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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.*,[1]	:	Case No. 17- 34665 (KLP)
Debtors.	:	Jointly Administered

ABL/FILO DIP AGENT'S OMNIBUS REPLY TO THE OBJECTIONS FILED WITH RESPECT TO THE DEBTORS' MOTION FOR ENTRY OF AN ORDER (A) AUTHORIZING THE NORTH AMERICAN DEBTORS' ENTRY INTO WAIVERS WITH RESPECT TO THE 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

[1] The debtors in these chapter 11 cases (the "**Debtors**"), along with the last four digits of each Debtor's federal tax identification number, are set forth in the Order (I) Directing Joint Administration of Chapter 11 Cases and (II) Granting Related Relief [Docket No. 78]. The location of the Debtors' service address is One Geoffrey Way, Wayne, New Jersey 07470.

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JPMorgan Chase Bank, N.A., acting as ABL/FILO DIP Agent[2] for itself and the ABL/FILO DIP Lenders (together, the "**ABL/FILO DIP Secured Parties**"), hereby files this omnibus reply to the objections[3] to the Debtors' motion [Docket No. 2189] (the "**Motion**") for entry of a final order authorizing the Debtors to: (a) enter into (i) a waiver, consent, and amendment agreement to their amended superpriority secured debtor-in-possession credit agreement dated as of September 22, 2017 (the "**ABL/FILO DIP Credit Agreement**") and (ii) a waiver, consent, and amendment agreement to their debtor-in-possession credit agreement dated as of September 22, 2017,[4] and in each case perform the obligations thereunder; and (b) amend the Final North American DIP Order as set forth in the Motion.

[2] Capitalized terms used but not otherwise defined herein shall have the meaning ascribed to them in the *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* [Docket No. 711] (the "**Final North American DIP Order**") or the ABL/FILO DIP Credit Agreement (as defined below), as applicable.

[3] Those making these objections are hereinafter collectively referred to as the "**Objectors**." The Objectors include: Readerlink Distribution Services LLC ("**Readerlink**") [Docket No. 2358]; Crayola LLC ("**Crayola**") [Docket No. 2368] (the "**Crayola Objection**"); Dorel Industries Inc., Kids II, Inc. and Kent International, Inc. and several of their affiliated entities [Docket No. 2446] (the "**Dorel/Kids II/Kent Objection**"); HCL America, Inc. [Docket No. 2364] and KidCo, Inc., Maya Group HK Ltd., Peg Perego USA, Inc., Kolcraft Enterprises, Inc., LulyBoo, LLC, Bexco Enterprises, Inc., Bassett Furniture Industries, Inc., Export Development Canada and Halo Innovations, Inc. [Docket No. 2524] (the "**KidCo Objection**") and LSC Communications US, LLC [Docket No. 2557] (the "**LSC Objection**"); and all joinders, including those filed as Docket Nos. 2393 (Funrise, Inc. (USA)), 2417 and 2426 (The William Carter Company, Skip Hop, Inc., and OshKosh B'Gosh, Inc.), 2418 (Funko, Inc.), 2423 (Graco Children's Products, Inc. and NUK USA, LLC), 2430 (Summer Infant (USA), Inc. and Summer Infant, Inc.), 2439 (TOMY International, Inc.), 2453 (SquareTrade, Inc.), 2473 and 2487 (Artsana (USA) Inc., The Boppy Co., LLC and Caben Asia Pacific Ltd), 2475 (Munchkin, Inc.), 2490 (Learning Resources, Inc.), 2495 (Pearhead, Inc.), 2534 (New Adventures LLC Ltd.), 2538 (Heritage Baby Products, LLC) and 2572 (Epoch Everlasting Play LLC f/k/a International Playthings LLC, Goliath Games, LLC, Pressman Toy Corp., Jax, Ltd., Goliath Far East/Pressman Toy, Melissa & Doug, LLC, and USAopoly, Inc.).

[4] The two waivers are referred to collectively as the "**DIP Waivers**." The waiver offered by the ABL/FILO DIP Secured Parties is referred to as the "**ABL/FILO DIP Waiver**."

PRELIMINARY STATEMENT

1. The anger and disappointment that the Court has heard from the Debtors' vendors, both at the March 20 hearing and in objections filed to the wind-down budget and DIP Waivers, illustrates that the collapse of the Debtors' business is shocking and disappointing for every constituency involved in these cases. None of the Debtors' many stakeholders expected this result, and all are understandably attempting to find a path forward and to minimize the damage done by the deterioration of the Debtors' business. Against this backdrop, the waivers before the Court and the Debtors' wind-down budget have become flashpoints around which the frustration of creditors facing losses have coalesced. The waivers and the budget, however, will not cause these losses and will not harm any of the Objectors. Plainly and simply, the Objectors are facing losses because their claims against the Debtors have always ranked junior to the DIP financing claims, and there may not be sufficient value to pay all administrative claimants. Failure to approve the waivers will not change this, and will serve only to destabilize the Debtors' wind-down and further jeopardize the recoveries of their stakeholders.

2. Although their pleadings are styled as objections to the waivers before the Court, the Objectors do not in fact take issue with the waivers, which offer no new benefits to the ABL/FILO DIP Secured Parties, but to the contrary reflect significant concessions made for the benefit of the Debtors and junior creditors. What the Objectors truly seek is for the Court, without any legal basis, to revoke the provisions of the Final North American DIP Order, dated October 24, 2017, which was entered on a fully consensual basis, supported at the time by the Objectors, and provided the ABL/FILO DIP Secured Parties with the assurances necessary to commit to $2.3 billion of debtor-in-possession ("**DIP**") financing that the Debtors needed to survive. Several Objectors in

fact noted at the time their concerns that "[a]dministrative expense priority is valueless if there are insufficient assets to satisfy those claims where some creditors receive superpriority claims or secured liens . . . ."[5] These Objectors, however, not only withdrew their objections based on "an amicable resolution which addressed and resolved the concerns raised,"[6] they then also made the business judgment that the potential benefits of continuing to do business with the Debtors outweighed the risks of potential loss, and so agreed to extend short-term unsecured credit to the Debtors, knowing their claims would rank junior to the DIP financing. After the ABL/FILO DIP Secured Parties extended hundreds of millions of dollars of long-term new money financing in reliance on the protections of the Final North American DIP Order, the Objectors seek to simply tear up the bargain they made in an attempt to improve their positions. The relief requested by the Objectors should be rejected, as it is wholly unprecedented, lacks legal basis, and would violate not only the Bankruptcy Code's priority rules but also this Court's Final North American DIP Order, which is final, non-appealable and, as noted, was entered on a consensual basis.[7]

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[5] Objection of Kent International Inc., USA Helmet Sub Kent Intl. Inc. and Kazam LLC [Docket No. 289], ¶ 16.

[6] *See* Notice of Withdrawal [Docket No. 636]; *see also* Objection of Kids II, Inc., Kids II Far East, Inc. and Kids II Canada Co. [Docket No. 584], which was also withdrawn [Docket No. 644].

[7] The objections are also untimely. Only one objection, by Readerlink, an alleged consignment vendor, was timely filed before the March 23, 2018 at 4:00 p.m. prevailing Eastern time objection deadline set forth in the Interim Order authorizing the Debtors' entry into the DIP Waivers and amending the Final North American DIP Order [Docket No. 2318, as amended by Docket No. 2427]. Readerlink's objection, however, should be denied as moot. Under the wind-down order dated March 22, 2018 [Docket No. 2344] (the "**Wind-down Order**"), any party selling goods on consignment, scan-based trading or other similar arrangement is entitled to, "at its own cost and expense and in coordination with the Debtors and the Consultants, remove any validly-owned property from the Debtors' stores." Wind-down Order, ¶ 37. Furthermore, upon the sale of goods covered by such agreement, "the Debtors shall compensate the counterparty to such agreement in the amount and on the terms set forth in the [applicable agreement]." *Id.* Therefore, Readerlink's concerns have been addressed by the Wind-down Order and its objection to the Motion should be denied.

3. The question before the Court is narrow—whether to approve the DIP Waivers or not—and should not be controversial. A debtor need not show that each and every provision of a DIP financing amendment is the most favorable term possible, only that it has reasonably exercised its business judgment.[8] The waivers are necessary so that the Debtors do not default on their obligations and risk a disorderly liquidation, and they give the Debtors stability and a path forward on extremely reasonable terms. The ABL/FILO DIP Waiver does not actually do anything the Objectors have argued: it does not shield the lenders from litigation, it does not improve the lenders' claims (and in fact subordinates the lenders' claims to enormous new claims), and it grants the lenders no new rights or protections, instead carving back their existing protections substantially. By stabilizing the Debtors and enabling an orderly wind-down, this waiver benefits the Debtors and the unsecured junior claimants, who stand to gain the most from a value-maximizing liquidation. Failure to approve the waivers will not help the Objectors or improve their position, it will simply leave the Debtors in default on their DIP financing with no clear path forward.

4. The Final North American DIP Order gave the ABL/FILO DIP Secured Parties a first priority security interest in the Debtors' inventory, including any goods delivered by vendors postpetition, and a superpriority claim that is senior to any and all

[8] *See, e.g.*, *In re Alpha Nat. Res., Inc.*, 546 B.R. 348, 356 (Bankr. E.D. Va. 2016) (noting, under § 363(b), that courts apply a "deferential business judgment test," which asks only whether the transaction at issue "is within the fair and reasonable business judgment of the [d]ebtors" (internal quotation marks omitted)); *In re Crowthers McCall Pattern, Inc.*, 114 B.R. 877, 888 (Bankr. S.D.N.Y. 1990) ("But [the objecting creditor] did not negotiate the Agreement and the Court is not to second guess the inclusion of some provisions as long as the Agreement as a whole is within reasonable business judgment, and the subject provisions do not distort the balance Congress struck in Chapter 11."); *In re Roblin Indus., Inc.*, 52 B.R. 241, 245 (Bankr. W.D.N.Y. 1985) ("The Court can only approve or disapprove the proposed arrangement. It cannot require the Banks to put additional funds at risk against their better judgment.").

other administrative claims, including any claim any vendor might assert. This cannot be changed, and yet the Objectors fundamentally ask the Court to elevate their junior unsecured claims over the senior secured and superpriority claims of the ABL/FILO DIP Secured Parties.[9] There is no way under the law for the Court to do this. Inventory in possession of the Debtors and its cash proceeds—whether that inventory is paid for or not—are the collateral of the ABL/FILO DIP Secured Parties. This is blackletter law, including in this District,[10] and no Objector disputes or even attempts to address this point. Rather, the Objectors wish to bypass the clear terms of the Court's Final North American DIP Order, and upend the Bankruptcy Code's well-established priority scheme, for "equitable" reasons unsupported by logic or precedent. However styled, the relief the Objectors seek is unwarranted.

5. First, the Final North American DIP Order, including all the protections granted therein to the ABL/FILO DIP Secured Parties, is final, binding and not subject to revocation or reconsideration. Only two of the Objectors objected to the entry of the order, and both withdrew their objections before entry of the order.[11] Not a single party appealed, or otherwise challenged, the Final North American DIP Order after it was entered, and the time to take any appeal has long since passed. As the Bankruptcy Court for the Eastern District of Virginia explained in the *AMF Bowling* case, under such

[9] The "**DIP Secured Parties**" means, collectively, the ABL/FILO DIP Secured Parties and the term DIP secured parties.

[10] *See, e.g.*, *In re Circuit City Stores, Inc.*, 441 B.R. 496, 511 (Bankr. E.D. Va. 2010) (holding that reclamation claims were defeated by prior lien in inventory because those claims "were inferior to the interests of . . . the Pre-petition Lenders and the DIP Lenders"); *accord In re hhgregg, Inc.*, 578 B.R. 814, 818 (Bankr. S.D. Ind. 2017).

[11] *See supra*, nn. 5, 6.

circumstances, "all parties are bound by the order."[12]

6. The ABL/FILO DIP Secured Parties relied on the terms of the order being final when they extended billions of dollars of new money DIP financing to the Debtors, on highly favorable terms.[13] This DIP financing was so favorable to the Debtors precisely because it was designed to be so safe and because the lenders received the protection of a Court order. As many Courts have noted, it is critical that DIP orders be enforced in accordance with their plain terms.[14] If the standard protections and assurances granted to DIP lenders could be revoked when they are most needed due to poor financial performance by the debtor, there would be no market for DIP financing.

7. Second, neither the law nor the facts support the equitable relief sought by the Objectors. The Objectors' narrative that the company somehow intentionally harmed them is directly contrary to the undisputed facts of these cases, and their allegations of misconduct are pure conjecture without factual support. Far from being run for the benefit of the DIP lenders, the Debtors' continued operation after their dismal holiday season performance served to shift hundreds of millions of dollars out of the DIP lenders'

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[12] *In re AMF Bowling Worldwide, Inc.*, 278 B.R. 96, 102 (Bankr. E.D. Va. 2002).

[13] For example, the financing provided by the ABL/FILO DIP Secured Parties (a) "enable[d] the company to borrow really on the least expensive basis," Hr'g Tr. 68:20-21 (Sept. 19, 2017) (Kurtz); (b) was "fully underwritten" and provided "the certainty of this financing being available as fast as possible," Hr'g Tr. 70:2-7 (Sept. 19, 2017) (Kurtz); (c) did not include cross-collateralization provisions, Hr'g Tr. 70:13-14 (Sept. 19, 2017) (Kurtz); and (d) did not include milestones, contrary to many recent DIP financings provided to retail debtors, *see, e.g.*, *In re The Gymboree Corp.*, Case No. 17-32986 (KLP) (Bankr. E.D. Va. July 11, 2017) [Docket No. 384]; *see also In re Claire's Stores, Inc.*, Case No. 18-10584 (MFW) (Bankr. D. Del. Mar. 20, 2018) [Docket No. 130] (interim); *In re BCBG Max Azria Glob. Holdings, LLC*, No. 17-10466 (SCC) (Bankr. S.D.N.Y. Mar. 28, 2017) [Docket No. 228]; *In re RadioShack Corp.*, No. 15-10197 (BLS) (Bankr. D. Del. Mar. 12, 2015) [Docket No. 947].

[14] *See, e.g.*, *In re Am. Res. Mgmt. Corp.*, 51 B.R. 713, 722 (Bankr. D. Utah 1985) ("*The Chapter 11 process would be undermined if this Court were to, in effect, undo [the DIP] orders by placing the administrative claims of the creditors' committee ahead of the superpriority which [the bank] bargained for.*" (emphasis added)); *see also In re Rite Indus.*, No. B-99-12653C-11G, 2000 WL 33673764, at *3, *5 (Bankr. M.D.N.C. Aug. 16, 2000).

collateral pool and directly into the pockets of the vendors. The Objectors nonetheless claim that the Debtors, aware of the holiday results and their financial condition, acted in bad faith by continuing to order merchandise from their vendors without informing these same vendors of the holiday results, causing the vendors to continue shipping merchandise to the Debtors through the beginning of March 2018 that remains unpaid. Certain Objectors even insert the ABL/FILO DIP Secured Parties into this story by insinuating, without any factual basis whatsoever, that they somehow colluded with the Debtors to order more inventory in the months prior to the wind-down decision in March so that the value of their collateral would increase.

8. That is not what happened. As the Debtors' Wind-down Motion[15] and the unrebutted testimony of the Debtors' advisors at the March 20 hearing made very clear, circumstances changed materially when the Debtors' sales during the critical 2017 holiday period came in well below worst-case projections. The Debtors considered, and pursued, various feasible alternatives that would permit the company to recover from the bad holiday period and reorganize as a going concern.[16] While exploring options to save the company, the Debtors continued to pay postpetition vendors on schedule for shipments of inventory. In January and February 2018, postpetition vendors received payments totaling approximately $260 million in excess of the amount of inventory deliveries during that period—which, as the unrebutted testimony from the March 20, 2018 hearing shows, improved the vendors' position and reduced the

[15] *See Motion to Authorize Debtors' Omnibus Motion for Entry of Orders: (I) Authorizing the Debtors to Wind-Down U.S. Operations, (II) Authorizing the Debtors to Conduct U.S. Store Closings, (III) Establishing Bidding Procedures for the Sale of the Debtors' Canadian Equity, (IV) Enforcing an Administrative Stay, and (V) Granting Related Relief* [Docket. No. 2050] (**"Wind-down Motion"**).

[16] *See* Hr'g Tr. 23:15-46:6.

ABL/FILO DIP Secured Parties' collateral by the same amount.[17] The Debtors' monthly operating reports similarly show significant payments to the vendors in January and February 2018.[18]

9. During the vital time after the holiday season, the ABL/FILO DIP Secured Parties and their advisors continued to actively support the Debtors' efforts to reorganize.[19] Notably, during this time the Debtors were not in default under the ABL/FILO DIP Credit Agreement,[20] meaning the ABL/FILO DIP Secured Parties could not have exerted leverage even had they wanted to. Ultimately, however, the Debtors determined that all avenues of recovery were closed and that a wind-down of their North American business was required to avoid further value destruction.[21]

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[17] *See* Hr'g Tr. 46:17-48:19; 51:15-52: 11; 68:10-12 (Mar. 20, 2018) (Kurtz). The Debtors made payments of approximately $350 million to critical vendors and foreign vendors during these chapter 11 cases. *See* Hr'g Tr. 52:6-11 (Mar. 20, 2018) (Kurtz). In fact, some of the Objectors are in a better financial position for having continued to supply Debtors postpetition. For example, Crayola notes in its objection that its prepetition claim was approximately $4.5 million, the Debtors subsequently paid Crayola for most of the merchandise ordered through the end of November 2017, and Crayola's unpaid administrative expense claim now amounts to $2,332,010.62, or approximately half its initial prepetition claim. *See* Crayola Objection, ¶¶ 2-3.

[18] Specifically, the monthly operating reports show that between December 24, 2017 and March 3, 2018, trade payables decreased overall by over 34.6%, or roughly $295 million. *See Monthly Operating Report of Debtor In Possession for the Period November 26, 2017 to December 23, 2017* [Docket No. 1658], at 21; *Monthly Operating Report of Debtor In Possession for the Period February 4, 2018 to March 3, 2018* [Docket No. 2493], at 21.

[19] *See* Hr'g Tr. 37:8-24 (March 20, 2017) (Kurtz) ("On the next day, February 27th, we had a meeting with representatives of JPMorgan, and they came to us and they said, you know, we – we've made a determination that, you know, we want to continue to support the company and give the company more time to engage in discussions with potential investors to see if those negotiations could–could come to fruition, and so we want to engage with you on the financial-covenant negotiation that had been aborted in – in January and we want to work with you to address those covenants in a way that would extend the company's runway. That was on Tuesday, February 27th.").

[20] *See* Hr'g Tr. 22:1-15 (March 20, 2017) (Kurtz) ("One other important development occurred during this time, on the positive side. The company concluded that, based upon its cash flows and based upon its working-capital experience during the month of January, it would not violate the net-cashflow covenant at the end of January, which we had originally feared going into that month. . . . [W]e were very confident by the middle of January that there would not be a breach in January.").

[21] *See* Hr'g Tr. 42:3-43:2.

10. Upon making the decision that a liquidation of the North American business was in the best interests of the estates, the Debtors had to develop an orderly, efficient, and fair process for the wind-down that also maximized value to the estates. The unrebutted testimony at the March 20 hearing was that the ABL/FILO DIP Secured Parties supported the Debtors in this effort, and that the budget reflects the Debtors' best business judgment in connection with the wind-down. *See* Hr'g Tr. 99:2-21; 130:17-22 (Mar. 20, 2018) (Kurtz).

11. Third, far from representing any concessions to the ABL/FILO DIP Secured Parties on the part of the Debtors, or a beneficial "retroactive modification" of the Final North American DIP Order,[22] the waiver and the wind-down budget in no way improve the position of the ABL/FILO DIP Secured Parties but reflect numerous concessions by the ABL/FILO DIP Secured Parties for the benefit of other creditors, including:

(a) an unprecedented agreement to subordinate the ABL/FILO DIP Superpriority Claims to over $650 million in claims for wind-down-related costs;

(b) consent to the TRU Canada Sale (as defined in the DIP Waivers) on an extended time frame as opposed to liquidation of the Debtors' Canadian business, which will principally benefit other (and junior) creditors;

(c) extra time for the U.S. wind-down to maximize value, again to benefit other (and junior) creditors;

(d) an agreement not to trigger the professional fee carve-out cap in the Final North American DIP Order, thereby allowing continued incurrence of professional fees to support the wind-down; and

(e) a new carve-out for the fees of Lazard Frères & Co. LLC ("**Lazard**"), the Debtors' investment banker, that relate exclusively to asset sales that will solely benefit creditors *other than* the ABL/FILO DIP Secured Parties.

[22] *See*, *e.g.*, LSC Objection, ¶¶ 6-7, 10.

12. Cessation of ordinary operations by the Debtors is a clear Event of Default under the ABL/FILO DIP Credit Agreement.[23] Rather than commencing an exercise of remedies, or extracting additional fees, or even risking destabilizing the Debtors by simply refusing to waive the default or granting only a short term simple forbearance, the ABL/FILO DIP Secured Parties agreed to negotiate the waiver and (with other key stakeholders) the wind-down budget to give the Debtors a foundation for an orderly wind-down that would increase recoveries for other creditors, even though such a process would delay the ABL/FILO DIP Secured Parties' recovery. Furthermore, while any TRU Canada Sale (the only hope for administrative solvency in these cases)[24] would also violate the ABL/FILO DIP Credit Agreement,[25] and delay repayment of the ABL/FILO DIP claims, the ABL/FILO DIP Secured Parties have agreed to permit a going-concern sale of TRU Canada on an extended timeline to maximize recovery for other, and junior, creditors. As noted above, the ABL/FILO DIP Secured Parties have agreed to provide the waiver without requiring new releases, and as such nothing in the waiver shields the ABL/FILO DIP Secured Parties from litigation. The ABL/FILO DIP Secured Parties are comfortable that no valid claims against them exist, but all parties are free to try to pursue

[23] *See, e.g.*, ABL/FILO DIP Credit Agreement §§ 7.01(d) (violation of the asset sale covenant is an event of default); (j) (a determination to suspend ordinary-course operations, liquidate all or substantially all assets or store locations, or employment of an agent to conduct store closing, store liquidations, or "Going-Out-Of-Business Sales," is an event of default); (bb) (any sale of assets valued at over $5,000,000 without the prior written consent of the Administrative Agent is an event of default); *see also* Term DIP Credit Agreement § 8.01(b), (v) (similar provisions); Final North American DIP Order, ¶ 13(c) (allowing for the exercise of remedies after the "Remedies Notice Period," which is five business days (subject to a two business day extension solely to account for Court availability)).

[24] *See* Hr'g Tr. 132:1-14 (Mar. 20, 2018) (Kosturos) (noting that while it is highly likely the debtors are administratively insolvent, the sale of the Canadian stores as a going concern could "change[] the dynamics of the analysis, and . . . change[] the dynamics of the asset value.")

[25] *See* ABL/FILO DIP Credit Agreement, § 7.01(d) (violation of the asset sale covenant is an event of default); *see also* Term DIP Credit Agreement § 8.01(b) (similar provision).

any claims should they want to do so.

13. Fourth, the ABL/FILO DIP Secured parties have full discretion to carve out value from their collateral to fund certain administrative expenses and not others. The ABL/FILO DIP Secured Parties have agreed to a carve-out for post-March 15 wind-down expenses that will total over $650 million and come directly from the ABL/FILO DIP Secured Parties' collateral. To the ABL/FILO DIP Agent's knowledge, this concession to junior creditors in a wind-down budget is unprecedented. The ABL/FILO DIP Secured Parties also agreed to a new carve-out for Lazard's fees relating exclusively to transactions not benefitting the ABL/FILO DIP Secured Parties. The Objectors argue that these unprecedented carve-outs are somehow not enough and that they are entitled to more. Quite simply, they are not. The ABL/FILO DIP Secured Parties are not obligated to subordinate their claims to *any* wind-down costs, and the law is clear that carve-outs shifting value from secured lenders to unsecured creditors are purely discretionary.

14. Because there is no basis for the relief sought by the Objectors, the Court should grant the Motion and approve the waivers so that the wind-down can proceed in an orderly, value-maximizing and, indeed, equitable way, free from any cloud of uncertainty. Yes, absent a substantial improvement in the results of the wind-down, many unsecured creditors, including many Objectors, may face losses on their claims. This is an unfortunate result, but it is not inequitable and the seniority of the ABL/FILO DIP claims is not a surprise to anyone. To the contrary, the risks that vendors took with eyes wide open by extending credit to the Debtors on an unsecured and junior basis have simply and unfortunately been brought to life by poor performance by the Debtors. There is no more complicated story.

ARGUMENT

I. This Court's Final North American DIP Order Is Final, Not Subject to Revocation, and Binding

15. The Final North American DIP Order, dated October 24, 2017, which was fully supported by all parties in interest, is final and irrevocable.[26] The vast majority of the Objectors did not object to the motion seeking entry of the Final North American DIP Order, and the two Objectors that did object withdrew their objections.[27] All parties then received notice of the entry of the order.[28] None of the Objectors appealed the Final North American DIP Order and the time for an appeal has long passed. The few Objectors to explicitly ask in their Objections, five months after the entry of the Final North American DIP Order, for provisions of the order to be discarded, have done so cavalierly and without citing to any legal authority, and have not even bothered to assert any theory on which the finality of the order might be disputed.[29] Other Objectors have not explicitly attacked the order, but the relief they seek would require a violation of the

[26] Under the terms of the Final North American DIP Order, "it shall constitute an Event of Default and terminate the right of the Debtors to use Cash Collateral if *any of the DIP Loan Parties*, without the prior written consent of the DIP Agents . . . seeks, proposes, supports, or consents to or if there is entered or confirmed . . . (i) any modifications, amendments or extensions of [the Final North American DIP Order], and no such consent shall be implied by any other action, inaction or acquiescence by any party . . . ." Final North American DIP Order, ¶ 22(d) (emphasis added).

[27] *See supra*, nn. 5, 6.

[28] The Objectors received notice in person or through their counsel. *See* Affidavit of Service [Docket No. 833]; *see also* Affidavits of Service [Docket Nos. 50 and 228]. It appears as though neither The William Carter Company nor Funko received notice of the final DIP order, but these vendors received notice of the North American DIP motion and interim North American DIP order.

[29] *See* Dorel/Kids II/Kent Objection, ¶¶ 4-11 (requesting "removal" of the Debtors' waivers of sections 506(c) and 552 from the Final North American DIP Order); LSC Objection, ¶ 10 (requesting not to "extend" section 506(c) waiver); *see also* joinders in the Dorel/Kids II/Kent Objection by SquareTrade, Inc. [Docket No. 2453], Munchkin, Inc. [Docket No. 2475], Artsana (USA) Inc. [Docket No. 2487], Learning Resources, Inc. [Docket No. 2490], Pearhead, Inc. [Docket No. 2495] and New Adventures LLC Ltd. [Docket No. 2534], Baby Products, LLC [Docket No. 2538] and Epoch Everlasting Play LLC f/k/a International Playthings LLC, Goliath Games, LLC, Pressman Toy Corp., Jax, Ltd., Goliath Far East / Pressman Toy, Melissa & Doug, LLC, and USAopoly, Inc. [Docket No. 2572].

order.[30]

16. Case law, including in this District, is explicit that:

> "[w]here a party has adequate notice of a motion [seeking approval of a DIP financing order], fails to appeal the entry of an order granting the motion, and fails to avail itself of the process to object to its treatment under the motion and order, a new due process right does not arise and all parties are bound by the order."[31]

Therefore, the Final North American DIP Order, and the protections granted therein to the ABL/FILO DIP Secured Parties, are final and binding on all parties (including the Objectors).

17. The relief sought by the Objectors amounts to an end run around Federal Rule of Civil Procedure 60(b), which is the only mechanism by which the Objectors may, at this late stage, attempt to change the terms of the Final North American DIP Order.[32] In the Fourth Circuit, Rule 60(b) relief is "an extraordinary remedy" that "is to be applied sparingly,"[33] and only if the movant demonstrates, as a threshold matter, that its motion is

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[30] *See, e.g.*, Crayola Objection, ¶¶ 10, 17 (requesting § 506(c) surcharge and clawback right in violation of Final North American DIP Order) and joinders thereto; *see also* KidCo Objection, at 6 (requesting that the order approving the waivers not prevent "the investigation of the conduct of the Debtors and their post-petition secured lenders [and] the commencement of any litigation in conjunction [therewith]." To the extent any such investigation or litigation would be funded with estate assets, it would be a clear violation of the Final North American DIP Order); LSC Objection, at 7 (requesting, among others, no turnover of funds to the ABL/FILO DIP Secured Parties in violation of the Final North American DIP Order); Dorel/Kids II/Kent Objection and joinders thereto.

[31] *In re AMF Bowling Worldwide, Inc.*, 278 B.R. at 102 (concluding that landlord "is precluded from litigating the validity of the lien priming accomplished by the DIP Order because it allowed that order to become final without an objection to its finality"); *see also In re Varat Enters., Inc.*, 81 F.3d 1310, 1317-19 (4th Cir. 1996) (secured creditor's "failure to raise any objections to . . . claim prior to confirmation of [chapter 11] plan operates as a waiver and equitably estops the lender from subsequently contesting the claim").

[32] *See Spartan Mills v. Bank of Am. Ill.*, 112 F.3d 1251, 1256 (4th Cir. 1997) (recognizing that proper procedure in bankruptcy to challenge a "final order that deprives [a creditor] of a lien position" is Rule 60(b), not a collateral challenge in another forum); *see also* Fed. R. Bankr. P. 9024 (incorporating Fed. R. Civ. P 60).

[33] *In re Babcock*, 258 B.R. 646, 649 (Bankr. E.D. Va. 2001) (internal quotation marks omitted); (….continued)

timely, that it has a meritorious argument, that the opposing party would not be unfairly prejudiced by having the judgment set aside, and that "exceptional circumstances" warrant the requested relief.[34] Here, the Objectors have not even attempted to meet these threshold requirements, much less establish one of the six enumerated grounds for relief listed in the Rule (e.g., "fraud" or "newly discovered evidence"). In short, the Objectors have identified no basis in law to disturb the Final North American DIP Order.

18. The irrevocable protections granted to the ABL/FILO DIP Secured Parties in the Final North American DIP Order include, without limitation:

(a) Protections against the superpriority liens and claims of the DIP Secured Parties being modified or taken away, precisely so the DIP Secured Parties are protected in scenarios such as the Debtors' wind-down. Specifically, the Final North American DIP Order confirms the full protections of section 364(e), and that the modification of provisions of the Final North American DIP Order, or the entry of another cash collateral order, shall not affect the validity of the DIP Obligations and the DIP Liens. *See* Final North American DIP Order, ¶¶ 5(f), 13(e), 22(e). The liens, claims and rights under the Final North American DIP Order also shall not be affected by, *inter alia*, conversion to a chapter 7. *Id.*, ¶ 22(f);

(b) The Debtors irrevocably waived their right to surcharge collateral (including the collateral of the ABL/FILO DIP Secured Parties) under section 506(c) of the Bankruptcy Code. *Id.*, ¶ 14;

(c) Neither the doctrine of marshaling nor any similar doctrine shall apply to the ABL/FILO DIP Secured Parties without any qualifications. *Id.*, ¶ 13(d); and

(d) Cash collateral or proceeds of the DIP Facilities cannot be used to attack DIP Claims or interfere with enforcement thereof. *Id.*, ¶ 9(f), 24.

These are standard protections for secured postpetition lenders in chapter 11 cases

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(continued….)
see also Coomer v. Coomer, 217 F.3d 838 (4th Cir. 2000) (describing Rule 60(b) relief as "'extraordinary' and to be used only in 'exceptional circumstances,'" and describing four-part threshold test as "onerous").

[34] *In re AMF Bowling Worldwide, Inc.*, No. 12-36495-KRH, 2013 WL 5575470, at *3 (Bankr. E.D. Va. Oct. 9, 2013).

precisely to ensure the safety of the DIP loans and therefore incentivize lending to bankrupt companies.

19. To revoke these protections now would be a flagrant violation of the rights of the ABL/FILO DIP Secured Parties, who extended credit and assumed risk in reliance on them.[35] Failure to honor these protections during the wind-down of the Debtors' U.S. operations would violate the very premise on which the provision of DIP financing is based, undoubtedly have consequences far beyond these cases, and chill (if not completely freeze) future lending to bankrupt borrowers.[36]

20. The Court, therefore, should dismiss the request of certain Objectors to rewrite the terms of the Final North American DIP Order, including to "remove" the section 506(c) and section 552(b) waivers. *See* Dorel/Kids II/Kent Objection, ¶¶ 4-11. Like the rest of the order, the waivers contained in the Final North American DIP Order are permanent, final, and cannot be excised from the order because certain vendors now find them inconvenient. The Objectors have cited absolutely no authority permitting such relief. And, while under no obligation whatsoever to do so,[37] the ABL/FILO DIP

[35] *See In re Fleetwood Enters., Inc.*, 427 B.R. 852, 859 (Bankr. C.D. Cal. 2010) ("It is well-settled that the overall policy behind § 364 is to encourage lenders to provide financing to debtors by offering them incentives for their risk taking."), *aff'd*, 471 B.R. 319 (B.A.P. 9th Cir. 2012); *In re Fla. W. Gateway, Inc.*, 147 B.R. 817, 820 (Bankr. S.D. Fla. 1992) ("A lender makes advances in reliance upon such orders authorized by § 364.").

[36] *See, e.g.*, *In re Am. Res. Mgmt. Corp.*, 51 B.R. at 722 ("The Court's orders approving the post-petition financing stipulations conferred a priority to [bank] ahead of all administrative claims. The bank advanced funds to the trustee in reliance upon those orders. *The Chapter 11 process would be undermined if this Court were to, in effect, undo those orders by placing the administrative claims of the creditors' committee ahead of the superpriority which [bank] bargained for*." (emphasis added)); *see also In re Rite Indus.*, 2000 WL 33673764, at *3, *5 (citing *American Resources Management Corp.* favorably, and denying unsecured creditor committee's request to pay administrative claims with money allocated in post-petition financing agreement for legal fees where "[t]he post-petition financing agreement was negotiated and bargained for[,] . . . a hearing was held where arguments of counsel were heard[, and] . . . the court enter[ed] a final order approving the financing agreement").

[37] *See In re K & L Lakeland, Inc.*, 128 F.3d 203, 210-11 & n.6 (4th Cir. 1997) (indicating, in (….continued)

Secured Parties—in order to assure the most successful wind-down possible under the circumstances, to the benefit of creditors junior to them—have *already agreed* to what is in essence a giant § 506(c) surcharge in excess of $650 million: the carve-out for wind-down-related expenses in the wind-down budget. As set forth in more detail below, this enormous and unprecedented carve-out is purely discretionary, and the ABL/FILO DIP Secured Parties are not required to agree to an even larger or unlimited wind-down carve-out.[38] Finally, the "equities of the case" rule cited by the Objectors is completely irrelevant to the ABL/FILO DIP Secured Parties' *postpetition* claims, as it arises under section 552 of the Bankruptcy Code, a provision speaking only to a court's ability to cut off *prepetition* liens in after-acquired collateral.[39]

II. The ABL/FILO DIP Secured Parties Have a First Priority Security Interest in Inventory and the Proceeds Thereof, and Administrative Expenses Can Only Be Given Priority With the Consent of the ABL/FILO DIP Secured Parties

A. The ABL/FILO DIP Secured Parties Have a First Priority Security Interest in the Debtors' Inventory and the Proceeds Thereof, and the Unsecured Trade Vendors Cannot Assert a Senior Claim

21. Pursuant to the Final North American DIP Order, the ABL/FILO DIP Secured Parties have "a valid, binding, continuing, enforceable, fully perfected first priority priming security interest [subject only to the carve-out and pre-existing security

(continued….)

surcharge dispute, that secured creditor may consent to charges against its collateral but that "consent is not to be lightly inferred," and holding that surcharge was not warranted under section 506(c) where secured creditor did not consent, and absent evidence that charges were incurred primarily to protect or preserve collateral or provided a direct and quantifiable benefit to secured creditor) (internal quotation marks omitted).

[38] *See infra*, Section II.B.

[39] *See* 11 U.S.C § 552(a) ("[P]roperty acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case."); 11 U.S.C. § 552(b) (providing an exception to section 552(a), "except to any extent that the court . . . based on the equities of the case[] orders otherwise.").

interests that the ABL/FILO DIP Secured Parties have consented to in the ABL/FILO DIP Credit Agreement] in and lien upon all pre- and postpetition property [including inventory] of the ABL/FILO DIP Loan Parties other than the Canadian ABL/FILO Borrower." Final North American DIP Order, ¶ 11(a)(ii). All vendors are unsecured creditors. Under the most basic tenets of bankruptcy law, the interests of the ABL/FILO DIP Secured Parties in the inventory and its proceeds are senior to those of the vendors.[40]

22. The law, including in this District, is unequivocal that unsecured creditors' interests in inventory, even when the debtor has not paid for that inventory, *do not* trump the security interests of secured creditors in that same inventory.[41] The Objectors do not attempt to argue otherwise; their argument is (wrongly) based solely on invented equitable principles finding no basis in the law. There is nothing improper or unfair about the ABL/FILO DIP Secured Parties (and not unsecured trade creditors) receiving the proceeds of the liquidation of the ABL/FILO DIP collateral (and the ABL/FILO DIP Secured Parties' impeccable conduct does not warrant an unprecedented remedy in any event). That is simply how secured debt works. And that is why secured debt is cheaper for a borrower to obtain than unsecured debt.

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[40] In addition to their security interest, the ABL/FILO DIP Secured Parties also have a first priority administrative expense claim. The DIP Superpriority Claims granted by the Final North American DIP Order have priority "over any and all claims against such DIP Loan Parties, now existing or hereafter arising, of any kind whatsoever, including, without limitation, all administrative expenses of the kind specified in sections 503(b) and 507(b) of the Bankruptcy Code and any and all administrative expenses or other claims arising under sections 105, 326, 328, 330, 331, 365, 503(b), 506(c), 507(a), 507(b), 726, 1113 or 1114 of the Bankruptcy Code . . . ." Final North American DIP Order, ¶ 10. The DIP Superpriority Claims also are "payable from and have recourse to all pre- and postpetition property of the DIP Loan Parties" with certain limited exceptions that do not include inventory. *Id.*

[41] *See, e.g.*, *In re Circuit City Stores, Inc.*, 441 B.R. at 507 (holding that reclamation claims were defeated by prior lien in inventory because those claims "were inferior to the interests of . . . the Pre-petition Lenders and the DIP Lenders."); *accord In re hhgregg, Inc.*, 578 B.R.at 820 (holding that where DIP Lender had lien on postpetition inventory, a later-in-time "reclamation claim, *even if valid*, *is subordinate to [Lenders'] prior security interests in the [inventory].*" (emphasis added)).

23. For all of the aforementioned reasons, the ABL/FILO DIP Secured Parties have a superior claim to the Debtors' inventory and the proceeds thereof, and any claims to the contrary by unsecured trade vendors are without merit.

B. The ABL/FILO DIP Secured Parties Have Full Discretion to Fund Certain Administrative Expenses But Not Others

24. A fundamental principle of bankruptcy law is that administrative expenses must be satisfied from unencumbered assets of a debtor's estate that are not subject to liens or other security interests.[42] Where unencumbered assets are not available to pay the administrative expense claims, administrative claimants are not entitled to look to encumbered property of a debtor as a source of payment.[43] And, if a debtor does have unencumbered assets, superpriority administrative expense claims (such as the ABL/FILO DIP Secured Parties' superpriority claims) are to be satisfied before non-superpriority claims (such as the vendors' claims for unpaid inventory). Moreover, unsecured claimants have no right to immediate payment of administrative claims if, as is the case here, administrative solvency is in doubt.[44]

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[42] *See, e.g.*, *In re JKJ Chevrolet, Inc.*, 26 F.3d 481, 483 (4th Cir. 1994) ("Generally, administrative expenses are paid from the unencumbered assets of a bankruptcy estate rather than from secured collateral." (footnote omitted)).

[43] *See, e.g.*, *In re Molycorp, Inc.*, 562 B.R. 67, 76 (Bankr. D. Del. 2017) ("[O]nly surplus proceeds are available for distribution to other creditors of the estate and administrative claimants. Therefore, absent equity in the collateral, administrative claimants cannot look to encumbered property to provide a source of payment for their claims."); *In re Flagstaff Foodservice Corp.*, 739 F.2d 73, 77 (2d Cir. 1984) ("[I]t does not follow that in the event the estate has no unencumbered funds from which to pay such expenses, the secured creditor becomes obligated to satisfy these obligations." (internal quotation marks omitted)).

[44] *See, e.g.*, *In re Circuit City Stores, Inc.*, 447 B.R. 475, 511 (Bankr. E.D. Va. 2009) ("Under the facts . . . presented here, including the . . . dire financial circumstances . . . , the Court has discretion . . . to decline to order immediate payment of [an administrative claim]. If the Court were to order otherwise, it would be elevating the Lessors' administrative claim to superpriority status. Such status is neither required nor permitted under the Bankruptcy Code."); *In re Virginia Packaging Supply Co., Inc.*, 122 B.R. 491, 494-95 (Bankr. E.D. Va. 1990) (denying immediate payment of lessor's administrative claim and holding that "[i]n order to seek payment, there must be a showing either that all § 503(b) claims will be paid in full, or that [the lessor's] claim will be paid out on an equal basis as all other § 503(b) claims.").

25. However, while administrative claimants are not entitled to look to encumbered property to satisfy their claims, secured lenders have full discretion to *consent* to the use of their collateral to fund certain administrative expenses but not others.[45] Bankruptcy courts in this District and elsewhere have routinely approved such carve-outs in DIP financing facilities.[46]

26. Here, the ABL/FILO DIP Secured Parties have exercised their discretion to consent to substantial new carve-outs for administrative expenses related to the wind-down. These new carve-outs to which the ABL/FILO DIP Secured Parties have agreed consist of:

(a) In addition to consenting to continued accrual of the existing professional fee carve-out already provided in paragraph 9 of the Final North American DIP Order, a $650 million plus new carve-out for post-March 15 expenses related to goods and services provided to facilitate the wind-down; and

(b) A new carve-out for the fees of Lazard, the Debtors' investment banker, that relate exclusively to asset sales that will solely benefit creditors *other than* the ABL/FILO DIP Secured Parties.

27. The wind-down budget shifts enormous value from the ABL/FILO DIP

[45] *See In re Molycorp, Inc.*, 562 B.R. at 76 (noting with respect to a carve-out, which is "essentially an agreement by the secured creditor to subordinate its liens and claims to certain allowed administrative expenses," that "a secured creditor may, without doing violence to the letter or spirit of the Bankruptcy Code, selectively waive its liens and super-priority claims to permit payment of certain administrative expenses but not others," and emphasizing that "when there are insufficient unencumbered assets to pay [such administrative expenses] and no plan has been confirmed, [the administrative claimant's] only recourse is the carve-out. In such cases the secured creditor's consent to the payment of designated expenses limited in amount will not be read as a blanket consent to being charged with additional administrative expenses not included in the consent agreement." (internal quotation marks omitted)); *see also In re Blackwood Assocs., L.P.*, 153 F.3d 61, 67 (2d Cir. 1998) ("[I]t is undisputed that so-called 'counsel fee carve-outs' are a normal and enforceable provision in cash collateral stipulations.").

[46] This Court approved carve-outs in DIP financing facilities in the following cases, among others: *The Gymboree Corp.*, No. 17-32986 (Bankr. E.D. Va. July 11, 2017) [Docket No. 384]; *In re Penn Va. Corp.*, No. 16-32395 (Bankr. E.D. Va. June 8, 2016), [Docket No. 219]; *In re Alpha Nat. Res., Inc.*, No. 15-33896 (Bankr. E.D.Va. Sept. 17, 2015) [Docket No. 465]; *In re Patriot Coal Corp.*, No. 15-32450 (Bankr. E.D. Va. June 4, 2015) [Docket No. 230]; *In re James River Coal Co.*, No. 14-31848 (Bankr. E.D.Va. May 9, 2014) [Docket No. 241]; *In re AMF Bowling Worldwide, Inc.*, No. 12-36495 (Bankr. E.D. Va. Dec. 18, 2012) [Docket No. 263]; *In re Circuit City Stores, Inc.*, No. 08-35653 (Bankr. E.D. Va. Dec. 23, 2008) [Docket No. 1262].

Secured Parties not only to providers of wind-down goods and services and other parties essential to a successful wind-down, but also to junior claimants (including the Objectors) because those junior claimants will benefit from a value-maximizing wind-down. Specifically, instead of simply seizing their collateral, as they are entitled to under the Final North American DIP Order and the ABL/FILO DIP Credit Agreement, or extracting additional fees, or forcing an abrupt liquidation through a simple short term forbearance, the ABL/FILO DIP Secured Parties have agreed to, among other things, (a) an orderly wind-down of the Debtors' U.S. operations funded by a carve-out of more than $650 million for wind-down expenses that will be paid from their collateral, (b) consent to the TRU Canada Sale as opposed to liquidation, (c) extra time for the U.S. wind-down and (d) continued payment of professional fees to support an orderly wind-down and the payment of new Lazard fees, notwithstanding the ABL/FILO DIP Secured Parties' right to trigger the professional fee carve-out cap in the Final North American DIP Order. To the ABL/FILO DIP Agent's knowledge, these concessions to junior creditors in a wind-down are unprecedented.

28. For these reasons, the Objectors are in no position to request that the ABL/FILO DIP Secured Parties now agree to further expanded, or even open-ended, carve-outs for the payment of additional wind-down administrative expenses in violation of the Final North American DIP Order and the Bankruptcy Code's priority rules.

III. There Is No Basis to Hold Inventory Proceeds Back from the ABL/FILO DIP Secured Parties or Make Distributions Subject to a Clawback Provision

29. Although the relief many Objectors seek is vague, at bottom several Objectors want the ABL/FILO DIP Secured Parties not to be paid as they are entitled to be paid pursuant to the terms of the Final North American DIP Order and the Bankruptcy Code. To say it again: this entitlement does not come from the waiver and it is not an entitlement the lenders are now seeking; it comes from the ABL/FILO DIP Secured Parties' existing rights under the Final North American DIP Order. Crayola, for instance, asserts that "it is highly inappropriate to allow" the proceeds of the collateral generated through the liquidation and other dispositions of assets "to be immediately distributed to the DIP Secured Parties." Crayola Objection, ¶ 17. Perhaps recognizing the absurdity of its attempts to depict the payment of secured debt with the proceeds of collateral liquidations as "highly inappropriate," Crayola adds that "[i]f, however, the Court is inclined to allow distributions of certain proceeds to the DIP Secured Parties any such distributions should be made subject to an ironclad clawback condition." *Id.* The Court should not entertain either request.

30. A holdback of any proceeds of collateral from the ABL/FILO DIP Secured Parties, or making distributions subject to a clawback provision, would violate the Final North American DIP Order. As explained above, the ABL/FILO DIP Secured Parties have senior liens and superpriority claims granted by the Final North American DIP Order. These liens and claims are not subject to challenge or dispute or potential infirmity: they were granted by a final and non-appealable order of this Court and cannot be changed. Pursuant to that order, and the most basic tenets of bankruptcy law, the ABL/FILO DIP Secured Parties are entitled to the proceeds of their collateral upon its

liquidation. The Objectors do not seek to engage with the terms of the Final North American DIP Order—and have not raised any theory as to how they might escape the order—but rather are trying to prevent the ABL/FILO DIP Secured Parties from realizing the value of their collateral based on vague and unsupported allegations. There is, as explained above, nothing in the record indicating any wrongdoing whatsoever by the ABL/FILO DIP Secured Parties, and no basis under the law to ignore the Final North American DIP Order.

31. In any case, a holdback or clawback would ultimately be *against* the unsecured creditors' own interest because of the seniority of the ABL/FILO DIP claims and the Debtors' indemnification obligations to the ABL/FILO DIP Secured Parties.[47] As discussed extensively above, the ABL/FILO DIP claims need to be paid in full in cash before any value can flow to unsecured administrative claimants. There is nothing that can change this fact. Additionally, the Debtors have indemnified the ABL/FILO DIP Secured Parties for any and all damages or losses resulting from any and all claims (including any clawback claims) related to these cases.[48] Such indemnification obligations survive the termination of the ABL/FILO DIP Credit Agreement and the repayment of the ABL/FILO DIP Obligations.[49] As such, any clawback or other litigation would simply result in further estate value being drained in the form of additional interest expense and professional fees, all of which would need to be paid in

[47] And assuming, *arguendo*, that any proceeds of inventory could be clawed back, such proceeds would remain subject to the first priority security interest and superpriority claims of the ABL/FILO DIP Secured Parties.

[48] *See* ABL/FILO DIP Credit Agreement, § 9.03. The Term DIP Credit Agreement contains a similar indemnification provision. *See* Term DIP Credit Agreement, § 10.04(b).

[49] *See* ABL/FILO DIP Credit Agreement, § 9.03(d).

full in cash before any value can flow to junior claimants.

IV. Crayola and Others Misunderstand the Waiver and Their Objections Should be Denied

A. The Section 506(c) Waiver in the Final North American DIP Order Is Permanent and a New Waiver Is Neither Required Nor Sought

32. The Court should dismiss Crayola's and LSC's allegations that the ABL/FILO DIP Secured Parties are inappropriately seeking to "extend" the benefit of the section 506(c) waiver granted in the Final North American DIP Order. *See* Crayola Objection, ¶ 10; LSC Objection, ¶ 10. The ABL/FILO DIP Secured Parties are doing no such thing. The Final North American DIP Order already includes a permanent section 506(c) waiver. *See* Final North American DIP Order, ¶ 14. Therefore, a new section 506(c) waiver is not required, and neither the Debtors nor the ABL/FILO DIP Secured Parties are seeking a new waiver. To the extent Crayola or others ask this Court to modify the section 506(c) waiver that was previously granted in the Final North American DIP Order, there is no legal basis on which that waiver could be modified for the reasons set forth in Section I above.

B. The ABL/FILO DIP Secured Parties Are Protected under Section 364(e) Pursuant to the Final North American DIP Order and Seek No New Protections

33. Crayola is also incorrect that the ABL/FILO DIP Secured Parties are seeking the benefit of any new section 364(e) protections with respect to the ABL/FILO DIP Waiver. *See* Crayola Objection, ¶ 8. Pursuant to that waiver, the Debtors are seeking neither an "authorization under [section 364] to obtain credit or incur debt" nor "an authorization . . . of a grant [under section 364] of a priority or a lien." 11 U.S.C. § 364(e). Indeed, in the waiver, the ABL/FILO DIP Secured Parties are neither extending credit nor receiving additional liens or claims. Hence, section 364(e) of the Bankruptcy

Code does not apply in connection with the Debtors' and the ABL/FILO DIP Secured Parties' entry into the ABL/FILO DIP Waiver.[50]

34. The ABL/FILO DIP Secured Parties are already protected under section 364(e) of the Bankruptcy Code. The Final North American DIP Order reflects the Court's previous assessment of the ABL/FILO DIP Secured Parties' good faith,[51] and the order provides that the "DIP Agents, the DIP Lenders and the Adequate Protection Parties shall be entitled to all the rights, remedies, privileges and benefits granted in section 364(e) of the Bankruptcy Code . . . ."[52]

V. Although Releases Are Appropriate under the Circumstances, the ABL/FILO DIP Secured Parties Have Agreed to Remove the Releases from the Waiver

35. Several Objectors argue that the releases by the Debtors in the ABL/FILO DIP Waiver (the "**Releases**") for the benefit of the DIP Secured Parties, their representatives and assignees should be removed. *See, e.g.*, Crayola Objection, ¶¶ 13-16.

36. The Releases are wholly appropriate and customary under the circumstances. First, none of the Objectors has put forth any evidence whatsoever of any inappropriate conduct of the ABL/FILO DIP Secured Parties in connection with the negotiation of the ABL/FILO DIP Waiver or the wind-down budget, or otherwise. Indeed, the unrebutted testimony shows that the ABL/FILO DIP Secured Parties have been extremely constructive and supportive of the Debtors' efforts to maximize value.

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[50] Accordingly, the ABL/FILO DIP Secured Parties have agreed to remove the section 364(e) finding from the proposed order granting the Motion, and a revised proposed order will be presented to the Court.

[51] *See* Final North American DIP Order, ¶ 5(f).

[52] *Id.*, ¶ 22(e).

Second, as set forth above, upon the filing of the Wind-down Motion (which constituted an event of default under the ABL/FILO DIP Credit Agreement), the ABL/FILO DIP Secured Parties did not exploit their leverage to extract fees or seize their collateral as they were entitled to. Instead, they chose to make substantial contributions to a value-maximizing wind-down of the Debtors' U.S. operations, not only by allowing an orderly wind-down to occur, but also by financing that wind-down through a more than $650 million carve-out in the wind-down budget for the benefit of all parties in interest, including the unsecured administrative claimants. Previously, in January and February, the ABL/FILO DIP Secured Parties had accommodated the Debtors' request to negotiate an amendment to the financial covenants of the ABL/FILO DIP Credit Agreement.[53] These negotiations were ended by events the ABL/FILO DIP Secured Parties had zero control over. Under these circumstances, granting Releases would be a valid exercise of the Debtors' business judgment, as is further demonstrated by the fact that similar releases have been granted by other borrowers in similar circumstances.[54]

37. Although releases are wholly justified in this context, the ABL/FILO DIP Secured Parties have agreed to remove them given the unimpeachable conduct of the ABL/FILO DIP Secured Parties in these cases to avoid needless distraction. This concession should not be interpreted as a waiver of indemnity[55] or any other existing

[53] *See* Hr'g Tr. 19:25-21:25; 37:8-24 (Mar. 20, 2018) (Kurtz).

[54] *See Babcock & Wilcox Enters., Inc.*, Amendment No. 5 to Credit Agreement, at 17, available at https://www.sec.gov/Archives/edgar/data/1630805/000163080518000019/ exhibit103-fifthrevolveram.htm; *Jack Cooper Holdings Corp.*, Amended and Restated Amendment No. 3 to Credit Agreement and Amendment No. 2 to Security Agreement, at 7-8, available at https://www.sec.gov/Archives/edgar/data/1655780/000155837017004822/ex-10d3.htm; *Vanguard Natural Gas, LLC*, Limited Waiver and Eleventh Amendment to Third Amended and Restated Credit Agreement, § 6, available at https://www.sec.gov/Archives/edgar/data/1384072/000138407216000198/ex101limitedwaiverandeleve.htm.

[55] As discussed above, the ABL/FILO DIP Secured Parties are fully indemnified by the Debtors (….continued)

rights under the ABL/FILO DIP Credit Agreement or the Final North American DIP Order, and the ABL/FILO DIP Agent, on behalf of itself and the other ABL/FILO DIP Secured Parties, expressly reserves all such rights, as well as the right to seek releases in the future to avoid the needless depletion of estate resources in defending frivolous litigation[56] and to provide certainty for the ABL/FILO DIP Secured Parties that they will not be sued after providing substantial value to these estates.

VI. The ABL/FILO DIP Agent Reserves the Right to Supplement this Reply to Address any UCC Objections

38. As of the filing of this reply, the unsecured creditors' committee (the "**UCC**") has raised a plethora of issues relating to the waivers and the wind-down budget. The ABL/FILO DIP Agent and lenders have been working around the clock to attempt to reach a consensual resolution of these numerous and complex issues, and have agreed to numerous extensions of the UCC's objection deadline, which is the reason for the delay in filing this reply with the Court. While the ABL/FILO DIP Agent has filed this reply to provide the Court and the Objectors sufficient time to review, the agent reserves the right, if a resolution with the UCC is not reached, to later supplement this reply to address any arguments raised by the UCC.

RESERVATION OF RIGHTS

39. The ABL/FILO DIP Agent, on behalf of itself and the other ABL/FILO DIP Secured Parties, hereby expressly reserves all of its rights under the ABL/FILO DIP

(continued….)
for any and all damages or losses resulting from any claims related to these cases. *See supra*, Section III.

[56] Contrary to the allegations in the LSC Objection, there is no liability "shield." LSC Objection, ¶ 8. The ABL/FILO DIP Secured Parties have never asked for any relief that would bar any vendor from suing any party involved in these cases.

Credit Agreement, including without limitation indemnity rights and the right to assert a claim for a reserve for indemnification in connection with any actual or prospective claims, litigation, investigation or proceeding by any party against any ABL/FILO DIP Secured Parties. The fact that a litigation reserve is not included in the wind-down budget at this time should not be construed as a waiver of any such rights.

CONCLUSION

40. For these reasons, the ABL/FILO DIP Agent respectfully requests that the Court enter the order granting the Motion on a final basis, overrule all Objections and grant such other relief that is just and proper.

Dated: Richmond, Virginia
April 9, 2018

/s/ *Justin F Paget*

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