

IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF DELAWARE

In re:

SPORTS AUTHORITY HOLDINGS, INC., *et al.*,<sup>1</sup>

Debtors.

Chapter 11

Case No. 16-10527 (MFW)

(Jointly Administered)

Hearing Date: April 14, 2016 at 9:30 a.m. (ET)

Objections Due: April 12, 2016 at 4:00 p.m. (ET)

RE: D.I. 959

**TERM LOAN AGENT’S OBJECTION TO DEBTORS’  
MOTION FOR AN ORDER, PURSUANT TO SECTION 105(a) OF  
THE BANKRUPTCY CODE AND BANKRUPTCY RULE 9019,  
APPROVING THE SETTLEMENT AGREEMENT BETWEEN THE  
DEBTORS AND CERTAIN CONSIGNMENT VENDORS PARTY THERETO**

Wilmington Savings Fund Society, FSB, as successor administrative and collateral agent (together, the “Term Loan Agent”) under that certain Amended and Restated Credit Agreement, dated as of November 16, 2010 (the “Term Loan Credit Agreement”), by and among The Sports Authority, Inc., as the Borrower, Slap Shot Holdings Corp., as Holdings, Wilmington Savings Fund Society, FSB, as successor Administrative Agent and Collateral Agent to Bank of America, N.A, and the lenders from time to time party thereto (the “Term Loan Lenders”), hereby files this objection (the “Objection”) to the *Debtors’ Motion for an Order, Pursuant to Section 105(a) of the Bankruptcy Code and Bankruptcy Rule 9019, Approving the Settlement Agreement Between the Debtors and Certain Consignment Vendors Party Thereto*, dated April 1, 2016 [Docket No. 959] (the “Rule 9019 Motion”). In support of this Objection, the Term Loan Agent respectfully states as follows:

<sup>1</sup> The Debtors and the last four digits of their respective taxpayer identification numbers are as follows: Sports Authority Holdings, Inc. (9008); Slap Shot Holdings, Corp. (8209); The Sports Authority, Inc. (2802); TSA Stores, Inc. (1120); TSA Gift Card, Inc. (1918); TSA Ponce, Inc. (4817); and TSA Caribe, Inc. (5664). The Debtors’ headquarters are located at 1050 West Hampden Avenue, Englewood, Colorado 80110.



161052716041200000000034

**PRELIMINARY STATEMENT**

1. The Term Loan Agent objects to the proposed settlement on, *inter alia*, the ground that pursuant to its terms the Debtors would continue to use the Term Loan Agent's collateral without demonstrating that the Term Loan Agent's collateral interests are adequately protected. In fact, under the guise of settling "disputes" with consignment vendors, the Debtors propose to effectively eliminate rights of secured lenders to material amounts of a collateral interest Redacted Using Redact-It

2. In support of these proposed vendor "compromises," the Debtors argue that they desperately need the support of these vendors to continue to operate in historical fashion. True, the Debtors might have an easier time maintaining operations if tens of millions of dollars of the Term Loan Lenders' collateral proceeds could be diverted to junior creditors to convince those junior creditors to continue to ship. But, this not a legally sufficient justification to use the collateral of a secured creditor without adequate protection.

3. Even assuming the proposed settlement that is the subject of the Debtors' Rule 9019 Motion could be reconciled with the Term Loan Agent's right to adequate protection, (which it cannot be), the proposed settlement does not pass muster under the well-established criteria for settlement approval – it is not a bona fide settlement of an actual dispute and fails to provide the Term Loan Agent with due process protections to which it is entitled.

4. The Debtors' proposed means of, in substance, avoiding the fully perfected liens of the Term Loan Agent without due process and otherwise without basis in law is as follows:

- Step One: A purported "settlement" of disputes between the Debtors and consignment vendors pursuant to which the vendors will receive 60% of the Consignment Sale Price (to which they were entitled under the prepetition consignment agreements) from the Debtors upon the sale of an

item of consigned inventory.<sup>2</sup> See Settlement Re Pay-By-Scan Vendors, dated as of March 30, 2016 (the “Proposed Settlement”), attached as Exhibit A-1 to the Rule 9019 Motion, at ¶ 1(b).

- Step Two: The inclusion in the purported settlement of a provision pursuant to which all amounts remitted to consignment vendors upon the sale of consigned inventory—all of which is subject to the perfected liens of the Debtors’ secured lenders—will be received free of any “claw back or right of return arising from any dispute or proceeding relating to title, ownership, nature of consignment relationship or security interests” in the consigned inventory. Id.
- Step Three: A provision for the entire deal to be binding on “all creditors” such that the Debtors’ secured lenders, whose collateral has been sold and its proceeds remitted to junior creditors, will be unable to pursue any remedy against participating consignment vendors. See Proposed 9019 Order, attached as Exhibit A to Rule 9019 Motion, at ¶ 15.

5. The effect of the proposed settlement is indistinguishable from the issuance of a judgment invalidating the senior perfected liens of the Term Loan Agent.<sup>3</sup> Upon the sale of the Prepetition Consigned Goods, the Term Loan Agent would have no rights whatsoever to the proceeds paid to participating vendors.<sup>4</sup> While the Debtors propose to achieve lien avoidance through a “settlement,” the law of this Circuit is clear: For a debtor to extinguish or modify a lien during the bankruptcy process, it must commence an adversary proceeding against the holder of the security interest. SLW Capital, LLC v. Mansaray-Ruffin (In re Mansaray-Ruffin), 530 F.3d 230, 237 (3d Cir. 2008) (“It is appropriate that the Rules permit lien invalidation to

---

<sup>2</sup> Throughout its papers, Debtors refer to consigning vendors using the terminology of the Vendor Relationship Guide (the “VRG”) that it uses with its suppliers. Consignment vendors are participating in a “pay-by-scan” program pursuant to which their right to be paid for goods supplied to the Debtors is first triggered by the purchase of the consigned inventory by a customer. See VRG, at 8-2 (referring to “pay-by-scan” vendors as consignment vendors).

<sup>3</sup> UCC filings perfect the interest of the Term Loan Agent in “Inventory” which, as defined, includes goods “held for sale.” The Term Loan Agent knows of no grounds for the avoidance of its perfected liens, and certainly no consignment vendor has identified a basis to challenge such perfected liens.

<sup>4</sup> The proposed settlement is made retroactive to March 2, 2016, the Petition Date. Accordingly, it would also immunize the payments already made to consignment vendors (which this Court explicitly stated were subject to potential claw back), and authorize the Debtors to release to consignment vendors the millions of dollars currently being held in escrow, every dollar of which is the proceeds of collateral secured by a lien of the Term Loan Agent.

occur only through litigation in an adversary proceeding ... for the invalidation of a lien on the property of the debtor held by a specific creditor is a matter of particularly great consequence, in terms of the applicable legal principles and the practical result.”).

6. Additionally, there is no bona fide legal or factual dispute that could conceivably justify the economic terms of the proposed settlement. In fact, there is no serious factual or legal argument that the vendors are anything but unsecured creditors. Indeed, the Debtors thoroughly establish this in their Omnibus Reply in support of the Consigned Goods Motion [Docket No. 991] (the “Debtors’ Omnibus Reply”).

7. The proposed settlement is also inequitable. The Debtors’ motion in support of the purported settlement does not own up to its clear and improper objectives. The Term Loan Agent’s senior rights and interests in the Prepetition Consigned Goods, which the Debtors have repeatedly acknowledged, most recently in the Debtors’ Omnibus Reply, are not even mentioned in the Rule 9019 Motion. Not surprisingly, the proposed settlement was put together without any involvement from the Term Loan Agent or the Term Loan Lenders.<sup>5</sup>

8. The Debtors’ assertions as to the equities of the proposed settlement ring hollow. The Debtors should not be heard to argue that the consignment arrangements or their consignment vendors are “critical” to the Debtors’ business or that consignment arrangements

---

<sup>5</sup> The Term Loan Agent also briefly responds to the Official Creditors’ Committee’s statement in support of the Rule 9019 Motion [Docket No. 979]. The Committee, which includes Asics, the Debtors’ largest consignment vendor, is clearly trying to create an “us vs. them” case narrative by hurling invective at the Debtors’ secured lenders in a statement that is wholly devoid of factual or legal support. The Term Loan Agent is simply trying to protect its and the Term Loan Lenders’ secured interests in their collateral. The Term Loan Agent was fully supportive of escrowing the Consignment Sale Price and deferring a final determination of entitlement to such proceeds until after other pressing issues in the Debtors’ chapter 11 cases had been resolved. And, if the Vendors had fully perfected senior interests in those proceeds and timely provided the requisite authenticated notice to the other secured lenders, they would have received their allocable share of the escrow amount. It was the Vendors that precipitated this situation, just as it was the Debtors’ trade creditors, not the secured lenders, that precipitated the Debtors’ “free-fall” chapter 11 filings. The secured lenders were willing to forbear on defaults and exercising remedies to allow for a prepetition work-out process to run its course, but the Debtors’ trade creditors tightened trade terms, forcing the chapter 11 filings at a time when the Debtors were clearly unprepared.

provide a necessary enhancement of the Debtors' liquidity. Nor should they be crowing about the Debtors' prospects of receiving "millions in proceeds" that were not contemplated by the DIP financing budget.

*Redacted Using Redact-It*

10.

*Redacted Using Redact-It*

*Redacted Using Redact-It*

are a form of credit that, with respect to the applicable consigned goods, would have been potentially senior to the Term Loan Lenders if the vendors had properly perfected their interests and timely provided the requisite notice (which they did not). See Rule 9019 Motion, ¶ 27.

*Redacted Usin...*

*Redacted Using Redact-It*

*Redacted Using Redact-It*

In light of the foregoing, and for

*Redacted Using Redact-It*

the reasons set forth below, the Court should decline to approve the Debtors' purported settlement with the vendors.

**RELEVANT FACTUAL BACKGROUND**

11. Relevant factual background regarding the matters addressed herein is set forth in: (i) the *Term Loan Agent's Reply (I) in Support of Debtors' Consigned Goods Motion and Other First Day Relief, and (II) to Vendors' Objections to Same*, dated March 31, 2016 [Docket No. 932] (the "Term Loan Agent's Reply"); (ii) the *Declaration of Michael J. Genereux in Support of (A) Term Loan Agent's Reply (I) in Support of Debtors' Consigned Goods Motion and Other First Day Relief, and (II) to Vendors' Objections to Same, and (B) Term Loan Agent's Emergency Motion for Adequate Protection* [Docket No. 1095] (the "Genereux Declaration" or "Genereux Decl."); and (iii) the *Term Loan Agent's Emergency Motion for Adequate Protection* [Docket No. 1092] (the "Term Loan Agent's Adequate Protection Motion"), all of which are fully incorporated herein by reference.<sup>7</sup>

**A. The Term Loan And Security Agreement.**

12. In 2006, the Debtors obtained approximately \$1.05 billion of secured financing that included a \$750 million asset-based revolving loan and a \$300 million term loan (the "Term Loan").

*Redacted Using Redact-It*

*Redacted Using Redact-It*

<sup>7</sup> Capitalized terms used herein but not otherwise defined shall have the meanings ascribed to such terms in the Term Loan Agent's Reply or the Genereux Declaration, as applicable.

*Redacted Using Redact-It*

*Redacted Using Redact-It*

The Term Loan is secured by a first-priority security interest in and lien on the borrowers' and guarantors' property, plant and equipment, real property, intellectual property, investment property, and general intangibles (collectively, the "Term Loan Collateral") and by a second-priority interest in and lien on the borrowers' and guarantors' accounts receivable, deposit accounts, chattel paper, and inventory (the "ABL Collateral," and, together with the Term Loan Collateral, the "Collateral").<sup>10</sup>

*Redacted Using Redact-It*

---

<sup>9</sup> The UCC also defines "Inventory" to include "goods ... held by a person for sale..." Del. Code Ann. tit. 6, § 9-102(a)(48)(B).

<sup>10</sup> The relative lien priority rights of the Term Loan Agent and the Term Loan Lenders, on the one hand, and the ABL Agent and the ABL Lenders, on the other hand, are governed by that certain Intercreditor Agreement, dated as of May 3, 2006.

<sup>11</sup> The Grantor Debtors are: (a) The Sports Authority, Inc.; (b) Slap Shot Holdings Corp.; (c) TSA Stores, Inc.; and (d) TSA Gift Card, Inc. Security Agreement, at 1, Schedule 1.

*Redacted Using Redact-It*

*Redacted Using Redact-It*

**B. The First Day Hearing And Additional Procedural Background.**

17. At the Debtors' first day hearing, certain consignment Vendors objected to the Debtors' Consigned Goods Motion, claiming that the Prepetition Consigned Goods could not be sold pursuant to Section 363 because such Goods did not constitute property of the Debtors' estates. The Court authorized the Debtors to continue selling the Prepetition Consigned Goods

*Redacted Using Redact-It*



on an interim basis while placing the Consignment Sale Price in escrow. On May 10, 2016, the Vendors and Debtors submitted competing forms of proposed interim orders to memorialize the Court's first day ruling. [Docket Nos. 259, 265].

18. On March 11, 2016, the Court entered the Vendors' form of proposed order (the "Interim Consigned Goods Order"). [Docket No. 278]. Unlike the Debtors' proposed form of order, the Vendors' proposed order gave the Vendors the right to prohibit the sale of Prepetition Consigned Goods and required such Goods to be segregated and accounted for to the Vendors. The Debtors immediately made an oral motion for reconsideration, and, on the same day, the Court conducted an emergency teleconference with the Debtors and certain Vendors. The Term Loan Agent neither received notice of nor participated in the teleconference. Thereafter, the Court issued an Order deleting that provision of the Interim Consigned Goods Order that gave the Vendors the right to prohibit the sale of Prepetition Consigned Goods and scheduled a hearing for March 16, 2016. [Docket. No. 289].

19. On March 15, 2016, the Debtors filed adversary proceedings against approximately 160 consigning Vendors (the "Adversary Proceedings"). Each complaint filed in these Adversary Proceedings seeks a long list of declarations, including declarations that challenge the claimed "title" of the consigning Vendors in inventory. See, e.g., Docket Nos. 344, 345, 346, 347, 348. Such adversary proceedings were presumably intended to satisfy the requirements of Bankruptcy Code Section 363(f)(4) by establishing that the Vendors' claimed interests in the Debtors' inventory was in *bona fide* dispute. See 11 U.S.C. § 363(f)(4) (allowing sales of property where there exists a *bona fide* dispute).

20. Among the declarations sought by the Debtors in the Adversary Proceeding complaints is whether "any security interest held by the Vendor in the Goods or the Property is

entitled to priority as against any other *competing security interests*.” See, e.g., Docket No. 482, Asics Adversary Complaint, ¶ 34(c) (emphasis added). No Vendor has responded to the complaint against it with any proof that it holds any duly perfected interest in the Prepetition Consigned Goods.<sup>14</sup> The Bankruptcy Code is clear that each Vendor bears the burden of doing so. 11 U.S.C. § 363(p)(2).

21. Notwithstanding that the declaratory relief sought by the Debtors would constitute an adjudication concerning the rights of the Term Loan Agent as the holder of a “competing security interest,” the Term Loan Agent was not named as a party to any of the Adversary Proceedings. The Term Loan Agent moved to intervene in each of the Adversary Proceedings for the purpose of establishing its priority to the Prepetition Consigned Goods. As of the date hereof, the parties to the Adversary Proceedings have not consented to intervention.

22. No adversary proceeding has been commenced against the Term Loan Agent for the purpose of adjudicating the validity of its lien in the Prepetition Consigned Goods.

23. On March 16, 2016, the Court held a hearing on the Court’s March 11th reconsideration order. At the hearing, the Debtors claimed that as a practical matter, consignment inventory could not be segregated from other inventory and that, accordingly, a prohibition on the sale of consignment inventory would preclude both normal and going-out-of-business sales. See Mar. 16, 2016 Hr’g Tr. at 12:9-13; 21:6-22:23; 23:23-24:3. On this basis,

---

<sup>14</sup> Two of the Vendors, Gordini USA, Inc. and SP Images, Inc., allege that they took the steps necessary to perfect a senior purchase-money security interest in the applicable Prepetition Consigned Goods. Further information is needed to determine if Gordini and SP Images have perfected their interests in the applicable Prepetition Consigned Goods and taken the steps necessary to obtain a senior interest in all or some of such respective Goods. As the Term Loan Agent has agreed to since the beginning of the Debtors’ chapter 11 cases, if a Vendor, including Gordini and SP Images, in fact took the proper steps to perfect its interest in the Prepetition Consigned Goods and obtain priority over the Term Loan Agent’s interests by timely sending the requisite authenticated notification, then such Vendor would have a senior interest in such Vendor’s specific Prepetition Consigned Goods and the proceeds thereof.

the Vendors were able to exercise leverage over the Debtors, which were induced to capitulate to demands by the Vendors to pay the proceeds of consignment sales to the Vendors.

24. On March 31, 2016, the Term Loan Agent filed the Term Loan Agent's Reply, pursuant to which it argued that the Adversary Proceeding complaints were sufficient to establish the existence a *bona fide* dispute as to the Vendors' interests in the Prepetition Consigned Goods, thereby entitling the Debtors to sell such Goods under Section 363(f). The Term Loan Agent also established that if proceeds were allowed to be paid to the Vendors, then the Term Loan Agent was entitled to adequate protection for any diminution in the value of its Collateral.

25. On April 1, 2016, the Debtors filed their Rule 9019 Motion seeking approval of the Proposed Settlement.

26. On April 4, 2016, the Debtors filed the Debtors' Omnibus Reply in support of the Consigned Goods Motion, in which the Debtors argued again that the Vendors hold merely unsecured claims in these cases or, at best, junior interests in the Prepetition Consigned Goods. Additionally, through the Omnibus Reply, the Debtors affirmatively request for the first time that, if the Court does not grant the relief requested in the Rule 9019 Motion or the remaining Vendors do not join the Proposed Settlement, the Court authorize the Debtors to continue to sell the Prepetition Consigned Goods in accordance with the terms of the prepetition Agreements, including the payment of the Term Loan Agent's Collateral proceeds to the Vendors. The Debtors' Omnibus Reply and the accompanying pleadings provide no mention of, or evidence with respect to, the adequate protection to be provided to the Term Loan Agent in connection with this use of its Collateral.

27. On April 5, 2015, the Court held a hearing to consider, among other things, the Consigned Goods Motion on a final basis. The Court continued that hearing until April 14,

2016. At the April 5th hearing, the Term Loan Agent objected to the continued dissipation of its interests in the Prepetition Consigned Goods by the payment of the proceeds thereof to the Vendors without any provision of adequate protection to the Term Loan Agent. Apr. 5, 2016 Hr'g Tr. 24:10-26:22. The Court declined to hear evidence on the Term Loan Agent's adequate protection demand, and indicated that the demand for adequate protection would be continued to the April 14, 2016 hearing as a "part of and inextricably intertwined with" the DIP Financing Motion, the Consigned Goods Motion, and the other first day motions, all of which were scheduled for final hearings on April 14, 2016. *Id.* at 32:10-15.

28. On April 6, 2016, the Court entered its *Supplemental Interim Order Authorizing the Debtors to Continue to Sell Certain Prepetition Consigned Goods* [Docket No. 1044] (the "Supplemental Interim Consigned Goods Order"). Pursuant to the Supplemental Interim Consigned Goods Order, the Court denied the Section 363(f) relief requested in the Consigned Goods Motion and ordered that the Debtors were permitted to continue selling the Prepetition Consigned Goods, provided that they perform in accordance with the prepetition Agreements, including taking the proceeds of the Prepetition Consigned Goods and paying them to the applicable Vendors.

29. On April 7, 2016, the Term Loan Agent filed its notice of appeal of the Court's Supplemental Interim Consigned Goods Order, as well as the Interim Consigned Goods Order, as modified by the Court's reconsideration order. [Docket No. 1074]. That appeal is pending.

30. On April 8, 2016, the Term Loan Agent filed its Adequate Protection Motion and, consistent with the Court's indications at the April 5th hearing, requested that it be heard at the April 14th omnibus hearing.

**C. The Debtors' Rule 9019 Motion and Proposed Settlement.**

31. Pursuant to the Rule 9019 Motion, the Debtors seek approval of the Proposed Settlement among the Debtors and certain participating Vendors with respect to the resolution of certain pending “disputes” with Vendors of Prepetition Consigned Goods. *See Declaration of Stephen Binkley in Support of the Debtors' Motion for an Order, Pursuant to Section 105(a) of the Bankruptcy Code and Bankruptcy Rule 9019, Approving the Settlement Agreement between the Debtors and Certain Consignment Vendors Party Thereto*, dated April 1, 2016, [Docket No 961], ¶ 2.

32. Under the Proposed Settlement, the Debtors propose to pay the participating Vendors no less than 60% of the amount to which the consigning vendors would have been entitled prepetition upon the sale of Prepetition Consigned Goods. *See Proposed Settlement*, ¶ 1(b). The Proposed Settlement also includes a “most favored nations” provision. *See Proposed Settlement*, ¶ (3)(l). Under this provision, if the Debtors subsequently reach an agreement with a Vendor on terms more favorable to such Vendor than those set forth in the Proposed Settlement, then the Proposed Settlement will be deemed amended automatically, without notice to any other parties or approval of the Court, to provide all participating Vendors with the benefit of those more favorable terms.<sup>15</sup> *Id.*

33. Pursuant to the Proposed Settlement, the participating Vendors would obtain the proceeds of the Prepetition Consigned Goods irrespective of their priority as to such Goods.

34. The Debtors further seek to shield these payments from any claw back or right of return arising from “any dispute or proceeding relating to title, ownership, nature of the

---

<sup>15</sup> Thus, if the Debtors subsequently settle with just one of the approximately 154 consignment Vendors not currently party to the Proposed Settlement on terms that provide such Vendor with 80% of the proceeds of the applicable Prepetition Consigned Goods, all participating Vendors in the Proposed Settlement would see their share of the applicable Prepetition Consigned Goods proceeds rise from 60% to 80%.

consignment relationship, or security interests in the Prepetition [Consigned] Goods, or otherwise.” Id.

35. The Debtors propose that the Proposed Settlement will bind the Court and all other creditors and parties in interest with respect to any future decisions that may affect the subject matter of the Proposed Settlement, including the disposition of the Prepetition Consigned Goods and proceeds thereof. See Proposed Settlement, ¶ 3(k); Proposed 9019 Order, ¶ 15.

36. In addition, the Debtors propose that each Adversary Proceeding relating to a participating Vendor will be dismissed and all rights to assert any of the claims set forth in the complaints will be forever discharged and extinguished. See Proposed Settlement, ¶ 3(c).

**D. The Term Loan Agent’s Perfected Security Interest In And Lien On The Prepetition Consigned Goods.**

37. In accordance with Article 9 of the UCC, the Term Loan Agent properly perfected its security interests in the Prepetition Consigned Goods.<sup>16</sup> No party in interest has disputed the Term Loan Agent’s senior rights and interests in the Prepetition Consigned Goods. As set forth in the Term Loan Agent’s Reply, the complaints filed in the Adversary Proceedings, and the Debtors’ Omnibus Reply, the Term Loan Agent’s secured interest in the Prepetition Consigned Goods is senior to any interest of the Vendors because the Vendors either failed to properly file UCC financing statements or failed to timely provide the Term Loan Agent with the requisite authenticated notification as required under the UCC.

38. The Debtors acknowledge that the Prepetition Consigned Goods constitute ABL Collateral on which the Term Loan Agent holds a second-priority interest in and lien. See DIP Financing Motion, ¶ 19. The Debtors further acknowledge that the Term Loan Agent has

---

<sup>16</sup> UCC statements filed by the Term Loan Agent (or its predecessor) evidencing the perfection of the Term Loan Agent’s security interests in the Collateral are annexed to the motions to intervene filed by the Term Loan Agent in each of the Adversary Proceedings.

properly perfected its security interest in the Prepetition Consigned Goods. See Debtors' Omnibus Reply, ¶ 23.

39. Accordingly, the record in these cases, as it stands today, is that: (a) the Term Loan Agent (and the other Secured Lenders) holds a duly perfected security interest in the Debtors' interest in Prepetition Consigned Goods; (b) the Debtors have themselves presented solid argument and good proof, by procedurally proper adversary complaints, to demonstrate that none of the Vendors have taken the steps necessary to duly perfect their own interests in the Prepetition Consigned Goods; (c) the Term Loan Agent has attempted to intervene as a party plaintiff in those proceedings; (d) none of the Vendors have themselves come forward with any proof of due perfection; (e) but, by mere exertion of leverage in the fashion of withholding further deliveries (as to which the Vendors would have recognized senior rights, by agreement of all parties), the Vendors have threatened to cause the liquidation of the Debtors unless a major part of the Term Loan Lenders' cash collateral is diverted to the Vendors; and (f) up against the proverbial wall, and unable to get the rulings that would confirm the Vendors' status as mere general unsecured creditors, the Debtors have now capitulated, telling the Term Loan Agent that it is up to the Term Loan Agent to protect its property interests and adequate protection.

### **ARGUMENT IN OBJECTION**

#### **I. The Proposed Settlement Violates The Term Loan Agent's Rights To Adequate Protection And Due Process And, Therefore, Must Be Denied.**

40. Bankruptcy Rule 9019(a) grants the Court the authority to "approve a compromise or settlement" on a bankruptcy trustee's motion. "[T]he unique nature of the bankruptcy process means that judges must carefully examine settlements before approving them." See Will v. Nw. Univ. (In re Nutraquest, Inc.), 434 F.3d 639, 644 (3d Cir. 2006). The Court must determine that the Proposed Settlement is "fair and equitable" before approving it.

Id. (citing TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 424 (1968)). The Debtors bear the burden of proving that the Proposed Settlement is in fact fair and equitable and should therefore be approved. See In re Spansion, Inc., No. 09-10690(KJC), 2009 WL 1531788, at \*4 (Bankr. D. Del. June 2, 2009). Here, the Debtors have failed to meet this burden.

41. Under the “fair and equitable” standard, the Court must consider the fairness of the Proposed Settlement to the Term Loan Agent, as a secured creditor with a senior interest in the Prepetition Consigned Goods. See Official Committee of Unsecured Creditors v. CIT Group/Business Credit Inc. (In re Jevic Holding Corp.), 787 F.3d 173, 184-85 (3d Cir. 2015). The Proposed Settlement violates the right of the Term Loan Agent to receive adequate protection and violates the due process rights of the Term Loan Agent. It is, accordingly, neither fair nor equitable.

**A. The Proposed Settlement Violates  
The Term Loan Agent’s Rights To Adequate Protection.**

42. Through the Proposed Settlement, the Debtors seek to strip the Term Loan Agent of its rights and interests in the Prepetition Consigned Goods without just compensation. As set forth herein, in the Term Loan Agent’s Reply, and in the Term Loan Agent’s Adequate Protection Motion, and as the Debtors have previously acknowledged in the Debtors’ Omnibus Reply and other pleadings, the Term Loan Agent has a perfected security interest in the Prepetition Consigned Goods.

43. Although the Debtors are proposing to compromise estate assets through Bankruptcy Rule 9019, binding Third Circuit precedent provides that the requirements of Section 363 apply here and must be satisfied. Myers v. Martin (In re Martin), 91 F.3d 389, 394-95 (3d Cir. 1996) (“The instant agreement compromised an asset of the debtors’ estate. And clearly,



this act ventured beyond the domain of transaction that the [debtors] encountered in the ordinary course of business prior to the filing of bankruptcy, thereby implicating Section 363.”).

44. Accordingly, pursuant to Bankruptcy Code Section 363(e), the Term Loan Agent is entitled to adequate protection of its interests in the Prepetition Consigned Goods as a matter of law. 11 U.S.C. § 363(e) (“at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold or leased, by the trustee, the court ... shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest.”).

45. The adequate protection provisions of the Bankruptcy Code embody the constitutional prohibition against deprivation of property without just compensation. See In re Timbers of Inwood Forest Assocs., Ltd., 793 F.2d 1380, 1396 (5th Cir. 1986), aff’d, United Sav. Ass’n of Texas v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365, 376 (1988) (“The concept [of adequate protection] is derived from the fifth amendment protection of property interests.”); H.R. Rep. No. 595, 95th Cong., 1st Sess. 339 (1977) and S. Rep. No. 989, 95th Cong., 2d Sess. 49 (1978) (stating that the concept of adequate protection is derived from “the Fifth Amendment protection of property interests”); see, e.g., 11 U.S.C. §§ 361; 362(d)(1); 363(e); 363(p)(1).

46. The provision of adequate protection is mandatory, not discretionary. See In re Cont’l Airlines, Inc., 146 B.R. 536, 539 (Bankr. D. Del. 1992), aff’d 91 F.3d 553 (3d Cir. 1996); In re Worldcom, Inc., 304 B.R. 611, 618-19 (Bankr. S.D.N.Y. 2004); In re Metromedia Fiber Network, Inc., 290 B.R. 487, 491 (Bankr. S.D.N.Y. 2003); In re Heatron, Inc., 6 B.R. 493, 494 (Bankr. W.D. Mo. 1980).

47. Pursuant to Bankruptcy Code Section 363(p)(1), the Debtors bear the burden of proving that the Term Loan Agent's interests are adequately protected. 11 U.S.C. § 363(p)(1) ("In any hearing under this section ... the trustee has the burden on the issue of adequate protection...."). If the Debtors fail to meet their burden, then the Court cannot approve the Proposed Settlement. See Reiser v. Dayton Country Club Co. (In re Magness), 972 F.2d 689, 697 (6th Cir. 1992) (finding that, if adequate protection cannot be provided, the use, sale or lease of collateral must be prohibited); Martin v. Commodity Credit Corp., 761 F.2d 472, 478 (8th Cir. 1985) (same); In re Dewey Ranch Hockey, LLC, 414 B.R. 577 (Bankr. D. Az. 2009) (sustaining objection to proposed Section 363 sale and denying proposed sale because objecting party's interests would not be adequately protected); In re Adelpia Commc'ns, 364 B.R. 518 (Bankr. S.D.N.Y. 2007) (denying proposed 9019 settlement because, *inter alia*, objecting parties' interests would not be adequately protected).

48. Where, as here, a debtor is seeking the use of a secured lender's cash collateral, "the Bankruptcy Code 'places a high burden of proof on the party requesting the use of cash collateral.'" N. Trust Co. v. Leavell (In re Leavell), 56 B.R. 11, 13 (Bankr. S.D. Ill. 1985) (quoting In re Sheehan, 38 B.R. 859, 868 (Bankr. S.D. 1984)). A debtor must prove "by clear and convincing evidence that the secured creditor will realize the value of its bargain in light of all the facts and circumstances of the case." Id. (citing In re Sheehan, 38 B.R. at 868).

49. Accordingly, absent a constitutionally required finding by the Court, supported by clear and convincing evidence adduced by the Debtors, that the Term Loan Agent's interests in the Prepetition Consigned Goods are adequately protected, the Court cannot approve the Proposed Settlement. See In re Cont'l Airlines, Inc., 146 B.R. at 539 (noting that a debtor's right to use, sell or lease property is limited by Section 363(e) of the Bankruptcy Code which provides

“the court ... shall prohibit or condition such use ... as is necessary to provide adequate protection of such interest”); In re Adelpia Commc’ns, 364 B.R. 518 (denying proposed 9019 settlement because, *inter alia*, objecting parties’ interests would not be adequately protected); In re Am. Kitchen Foods, 2 Bankr. Ct. Dec. 715, 719 (Bankr. D. Me. 1979) (“No material impairment of collateral is constitutionally permissible, either within or without bankruptcy proceedings, in the absence of just compensation.”).

50. To the extent that any parties challenge the Term Loan Agent’s interests in the Prepetition Consigned Goods, the Court must determine prior to ruling on the Proposed Settlement that the Term Loan Agent’s claimed interests in the Prepetition Consigned Goods would be adequately protected if such interests are later found to be valid and senior (as all available evidence to date indicates, and as the Debtors themselves concede). See In re Dewey Ranch Hockey, LLC, 414 B.R. at 591-92 (sustaining objection to proposed Section 363 sale and denying proposed sale because objecting party’s claimed interests in assets would not have been adequately protected if such interests later proved to be valid).

*Redacted Using Redact-It*

52. As of the Petition Date, the Debtors owe approximately \$276.6 million in principal under the Term Loan Credit Agreement. As set forth above, the Term Loan Agent has

a first priority lien on the Term Loan Collateral and a second priority lien on the ABL Collateral. A material portion of the Term Loan recovery will derive from the second lien interest in ABL Collateral.

53. The only material assets comprising the ABL Collateral are the Debtors' cash, credit card receivables, and inventory. See Mar. 31, 2016 Deposition of Bernard Douton (the "Douton Dep."), at 124:17-23.

*Redacted Using Redact-It*

*Redacted Using Redact-It*

*Redacted Using Redact-It*

*Redacted Using Redact-It*

The

Debtors do not even know the value of the Term Loan Collateral. See Douton Dep. at 137:18-139:15. Replacement liens on new goods delivered by the Vendors post-petition cannot serve as adequate protection because such goods (by agreement of all parties) will be subject to the delivering Vendors' first-priority purchase-money security interests.

*Redacted Using Redact-It*

*Redacted Using Redact-It*

Moreover, maintaining the "status quo" of paying the proceeds of the Term Loan Agent's Collateral to the Vendors, as requested in the Debtors' Omnibus Reply, cannot continue either absent a finding that the Term Loan Agent's interests are adequately protected. The Term Loan Agent submits that the only practicable way to provide all

parties in interest with adequate protection of their interests in the Prepetition Consigned Goods is to permit the Debtors to continue selling such Goods, but condition such sales on the Debtors placing the proceeds thereof in escrow pending a final determination of which parties' interests in such proceeds are senior. See In re Dewey Ranch, 414 B.R. at 591 (noting that, where the "interest" in property is a lien, adequate protection is typically provided "by impounding funds to pay such interest if it is ultimately determined to be a valid interest."); In re Clark, 266 B.R. 163 (9th Cir. B.A.P. 2001) (same).

**B. The Proposed Settlement Violates The Term Loan Agent's Rights To Due Process.**

60. Pursuant to the Proposed Settlement, the Debtors seek to determine, on a final basis, all rights and interests in the Prepetition Consigned Goods (and the proceeds thereof) and any other "dispute or proceeding relating to title, ownership, nature of the consignment relationship, or security interests in the Prepetition [Consigned] Goods, or otherwise." See Proposed Settlement ¶ 1(b). The Debtors also seek to make all payments made to Vendors immune from claw back or any right of return, and further seek the extraordinary relief of making the terms of the Proposed Settlement binding on all parties in interest in the Debtors' chapter 11 cases and prevail over any future order of the Court related to the Prepetition Consigned Goods or the proceeds thereof. See Proposed Settlement §§ 1(b), 3(k).

61. What the Debtors seek, in substance, is the avoidance of the Term Loan Agent's perfected security interest in the Prepetition Consigned Goods and the proceeds thereof. Such relief violates the Term Loan Agent's due process rights.

62. As this Court is well aware, under the Bankruptcy Code, Bankruptcy Rules, and binding Third Circuit precedent, the avoidance of the Term Loan Agent's security interest, or a determination as to the priority or extent of such interest, may be accomplished only through the

commencement of an adversary proceeding pursuant to Bankruptcy Rule 7001(2), not an expedited contested matter. See Fed. R. Bankr. P. 7001(2); SLW Capital, 530 F.3d at 237-38; In re Whitehall Jewelers Holdings, Inc., 2008 WL 2951974, \*5 (Bankr. D. Del. Jul. 8, 2008) (Gross, J.) (holding that, where proposed Section 363 sale would in effect invalidate a creditor's interest in property, the debtors were required to commence an adversary proceeding).

63. The mandatory nature of Rule 7001(2) is grounded in bedrock principles of due process. See SLW Capital 530 F.3d at 238. The Debtors cannot be permitted to subvert the Term Loan Agent's substantive and procedural rights under constitutional and bankruptcy law by seeking, through an expedited contested matter, to in substance avoid, or at the very least determine the priority and extent of, the Term Loan Agent's interests in the Prepetition Consigned Goods.

**II. The Proposed Settlement Fails To Satisfy  
The Requirements For Approval Under Bankruptcy Rule 9019.**

64. Where a proposed settlement is otherwise consistent with the Bankruptcy Code and with due process, its approval will require the Court to assess and balance the value of the claim that is being compromised against the value to the estate of the acceptance of the compromise proposal. Myers v. Martin (In re Martin), 91 F.3d 389, 393 (3rd Cir. 1996). Four criteria are considered in striking this balance: (1) the probability of success in litigation; (2) the complexity of the litigation involved and the expense, inconvenience, and delay necessarily attending it; (3) the likely difficulties in collection; and (4) the interests of creditors. Id. In their Rule 9019 Motion, the Debtors do not even purport to satisfy the Martin factors through a legal or factual analysis, relying instead on inadequate conclusory statements that are unsupported by any legal or evidentiary basis. Indeed, here, all four Martin factors weigh decisively against approving the Proposed Settlement.

**A. The Debtors Are Highly Likely To Succeed In The Litigation.**

65. First, as to the probability of success in litigation against the Vendors, the Debtors are highly likely to succeed in establishing that their right as a hypothetical judgment lien creditor are senior to any rights of the Vendors. In the Debtors' Omnibus Reply, the Debtors thoroughly establish precisely why they are likely to succeed in their litigation against the Vendors. Debtors' Omnibus Reply ¶¶ 16-61.

66. As set forth more fully in the Debtors' Omnibus Reply and the Term Loan Agent's Reply, and as alleged by the Debtors in the Adversary Proceedings, the Vendors have either failed to properly file financing statements, filed them within the avoidable preference period, or failed to timely provide the requisite authenticated notification to the Secured Lender Agents (*e.g.*, the Term Loan Agent). Indeed, the Debtors state that approximately 120 of the 160 Vendors (or 75%) did not even perform the "simple act" of filing a UCC financing statement, which is a necessary step that the Vendors were required to take under the UCC to perfect their interests. See Mar. 16 Hr'g. Tr. 16:16-21. Under these circumstances, the outcome under the UCC is clear, as articulated in the official comments to UCC 9-319:

- (i) Consignor Fails To File Financing Statement: "SP-1 delivers goods to Debtor in a transaction constituting a 'consignment' as defined in Section 9-102. SP-1 does not file a financing statement. Debtor then grants a security interest in the goods to SP-2. SP-2 files a proper financing statement. Assuming Debtor is a mere bailee, as in a 'true' consignment, Debtor would not have any rights in the collateral (beyond those of a bailee) so as to permit SP-2's security interest to attach to any greater rights. Nevertheless, under [Section 9-319], for purposes of determining the rights of Debtor's creditors, Debtor is deemed to acquire SP-1's rights. ***Accordingly, SP-2's security interest attaches, is perfected by the filing, and, under Section 9-322, is senior to SP-1's interest.***" (emphasis added).
- (ii) Consignor Fails To Provide Authenticated Notification To Other Secured Lenders: "SP-1 obtains a security interest in all Debtor's existing and after-acquired inventory. SP-1 perfects its security



interest with a proper filing. Then SP-2 delivers goods to Debtor in a transaction constituting a ‘consignment’ as defined in Section 9-102. SP-2 files a proper financing statement but does not send notification to SP-1 under Section 9-324(b). *Accordingly, SP-2’s security interest is junior to SP-1’s under Section 9-322(a). Under Section 9-319(a), Debtor is deemed to have the consignor’s rights and title, so that SP-1’s security interest attaches to SP-2’s ownership interest in the goods.*” (emphasis added).

Del. Code Ann. tit. 6, § 9-319, Official Comments 2, 3.

67. In attempting to argue the uncertainty of their success, the Debtors merely claim in vague terms that the dispute “is highly contested,” given that both the Debtors and Vendors “have each supported their mutually exclusive positions with citations to statutes and case law,” and “[t]hus, the Debtors face significant and potentially crippling uncertainty with respect to the ultimate recoveries and outcomes,” without any explanation of the merits of the arguments. Rule 9019 Motion, at ¶ 42. This baseless assertion of the purported uncertainty of success weighs against approval of the settlement. See In re Spansion, 2009 WL 1531788, at \*8 (quoting TMT Trailer, 390 U.S. at 434) (denying motion to approve settlement where “there [was] no explanation of how the strengths and weaknesses of the debtors’ causes of action were evaluated or upon what grounds it was concluded that a settlement ... was ‘fair and equitable.’”).

68. The Debtors have a high probability of success in the litigation, and this factor therefore weighs strongly against settlement. See, e.g., In re Martin, 91 F.3d at 393 (finding a certainty of success in litigation, among other factors, “clearly militate[d]” disapproval of compromise); In re Kay, 223 B.R. 816, 820 (Bankr. M.D. Fla. 1998) (finding the likelihood of success factor weighed against approval where trustee had high probability of success).

**B. The Legal Issues In Dispute Are Straightforward.**

69. The next factor, the complexity of the litigation, is closely intertwined with the first factor. As argued by the Debtors in the Debtors’ Omnibus Reply and the Adversary

Proceedings, the Vendors have failed to take the necessary steps to obtain security interests in the Prepetition Consigned Goods that could withstand a challenge by a hypothetical lien creditor. In the Debtors' Omnibus Reply, the Debtors firmly contend that the issues here are not complex, but rather are governed by the straight-forward application of the UCC. Debtors' Omnibus Reply ¶¶ 16-23.

70. Given the simplicity of the underlying dispute, the complexity factor weighs strongly against approval of the Proposed Settlement. See Martinson v. Michael (In re Michael), 183 B.R. 230, 239 (Bankr. D. Mont. 1995) (finding complexity factor weighed against settlement where facts were simple and stipulated and law had largely been researched); cf. In re Nutritional Sourcing Corp., 398 B.R. 816, 835 (Bankr. D. Del. 2008) (finding complexity factor only weighed marginally in favor of approval of a settlement and plan where the plan at issue was "highly complex and impact[ed] numerous classes of creditors, including inter-company claims of some creditors," though still ultimately denying approval of settlement).

71. Moreover, the threat of some complexity, expense, inconvenience, or delay does not in itself support approval of a settlement. In re Caubble, 505 B.R. 857, 878 (Bankr. E.D. Ark. 2014) (finding that even though "there would be some complexity, expense, inconvenience and delay attending the necessary litigation," this was "not enough to outweigh the probability of success and fairness to creditors that the Court determines would most likely result from pursuing various causes of action"). In sum, the complexity factor weighs decisively against the approval of the Proposed Settlement.

**C. There Is No Collection Issue.**

72. The next factor, the likely difficulties in collection, likewise weighs heavily against approving the Proposed Settlement. The Prepetition Consigned Goods are presently in

the Debtors' possession, and so too will the proceeds of such Goods be upon sale. The Debtors' assertion that, if they are successful in their litigation, "it will be difficult to collect against up to 160 separate defendants" is, therefore, unavailing. Rule 9019 Motion, at ¶ 43.

73. Moreover, the Debtors' claims in the Adversary Proceedings primarily seek declaratory and injunctive relief, and only secondarily seek "damages recoverable at law or in equity." See, e.g., TSA Stores, Inc. v. Slendertone Distr., Inc. (In re: Sports Authority Holdings, Inc.), No. 16-10527-MFW, Dkt. 344 (Bankr. D. Del.). Thus, any potential issue of collection, even if established, would be entirely *de minimis*. See In re Langfield, No. 11-28853-D-7, 2012 WL 8261735, at \*3 (Bankr. E.D. Cal. Jan. 19, 2012) ("[B]ecause the recovery would not be monetary, there is no matter of collection."). Accordingly, the collectability factor does not favor approving the Proposed Settlement.

**D. Significant Creditor Interests Would Be Injured.**

74. Finally, the Proposed Settlement cannot be approved because it would not only injure, but completely eliminate interests of a secured creditor in its collateral by taking the proceeds thereof and paying them to junior (and in most cases unsecured) creditors without any compensation. See In re SPM Mfr. Corp., 984 F.2d 1305, 1313 (1st Cir. 1993 ("If a lien is perfected and not otherwise invalidated by law, it must be satisfied out of the assets it encumbers before any proceeds of the assets are available to unsecured claimants."); In re Darnell, 834 F.2d 1263, 1265 (6th Cir. 1987) (citing Collier on Bankruptcy ¶ 507.02[2] (15th ed. 1985) ("[A]s a general rule, if a lien is perfected, it must be satisfied out of the asset(s) it encumbers before any proceeds of the asset(s) are available to unsecured claimants....").

75. As the Third Circuit held in In re Jevic Holding Corp., "compliance with the [Bankruptcy] Code priorities will usually be dispositive of whether a proposed settlement is fair

and equitable” and, therefore, can be approved. 787 F.3d at 184. This is because the policy underlying the absolute priority rule applies equally in the context of a Rule 9019 settlement. Id. Thus, “bankruptcy courts cannot approve settlements ... devised by certain creditors in order to increase their shares of the estate at the expense of other creditors.” Id.

76. This is precisely what the Vendors have done here. They have leveraged their ability to inflict substantial harm upon the estates to force the Debtors to capitulate to their demands and agree to a settlement that takes the proceeds of the Term Loan Agent’s Collateral and pays such proceeds to, as the Debtors concede, unsecured creditors.

77. Moreover, the Proposed Settlement is illusory in that any subsequent settlement with a Vendor that provides better terms to such Vendor will immediately redound to the benefit of all Vendors. Thus, the Debtors cannot even assure the Court or any other creditors that *any* proceeds of the Prepetition Consigned Goods will actually be retained by the estates. Accordingly, this last prong weighs against approval of the Proposed Settlement.

**RESERVATION OF RIGHTS**

78. The Term Loan Agent hereby fully reserves its right to seek any other applicable form of relief, whether in law or in equity, including, without limitation, any relief with respect to any claims or causes of action that the Term Loan Agent may have against the Debtors, the Vendors, or any other parties.

*[Remainder of page intentionally left blank.]*

**WHEREFORE**, the Term Loan Agent respectfully requests that the Court deny the relief requested in the Rule 9019 Motion, including, without limitation, denying approval of the Proposed Settlement, and grant such other and further relief as the Court deems just and proper.

Dated: April 12, 2016  
Wilmington, Delaware

**MORRIS, NICHOLS, ARSHT & TUNNELL LLP**

*/s/ Daniel B. Butz*

---

Robert J. Dehney (No. 3578)  
Gregory W. Werkheiser (No. 3553)  
Daniel B. Butz (No. 4227)  
1201 N. Market St., 16th Floor  
P.O. Box 1347  
Wilmington, DE 19899-1347  
Tel: 302-658-9200  
Fax: 302-658-3989  
Email: rdehney@mnat.com  
gwerkheiser@mnat.com

- and -

**BROWN RUDNICK LLP**

Robert J. Stark (admitted *pro hac vice*)  
William R. Baldiga (admitted *pro hac vice*)  
May Orenstein (*pro hac vice* pending)  
Bennett S. Silverberg (admitted *pro hac vice*)  
Seven Times Square  
New York, NY 10036  
Tel: (212) 209-4800  
Fax: (212) 209-4801

*Counsel to Wilmington Savings  
Fund Society, FSB, as Term Loan Agent*

**EXHIBITS A THROUGH E**

**(FILED UNDER SEAL)**