

CITATION: Payless ShoeSource Canada Inc. and Payless ShoeSource Canada GP Inc. (Re)
ONSC 1215

COURT FILE NO.: CV-19-00614629-00CL

DATE: 20190220

**RE: SUPERIOR COURT OF JUSTICE – ONTARIO
(COMMERCIAL LIST)**

**RE: IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT
ACT, R.S.C. 1985, c. C-36, AS AMENDED**

**AND IN THE MATTER OF A PLAN OF COMPROMISE OR
ARRANGEMENT OF PAYLESS SHOESOURCE CANADA INC. AND
PAYLESS SHOESOURCE CANADA GP INC.**

Applicants

BEFORE: Regional Senior Justice G. B. Morawetz

COUNSEL: *J. Dietrich and S. Kukulowicz and R. Jacobs*, for the Applicants

S. Zweig and A. Nelms, for FTI Consulting Canada Inc., Proposed Monitor

S. Brotman and D. Chochla, for the Ad Hoc Group of Term Lenders

S. Kour, for Term Loan Agent, Cortland Products Corp.

T. Reyes for Wells Fargo, ABL Agent

HEARD AND ENDORSED: February 19, 2019

REASONS: February 20, 2019

ENDORSEMENT

OVERVIEW

[1] At the conclusion of argument, the record was endorsed as follows:

CCAA application has been brought by Applicants. Initial Order granted. Order signed. Applicants will serve parties today and return to court for further directions on Thursday, February 21, 2019 at 9:30 a.m. Reasons will follow.

[2] These are the Reasons.

[3] This application is brought by Payless ShoeSource Canada Inc. ("Payless Canada Inc.") and Payless ShoeSource Canada GP Inc. ("Payless Canada GP") for relief under the Companies' Creditors Arrangement Act ("CCAA"), including an initial stay of proceedings. The Applicants

also seek to have the stay of proceedings and the other benefits of the Initial Order extended to Payless ShoeSource Canada LP (“Payless Canada LP”, together with the Applicants, the “Payless Canada Entities”), a limited partnership which carries on substantially all of the operations of the Payless Canada Entities. The requested relief is not opposed.

[4] The evidence provided in the affidavit of Stephen Marotta, Managing Director at Ankura Consulting Group LLC, the Chief Restructuring Organization (“CRO”) establishes that each of the Payless Canada Entities is insolvent and unable to meet its liabilities as they become due. The Applicants seek relief provided by the proposed Initial Order under the CCAA in order to provide a stable environment for the Payless Canada Entities to undertake the Canadian Liquidation.

[5] On February 18, 2019, a number of Payless Entities in the United States (the “U.S. Debtors”) (including the Payless Canada Entities) commenced cases under chapter 11 of title 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Eastern District of Missouri (the “U.S. Bankruptcy Court”) (the “U.S. Proceedings”). The U.S. Debtors’ “First Day Motions” are scheduled to be heard by the U.S. Bankruptcy Court on February 19, 2019.

[6] Counsel to the Applicants advises that the orders to be sought by the U.S. Debtors from the U.S. Bankruptcy Court at the First Day Motions contain language providing that if there are inconsistencies between any order made in the U.S. Proceedings and in this court, the orders of this court will govern with respect to the Payless Canada Entities and their business.

FACTS

[7] The Applicants are indirect wholly owned subsidiaries of a U.S. Debtor, Payless Holdings LLC. Both Payless Canada Inc. and Payless Canada GP are governed by the *Canada Business Corporations Act* (the “CBCA”).

[8] Payless Canada LP is a limited partnership organized under the laws of Ontario. The general partner and limited partner of Payless Canada LP are Payless Canada GP and Payless Canada Inc., respectively. Payless Canada LP is the primary vehicle conducting the business operations of the Payless Canada Entities.

[9] The Payless Canada Entities operate 248 retail stores in 10 provinces throughout Canada. The retail locations are leased from commercial landlords.

[10] The Payless Canada Entities also have a corporate office at leased premises located in Toronto, Ontario.

[11] There are approximately 2,400 employees in Canada of which 12 are corporate office employees. The remainder work at the retail locations.

[12] The Payless Canada Entities rely on the infrastructure of the U.S. Debtors for substantially all head office functions. These services are provided by certain U.S. Debtors pursuant to intercompany agreements.

[13] The assets of the Payless Canada Entities primarily consist of inventory and an intercompany promissory note receivable which was reported on the balance sheet in the amount of approximately USD \$110 million. Given that the issuer of the note is a U.S. Debtor, the Applicants advise that it is doubtful that the full value can be realized.

[14] The liabilities of the consolidated Payless Canada Entities include, among other things, outstanding gift cards, leased payments, trade and other accounts payable, taxes, accrued salary benefits, long term liabilities, and intercompany service payables.

[15] The Payless Canada Entities are also guarantors under two credit facilities, the ABL Credit Facility and the Term Loan Credit Facility. There is approximately USD \$156.7 million outstanding under the ABL Credit Facility and USD \$277.2 million outstanding under the Term Loan Credit Facility.

[16] The total amount of liabilities of the Payless Canada Entities inclusive of obligations under the guarantees of the ABL Credit Facility and the Term Loan Credit Facility is in excess of USD \$500 million.

[17] In December 2018, Payless engaged an investment bank, PJ Solomon L.P., to review strategic alternatives. In consultation with its advisers, the Payless Canada Entities decided to take steps to monetize or preserve its Latin America business and liquidate its North American operations.

[18] The Payless Canada Entities have determined that there is no practical way for the company to operate on a standalone basis. The Payless Canada Entities have decided that it was in their best interest and in the best interest of their stakeholders to complete the Canadian Liquidation.

ISSUES

[19] Counsel to the Payless Canada Entities state that the issues to be determined on this application are as follows:

- (a) Whether the CCAA applies in respect of the Applicants;
- (b) Whether a stay of proceedings is appropriate;
- (c) Whether the Monitor should be appointed;
- (d) Whether the CRO should be appointed;
- (e) Whether the Administration Charge should be approved;
- (f) Whether the Directors' Charge should be approved;
- (g) Whether the Cross-Border Protocol should be approved.

LAW

[20] The CCAA applies to a company where the aggregate claims against it or its affiliated debtor companies are more than five million dollars. I am satisfied that both of the Applicants meet the definition of a “company” under section 2(1) of the CCAA.

[21] The evidence is such that I am able to conclude that the Payless Canada Entities have failed to pay their February rent for a number of Canadian stores. In addition, defaults have occurred under the ABL Credit Facility and the Term Loan Credit Facility, and the ABL Agent has issued a Cash Dominion Direction.

[22] It has been demonstrated that the Payless Canada Entities have insufficient assets to discharge their liabilities and insufficient cash flow to meet their obligations as they come due.

[23] Accordingly, I find that the Applicants are insolvent debtor companies under the CCAA.

[24] Counsel for the Applicants submits that the Payless Canada Entities require a stay of proceedings in order to prevent enforcement actions by various creditors including landlords and other contractual counterparties. I accept this submission and in my view, it is appropriate to grant the requested stay of proceedings.

[25] I am also of the view that it is appropriate that the stay of proceedings apply not only in respect of the Applicants’ themselves, but that it extend to the partnership Payless Canada LP.

[26] Although the definition of “debtor company” in the CCAA does not include partnerships, this court has previously held that where a limited partnership is significantly interrelated to the business of the applicants and forms an integral part of its operations, the CCAA Court may extend the stay of proceedings accordingly. (See: *Re Lehndorff General Partner Ltd.*, (1993) 9 BLR (2d) 975 (Ont. S.C); *Re Prizm Income Fund*, 2011 ONSC 2061; *Re Urbancorp Toronto Management Inc.*, 2016 ONSC 3288; and *Re Target Canada Co.*, 2015 ONSC 303).

[27] In these circumstances, and in order to ensure that the objectives of the CCAA are achieved, I am satisfied that it is appropriate to grant the requested stay of proceedings to Payless Canada LP.

[28] In addition, the Payless Canada Entities also seek a stay of proceedings against the Directors and Officers. I am satisfied that the stay against to the Directors and Officers is appropriate as it will allow such parties to focus their time and energies on maximizing recoveries for the benefit of stakeholders.

[29] The Applicants propose FTI Consulting Canada Inc. as Monitor. I am satisfied that FTI is qualified to act as Monitor in these proceedings.

[30] The proposed Initial Order also provides for the appointment of Ankura as CRO. Counsel to the Applicants submits that the proposed CRO is necessary to assist with the Canadian liquidation and is particularly critical given the number of departures by senior management.

[31] The Proposed CRO Engagement Letter has been heavily negotiated and no parties, including the ABL agent and the term lenders, voice objection to the Engagement Letter.

[32] I am satisfied that the CRO should be appointed and the CRO Engagement Letter should be approved.

[33] I am also satisfied that it is appropriate to grant a charge on the Property in priority to all other charges to protect the CRO, Proposed Monitor, counsel to the Proposed Monitor, and Canadian counsel to the Payless Canada Entities, up to a maximum amount of USD \$2 million (the "Administration Charge"). In arriving at this conclusion, I have taken into account the provisions of section 11.52 of the CCAA and the appropriate considerations which include:

- (a) the size and complexity of the business being restructured;
- (b) the proposed role of the beneficiaries of the charge;
- (c) whether there is an unwarranted duplication of roles;
- (d) whether the quantum of the proposed charge appears to be fair and reasonable;
- (e) the position of the secured creditors likely to be affected by the charge; and
- (f) the position of the monitor.

[34] I am also of the view that the requested Directors' Charge is appropriate in the circumstances and it is approved in the maximum amount of USD \$4 million that will reduce to USD \$2 million after March 21, 2019. It is noted that the Directors' Charge only applies with respect to amounts not otherwise covered under the Payless Canada Entities directors' and officers' liability insurance policies.

[35] In order to facilitate the orderly administration of the Payless Canada Entities and in recognition of their reliance upon the U.S. Debtors, the Applicants propose that these proceedings be coordinated with the U.S. Proceedings and accordingly the proposed Initial Order includes the approval of a cross-border protocol.

[36] I am satisfied that the proposed cross-border protocol establishes appropriate principles for dealing with international jurisdictional issues and procedures to file materials and conduct joint hearings. It is my understanding that the U.S. Debtors will also be seeking the approval of the proposed protocol by the U.S. Bankruptcy Court as part of their First Day Motions.

[37] Counsel advises that the form of the Cross-Border Protocol is consistent with this court's decision in *Re Aralez* (25 October 2018), Toronto CV-18-603054-00CL (Ont. S.C) which is based on the Judicial Insolvency Network ("JIN Guidelines"). As stated on the JIN website:

The JIN held its inaugural conference in Singapore on 10 and 11 October 2016 which concluded with the issuance of a set of guidelines titled "Guidelines for Communication and Cooperation between Courts in Cross-Border Insolvency Matters" also known as the JIN Guidelines...The JIN Guidelines address key aspects and the modalities for

communication and cooperation amongst courts, insolvency representatives and other parties involved in cross-border insolvency proceedings, including the conduct of joint hearings. The overarching aim of the JIN Guidelines is the preservation of enterprise value and the reduction of legal costs.

[38] The JIN Guidelines have been endorsed by the Commercial List Users' Committee of this court.

[39] I also note that the JIN Guidelines have been recognized in a number of jurisdictions globally, including the United Kingdom, United States (New York, Delaware and Florida), Singapore, Bermuda, Australia (New South Wales), Korea (Seoul Bankruptcy Court), and the Cayman Islands.

[40] The JIN Guidelines have received international recognition and acceptance. As noted, the aim of the JIN Guidelines is the preservation of enterprise value and the reduction of legal costs, an objective that all parties should strive to achieve in every insolvency proceeding.

[41] Counsel to the Applicants advised that this application will be served on a number of interested parties, including the landlords of the leased premises.

[42] It is both necessary and appropriate to schedule a Comeback Hearing in order to provide affected parties with the opportunity to respond to this application. Counsel to the Applicants propose that the Comeback Hearing be held on Thursday, February 21, 2019.

[43] It is expected that the following will be considered at the Comeback Hearing:

- (a) Whether the Liquidation Consulting Agreement and Sale Guidelines should be approved; and
- (b) Whether an extension of the stay of proceedings is appropriate.

[44] I am not certain as to whether this schedule will provide interested parties with adequate time to respond to the issues raised in this application. The Comeback Hearing will proceed on February 21, 2019 on the understanding that certain matters may not be addressed at that time, if it is determined that parties have not had adequate time to respond to the issues raised in the application.

[45] The Initial Order has been signed by me.


Morawetz R.S.J.

Date: February 20, 2019