

Kenneth H. Eckstein (admitted *pro hac vice*)
Adam Rogoff (admitted *pro hac vice*)
Stephen D. Zide (admitted *pro hac vice*)
David E. Blabey Jr. (admitted *pro hac vice*)
Rachael L. Ringer (admitted *pro hac vice*)
KRAMER LEVIN NAFTALIS & FRANKEL LLP
1177 Avenue of the Americas
New York, New York 10036
Telephone: (212) 715-9100
Facsimile: (212) 715-8000

Cullen D. Speckhart (VSB No. 79096)
Olya Antle (VSB No. 83153)
Joshua D. Stiff (VSB No. 86105)
WOLCOTT RIVERS GATES
919 E. Main Street, Suite 2010
Richmond, VA 23219
200 Bendix Road, Suite 300
Virginia Beach, VA 23452
Telephone: (757) 497-6633

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

-----)
In re:) Chapter 11
)
TOYS "R" US, Inc., *et al.*,) Case No. 17-34665 (KLP)
)
Debtors.¹) (Jointly Administered)
-----)

**STATEMENT OF OFFICIAL COMMITTEE OF UNSECURED
CREDITORS IN RESPONSE TO DEBTORS' NORTH AMERICAN
DIP AMENDMENT AND WIND DOWN BUDGET MOTION**

¹ The Debtors in these cases, along with the last four digits of each Debtor's tax identification number, are set forth in the Order (I) Directing Joint Administration of Chapter 11 Cases and (II) Granting Related Relief [Dkt. No. 78].

The Official Committee of Unsecured Creditors (the “**Committee**”) of the debtors and debtors-in-possession (collectively, the “**Debtors**” or the “**Company**”) in the above-captioned chapter 11 cases (the “**Chapter 11 Cases**”) hereby files this statement in response to: *Debtors’ Motion for Entry of an Order (A) Authorizing the North American Debtors’ Entry into Waivers with Respect to ABL/FILO DIP Documents and the Term DIP Documents and (B) Amending Final Order (I) Authorizing the North American Debtors to Obtain Postpetition Financing, (II) Authorizing the North American Debtors to Use Cash Collateral, (III) Granting Liens and Providing Superpriority Administrative Expense Status, (IV) Granting Adequate Protection to the Prepetition Lenders, (V) Modifying the Automatic Stay, and (VI) Granting Related Relief* (the “**DIP Waiver Motion**”) [Dkt. No. 2189].² In support of its statement, the Committee respectfully represents as follows:

STATEMENT

1. The Committee is continuing to analyze the Court’s request to consider “whether it is in the view of the Committee in the best interest of creditors to consider a conversion” from a Chapter 11 to a Chapter 7 case. Mar. 20, 2018 Tr. at 325:15-17. At this time, the Committee has not yet determined whether a Chapter 11 case will provide a better outcome for creditors than conversion to Chapter 7 or dismissal. Nevertheless, based upon material modifications the Committee negotiated for with respect to the relief requested in the DIP Waiver Motion, as more fully discussed below, the Committee is prepared to support a wind down of the Company’s North American businesses in Chapter 11 *on a provisional basis*. As the Committee has made clear, any continuation in Chapter 11 can only be based upon the requirement that the secured lenders do not benefit from the Chapter 11 process at the expense of postpetition creditors,

² Capitalized terms used but not defined herein have the meanings ascribed to them in the DIP Waiver Motion.

including the vendor community, suppliers, landlords, and other service providers, who provide goods or services as part of the wind down. As the wind down continues, however, the Committee will continue to reassess whether proceeding with the liquidation in Chapter 11 remains beneficial to creditors.

2. With its goals of maximizing value and preserving claims in mind, the Committee worked diligently with the Debtors and the NA DIP Lenders to reach agreement on material modifications to the proposed relief requested in the DIP Waiver Motion, and has significantly improved the terms of the proposed final order and DIP waivers to meet these goals. Recognizing that the Toys-Delaware Debtors' cases are likely administratively insolvent, the Committee is now primarily focused on maximizing the recoveries of administrative creditors. In fact, many of the prepetition unsecured creditors in the Chapter 11 Cases – including Committee members – are the same creditors that have significant postpetition exposure, with massive unpaid administrative claims against the Debtors' estates. Notably, in the aggregate, the Committee members hold *approximately \$185 million in unpaid administrative claims*, inclusive of claims for unpaid postpetition merchandise (whether received before or after March 5, 2018), unpaid critical vendor commitments, and unpaid 503(b)(9) claims. Unquestionably, Committee members (like other vendors and service providers) have been significantly damaged by the Debtors' decision to liquidate their domestic operations, and the Committee is motivated to maximize the recoveries of all administrative creditors.

3. In this role, since the interim hearing on the Motion, the Committee has worked extensively with the Debtors, the North American DIP Lenders, and certain of the objecting postpetition vendors, to both gain a better understanding of the magnitude of the potential outstanding claims, as well as setting the foundation through negotiations for a potential global

resolution for *all* administrative creditors of the Toys-Delaware Debtors. An understanding of the total unpaid claims for goods and services (both pre- and post-March 5th) is key to determining whether a broader solution is possible for these creditors. The Committee has been advised by the Debtors that, prior to March 5, 2018, the Debtors had approximately: (i) \$393 million in claims for unpaid postpetition merchandise received by the Debtors, (ii) \$192 million in unpaid 503(b)(9) claims, and (iii) \$26 million in additional unpaid non-503(b)(9) claims under postpetition critical vendor agreements. The Debtors also estimate that there are approximately \$39 million in non-merchandise vendor payables, although the Committee has been advised that some portion of this will be covered by the Wind Down Budget as payable in the ordinary course. Together with an estimated over \$150 million in payables for merchandise received *after* March 5, 2018, the total administrative claims pool is estimated to be approximately \$800 million – of which the Committee members alone comprise nearly a quarter.

4. Given the massive decline in value of the Debtors' businesses – both in the years leading up to, and in the months following, the bankruptcy cases – the Committee has been, and is, focused on both maximizing the potential value available for creditors and preserving creditors' rights and claims notwithstanding any consensual resolution of the issues surrounding the Wind Down Budget and Waivers. While the original Waivers contained sweeping, page-long releases by or through the Debtors against the Lenders, the Administrative Agent, and the Collateral Agent of any claims or causes of action related to “the making or administration of the Loans,” among other things (*see* ABL/FILO Waiver at § 11(a); Term DIP Waiver at § 11(a)), the Committee determined that these releases were premature and inappropriate at this time. Before agreeing to any releases, the Committee and other parties-in-interest need an opportunity to

adequately examine the events leading up to the liquidation. In other words, it was essential that such releases be eliminated.

5. By preserving the rights and claims of creditors (including the Committee), through its negotiations, the Committee has taken the first step towards achieving a potential global resolution of all issues relating to the Toys-Delaware Debtors. In a further attempt to facilitate such a resolution, by the end of April 2018, the Committee intends to file a report which will detail the results of the Committee's investigation of prepetition matters to date. The Committee expects that this report will identify unencumbered assets as of the Petition Date, as well as other potential causes of action arising out of prepetition transactions that may inure to the benefit of the estates and potentially creditors of Toys-Delaware. In light of the liquidation, the Committee expects to continue its investigation pursuant to Bankruptcy Rule 2004 to include an examination of prepetition and postpetition claims leading up to the wind down. Moreover, in addition to eliminating the proposed lender releases, the Committee likewise reaffirmed and preserved certain rights it negotiated for in the original DIP Orders relating to modifications of the 552(b), 506(c) and marshaling waivers – atypical protections that may facilitate a source of recovery for administrative expense creditors. Together, the Committee is hopeful that the preservation and understanding of these rights and claims will serve as a foundation for a future, broader global resolution in the context of the Toys-Delaware chapter 11 cases.

6. Recognizing that a comprehensive resolution was not attainable at this juncture, it was essential that modifications be made to the requested relief to (i) preserve claims and rights and (ii) provide assurances that going-forward suppliers and service providers would be paid and not subject to budgeted caps (at least prior to a future noticed event of default). The Committee's discussions with the Debtors and their secured lenders have resulted in a variety of

meaningful improvements to the waivers – although one issue remains relating to the modifications to certain covenants provided in the Waivers. The negotiated improvements include, among others, the following:

- Elimination of Releases. As discussed above, the NA DIP Lenders have agreed to eliminate any releases in the Waivers or the proposed order granting the Motion. All other claims and causes of action against other parties (including, for example, directors and officers) in connection with the wind down, the bankruptcy cases, or any prepetition transactions continue to be preserved.
- Payment of Ongoing Creditors on or After March 15th. The original amendment provided that the Debtors would pay administrative creditors for goods and services provided on or after March 15th, *but only to the extent that the payments were expressly included in the Wind Down Budget.* This was both unworkable (since the Wind Down Budget did not provide creditors with sufficient insight to understand whether their claims would be covered) and improper (since going-forward administrative creditors should not bear the risk of payment for new goods and services when they are helping in the wind down). After negotiations, the NA DIP Lenders agreed that (subject and the future event of default notice provision discussed below) all third-party goods and services incurred by the Debtors on or after March 15, 2018 will be paid, *regardless of whether they are included in the Wind Down Budget,* thereby giving creditors comfort that they will be able to provide goods and services to the Debtors during the wind down process without risk of nonpayment.
- Establishment of Reserve. The Term DIP Lenders have also agreed to provide for a Carveout from their collateral of an amount equal to all merchandise received (including for goods in-transit) on or after March 5, 2018, regardless of the amounts estimated or provided in the budget (but subject to a reconciliation) (the “Reserve”). Currently, the Debtors estimate that the Reserve amounts will equal over \$150 million (subject to reconciliation). The Motion originally allocated such funds to be available *solely* to pay merchandise vendors whose goods were received on or after March 5th.³ Without prejudice to any position on how this Reserve should be allocated, *the Committee negotiated for a full reservation of rights of all parties (including the Committee) as to the allocation of the Reserve among all unpaid administrative creditors (whether prior to or after March 5th and whether on a pro rata basis or another equitable distribution basis).* By preserving all parties’ rights and claims, coupled with the elimination of any releases, such rights will be an important factor in determining an appropriate allocation of the Reserve.⁴ As noted,

³ The Committee has not agreed that March 5, 2018 is a relevant or appropriate “cut-off” date, and reserves all rights to challenge such date or propose an alternative date in the proposed Order.

⁴ The proposed order will further provide that the timing of funding the Reserve will not impact the obligation to fund the Reserve, nor will it impact the inclusion of the Reserve in the Term Loan Wind-Down Collateral (as defined in the order).

this is an important first step towards the Committee's ultimate goal of materially increasing the amounts in the Reserve and formulating an appropriate allocation in connection with a more comprehensive, global settlement.

- Payment Following an Event of Default/Notice of Future Event of Default. The NA DIP Lenders originally provided that, notwithstanding the agreements regarding payments of claims arising after March 5th or 15th, as applicable, there would be no obligation to pay claims of creditors *immediately following a future event of default* (e.g., expenses exceeded budgeted amounts, liquidation sales performed poorly, etc.). The Committee objected to ongoing creditors being exposed – once again – to the risk of non-payment while still performing services that benefitted the liquidation. As a result, the NA DIP Lenders agreed to provide a written notice of any future “Event of Default” and, importantly, *to continue to fund claims for five (5) Business Days following the notice of any such Event of Default*, thereby giving creditors sufficient opportunity to limit any further exposure following the Lenders’ determination to call an Event of Default.⁵ The Lenders shall be required to file a copy of any notice of default on the docket and the Debtors will be required to promptly advise ongoing suppliers and creditors of the notice of default.
- Paydown of NA DIP Facilities. The Committee was concerned that the use of *all* proceeds of the liquidation would be used to prematurely pay down the NA DIP Facilities (and potentially the Prepetition Secured Obligations) without recourse in the event creditors determined they had equitable or other remedies regarding such payments. The NA DIP Lenders have agreed, as a result, that (i) in the first instance, the proceeds from the sale of inventory and other assets securing the ABL/FILO DIP Obligations on a senior basis to the Term DIP Obligations (the “ABL/FILO Priority DIP Collateral”) will be used to repay Term DIP Obligations and fund the costs of winding down collateral, (ii) the proceeds from the sale of prepetition unencumbered assets will be segregated and only used to repay the Term DIP Obligations to the extent the proceeds from the sale of the remaining ABL/FILO Priority DIP Collateral are insufficient to repay the Term DIP Facility (or with the Committee’s consent or by further order of the Court), and (iii) following the repayment-in-full of the NA DIP Facilities, no proceeds of the liquidation will be used to repay any Prepetition Secured Obligations absent further Court order. The revised Order will further provide that nothing in the Order will prejudice or impair the rights of any creditor or other party-in-interest, and, coupled with the elimination of releases and reservations of rights discussed herein, creditors will have the ability to pursue claims (including equitable remedies) to the extent such rights or remedies are available to them.

⁵ The Committee understands that rent is payable in advance each month. In the event that notice of an Event of Default occurs prior to the payment of applicable rent for a store location (or distribution center) that is still being occupied as part of ongoing “going out of business” sales, the Committee understands that landlords will be permitted to seek immediate relief from the Court as to whether such sales should be permitted to continue absent agreement between the landlord and the Debtors and NA DIP Lenders on the payment of rent following the five (5) Business Day period.

- Reservation of Rights. The Committee negotiated for a reservation of rights in the proposed order to ensure that no rights of any party-in-interest (or the Committee) to pursue any claims against the NA DIP Lenders are prejudiced by the granting of the relief requested in the Motion, including the paydown of the NA DIP Facilities. While the NA DIP Lenders are preserving all rights under the Final DIP Order and any potential defenses to claims, creditors and/or the Committee will continue to have the ability to pursue any claims or causes of action (including, without limitation, claims for unjust enrichment, constructive trust, or other legal or equitable remedies or claims against the NA DIP Lenders) that are available to such parties as of the date of the entry of the proposed order.
- Information for the Committee. During the Company's unprecedented meltdown, the Committee had limited insight into the events transpiring. When the Debtors did provide information, it was always on a confidential basis and often on a professional eyes only basis, so that Committee professionals could not share that information with unsecured creditors or even, in many cases, with the members of the Committee themselves. The Company has now committed to providing the Committee with all reporting information provided to the NA DIP Lenders and to giving the Committee access to representatives who can answer questions they may have on related topics, including the Wind Down Budget. In addition, the Company has agreed to not only provide certain information to the Committee on a non-professional eyes only basis so that it can be shared with Committee members, but has also agreed to provide as much information as possible on a public basis so that the Committee can effectively coordinate and communicate with all unsecured creditors on the status of the Company's wind down.
- Preserving Flexibility on Lease Treatment. The original waivers required rejection of all leases by June 30, 2018. The NA DIP Lenders have agreed to provide the Company with the flexibility to assume and assign real estate leases that can be monetized and provide value and to extend the rejection deadline for leases if they would be useful for the wind down.⁶
- Agreed Wind Down Budget. The Committee reached resolution with the Debtors and the NA DIP Lenders on a Wind Down Budget that the Committee believes is reasonable. The budget includes sufficient professional fees to allow the Committee to fulfill its obligations and work with the parties and the Court to oversee the wind down and complete a more comprehensive resolution that benefits administrative creditors. Professionals will be subject to a separate carveout and will not benefit from funds in the Reserve.

7. As indicated above, the only issue the Committee has not been able to fully resolve at this juncture is the issue of the proposed performance-based covenants in the Waivers.

⁶ Nothing herein modifies the limitation on the assumption or rejection period in any agreements between the Debtors and applicable landlords. In other words, the contractual deadlines still apply and the relief relates solely to the NA DIP Lender's ability to compel a sooner rejection.

The original waivers included covenants regarding the Company's performance in a liquidation. These covenants were inappropriate, since the liquidation was already being done at the NA DIP Lenders' insistence and for their benefit. As the Court recognized at the March 20 hearing, "some legitimate points have been raised about really who is benefiting by continuing to liquidate the property in the fashion that's been proposed." Mar. 20, 2018 Tr. at 324:20-22. The Committee has worked to incorporate certain beneficial modifications to these covenants, but still has concerns that the variance provided by the waivers may provide insufficient cushion to avoid future defaults. Currently, the Committee understands that the net cash flow covenant provides a cumulative forecast variance of approximately 10%. But given that the Debtors are embarking on an unprecedented liquidation of a toy retailer, the Committee is concerned about the Debtors ability to formulate projections with confidence. The wind-down is already underway, and the NA DIP Lenders will continue to get paid on their claims from the results of the liquidation. The NA DIP Lenders should not be allowed to hold the case hostage in the event that their own liquidation process realizes less value than they hoped it would. The Committee is continuing to discuss these issues with the NA DIP Lenders to ensure that unnecessary defaults do not jeopardize the wind down process; to the extent the Committee is unable to reach a resolution of these issues in advance of the hearing, it reserves the right to object to these covenants and/or raise these issues at the hearing.

8. With the critical improvements negotiated by the Committee, including the elimination of premature releases, the Committee feels it has accomplished its immediate goal of ensuring that postpetition creditors, including the vendor community, suppliers, landlords, and other service providers, are properly protected while the parties seek to negotiate a more comprehensive, global resolution of matters. The Committee understands that the Debtors intend

to submit revised proposed orders reflecting these (and other) agreed changes in advance of the final hearing.

Dated: April 10, 2018

Respectfully submitted,

/s/ Cullen D. Speckhart

Cullen D. Speckhart (VSB No. 79096)

Olya Antle (VSB No. 83153)

Joshua D. Stiff (VSB No. 86105)

WOLCOTT RIVERS GATES

919 E. Main Street, Suite 1040

Richmond, VA 23219

200 Bendix Road, Suite. 300

Virginia Beach, VA 23452

Telephone: (757) 497-6633

AND

Kenneth H. Eckstein (admitted *pro hac vice*)

Adam Rogoff(admitted *pro hac vice*)

Stephen D. Zide (admitted *pro hac vice*)

David E. Blabey Jr. (admitted *pro hac vice*)

Rachael L. Ringer (admitted *pro hac vice*)

KRAMER LEVIN NAFTALIS & FRANKEL LLP

1177 Avenue of the Americas

New York, New York 10036

Telephone: (212) 715-9100

Facsimile: (212) 715-8000

keckstein@kramerlevin.com

arogoff@kramerlevin.com

szide@kramerlevin.com

dblabey@kramerlevin.com

rringer@kramerlevin.com

Counsel to the Official

Committee of Unsecured Creditors