Court File No.

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

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.

(the "**Applicants**")

FACTUM OF THE APPLICANTS
(CCAA Initial Application)

February 19, 2019

CASSELS BROCK & BLACKWELL LLP
2100 Scotia Plaza
40 King Street West
Toronto, ON M5H 3C2

Ryan Jacobs
Tel: 416.860.6465
Fax: 416.640.3189
rjacobs@casselsbrock.com

Jane Dietrich
Tel: 416.860.5223
Fax: 416.640.3144
jdietrich@casselsbrock.com

Natalie Levine
Tel: 416.860.6568
Fax: 416.640.3207
nlevine@casselsbrock.com

Lawyers for Payless ShoeSource Canada Inc., Payless ShoeSource Canada GP Inc. and Payless ShoeSource Canada LP

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PART I - OVERVIEW

1. This Factum is filed in support of an application 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*[1] (the "**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.

2. Each of the Payless Canada Entities is insolvent and unable to meet its liabilities as they become due. The protection and other relief provided by the proposed Initial Order under the CCAA are needed to provide a stable environment for the Payless Canada Entities to undertake the Canadian Liquidation.[2]

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[1] *Companies' Creditors Arrangement Act*, RSC 1985, c. C-36 [CCAA].
[2] Terms not otherwise defined herein have the meaning provided to them in the affidavit of Stephen Marotta

3. On or about February 18, 2019, the U.S. Debtors (including the Payless Canada Entities) will commence cases under chapter 11 of title 11 of the United States Code in the United States Bankruptcy Court for the Eastern District of Missouri (the "**U.S. Bankruptcy Court**"). The U.S. Debtors' "First Day Motions" are scheduled to be heard by the U.S. Bankruptcy Court on the afternoon of February 19, 2019.[3]

4. 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 orders made in the U.S. Proceedings and in the Canadian Court in these proceedings that the orders of the Canadian Court will govern with respect to the Payless Canada Entities and their business.[4]

PART II - FACTS

5. 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*[5] (the "**CBCA**").[6]

6. 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 for conducting the business operations of the Payless Canada Entities.[7]

7. The Payless Canada Entities operate 248 retail stores in 10 provinces throughout Canada. The retail locations are leased from commercial landlords.[8]

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sworn February 18, 2019 (the "**Affidavit**").
[3] Affidavit, para 5.
[4] Affidavit, para 6.
[5] *Canada Business Corporations Act*, RSC, 1985 c. C-44 [CBCA].
[6] Affidavit, paras 20 - 21.
[7] Affidavit, para 24.
[8] Affidavit, para 25.

8. The Payless Canada Entities also have a corporate office at leased premises located in Etobicoke, Ontario. [9]

9. There are approximately 2,400 employees in Canada of which 12 are corporate office employees and the remainder work at the retail locations.[10]

10. The Payless Canada Entities rely on the infrastructure of the U.S. Debtors for substantially all head-office functions including, among others, strategic decision making, financial reporting, human resources, inventory, and licensing of intellectual property. These services are provided to the Payless Canada Entities by certain U.S. Debtors pursuant to intercompany agreements that require payment by the Payless Canada Entities to the U.S. counterparties to these agreements.[11]

11. The assets of the Payless Canada Entities primarily consist of inventory and an intercompany promissory note receivable. The note was reported on the balance sheet as an unsecured note in the amount of approximately USD $110 million. Given that the issuer of the note is a U.S. Debtor, it is doubtful that the full value can be realized. Including the unsecured note, the aggregate book value of the consolidated Payless Canada Entities' assets according to the Financial Statements is approximately USD $192 million.[12]

12. The liabilities of the consolidated Payless Canada Entities include, among other things, outstanding gift cards, lease payments, trade and other accounts payable, taxes, accrued salary benefits, long term liabilities and intercompany service payables. Payless Canada Inc. is also liable to Collective Brands II Cooperatief UA, a Payless entity that is not a U.S. Debtor, under an

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[9] Affidavit, para 27.
[10] Affidavit, para 28.
[11] Affidavit, para 35.
[12] Affidavit, paras 41 – 43 and Exhibit F.

intercompany note in the amount of approximately USD $62 million (inclusive of accrued interest).[13]

13. The Payless Canada Entities are also guarantors under two credit facilities, the ABL Credit Facility and the Term Loan Credit Facility, as defined and described in more detail in the Affidavit. 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.[14]

14. The total amount of liabilities of the Payless Canada Entities inclusive of obligations under the guarantees of the ABL Credit Facility and Term Loan Credit Facility is in excess of USD $500 million.[15]

15. As a result of declining performance, on April 4, 2017, various Payless entities, including Canadian predecessors, commenced the Prior U.S. Proceedings. The Prior U.S. Proceedings were recognized as a "foreign main proceeding" under section 46 of the CCAA.[16]

16. The Canadian Court and the U.S. Bankruptcy Court approved the Joint Plan which was effective as of August 10, 2017 and which, among other things, reduced the debt burden of Payless Holdings LLC with its subsidiaries and related parties ("**Payless**"). Notwithstanding the Joint Plan and various cost-cutting measures, Payless' North American retail stores continued to suffer.[17]

17. Although Payless received additional capital during the course of 2018, Payless was not able to return to profitability. In December 2018, Payless engaged an investment bank, PJ

[13] Affidavit, paras 43 and 51 - 62.
[14] Affidavit, paras 45 and 49.
[15] Affidavit, paras 45 and 49 and Exhibit F.
[16] Affidavit, para 63.
[17] Affidavit, paras 64 and 67.

Solomon, L.P., to review strategic alternatives for the business. In early January it also engaged Ankura to assist with crises management and develop a restructuring strategy.[18]

18. Payless, with the assistance of its advisors, completed a store-level analysis of the North America business and determined that meaningful business improvements and capital investment would be required to achieve profitability. In consultation with its advisors, Payless decided to take steps to monetize or preserve its Latin America business and liquidate its North American operations.[19]

19. Following the decision to wind-down the North American business, the Payless Canada Entities considered continuing to operate independent of the U.S. business, but determined that it would be impossible. Given the operating losses incurred by the Payless Canada Entities (of over USD $12 million on a consolidated basis for 2018), there is no practical way for the Payless Canada Entities to replace the corporate functions provided by the U.S. operations and operate on a standalone basis.[20]

20. The Payless Canada Entities subsequently also engaged Ankura as CRO to work with the Board of Directors to explore strategic alternatives. Through discussions with the CRO, the Payless Canada Entities decided that it was in their best interest and the best interest of their stakeholders to complete the Canadian Liquidation.[21]

21. Payless lost a significant number of key management personnel during late 2018 and continues to see management-level attrition. The services provided by the proposed CRO are intended, under the direction of the Payless Canada Entity's directors, to stabilize the Payless

[18] Affidavit, paras 68 – 69.
[19] Affidavit, para 70.
[20] Affidavit, paras 41 and 71.
[21] Affidavit, para 71.

Canada Entities' business in the course of these proceedings given the reduced level of management employee bandwidth.[22]

PART III - ISSUES

22. 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; and

(g) Whether the Cross-Border Protocol should be approved.

23. The issues to be determined on the Comeback Motion are described in this factum and are as follows:

(a) Whether the Liquidation Consulting Agreement and Sale Guidelines should be approved; and

(b) Whether an extension of the stay of proceedings is appropriate.

PART IV - LAW

I. THE CCAA APPLIES TO THE APPLICANTS

(A) Applicants are insolvent

[22] Affidavit, para 72.

24. The CCAA applies to a company where the aggregate claims against it or its affiliated debtor companies are more than five million dollars.[23] Both of the Applicants meet the definition of a "company" under section 2(1) of the CCAA. Each Applicant is a corporation incorporated under the CBCA and neither of the Applicants fall within the excluded categories of "company" pursuant to the definition.[24]

25. Under section 2 of the CCAA, a "debtor company" is "any company that is bankrupt or insolvent".[25] The term "insolvent" is not defined under the CCAA. The word, however, has been interpreted by this Court to mean "insolvent person" pursuant to section 2 of the *Bankruptcy and Insolvency Act*[26]:

> ***insolvent person*** means a person who is not bankrupt and who resides, carries on business or has property in Canada, whose liabilities to creditors provable as claims under this Act amount to one thousand dollars, and
>
> (a) who is for any reason unable to meet his obligations as they generally become due,
>
> (b) who has ceased paying his current obligations in the ordinary course of business as they generally become due, or
>
> (c) the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due;[27]

26. In respect of the CCAA, the "insolvency" threshold in paragraph (a) of the test has been interpreted more broadly in that a company need only establish that it is reasonably foreseeable that it will run out of liquidity in a period of time insufficient to allow for a restructuring.[28]

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[23] CCAA, s 3(1).
[24] CCAA, s 2(1).
[25] CCAA, s 2(1).
[26] *Bankruptcy and Insolvency Act*, RSC, 1985, c. B-3 [BIA].
[27] BIA, s 2.
[28] *Re Stelco Inc.*, (2004) 48 CBR (4th) 299 (Ont SCJ) at para 40, Book of Authorities of the Applicants ("**BOA**") Tab A, leave to appeal to CA refused, [2004] OJ No 1903 leave to appeal to SCC refused, [2004] SCCA No 336.

27. The Payless Canada Entities have failed to pay their February rent for a number of Canadian stores. As well, defaults have occurred under both the ABL Credit Facility and the Term Loan Credit Facility and the ABL Agent has issued a Cash Dominion Direction.[29]

28. The Payless Canada Entities therefore have insufficient assets to discharge their liabilities and insufficient cash flow to meet their obligations as they come due.

29. Accordingly, the Applicants are insolvent debtor companies under the CCAA.

(B) Jurisdiction

30. Under section 9(1) of the CCAA, an application may be made in respect of a debtor company in the province where its registered head office or chief place of business in Canada is situated.[30]

31. The Applicants' chief place of business is at the Payless Canada Entities' corporate office in Etobicoke, Ontario.[31] The Payless Canada Entities also have 119 stores in Ontario, being the largest number of locations it has in any province.[32]

II. A Stay of Proceedings is Appropriate

32. The Payless Canada Entities require a stay of proceedings in order to prevent enforcement actions by various creditors including landlords and other contractual counterparties, and to provide breathing room to effectively plan and execute a controlled liquidation process to maximize value for stakeholders. Under section 11.02 of the CCAA, the Court has the discretion to order a stay of proceedings "on any terms" provided the Court is satisfied the order is appropriate in the circumstances.[33]

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[29] Affidavit, para 16.
[30] CCAA, s 9(1).
[31] Affidavit, para 27.
[32] Affidavit, para 25.
[33] CCAA, s 11.02.

33. The proposed Initial Order provides that the stay of proceedings apply not only in respect of the Applicants themselves, but that it extend, together with the benefits of the other relief sought in this Application, to the partnership, Payless Canada LP. Payless Canada LP is the substantial operating entity of the Payless business in Canada and is a guarantor under both the ABL Credit Facility and the Term Loan Credit Facility.[34]

34. Although the definition of "debtor company" under the CCAA does not include partnerships, this Court has established 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.[35]

35. The Applicants respectfully submit that in the present circumstances it is appropriate and necessary to grant the stay of proceedings and to extend the stay of proceedings to Payless Canada LP to ensure that the objectives of the CCAA in these proceedings are achieved.[36]

36. The Payless Canada Entities are also seeking a stay of proceedings against the Directors and Officers in order to prevent the assertion of claims or other relief in respect of the obligations of the Payless Canada Entities against such individuals.[37] The temporary stay in respect of the Directors and Officers will allow such parties to focus their time and energies on maximizing the recoveries from the Canadian Liquidation for the benefit of stakeholders.[38]

III. Appointment of the Monitor

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[34] Affidavit, para 44.
[35] See for example, *Re Lehndorff General Partner,* (1993) 9 BLR (2d) 975 (Ont SCJ) at para 21, BOA Tab B; *Re Priszm Income Fund*, 2011 ONSC 2061 at paras 26 – 28, BOA Tab C; *Re Urbancorp Toronto Management Inc.*, 2016 ONSC 3288 at paras 43 – 44, BOA Tab D; *Re Target Canada Co.,* 2015 ONSC 303 [*Target*] at paras 42 – 43, BOA Tab E.
[36] See also *Target*, *supra* BOA Tab E at paras 33 – 34 and 40 where this Court approved a broad stay of proceedings under the CCAA for the purposes of a retail liquidation.
[37] CCAA, s 11.03.
[38] Affidavit, para 86.

37. The Court is required to appoint a monitor over the business and financial affairs of a debtor company at the time an initial CCAA order is made.[39]

38. FTI is a licensed insolvency trustee within the meaning of section 2 of the BIA and is not subject to any restriction to act as monitor under section 11.7(2) of the CCAA.[40]

39. In mid-January 2019 the Payless Canada Entities selected FTI as proposed monitor in the event CCAA proceedings were commenced (the "**Proposed Monitor**"). Since then, the Proposed Monitor has assisted with, among other things, strategic discussions in connection with Payless Canada Entities' liquidity position and preparation of the Cash Flow Statement.[41]

IV. Appointment of the CRO

40. The proposed Initial Order provides for the appointment of Ankura as CRO.

41. The Court has authority under section 11 of the CCAA to allow a debtor company to enter into agreements that facilitate the debtor's restructuring, including the appointment of a restructuring organization.[42]

42. Ankura was hired by Payless Holdings LLC to provide restructuring services to Payless including the Payless Canada Entities, under an engagement letter dated January 29, 2019. The Payless Canada Entities also entered into an engagement letter with Ankura dated January 24, 2019, to retain Ankura as CRO for the Payless Canada Entities.[43]

43. The proposed CRO is necessary to assist with the Canadian Liquidation and is particularly critical given the number of departures by senior management. The appointment of the proposed CRO is not intended to replace the Board of Directors which will continue to oversee the business

[39] CCAA, s 11.7.
[40] Pre-filing Report of FTI Consulting Canada Inc., as Proposed Monitor dated February 19, 2019 (the "**Pre-filing Report**").
[41] Affidavit, para 90.
[42] CCAA, s 11.
[43] Affidavit, paras 72 - 73.

and have significant institutional knowledge. The proposed CRO will assist the Board and will use its restructuring experience for the benefit of stakeholders.[44]

44. The proposed CRO's mandate includes, among other things, to (i) make decisions with respect to the day to day operations of the Payless Canada Entities, including authorization to execute such documents as required or appropriate; (ii) realize and dispose of the property of the Payless Canada Entities on its behalf; and (iii) assist the Payless Canada Entities with store closures and liquidations. The full scope of the proposed CRO's role is described in the CRO's Engagement Letter.[45]

45. The CRO Engagement Letter provides for the proposed CRO to be remunerated on behalf of the Payless Canada Entities as part of the services provided under the existing Intercompany Agreements. In the event payments under the Intercompany Agreements are not made, however, the proposed CRO may charge the Payless Canada Entities directly for its services at an hourly rate.[46]

46. Under the relevant case law, it has been held that in situations similar to these proceedings where the proposed CRO has already been working closely with the debtor company, the Court should approve the proposed CRO's appointment.[47] This is particularly important in light of the recent attrition of the management of Payless such that it is critical to have experienced restructuring professionals to oversee and assist with the proceedings.

47. As part of such appointment, the Initial Order provides certain protections which would shield the proposed CRO from liabilities arising in the performance of its duties. The Payless

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[44] Affidavit, para 74.
[45] Affidavit, Exhibit H.
[46] Affidavit, para 75.
[47] *Re Mobilicity Group*, 2013 ONSC 6167 at paras 46 – 48, BOA Tab F.

Canada Entities would have difficulty retaining a capable organization to carry out the proposed mandate of the chief restructuring organization without similar protections.

48. Given that the proposed CRO has been advising the U.S. Debtors and is familiar with the Payless Canada Entities' operations, the Proposed Monitor believes the proposed CRO will provide benefits to the Payless Canada Entities and its stakeholders, and recommends the proposed CRO's appointment.[48]

49. Accordingly, the Payless Canada Entities respectfully submit that it is appropriate and necessary to approve the engagement of the proposed CRO.

V. Administration Charge

50. The Payless Canada Entities are seeking 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 Payless Canada Entities, up to a maximum amount of USD $2 million (the "**Administration Charge**").

51. The CCAA authorizes this Court to grant a priority charge for the fees and expenses of financial, legal and other experts under section 11.52.[49]

52. This Court has developed a non-exhaustive set of factors to consider in determining the quantum and whether certain professionals should be covered by an administration charge. These considerations include:

(a) the size and complexity of the businesses being restructured;

(b) the proposed role of the beneficiaries of the charge;

(c) whether there is an unwarranted duplication of roles;

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[48] Pre-filing Report.
[49] CCAA, s 11.52.

(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.[50]

53. The Administration Charge proposed in the Initial Order is reasonable in the circumstances taking into account the nature and size of the Payless Canada Entities' business and the value of charges approved in similar proceedings.

54. The Payless Canada Entities worked with the Proposed Monitor and the other professionals to formulate the quantum of the Administration Charge.[51] The Proposed Monitor is of the view that the service professionals benefitting from the Administration Charge are necessary to these proceedings and their roles will not result in any unwarranted duplication. As a result, the Proposed Monitor recommends the approval of the Administration Charge.[52]

55. The Payless Canada Entities submit that it is reasonable and appropriate for the Court to approve the Administration Charge.

VI. Directors' Charge

56. The proposed Initial Order provides for the creation of an indemnity and charge on the Property in order to protect the Directors and Officers against post-filing claims. The Property includes a reserve account which will be created for unpaid wages, vacation pay, certain other employment obligations and taxes as detailed in the Cash Flow Statement attached to the Pre-filing Report of the Proposed Monitor (the "**Reserve**").[53]

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[50] *Re Canwest Publishing Inc.,* 2010 ONSC 222 at para 54, as found in the Commercial List Authorities Book.
[51] Affidavit, para 96.
[52] Pre-filing Report.
[53] Affidavit, para 82 and 100.

57. The Directors' Charge has two components: (a) a charge specifically over the Reserve and in the amount of the Reserve at any given point in time; and (b) a general charge on the Property in the maximum amount of USD $4 million that would reduce to USD $2 million after March 21, 2019 (which reflects the corresponding increase of the Reserve over that period).[54]

58. The CCAA authorizes this Court to grant a priority directors' and officers' charge under section 11.51.[55]

59. The Directors' Charge would only apply with respect to amounts not otherwise covered under the Payless Canada Entities' directors' and officers' liability insurance policies. This Court has previously adopted this approach.[56]

60. Justice Pepall considered section 11.51 of the CCAA in *Re Canwest Global Communications Corp.*, and held:

> The purpose of such a charge is to keep the directors and officers in place during the restructuring by providing them with protection against liabilities they could incur during the restructuring: *General Publishing Co., Re* [(2003), 39 CBR (4th) 216)]. Retaining the current directors and officers of the applicants would avoid destabilization and would assist in the restructuring. The proposed charge would enable the applicants to keep the experienced board of directors supported by experienced senior management. The proposed Monitor believes that the charge is required and is reasonable in the circumstances and also observes that it will not cover all of the directors' and officers' liabilities in the worst case scenario. In all of these circumstances, I approved the request.[57]

61. The Payless Canada Entities require the continued service of its Directors to successfully facilitate the liquidation.[58] The Directors have provided valuable service to the Payless Canada Entities including through their restructuring efforts and have significant institutional knowledge of

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[54] Affidavit, para 101.
[55] CCAA, s 11.51.
[56] *Re Timminco Ltd.*, 2012 ONSC 106 at paras 33 – 36, BOA Tab G.
[57] *Re Canwest Global Communications Corp.* (2009), 59 CBR (5th) 72 (Ont SCJ) [*Re Canwest Global Communications Corp.*] at para 48, BOA Tab H.
[58] Affidavit, para 100.

the business and its stakeholders. The continued support of the Directors through these proceedings will provide stability and allow the Payless Canada Entities to maximize value for their stakeholders.[59]

62. In making a determination on the quantum of the Directors' Charge, the Proposed Monitor and the Payless Canada Entities considered the potential statutory liabilities for the Directors and Officers relating to wages, vacation pay, severance and termination, unremitted source deductions, and sales and services taxes.[60]

63. The Proposed Monitor believes the Directors' Charge and the quantum are reasonable and appropriate, and in accordance with this Court's past practice.[61] The Directors' Charge is intended to only cover liabilities the Directors and Officers may incur post-filing for foreseeable director and officer liabilities in connection with unremitted or unpaid employee obligations and taxes.[62]

64. Accordingly, the Payless Canada Entities respectfully submit that the Directors' Charge is reasonable in the circumstances and should be granted as proposed in the Initial Order.

VII. Approval of The Cross-Border Protocol

65. In order to facilitate the orderly administration of the Payless Canada Entities and in recognition of their reliance upon the U.S. Debtors, these proceedings should be coordinated with the U.S. Proceedings. Accordingly, the proposed Initial Order includes the approval of a cross-border protocol.[63]

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[59] Pre-filing Report.
[60] Pre-filing Report.
[61] Pre-filing Report.
[62] Pre-filing Report.
[63] Affidavit, para 104.

66. In order to approve a cross-border protocol, CCAA Courts have required that it be apparent that there are issues of over-lapping jurisdiction.[64] This situation commonly arises where the debtors' cross-border operations are reliant on one another and deeply related. As a result, open communication and cooperation between the U.S. and Canadian Courts are required to facilitate the restructuring.[65]

67. In cases where a Canadian retailer is wholly reliant on its U.S. parent for all head-office functions, this Court has noted the following cross-border goals:

> (i) both the CCAA and Chapter 11 Proceedings are coordinated to avoid inconsistent, conflicting or duplicative rulings by the Courts; (ii) all parties in interest are provided with sufficient notice of key issues in both proceedings; (iii) the substantive rights of all parties in interest are protected; and (iv) the jurisdictional integrity of the Court is preserved.[66]

68. The proposed Cross-Border Protocol achieves the above noted objectives by establishing principles for dealing with international jurisdictional issues and procedures to file materials and conduct joint hearings.

69. The U.S. Debtors will also be seeking the approval of the proposed Cross-Border Protocol by the U.S. Bankruptcy Court as part of their First Day Motions.[67] The Cross-Border Protocol will only become effective upon its approval by both this Court and the U.S. Bankruptcy Court.

70. The Proposed Monitor supports the approval of the Cross-Border Protocol. The Proposed Monitor believes the Cross-Border Protocol will enable improved coordination between the Canadian Court and the U.S. Bankruptcy Court.[68]

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[64] *Calpine Canada Energy Limited (Companies' Creditors Arrangement Act)*, 2006 ABQB 743 at para 36, BOA Tab I.
[65] *Northstar Aerospace, Inc. (Re)*, 2012 ONSC 3974 at para 23 – 25, BOA Tab J.
[66] *Eddie Bauer of Canada, Inc. (Re)* (2009), 55 CBR (5th) 33 (Ont SCJ) at paras 27-28, BOA Tab K.
[67] Affidavit, para 104.
[68] Pre-filing Report.

71. The Cross-Border Protocol is consistent with this Court's recent decision in *Aralez*, which is in accordance with similar decisions of this Court and attaches the Judicial Insolvency Network's Guidelines (the "**JIN Guidelines**") for Communication and Cooperation between Courts in Cross-Border Insolvency Matters as approved by the Commercial List User's Committee.[69]

VIII. Approval of the Liquidation Consulting Agreement and Sale Guidelines

72. At the Comeback Motion, the Payless Canada Entities will seek the approval of the Liquidation Consulting Agreement and the Sale Guidelines.

73. The Payless Canada Entities have determined, after working with their advisors that a liquidation in accordance with the Liquidation Consulting Agreement is the best course of action to maximize stakeholder value.[70] The U.S. Debtors and the Payless Canada Entities, with the assistance of the CRO, have negotiated and subject to Court approval, entered into the Liquidation Consulting Agreement.[71]

74. Pursuant to section 36 of the CCAA this Court may authorize a sale of assets outside of the ordinary course of business.[72] Although not intended to be exhaustive or a complete checklist, the CCAA provides for the following factors among others to be considered[73]:

(a) whether the process leading to the proposed sale or disposition was reasonable in the circumstances;

(b) whether the monitor approved the process leading to the proposed sale or disposition;

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[69] *Re Aralez* (25 October 2018), Toronto CV-18-603054-00CL (Ont SCJ) [*Aralez*] at para 2, referencing Schedule "A" to the *Aralez* order, the Cross-Border Border Insolvency Protocol, which attaches the JIN Guidelines as Schedule A, BOA Tab L.
[70] Affidavit, para 107.
[71] Affidavit, para 109.
[72] *Target*, *supra* BOA Tab E at paras 33 - 34.
[73] *Target Canada Co. (Re)*, 2015 ONSC 1487 at paras 15 – 16, BOA Tab M.

(c) whether the monitor filed with the court a report stating that in their opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition under a bankruptcy;

(d) the extent to which the creditors were consulted;

(e) the effects of the proposed sale or disposition on the creditors and other interested parties; and

(f) whether the consideration to be received for the assets is reasonable and fair, taking into account their market value.[74]

75. The proposed liquidation pursuant to the Liquidation Consulting Agreement satisfies the section 36 criteria for the following reasons:

(a) The Payless Canada Entities have determined that in the circumstances there is virtually no basis for them to continue as going concerns. The Payless Canada Entities have suffered significant operating losses. The Payless Canada Entities are completely reliant on the U.S. and cannot continue to operate independently following the U.S. Liquidation. Accordingly, the Canadian Liquidation is inevitable;

(b) Payless engaged Malfinato Advisors to advise on the liquidation and assist with the liquidator selection process. A formal request for proposal process was undertaken with standard bid submission requirements. Two bidders submitted proposals. The Liquidation Consultant was selected because the terms of its proposal best met the following evaluation criteria on whether the bidder (a) had realistic views on overall recovery on the inventory, (b) had recent experience liquidating specialty footwear retail inventory, (c) would dedicate the best

[74] CCAA, s 36.

resources to accomplish Payless' goals, (d) had familiarity with Payless, its inventory systems and operational structure, and (e) had shown the ability to execute a large-scale liquidation on an expedited basis;

(c) The Proposed Monitor is supportive of the Liquidation Consulting Agreement and believes both that it will maximize value and is in the best interest of the Payless Canada Entities and their stakeholders[75]; and

(d) Given the circumstances of these proceedings, the Payless Canada Entities expect that the liquidation pursuant to the Liquidation Consulting Agreement is in the best interests of the Payless Canada Entities and their stakeholders.

76. The Liquidation Approval Order provides for the Payless Canada Entities to accept gift cards for the first 30 days after the Liquidation Approval Order consistent with the U.S. Proceedings. This period of time for the acceptance of gift cards by a retailer during a liquidation period was previously approved by this Court in *HMV*.[76]

77. The Sales Guidelines attached as Schedule "A" to the draft Court Order for approval of the Liquidation Consulting Agreement are in a form that is in accordance with customary inventory liquidation precedents in Canada.

IX. Extension of the stay of proceedings

78. The proposed Initial Order provides for a stay of proceedings until March 21, 2019. At the Comeback Motion, the Applicants intend to request an extension of the initial stay of proceedings to provide the Payless Canada Entities the time necessary to complete the Canadian Liquidation

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[75] Pre-filing Report.

[76] *HUK 10 Limited v HMV Canada Inc.* (27 January 2017), Toronto CV-17-11674-OOCL (Ont SCJ (Comm List)) [*HMV*] at para 3, approving the Agency Agreement between a contractual joint venture composed of Gordon Brothers Canada ULC, Merchant Retail Solutions ILC, HMV Canada Inc. and Richter Advisory Group, Inc., solely in its capacity as Court-appointed receiver of HMV Canada Inc., dated January 26, 2017, s 9.6, BOA Tab N.

in a controlled manner. The Liquidation Approval Order requests for an extension of the stay of proceedings until May 10, 2019.

79. The Court may extend the stay of proceedings under section 11.02 where (a) the order is appropriate in the circumstances; and (b) the debtor companies have acted and are acting in good faith and with due diligence.[77]

80. Based on the Cash Forecast, the Payless Canada Entities have sufficient funds to allow for the completion of the Canadian Liquidation by the end of the period of the extended stay of proceedings.

81. The Payless Canada Entities have acted and, assuming the Liquidation Consulting Agreement is approved, will continue to act in good faith and with due diligence in conducting the Canadian Liquidation to maximize value for their stakeholders. The Proposed Monitor is supportive of the approval of extending the stay of proceedings until May 10, 2019.

82. The Payless Canada Entities respectfully submit that the extension of the stay of proceedings is appropriate and reasonable in the circumstances and should be granted as proposed in the Liquidation Approval Order.

PART V - RELIEF SOUGHT

83. The Applicants request that this Court grant the proposed relief by making an order substantially in the form of the Initial Order.

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[77] CCAA, s 11.02(2).

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 19th day of February 2019.

Cassels Brock & Blackwell LLP

Lawyers for the Applicants

SCHEDULE "A"

LIST OF AUTHORITIES

1. *Re Stelco Inc.*, (2004) 48 CBR (4th) 299 (Ont SCJ), leave to appeal to CA refused, [2004] OJ No 1903 leave to appeal to SCC refused, [2004] SCCA No 336.
2. *Re Lehndorff General Partner,* (1993) 9 BLR (2d) 975 (Ont SCJ).
3. *Re Priszm Income Fund*, 2011 ONSC 2061.
4. *Re Urbancorp Toronto Management Inc.*, 2016 ONSC 3288.
5. *Re Target Canada Co.,* 2015 ONSC 303.
6. *Re Mobilicity Group*, 2013 ONSC 6167.
7. *Re Canwest Publishing Inc.,* 2010 ONSC 222.
8. *Re Timminco Ltd.*, 2012 ONSC 106.
9. *Re Canwest Global Communications Corp.* (2009), 59 CBR (5th) 72 (Ont SCJ).
10. *Calpine Canada Energy Limited (Companies' Creditors Arrangement Act)*, 2006 ABQB 743.
11. *Northstar Aerospace, Inc. (Re)*, 2012 ONSC 3974.
12. *Eddie Bauer of Canada, Inc. (Re)* (2009), 55 CBR (5th) 33 (Ont SCJ).
13. *Re Aralez* (25 October 2018), Toronto CV-18-603054-00CL (Ont SCJ).
14. *Target Canada Co. (Re)*, 2015 ONSC 1487.
15. *HUK 10 Limited v HMV Canada Inc.* (27 January 2017), Toronto CV-17-11674-00CL (Ont SCJ).

SCHEDULE "B"

TEXT OF STATUTES, REGULATIONS & BY - LAWS

***Bankruptcy and Insolvency Act*, RSC 1985, c B-3**

Definitions

2. (1) In this Act,

"insolvent person".

"insolvent person" means a person who is not bankrupt and who resides, carries on business or has property in Canada, whose liabilities to creditors provable as claims under this Act amount to one thousand dollars, and

(a) who is for any reason unable to meet his obligations as they generally become due,

(b) who has ceased paying his current obligations in the ordinary course of business as they generally become due, or

(c) the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due;

"trustee"

"trustee" or "licensed trustee" means a person who is licensed or appointed under this Act;

***Companies' Creditors Arrangement Act*, RSC 1985, c C-36**

Definitions

2. (1) In this Act,

"company"

"company" means any company, corporation or legal person incorporated by or under an Act of Parliament or of the legislature of a province, any incorporated company having assets or doing business in Canada, wherever incorporated, and any income trust, but does not include banks, authorized foreign banks within the meaning of section 2 of the *Bank Act*, railway or telegraph companies, insurance companies and companies to which the *Trust and Loan Companies Act* applies;

"debtor company"

"debtor company" means any company that

(a) is bankrupt or insolvent,

(b) has committed an act of bankruptcy within the meaning of the *Bankruptcy and Insolvency Act* or is deemed insolvent within the meaning of the *Winding-up and Restructuring Act*, whether or not proceedings in respect of the company have been taken under either of those Acts,

(c) has made an authorized assignment or against which a bankruptcy order has been made under the *Bankruptcy and Insolvency Act*, or

(d) is in the course of being wound up under the *Winding-up and Restructuring Act* because the company is insolvent;

Application

3. (1) This Act applies in respect of a debtor company or affiliated debtor companies if the total of claims against the debtor company or affiliated debtor companies, determined in accordance with section 20, is more than $5,000,000 or any other amount that is prescribed.

Jurisdiction of court to receive applications

9. (1) Any application under this Act may be made to the court that has jurisdiction in the province within which the head office or chief place of business of the company in Canada is situated, or, if the company has no place of business in Canada, in any province within which any assets of the company are situated.

General power of court

11. Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.

Stays, etc. — initial application

11.02 (1) A court may, on an initial application in respect of a debtor company, make an order on any terms that it may impose, effective for the period that the court considers necessary, which period may not be more than 30 days,

(a) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*;

(b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(c) prohibiting, until otherwise ordered by the court, the commencement of any action, suit or proceeding against the company.

Stays, etc. — other than initial application

(2) A court may, on an application in respect of a debtor company other than an initial application, make an order, on any terms that it may impose,

(a) staying, until otherwise ordered by the court, for any period that the court considers necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in paragraph (1)(a);

(b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(c) prohibiting, until otherwise ordered by the court, the commencement of any action, suit or proceeding against the company.

Burden of proof on application

(3) The court shall not make the order unless

(a) the applicant satisfies the court that circumstances exist that make the order appropriate; and

(b) in the case of an order under subsection (2), the applicant also satisfies the court that the applicant has acted, and is acting, in good faith and with due diligence.

Stays — directors

11.03 (1) An order made under section 11.02 may provide that no person may commence or continue any action against a director of the company on any claim against directors that arose before the commencement of proceedings under this Act and that relates to obligations of the company if directors are under any law liable in their capacity as directors for the payment of those obligations, until a compromise or an arrangement in respect of the company, if one is filed, is sanctioned by the court or is refused by the creditors or the court.

Exception

(2) Subsection (1) does not apply in respect of an action against a director on a guarantee given by the director relating to the company's obligations or an action seeking injunctive relief against a director in relation to the company.

Persons deemed to be directors

(3) If all of the directors have resigned or have been removed by the shareholders without replacement, any person who manages or supervises the management of the business and affairs of the company is deemed to be a director for the purposes of this section.

Security or charge relating to director's indemnification

11.51 (1) On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring that all or part of the property of the company is subject to a security or charge — in an amount that the court considers appropriate — in favour of any director or officer of the company to indemnify the director or officer against obligations and liabilities that they may incur as a director or officer of the company after the commencement of proceedings under this Act.

Priority

(2) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

Restriction — indemnification insurance

(3) The court may not make the order if in its opinion the company could obtain adequate indemnification insurance for the director or officer at a reasonable cost.

Negligence, misconduct or fault

(4) The court shall make an order declaring that the security or charge does not apply in respect of a specific obligation or liability incurred by a director or officer if in its opinion the obligation or liability was incurred as a result of the director's or officer's gross negligence or wilful misconduct or, in Quebec, the director's or officer's gross or intentional fault.

Court may order security or charge to cover certain costs

11.52 (1) On notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring that all or part of the property of a debtor company is subject to a security or charge — in an amount that the court considers appropriate — in respect of the fees and expenses of

(a) the monitor, including the fees and expenses of any financial, legal or other experts engaged by the monitor in the performance of the monitor's duties;

(b) any financial, legal or other experts engaged by the company for the purpose of proceedings under this Act; and

(c) any financial, legal or other experts engaged by any other interested person if the court is satisfied that the security or charge is necessary for their effective participation in proceedings under this Act.

Priority

(2) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

Court to appoint monitor

11.7 (1) When an order is made on the initial application in respect of a debtor company, the court shall at the same time appoint a person to monitor the business and financial affairs of the company. The person so appointed must be a trustee, within the meaning of subsection 2(1) of the *Bankruptcy and Insolvency Act*.

Restrictions on who may be monitor

(2) Except with the permission of the court and on any conditions that the court may impose, no trustee may be appointed as monitor in relation to a company

(a) if the trustee is or, at any time during the two preceding years, was

(i) a director, an officer or an employee of the company,

(ii) related to the company or to any director or officer of the company, or

(iii) the auditor, accountant or legal counsel, or a partner or an employee of the auditor, accountant or legal counsel, of the company; or

(b) if the trustee is

(i) the trustee under a trust indenture issued by the company or any person related to the company, or the holder of a power of attorney under an act constituting a hypothec within the meaning of the Civil Code of Quebec that is granted by the company or any person related to the company, or

(ii) related to the trustee, or the holder of a power of attorney, referred to in subparagraph (i).

Restriction on disposition of business assets

36 (1) A debtor company in respect of which an order has been made under this Act may not sell or otherwise dispose of assets outside the ordinary course of business unless authorized to do so by a court. Despite any requirement for shareholder approval, including one under federal or provincial law, the court may authorize the sale or disposition even if shareholder approval was not obtained.

Notice to creditors

(2) A company that applies to the court for an authorization is to give notice of the application to the secured creditors who are likely to be affected by the proposed sale or disposition.

Factors to be considered

(3) In deciding whether to grant the authorization, the court is to consider, among other things,

(a) whether the process leading to the proposed sale or disposition was reasonable in the circumstances;

(b) whether the monitor approved the process leading to the proposed sale or disposition;

(c) whether the monitor filed with the court a report stating that in their opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition under a bankruptcy;

(d) the extent to which the creditors were consulted;

(e) the effects of the proposed sale or disposition on the creditors and other interested parties; and

(f) whether the consideration to be received for the assets is reasonable and fair, taking into account their market value.

Additional factors — related persons

(4) If the proposed sale or disposition is to a person who is related to the company, the court may, after considering the factors referred to in subsection (3), grant the authorization only if it is satisfied that

(a) good faith efforts were made to sell or otherwise dispose of the assets to persons who are not related to the company; and

(b) the consideration to be received is superior to the consideration that would be received under any other offer made in accordance with the process leading to the proposed sale or disposition.

Related persons

(5) For the purpose of subsection (4), a person who is related to the company includes

(a) a director or officer of the company;

(b) a person who has or has had, directly or indirectly, control in fact of the company; and

(c) a person who is related to a person described in paragraph (a) or (b).

Assets may be disposed of free and clear

(6) The court may authorize a sale or disposition free and clear of any security, charge or other restriction and, if it does, it shall also order that other assets of the company or the proceeds of the sale or disposition be subject to a security, charge or other restriction in favour of the creditor whose security, charge or other restriction is to be affected by the order.

Restriction — employers

(7) The court may grant the authorization only if the court is satisfied that the company can and will make the payments that would have been required under paragraphs 6(5)(a) and (6)(a) if the court had sanctioned the compromise or arrangement.

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

Court File No.

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

PROCEEDING COMMENCED AT TORONTO

FACTUM OF THE APPLICANTS
(CCAA Initial Application)

CASSELS BROCK & BLACKWELL LLP
2100 Scotia Plaza
40 King Street West
Toronto, ON M5H 3C2

Ryan Jacobs
Tel: 416.860.6465
Fax: 416.640.3189
rjacobs@casselsbrock.com

Jane Dietrich
Tel: 416.860.5223
Fax: 416.640.3144
jdietrich@casselsbrock.com

Natalie Levine
Tel: 416.860.6568
Fax: 416.640.3207
nlevine@casselsbrock.com

Lawyers for Payless ShoeSource Canada Inc., Payless ShoeSource Canada GP Inc. and Payless ShoeSource Canada LP