to section 345(b) of the Bankruptcy Code to the extent required; and (b) the related relief set forth herein.

E. Motion of the Debtors for Interim and Final Orders Under Sections 105, 361, 362, 63, 364, 1107 and 1108 of the Bankruptcy Code and Federal Rule of Bankruptcy Procedure 6003 (A) Authorizing the Debtors to (I) Maintain and Renew Existing Insurance Policies; (II) Continue Insurance Premium Financing Programs, (III) Pay Insurance Premium Financing (the "Insurance Motion")

62. In the ordinary course of the Debtors' business, the Debtors maintain numerous insurance policies providing coverage for, inter alia, commercial general liability, liquor liability, umbrella liability, property, worker's compensation, and fiduciary liability (collectively, the "Policies").

63. These Policies are essential to the preservation of the Debtors' business, and assets, and, in many instances, such insurance coverage is required by regulation, law, or contract that governs the Debtors' business. The Debtors filed the Insurance Motion to maintain

their existing insurance program including authority to pay premiums and finance insurance policies.

64. The Policies are essential to the Debtors' business and the Debtors believe that it is in the best interests of the estates to continue to pay the amounts due under the Policies and the Premium Finance Agreement (the "PFA") regardless of whether a given payment became due prior to or after the Petition Date. Furthermore, the Debtors submit that payment of amounts that come due under the existing Premium Finance Agreement is within the ordinary course of business. Unless the Debtors are authorized to continue to pay pursuant to the Policies and PFA on a monthly basis, Liberty Mutual and the Insurance Financier, as applicable, will have the right to cancel the Policies and the Insurance Financier will be entitled to recover the unearned premiums from its collateral. The termination of the Policies would leave the Debtors' estates at risk of catastrophic loss if an unforeseen event occurred. To avoid this risk, the Debtors would need to obtain new insurance policies and pay for the policies, which they may not be able to obtain at favorable prices, or be required to pay the policies in full, which would in turn reduce the estates' assets available to pay creditors.

65. The Debtors also seek authority to continue and renew all of the Policies throughout the duration of these chapter 11 cases. The Debtors submit that the continuation, renewal or negotiation of these Policies and the Premium Finance Agreements falls squarely within the ordinary course of their business. Out of an abundance of caution, the Debtors request that the Court authorize them to renew the Policies and Premium Finance Agreement as they expire in the ordinary course of business, including entering into a new Premium Finance

Agreement as and when the existing PFA expires post-petition, and to continue making monthly payments on account of any Policy for which the Debtors make monthly premium payments.

F. Debtors' Motion for Entry of Interim and Final Orders Authorizing the Debtors to (I) Pay and/or Honor Prepetition Wages, Salaries, Employee Benefits, and Other Compensation and Pay Third Party and Contract Workers; (II) Remit Withholding Obligations and Deductions; (III) Maintain Employee Compensation and Benefits Programs and Pay Related Administrative Obligations; and (IV) Have Applicable Banks and Other Financial Institutions Receive, Process, Honor, and Pay Certain Checks Presented for Payment and Honor Certain Fund Transfer Requests (the "Wage Motion").

66. As of the Petition Date, the Debtors employ approximately 2,400 Employees. Except as otherwise noted, the employee benefits described are generally applicable to all Employees unless otherwise noted. The Employees are not unionized.

67. The Debtors represent that they will have sufficient funds available postpetition, through the use of cash collateral and postpetition financing, to pay or honor all Wages and Benefits and other amounts detailed in the Wage Motion, to the extent described herein, on an ongoing basis and in the ordinary course of business and subject to the applicable limits under section 507(a) of the Bankruptcy Code. Consequently, there is no reason for the regular payment of Wages and Benefits to be disrupted, which would directly harm the Debtors and their Employees.

68. The Employees are paid in arrears. Salaried Employees and hourly Employees are each paid bi-weekly (*i.e.*, once every two weeks) (each, a "Bi-Weekly Pay Date"). However, the Debtors process a payroll every week because approximately half of the work-force is paid on even weeks and the other half on odd weeks. The Debtors use a third party to process payroll and fund payroll prior to the Bi-Weekly Pay Date. All payroll-related

automatic deposits and checks are drawn against third party accounts (*i.e.*, Paycom, the Company's third party payroll processor).

69. The next Bi-Weekly Pay Date will occur on May 8, 2019, which relates to wages earned during the period of April 17, 2019 through and including April 30, 2019. As of the Petition Date, the Debtors estimate they owe approximately \$850,000 on account of accrued, but unpaid wages, for all Employees, which is scheduled to be paid on May 8, 2019. The last and final Bi-Weekly Pay Date that relates to the prepetition period is May 15, 2019, which relates to April 24, 2019 through and including May 7, 2019, of which only 7 days relate to the prepetition period. As of the Petition Date, the Debtors estimate they owe approximately \$425,000 on account of accrued, but unpaid wages, for all Employees being paid on May 15, 2019 (together with the May 8, 2019 Bi-Weekly Pay Date, the "Unpaid Wages").

70. The Debtors seek authority to pay Employees any Unpaid Wages up to \$1,275,000 and to continue to pay Wages that are due after the Petition Date in the ordinary course of business.

71. As part of the relief requested in the Wage Motion, the Debtors seek authority to permit Paycom to continue processing the Company's payroll obligations in the ordinary course of business. On each Bi-Weekly Pay Date, the Debtors pay Paycom fees to process their payroll. The fees vary depending upon the number of employees and the timing of the payroll processing. Historically, the fee for each Bi-Weekly Pay Date is approximately \$6,000 to \$9,000. The Debtors believe that they are current in fees owing to Paycom but will owe Paycom processing fees for the May 8 and May 15, 2019 Bi-Weekly Pay Dates. Although

the forecasted Paycom processing fees arise from postpetition services, the Debtors seek, out of an abundance of caution, authority to pay such fees because they relate to the payment of prepetition claims of Employees. The Debtors request authority, in their discretion, to remit such amounts to Paycom, in an aggregate amount not to exceed \$18,000.

72. In addition, to prevent any disruption in the Debtors' labor force, the Debtors seek authority to pay all gross payroll deductions and payroll taxes, certain customary reimbursable expenses incurred in the ordinary course of business. The Debtors seek authority to pay unpaid prepetition Reimbursable Expenses owed as of the Petition Date, not to exceed \$45,000, and to continue to honor, reimburse, and pay postpetition Reimbursable Expenses in the ordinary course of business in their discretion.

73. The Debtors administer two bonus programs to non-insider Employees. The first relates to salaried restaurant Employees: 29 General Managers; 29 Executive Chefs, 8 Assistant General Managers, 56 Assistant Managers, and 1 Sushi Chef. These salaried restaurant Employees are eligible for a monthly bonus based upon targeted goals of a specific restaurant's cash flow and same-store sales growth year over year (the "Monthly Restaurant Bonus") and such Employees must be employed on the day the payment is made. The total amount of a Monthly Restaurant Bonus is determined in the aggregate by location. Once the total is determined, 45% is allocated to that restaurant's General Manager, 20% to the restaurant's Executive Chef, and 20% is allocated evenly among the other eligible Employees. The remaining 15% of the Monthly Restaurant Bonus is paid to Directors of Operations as discussed further below.

74. Given the Debtors' projected restaurant cash flows, the Company estimates that the Monthly Restaurant Bonus for April 2019 for all locations will total approximately \$70,000, which will be allocated among the applicable locations and allocated among the applicable eligible Employees. No Employee will receive more than \$13,650 inclusive of any other wages or benefits. If the applicable bonus targets are not achieved, or if the Employee is not employed by the Company on the bonus payment date, the Debtors will not issue a Monthly Restaurant Bonus.

75. The Debtors also administer a bonus program for approximately four (4) Directors of Operations, who oversee multiple restaurant locations in a region ("Quarterly Director Bonus") and, together with the Monthly Restaurant Bonus, the "Employee Bonuses"). After the conclusion of each quarter, Directors are paid 15% of the total Monthly Restaurant Bonuses for those restaurants they direct.

76. Given the Debtors' projected restaurant cash flows, they estimate that the Quarterly Director Bonuses for the second quarter of 2019 for all locations will total approximately \$31,500 and is scheduled to be paid in July 2019. The Company projects that no single bonus will exceed \$7,875. No Employee will receive more than \$13,650 inclusive of any other wages or benefits. If the applicable bonus targets are not achieved, or if the Employee is not employed by the Company on the bonus payment date, the Debtors will not issue a Quarterly Director Bonus.

Third Party Labor Providers

77. The Debtors utilize the services of Vincent Benjamin (the “Third Party Labor Provider”), a staffing firm that provides labor service for the Debtors’ corporate office. The Debtors derive the benefit of services provided by the Third Party Labor Provider without having to incur the expenses associated with Benefits and payroll tax obligations that would otherwise be incurred if these workers were employed by the Debtors. Moreover, the Third Party Labor Provider provides critical labor services to the Debtors. Without the Third Party Labor Provider, the Debtors’ corporate office would be short-staffed and they would not be able to operate without having to hire additional personnel without having to incur the associated costs of having permanent employees. Due to the financial distress of the Debtors’ business, the Debtors need the flexibility to hire and downsize such labor depending upon the Debtors’ needs, which can change quickly. As of the Petition Date, the Debtors estimate that they may owe up to \$6,000 to the Third Party Labor Provider. Accordingly, the Debtors seek authority, in their discretion, to pay up to \$6,000 in prepetition Third Party Labor Provider costs, and to continue to use the services of the Third Party Labor Provider and pay postpetition Third Party Labor Provider costs in the ordinary course of business and in their discretion.

78. The Debtors also provide their employees with health and other insurance benefits, vacation and sick time.

79. The Debtors also offer a 401(k) program that they intend to continue in the ordinary course

Workers' Compensation Insurance

80. Under the laws of various states, the Debtors are required to maintain workers' compensation insurance to provide Employees with coverage for injury claims arising from or related to their employment with the Debtors (the "WC Claims"). The Company's workers' compensation program is fully insured ("WC Program") with Liberty Mutual for all locations, except Ohio and San Juan, Puerto Rico, which are each insured through the local municipality.

81. The Debtors seek authority to pay or honor, in their sole discretion, the following, subject to the limits noted in the chart below:

Wages or Benefits	Total
Unpaid Wages	\$1,275,000
Employer Payroll Taxes	\$170,000
Paycom Fees	\$18,000
Reimbursable Expenses	\$45,000
Employee Bonus Payments	\$101,500
Third Party Labor Providers	\$6,000
Blue Cross Medical Plan Benefit Expenses	Valid April claims under the Blue Cross Medical Plan as and when they come due.
Kaiser Medical Plan	\$11,000
Dental Plan	\$0.00
Vision Plan	\$2,000
Life and Disability Insurance Plans	\$4,000
Workers' Compensation Claims	\$71,000
401(k) Plan Contributions	\$20,000
401(k) Plan Administrator Expenses	\$2,000

82. The Debtors represent that (a) they will not distribute any amounts over \$13,650 directly to any individual Employee on account of the sum of unpaid: (i) prepetition Wages or (ii) any other compensation due to an Employee; (b) they will not make contributions to any employee benefit plan on account of unpaid prepetition amounts in excess of (i) the number of Employees covered by such plan multiplied by \$13,650, less (ii) the aggregate amount of prepetition Wages and ordinary course bonus payments, plus the aggregate amount paid by the Debtor on behalf of such Employees to any other employee benefit plan, as provided under section 507(a)(5) of the Bankruptcy Code; and (c) they will not pay any amounts in excess of the estimated outstanding prepetition cap amounts for each category of prepetition claims identified in the chart above and in the proposed interim order without further order from this Court, except to the extent required under state law.

G. Debtors' Motion Pursuant to Sections 105(A), 507(A)(8), and 541(D) of the Bankruptcy Code for an Order Authorizing the Payment of Prepetition Sales, Use and Franchise and Income Taxes; and Similar Taxes and Fees (the "Tax Motion")

83. In the ordinary course of business, the Debtors collect and pay taxes, including, but not limited to, sales and use taxes, franchise taxes, commercial activity taxes, and certain other business license fees, to various taxing authorities in multiple jurisdictions (the "Taxing Authorities"), as described below.

Sales and Use Taxes

84. The Debtors collect and remit sales, use and related taxes ("Sales and Use Taxes") to the Taxing Authorities in twenty-two (22) states and Puerto Rico. The Debtors' liability for Sales and Use Taxes is incurred daily through tax collection from consumers at the

time of restaurant or internet sales transactions. In general, the Debtors remit such collections to the applicable Taxing Authorities generally starting on or about the 15th day of the following month.⁵ The Debtors estimate that as of the Petition Date they owe approximately \$1,250,000 in unremitted Sales and Use Taxes for the month of April 2019. In addition, while the Debtors do not presently have any ongoing sales tax audits pending, the Debtors request authority to pay any amounts determined to be owed on any audits that may be commenced after the Petition Date. The Sales and Use Taxes collected by the Debtors are collected in trust for the benefit of certain taxing authorities and not property of the estate while other states the Debtors owe the collection of such taxes for the benefit of such taxing authorities.

Franchise and Income Taxes

85. The Debtors are required to pay franchise taxes (the “Franchise Taxes”) to certain Taxing Authorities to operate their businesses in the applicable taxing jurisdiction. Certain states may refuse to qualify a debtor to do business in a state or recognize a name change, merger or other activity if franchise taxes have not been paid. Most jurisdictions assess franchise taxes on an annual basis, in arrears or for the privilege to transact business in an upcoming period. In addition, the Debtors are required to pay income taxes federally and in the states where they operate. As of the Petition Date, the Debtors believe that they are current on the payment of Franchise Taxes and income taxes that are payable through the Petition Date. Out of an abundance of caution, the Debtors request authority to pay up to \$100,000 on account

⁵ Illinois requires a weekly prepayment per their calculation, and a few other states in which the Debtors operate (FL, GA, AL, and MO) require either a deposit or an estimated prepayment of the current month’s collections.

of prorated Franchise Taxes and income taxes for any prepetition amounts owing, which the Debtors expect will come due by the end of June 2019.

Commercial Activity Taxes

86. In Ohio, the Debtors pay a tax for the privilege of doing business within such jurisdiction. The tax is measured by taxable gross receipts from most business operations. The first \$1,000,000 is subject to a flat tax of \$150 but receipts above this amount are taxed at a rate of 0.26%. The Debtors estimate that the unpaid Ohio related tax will be approximately \$10,000 for the first four months of 2019. The next tax payment becomes due and payable on or about May 10, 2019, which relates to the first quarter of 2019, the April 2019 portion of the second quarter will become due in August 2019.

Personal Property Taxes

87. The Debtors are required to pay personal property taxes (the “Personal Property Taxes”) in connection with their ownership and use of personal property to applicable taxing jurisdictions. If these taxes are not paid when due, certain Taxing Authorities may impose liens against the subject personal property upon non-payment. Most jurisdictions assess personal property taxes on an annual or semi-annual basis. The Debtors believe that they are current on the payment of Personal Property Taxes. As of the Petition Date, the Debtors estimate that approximately \$450,000 in Personal Property Taxes will become due in 2019 relating to the period prior to the Petition Date. Accordingly, the Debtors request authority to pay up to \$450,000 in Personal Property Taxes as they become due in the ordinary course of business.

Business Licenses, Permits, and Other Fees

88. The Debtors are required to pay various taxes and fees for business licenses, liquor licenses, annual reports, permits, and other similar types of obligations (the “Business Fees”) in order to continue conducting their business in conformity with state and local laws. The Debtors remit required amounts for the Business Fees on a monthly, quarterly, or annual basis, depending on the requirements of the particular Taxing Authority or governmental authority. As of the Petition Date, the Debtors do not believe there are any Business Fees due and owing. Out of an abundance of caution, however, the Debtors request authority to pay any such Business Fees up to an amount of \$25,000.

89. Through the Tax Motion, the Debtors seek entry of interim and final orders authorizing the Debtors to pay any Sales and Use Taxes or Franchise Taxes, Commercial Activity Taxes, Personal Property Taxes and Business Fees (collectively, the “Prepetition Tax Obligations”) to the respective Taxing Authorities or to the parties who ordinarily collect the Prepetition Tax Obligations in the ordinary course of the Debtors’ business, including, without limitation, Sales and Use Taxes and other Taxes subsequently determined on audit to be owed for periods prior to the Petition Date. The Debtors seek authority to remit Prepetition Tax Obligations in an aggregate amount (excluding amounts paid prepetition by checks that have not yet cleared⁶ and amounts that may be subsequently determined on sales tax audit or adjustment to be owed a particular Taxing Authority or party who ordinarily collects the Prepetition Tax Obligations) not to exceed \$1,835,000 (the “Prepetition Tax Obligations Cap”), without

⁶ The Debtors request authority to reissue any amounts paid by check prepetition that have not cleared as of the Petition Date and are dishonored.

prejudice to the Debtors' rights to contest the amounts of any Prepetition Tax Obligations on any grounds they deem appropriate.⁷

90. The Debtors also request that all banks and other financial institutions on which checks to third parties are drawn and/or electronic payments be authorized to receive, process, honor, and pay any and all such checks (whether issued or presented prior to or after the Petition Date) and electronic payments, and to rely on the representations of the Debtors as to which checks are authorized to be paid.⁸

91. Accordingly, the Debtors respectfully request the authority to remit the Prepetition Tax Obligations as they become due to ensure that they remains focused on their business operations and restructuring efforts.

H. **Debtors' Motion for Entry of an Order Authorizing the Debtors to Honor Certain Prepetition Obligations to Customers and to Otherwise Continue Certain Customer Programs in the Ordinary Course of Business (the "Customer Programs Motion")**

92. The Debtors seek entry of an interim order and entry of a final order: (a) authorizing, but not obligating, the Debtors in their sole discretion, (1) to maintain and administer the Customer Programs, (2) to honor prepetition obligations to customers related thereto in the ordinary course of business, and (3) to continue, replace, implement, modify and/or terminate one or more of the Customer Programs, in each case as the Debtors deem appropriate

⁷ Nothing in the Tax Motion shall be deemed to constitute an admission to any asserted liability or obligation with respect to any Tax. The Debtors reserve any and all rights to contest any Tax asserted against them by any Taxing Authority.

⁸ Contemporaneously herewith, the Debtors have filed a motion seeking authority to continue to utilize their cash management system (the "Cash Management Motion"). Details regarding accounts used by the Debtors to pay all obligations in the ordinary course, including taxes, are described in the Cash Management Motion.

in their business judgment and in the ordinary course of business, without further application to the Court; and (b) granting related relief.

Description of Customer Programs

93. Maintaining the loyalty, support, and goodwill of their customers is critical to the Debtors' reorganization efforts. In addition, the Debtors must maintain positive customer relationships and their reputation for reliability to ensure that their customers continue to patronize the Debtors' restaurants during the pendency of these chapter 11 cases.

94. Specifically, the Customer Programs generally relate to the Debtors' programs in which they offer gift cards, customer reward programs, and coupons to customers. The Debtors believe that their ability to continue the Customer Programs and to honor their obligations thereunder in the ordinary course of business is necessary to retain their reputation for reliability, to meet competitive market pressures, and to ensure customer satisfaction, in order to retain current customers, attract new ones, and, ultimately, enhance revenue and profitability for the benefit of all the Debtors' stakeholders.

Customer Reward Programs

95. Gift Cards. In the ordinary course of business, the Debtors sell gift cards (the "Gift Cards") to customers. The Gift Cards do not have any expiration dates. Gift card programs of this nature are common place and popular in the restaurant industry, and the Debtors' competitors offer similar programs to their customers. The Debtors sell Gift Cards to customers in their restaurants and online. As of March 31, 2019, the Debtors estimate that their customers hold Gift Cards with an outstanding aggregate value in excess of \$3.5 million. The

redemption rate of the Gift Cards fluctuates, but generally averages \$230,000 per month over the last twelve months ending March 31, 2019. Gift Cards cannot be redeemed for cash except Gift Cards with de minimis value as required by applicable state law. The Debtors request authority but not the obligation and in their sole discretion, to honor all Gift Cards purchased prior to the Petition Date and to continue honoring Gift Cards in the ordinary course of business.

96. Customer Rewards Program. In the ordinary course of business, the Debtors offer their customers the opportunity to enroll in the Debtors' *Konavore Rewards* program, which is a customer rewards program ("Customer Rewards Program"). Pursuant to the terms of the Customer Rewards Program, program participants earn points that can be converted into "Kona Cash" which may be redeemed within 30 days of conversion for food and non-alcoholic beverage purchases at the Debtors' restaurants. The points do not expire. As of the Petition Date, the Debtors estimate that the outstanding cash value of member accruals under the Customer Rewards Program totals approximately \$100,000. The redemption rate of outstanding points fluctuates, but generally averages \$2,000 per month. Points cannot be redeemed for cash. The Debtors request authority but not the obligation and in their sole discretion, to honor the Customer Rewards Program accruals prior to the Petition Date and to continue honoring the Customer Rewards Program in the ordinary course of business.

97. Coupons. Associated with the Customer Rewards Program, there are two type of coupons/rewards (the "Coupons"): (a) Welcome Reward, which entitle members to one complimentary starter or roll not to exceed \$12 with the purchase of a second starter or roll of equal or greater value, good on the next visit; and (b) Birthday Reward entitles members to a \$15

certificate. Birthday Rewards are applied to members' accounts on Monday, the week prior to the birthdate listed in the account. Both coupons expire 30 days from date sent. The Debtors request authority to honor Coupons in the ordinary course of business in the same manner they did prior to the Petition Date.

I. Debtors' Motion for Entry of Order Authorizing Payment of Allowed 11 U.S.C. § 503(b)(9) Claims (the "503(b) Motion")

98. The operation of a restaurant chain relies heavily on the supply of goods. Generally, the goods purchased by the Debtors are perishable (*e.g.*, food and beverage related goods). The Debtors use other non-perishable goods at a high volume. As a result, the Debtors purchase goods frequently (multiple times per week) so that they can maintain the operation of dozens of restaurants.

99. The Debtors estimate they purchase approximately \$40 million in goods from vendors annually (exclusive of goods covered under PACA). While the Debtors have attempted to stay current with their vendors, they expect that certain goods will have been purchased and delivered during the 20 days prior to the Petition Date. The continuous supply of goods is essential to the operation of the Debtors' restaurants. If payment is not made, the Debtors' vendors could refuse to deliver future goods, which could irreparably harm the Debtors' operations.

100. Accordingly, the Debtors are seeking authorization, pursuant to section 503(b)(9) of the Bankruptcy Code, to pay valid administrative expense claims ("503(b)(9) Claims") as and when they come due in the ordinary course of business.

101. In the interest of expediting the process for paying allowed 503(b)(9) Claims and reducing the administrative and financial burden imposed on the Court and the Debtors' estates associated with potential individual motions of creditors holding allowed 503(b)(9) Claims, the Debtors request entry an order, substantially in the form as the Proposed Order, authorizing the Debtors to pay allowed 503(b)(9) Claims and for the payment of the allowed 503(b)(9) Claims in the amounts agreed to by the Debtors.

102. As of the Petition Date, the Debtors estimate that the 503(b)(9) Claims will total approximately \$1,700,000. The Debtors also estimate that a portion of such claims (approximately 15%) may also be covered by the Perishable Agricultural Commodities Act ("PACA"), which imposes a trust upon certain receivables of the Debtors.⁹ As noted above, the Debtors believe that the uninterrupted supply of goods is essential and that by having the authorization to pay 503(b)(9) Claims will enable the Debtors to maintain the flow of goods as necessary by paying such vendors who are entitled to an administrative expense claim.

103. The Debtors further request that they be authorized, but not required, in their discretion, to condition the payment of a 503(b)(9) Claim on the agreement of the applicable holder of a 503(b)(9) Claim to continue supplying goods to the Debtors on terms that are as or more favorable to the Debtors as the most favorable trade terms, practices, and programs in effect between the holder of the 503(b)(9) Claim and the Debtors in the twelve (12) months prior to the Petition Date (collectively, the "Customary Trade Terms"), or such other

⁹ The Debtors filed a PACA motion contemporaneously and the other first day pleadings.

trade terms as are agreed to by the Debtors and the 503(b)(9) Vendor (as described in detail below, the “503(b)(9) Procedures”).

J. Motion for Entry of an Order (I) Authorizing the Debtors to Pay Certain Prepetition Claims Arising Under (A) The Perishable Agricultural Commodities Act and (B) The Packers and Stockyards Act, and (II) Granting Certain Related Relief (the “PACA Motion”)

104. To ensure that the Debtors continue to receive a constant supply of fresh fruits and vegetables postpetition, the Debtors seek authority, but not direction, in their discretion, to continue to pay in the ordinary course of business and consistent with their historical practices claims arising, or of the type, under PACA to those vendors who supply the Debtors with fresh fruits and vegetables.

105. PACA addresses the regulation of the sale of “perishable agricultural commodities.” 7 U.S.C. § 499a; *see Pacific Int’l Marketing v. A & B Produce, Inc.*, 462 F.3d 279, 282 (3d Cir. 2006). Under PACA, the term “perishable agricultural commodity” is generally defined as “fruits and fresh vegetables of every kind and character.” 7 U.S.C. § 499a(b)(4). PACA provides various protections to fresh fruit and vegetable sellers, including the establishment of a statutory constructive trust (“PACA Trust”) consisting of a purchaser’s entire inventory of food or other derivatives of perishable agricultural commodities, the products derived therefrom and the proceeds related to any sale of the commodities or products (collectively, the “PACA Trust Assets”). *See* 7 U.S.C. § 499e(c)(2). PACA Trust beneficiaries are entitled to receive payment of sale goods ahead of other creditors of the buyer, including creditors that have liens or other security interest in the buyers’ interests. *Bear Mountain Orchards v. Mich-Kim, Inc.*, 623 F.3d 163, 167 (3d

Cir. 2010), *Pacific Int'l Marketing*, 262 F.3d at 283 (“PACA statutory trust grants certain unpaid suppliers and sellers of produce and their agents an interest in the PACA trust assets superior to that of a buyer’s perfected, secured creditor.”); *see also Idahoan Fresh v. Advantage Produce, Inc.*, 157 F.3d 197, 199 (3d Cir. 1998).¹⁰

106. PACA requires that certain procedural steps be taken by a seller of perishable agricultural commodities in order to preserve its rights as a trust beneficiary. Specifically, a PACA Vendor must provide written notice (a “PACA Notice”) to the purchaser of such goods and its intent to preserve the benefits of the PACA Trust. *See Tanimura & Antle, Inc. v Packed Fresh Produce, Inc.*, 222 F.3d 132, 136 (3d Cir. 2000); *In re Magic Restaurants Inc.*, 205 F.3d 108, 112 (3d Cir. 2000). Written notice under PACA may be accomplished by either (a) including the statutorily mandated language on the face of the vendor’s invoices or (b) providing written notice to the purchaser of the PACA goods within thirty days after the time payment is due. *Tanimura*, 122 F.3d at 136. Beneficiaries of a PACA Trust that adhere to the statutory notice requirements are entitled to prompt payment from the PACA Trust Assets ahead of secured and unsecured creditors of a debtor’s estate. *Pacific Int'l Marketing*, 462 F.3d at 283; *Cavendish Farms v. Ameriserve Food Distrib. (In re Ameriserve Food Distrib.)*, 2000 WL 33682392, at *1 (Bankr. D. Del. June 22, 2000) (“Thus, funds held in trust created pursuant to PACA are excluded from the bankruptcy estate and a perfected PACA trust beneficiary is entitled to priority payments in full

¹⁰ Nothing herewith shall constitute an admission as to the validity or amount as to any PACA Claims or an admission that any PACA Vendor has an allowed PACA Claims or is entitled to payments from the PACA Trust. The Debtors reserve any and all rights to contest any asserted PACA Claims or any and all available bases.

from those trust assets before other creditors, both secured and unsecured, receive any payment from those sale proceeds.”) *see also In re Long John Silver's Restaurants*, 230 B.R. 29, 32 (Bankr. D. Del. 1999).¹¹

107. The Debtors believe that a certain portion of their fresh fruits and vegetables purchased from vendors may qualify as “perishable agricultural commodit[ies]” under PACA. As a result, insofar as those vendors abide by the notice requirements of PACA and have submitted valid PACA Notices to the Debtors, such vendors will be eligible to assert PACA Claims granting them priority ahead of all other secured and unsecured creditors in the Debtors’ chapter 11 cases. Accordingly, payment of allowed PACA Claims at this time will not prejudice or affect the amount available for distributions to other creditors of the Debtors. To ensure that the supply of fresh fruits and vegetables continues unimpeded, it is imperative that the Debtors be authorized to pay all prepetition and postpetition PACA Claims in the ordinary of business and consistent with their historical practices. As of the Petition Date, the Debtors estimate they owe holders of PACA Claims approximately \$700,000 in the aggregate for PACA goods delivered prior to the Petition Date.

108. Any PACA Vendor who accepts payment from the Debtors in satisfaction of its valid PACA Claim will be deemed to have waived any and all claims of whatever type, kind, or priority, against the Debtors, their property, their estates, and any

¹¹ PACA’s application is limited to sales to commission merchants, brokers, and dealers. 7 U.S.C. § 499e(c). “Dealer,” as such term is defined in PACA, is “any person engaged in the business of buying or selling in wholesale or jobbing quantities, as defined by the Secretary, any perishable agricultural commodity in interstate or foreign commerce.” 7 U.S.C. § 499a(b).

PACA Trust Assets, but only to the extent that payment has been received by such PACA Vendor on account of its PACA Claim.

109. The Debtors believe that most of the PACA Claims relate to transactions where goods were received by the Debtors in the twenty-day period prior to the Petition Date, and holders of PACA Claims who delivered goods to the Debtors in the ordinary course of business are also entitled to an administrative expense claim for the value of those goods under section 503(b)(9) of the Bankruptcy Code.

K. Motion for Interim and Final Orders (A) Approving the Debtors' Proposed Adequate Assurance of Payment for Future Utility Services, (B) Prohibiting Utility Companies From Altering, Refusing, Or Discontinuing Services, (C) Approving the Debtors' Proposed Procedures For Resolving Adequate Assurance Requests, and (D) Granting Related Relief (the "Utility Motion")

110. Uninterrupted Utility Services are essential to the Debtors' ongoing business operations. The Debtors' operations require electricity and gas for lighting, heating, trash, sewer services, and air conditioning. Should any Utility Provider refuse or discontinue service, even for a brief period, the Debtors' business operations could be severely disrupted, and such disruption would jeopardize the Debtors' ability to operate their business. Accordingly, it is essential that the Utility Services continue uninterrupted during the chapter 11 cases.

111. The Debtors utilize various utility services provided by numerous utility companies (collectively, the "Utility Companies"). Because the Utility Companies provide essential services to the Debtors and their operations, any significant interruption in utility services would be highly problematic. In fact, the temporary or permanent discontinuation of utilities services at any of the Debtors' locations could irreparably disrupt business operations,

and, as a result, fundamentally undermine the Debtors' restructuring efforts. On average, the Debtors pay approximately \$263,000.00 each month for third party Utility Services.

112. The Debtors will propose procedures to protect the rights of Utility Companies by providing such Utility Companies with a deposit in an amount equal to approximately two weeks of the Debtors' aggregate utility expenses. The Debtors submit that the deposit (which will be in the amount of \$111,035, in conjunction with the Debtors' ability to pay for future utility services in the ordinary course of business and their existing security deposits constitutes sufficient adequate assurance of future payment to the Utility Companies. I believe that such relief is necessary to prevent immediate and irreparable harm to the Company.

113. To manage the Utility Services at their many locations, the Debtors contract with Engie Insight Services, Inc. ("Engie"), a third-party processor. Engie manages the Debtors' accounts for almost all of the Utility Companies, including managing the Utility Services, reviewing bills for the Utility Services, paying bills for the Utility Services as an agent for the Debtors (after receiving funds from the Debtors for such payments), establishing new Utility Services, terminating Utility Services for closing locations, and providing accounting information to the Debtors with respect to the Utility Services managed by Engie.

114. Engie charges the Debtors a monthly fee for such services based on the number of restaurant locations. The services provided by Engie are integral to the Debtors' operations. The Debtors spend approximately \$1,500 per month for Engie's services. The Debtors believe that, as of the Petition Date, they owe approximately \$3,000 to Engie for prepetition accrued but unpaid service and administrative fees. Further, the Debtors may require

Engie to continue to perform services for the Debtors under the terms set forth in their current agreement. The Debtors seek authority from the Court to pay Engie all prepetition accrued but unpaid service and administrative fees, and to continue such payments to Engie for postpetition services.

L. Debtors' Application for Entry of an Order Pursuant to 28 U.S.C. § 156(C) (I) Approving the Retention and Appointment of Epiq Corporate Restructuring, LLC as the Claims and Noticing Agent to the Debtors, Effective *Nunc Pro Tunc* to the Petition Date and (II) Granting Related Relief (the "Claims Agent Motion")

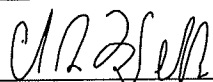
114. The Debtors request authority to retain Epiq Corporate Restructuring, LLC ("Epiq") as claims and noticing agent for the Debtors on the terms set forth in the Services Agreement attached as Exhibit B to the Claims Agent Motion.

115. As set forth in the Claims Agent Motion, the Debtors have obtained and reviewed engagement proposals from at least two (2) other court-approved claims and noticing agents to ensure selection through a competitive process. Moreover, I believe that, based on all engagement proposals obtained and reviewed, that Epiq's rates are competitive and reasonable given Epiq's quality of services and expertise.

116. Although the Debtors have not filed their schedules of assets and liabilities, it is anticipated that there will be in excess of 200 entities to be noticed. In view of the number of anticipated claimants and the complexity of the Debtors' businesses, I believe that the appointment of a claims and noticing agent is both necessary and in the best interests of both the Debtors' estates and their creditors.

Pursuant to 28 U.S.C. § 1746, I declare under penalty of perjury that the foregoing
is true and correct to the best of my knowledge and belief.

Executed this 30th day of April 2019.



Christopher J. Wells
Chief Restructuring Officer

EXHIBIT A
(CORPORATE ORGANIZATIONAL CHART)

Org Chart

KONA GRILL, INC. & SUBSIDIARIES
 CORPORATE ENTITY ORGANIZATIONAL CHART
 12/31/2018

