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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
RICHMOND DIVISION

In Re:	Chapter 11
TOYS "R" US, INC., et al.,	Case No. 17-34665 KLP
Debtors-in-Possession.	(Jointly Administered)

OMNIBUS POST-PETITION VENDORS' LIMITED OBJECTION AND JOINDER TO CRAYOLA LLC'S (1) LIMITED OBJECTION TO DEBTORS' ENTRY INTO WAIVERS WITH RESPECT TO ABL/FILO DIP DOCUMENTS AND THE TERM DIP DOCUMENTS AND (B) AMENDING FINAL ORDER (I) AUTHORIZING THE NORTH AMERICAN DEBTORS TO OBTAIN POSTPETITION FINANCING, (II) AUTHORIZING THE NORTH AMERICAN DEBTORS TO USE CASH COLLATERAL, (III) GRANTING LIENS AND PROVIDING SUPERPRIORITY ADMINISTRATIVE EXPENSE STATUS, (IV) GRANTING ADEQUATE PROTECTION TO THE PREPETITION LENDERS, (V) MODIFYING THE AUTOMATIC STAY, AND (VI) GRANTING RELATED RELIEF, AND (2) JOINDER IN AND ADOPTION OF CERTAIN OTHER OBJECTIONS THERETO

The Post-Petition Vendors listed hereto on Exhibit A (collectively, the "Post-Petition

Vendors"),[1] hereby join in the arguments set forth in the Crayola LLC's *(1) Limited Objection to Debtors' Motion for Entry of an Order (A) Authorizing the North American Debtors' Entry into Waivers with Respect to ALB/FILO DIP Documents and the Term DIP Documents and (B) Amending Final Order (I) Authorizing the North American Debtors to Obtain Postpetition Financing, (II) Authorizing the North American Debtors to Use Cash Collateral, (III) Granting Liens and Providing Superpriority Administrative Expense Status, (IV) Granting Adequate Protection to the Prepetition Lenders, (V) Modifying the Automatic Stay, and (VI) Granting Related Relief, and (2) Joinder in and Adoption of Certain Other Objections Thereto* [Docket No. 2368] (the "Limited Objection") filed on March 23, 2018. The Post-Petition Vendors believe that the legal reasoning in the Limited Objection, as well as the respective objections or limited objections to the Debtors' wind-down motion [Doc 2050] filed by each of the Post-Petition Vendors (the "Wind-Down Objections"), is sound and the Court should adopt the arguments advanced therein. In addition to the arguments set forth in the Limited Objection and the Wind-Down Objections, the Post-Petition Vendors also advance the following arguments that demonstrate that the Motion[2] should be denied or, in the alternative, granted on an interim basis, with the Court ordering that all proceeds of the current store liquidation process be placed in escrow.

A. Additional Discovery is Needed to Justify the Extraordinary Relief Sought in the Motion

1. Before the Court grants the final relief requested in the Motion, the Court should,

[1] The Post-Petition Vendors have also been contacted by several other similarly situated post-petition vendors, representing approximately 25% of all administrative claims, who all share the concerns expressed herein and support this Joinder. Due to the short time that parties were given to file responsive pleadings to the Motions, however, many of these vendors have not yet retained counsel. The names of those represented by counsel are included on Exhibit A.

[2] All capitalized terms not defined herein have the meaning ascribed to them in the Limited Objection.

at a minimum, allow the parties the opportunity to engage in discovery. The lack of the Debtors' evidence is well outlined in the Limited Objection. In addition to the deficiencies pointed out in the Limited Objection, at the March 20, 2018 interim hearing on this Motion, the two witnesses that testified, Mr. Kurtz and Mr. Kosturos, the Debtors' professionals, could not answer many critical questions. *See, e.g.,* March 20 Hearing Transcript at 73:14-17 (Mr. Kurtz testifying that he "was not a party to a discussion about how we're going to deal with vendors because I wasn't – it wasn't my job to deal with vendors and so I don't have personal knowledge of what was said or not said …to those vendors" Q: "So in the context of the discussions you were involved with, it never came up about being open and transparent to the trade vendors? A: I don't know what was said or not said to the trade vendors"); 117:2-8 (Mr. Kosturos testifying that it was "the company's responsibility to manage the inventory planning process" and not having personal knowledge of the process or details that were "followed to determine whether inventory ordering was consistent with the company's cash flow position and available budget.").

2. Thus, the Post-Petition Vendors believe that there is a need for discovery to determine, at a minimum, among other issues, whether the Waivers have been negotiated in good faith, when the Debtors' realized that the stores were likely to liquidate, when the Debtors made the decision to liquidate the stores, the process regarding inventory control and communication with vendors regarding the Company's liquidation issues; and the sufficiency of the Wind-Down Budget. Especially in this case, where the Court is facing the real possibility that the case will result in more than $450 million in unpaid administrative claims[3] (*see, e.g.,* March 20 Transcript at 77:20), there is no reason to "rush" to a result that will, among other things, 1) create a subclass

[3] At this time, we do not know if this number includes unpaid 503(b)(9) claims. If so, the administrative deficiency pool will increase. With respect to treatment of these claims (and any potential post-petition contractual claims with respect thereto), the Post-Petition Vendors reserve all rights.

of *de facto* subordinated administrative expense claim; 2) grant expansive releases; and 3) potentially result in a *sub rosa* plan, approved without the protections afforded by a duly court approved disclosure statement and informed balloting. *See, e.g., In re Oakwood Country Club, Inc.*, No. BKR. 10-60246-LYN, 2010 WL 4916436, at *7 (Bankr. W.D. Va. Apr. 6, 2010) (denying motion to sell substantially all of the debtor's assets where "[t]he provision for payments to the New Club before unsecured creditors constitutes a *sub rosa* plan that breaches the Debtor's fiduciary duty to unsecured creditors" and further noting that the court was aware that the debtor was on the brink of financial ruin, but that "[i]t is, however, one thing to seek to sell all of the Debtor's assets under this financial pressure and yet another to seek to direct the proceeds of that sale away from unsecured creditors and toward an insider that is nothing more than a legal reincarnation of the Debtor.").

3. Given the relief sought in the Motion, there is ample need for discovery to ensure that such relief is warranted under these extraordinary circumstances. To this end, the Post-Petition Vendors have already served discovery on the Debtors on March 26, 2018. *See* Exhibit B, "First Demand for the Production of Documents by Post-Petition Vendors to the Debtors," dated March 26, 2018. The Court should decline to enter final relief on the Motion until, at a minimum, the discovery is produced.[4]

B. <u>The DIP Lenders Should Not Receive The Continued Benefit of Any Waivers of Sections 506(c) and 552 of the Bankruptcy Code</u>

4. The Motion seeks approval of the amendment of the NA DIP Credit Agreements and the Final North American DIP Order entered by the Court on October 24, 2017. The NA DIP Credit Agreements and the Final North American DIP Order included provisions regarding the

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[4] Pursuant to the Bankruptcy Rule 9014, the Demand for Documents is currently due on April 25, 2018, after the scheduled hearing on this matter.

waivers (the "Waivers") by the Debtors and the Debtors' estates of the estates' rights under sections 506(c) and 552 of the Bankruptcy Code. The Motion and amendments to the DIP Financing do not seek to amend the Waiver, which is because such provisions are obviously for the benefit of the DIP Lenders and not the Debtors' estates. However, what is also obvious to anyone even tangentially involved with these Chapter 11 Cases, is that the Debtors are facing a much different world than in October 2017 when the Waivers were initially entered. The Debtors are now in the midst of a total melt-down of the Debtors' business and implementation of a fast moving wind-down process, which was approved by the Court on March 21st. Thus, the facts, realities and equities of the Chapter 11 Cases have drastically changed from the beginning of the Chapter 11 Cases. The Post-Petition Vendors therefore believe it is not only proper, but necessary to address the issues that are now presented surrounding the validity and effect of the Waivers on the Debtors, their estates and their creditors and the wind-down process itself.

5. The purpose of sections 506(c) and 552(b)(2) is to impose the costs of administration on a secured creditor that is using chapter 11 to liquidate its collateral, as is the case here. The testimony adduced at the hearing on the Wind-Down Motion on March 22, unequivocally indicated that the Debtors do not believe that the liquidation of the Lenders' collateral through the wind-down process will be sufficient to pay for accrued administrative expenses in the Chapter 11 Cases. In fact, the Debtors' entire position on administrative expenses is that it is only going to pay for, and the DIP Lenders will only allow, go-forward administrative expenses and administrative claims that accrued after March 5, 2018. Administrative insolvency issues aside, it appears that the Chapter 11 Cases are now being proposed to be run purely to maximize value for the secured creditors and to benefit estate professionals. But this should not be the case and if the secured creditors in the Chapter 11 Cases want to use the bankruptcy to

maximize their return then they need to "pay the freight" for such a process. Congress clearly recognized this basic bankruptcy fundamental, which is a driving force behind sections 506(c) and 552(b)(2).

6. Section 506(c) provides for the ability for a debtor's estate to surcharge the collateral of a secured lender. Specifically that section of the Bankruptcy Code provides:

> The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim, including the payment of all ad valorem property taxes with respect to the property.

11 U.S.C. § 506(c).

7. Courts have widely recognized that section 506(c) waivers are not granted lightly. *See, e.g., Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.,* 530 U.S. 1, 12 (2000) (determining that section 506(c) is a rule of fundamental fairness for all parties of interest, authorizing the surcharge of a secured lender's collateral where reasonable and appropriate). At its essence section 506(c) "is designed to prevent a windfall to the secured creditor … [and] understandably shifts to the secured party … the costs of preserving or disposing of the secured party's collateral., which costs might otherwise be paid from the unencumbered assets of the bankruptcy estate … ." *Precision Steel Shearing, Inc. v. Fremont Fin. Corp. (In re Visual Indus., Inc.),* 57 F.3d 321, 325 (3d Cir. 1995).

8. In addition, section 552, often called the "*equities of the case exception*" allows a bankruptcy judge to cut off a security interest in proceeds of collateral to the extent that it is an equitable outcome. Section 552(b)(2) of the Bankruptcy Code provides:

> (b)(1) Except as provided in sections 363, 506(c), 522, 544, 545, 547, and 548 of this title, if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds, products, offspring, or profits of such property, then such security interest

> extends to such proceeds, products, offspring, or profits acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable nonbankruptcy law, *except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.*

11 U.S.C § 552(b)(1).

9. There is little case-law on the court's treatment and/or interpretation of section 552(b)(1) and the "equities of the case exception." *In re Photo Promotion Assocs.,* 61 B.R. 936 is one of the few reported cases and which, though the facts are different than now before the Court, stands for the proposition that section 552(b)(1) can be utilized where the equities of the case demand it.

10. As set forth above, the Chapter 11 Cases now before the Court are dramatically different than they were last October. No more hope, no more discussions about restructuring, just a massive retailer in a free-fall liquidation. What assets are being liquidated? A variety of assets, but primarily the inventory located in the Debtors' warehouses and stores that was provided to the Debtors (on unsecured credit) by their faithful vendors that stood by them throughout the Chapter 11 Case. In return, those vendors are left with the majority of the more than $450 million accrued administrative expense claims accrued in the Chapter 11 Cases that are not going to be paid if the Debtors and the DIP Lenders are permitted to proceed with the amendment of the NA DIP Credit Agreements.

11. There has been no information provided by the Debtors, nor any evidence submitted before the Court, concerning the DIP Lenders' collateral at this point. Therefore, analysis of section 506(c) isn't even possible here. The Post-Petition Vendors, parties in interest, and the Court really cannot determine whether there is equity. If there is, then the Post-Petition Vendors and other administrative creditors of the Debtors are being even further subordinated by the DIP Facility amendments, DIP Financing, and the Waivers. These facts alone weigh heavily in favor

of removal of the Waivers. If, however, as the hearing on the Wind-Down Motion seemed to indicate, this case could be administratively insolvent and the only benefit to be obtained from the amended DIP Financing are the DIP Lenders and secured creditors. At a minimum, the Court should be free to explore whether the "equities" in this case demand a different result, such as a pro rata sharing of proceeds for the $450 million in accrued administrative expenses, rather than have this section simply waived.

RESERVATION OF RIGHTS

12. The Post-Petition Vendors reserve the right to: (i) further object to the Motion on any grounds whatsoever, through a supplemental objection and/or during oral argument; (ii) object to the Wind-Down Budget on any grounds, to the extent it is revised or additional detail becomes available; (iii) request that the Court adjourn the Motion, in whole or in part, pending further development of the record, including through discovery; and (iv) pursue all other available relief, including claims and causes of action against all responsible persons and entities.

CONCLUSION

For the reasons set forth herein, and in the Limited Objection, the Post-Petition Vendors respectfully asks the Court to deny the Motion. In the alternative, the Post-Petition Vendors also respectfully ask that the Court 1) Motion be granted on an interim basis; 2) order that all proceeds from the liquidation of the stores, pursuant to the Wind-Down Budget, be put in escrow, pending further orders from this Court; and 3) grant the Post-Petition Vendors such other and further relief as is just and proper.

Respectfully submitted,
WASSERMAN, JURISTA & STOLZ, PC
Counsel for Kent International Inc., USA Helmet Sub Kent Intl Inc., and Kazam, LLC.

Date: March 28, 2018

DONALD W. CLARKE

Exhibit A

Dorel Industries Inc. (d/b/a Dorel Home Products)

Dorel Juvenile Group, Inc.

Dorel Asia, Inc.

Pacific Cycle Inc. (f/k/a/ Pacific Cycle LLC)

Dorel Home Furnishings Inc. (f/k/a Ameriwood Industries, Inc.)

Just Play, LLC and certain of its subsidiaries

Kids II Far East Limited

Kids II, Inc.

The Step2 Holding Company, LLC.

The Step2 Company, LLC.

Step2 Direct

Step2 Discovery

Backyard Discovery

Kent International, Inc.

USA Helmet Sub Kent Int'l., Inc.

Kazam, LLC.