UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	Chapter 11
SCHOOL SPECIALTY, INC., *et al*.,[1]	Case No. 13-10125 (KJC)
Debtors.	Jointly Administered
	Hearing Date: May 23, 2013 at 2:00 p.m. (ET)

DEBTORS' MEMORANDUM OF LAW IN SUPPORT OF CONFIRMATION OF DEBTORS' AMENDED JOINT PLAN OF REORGANIZATION UNDER CHAPTER 11 OF THE BANKRUPTCY CODE

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[1] The Debtors in these cases, along with the last four digits of each Debtor's federal tax identification number and state of incorporation, are: School Specialty, Inc. (Wisc.; 1239), Bird-In-Hand Woodworks, Inc. (N.J.; 8811), Califone International, Inc. (Del.; 3578), Childcraft Education Corp. (N.Y.; 9818), ClassroomDirect.com, LLC (Del.; 2425), Delta Education, LLC (Del.; 8764), Frey Scientific, Inc. (Del.; 3771), Premier Agendas, Inc. (Wash.; 1380), Sax Arts & Crafts, Inc. (Del.; 6436), and Sportime, LLC (Del.; 6939). The address of the Debtors' corporate headquarters is W6316 Design Drive, Greenville, Wisconsin 54942.

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I.
PRELIMINARY STATEMENT

School Specialty, Inc. and its affiliated debtors and debtors-in-possession in the above-captioned cases (collectively, the "Debtors") submit this memorandum of law in support of confirmation of the *Debtors' Amended Joint Plan of Reorganization Under Chapter 11 of the Bankruptcy Code* (as may be amended, the "Plan").[1] As described more fully in the *Disclosure Statement for Debtors' Amended Joint Plan of Reorganization Under Chapter 11 of the Bankruptcy Code*, dated April 23, 2013 [Docket No. 866] (the "Disclosure Statement"), the Plan is the result of extensive, arm's length negotiations among the Debtors and their key creditor constituencies, including the Creditors Committee, the ABL DIP Lenders and the Ad Hoc DIP Lenders. As a result of these negotiations, all of the Debtors' key constituencies support the Plan. Moreover, the Debtors received overwhelming support from almost all of their unsecured creditors: all Classes of the Debtors' unsecured creditors except one voted resoundingly to approve the Plan. For these reasons as well as the reasons set forth below, the Plan meets each requirement of section 1129 of the Bankruptcy Code, and the Debtors submit that the Plan should be confirmed.[2]

II.
BACKGROUND

A. Introduction

On January 28, 2013, School Specialty, Inc. ("SSI" or "School Specialty") and its domestic subsidiaries, Bird-In-Hand Woodworks, Inc., Califone International, Inc., Childcraft

[1] Capitalized terms used but not otherwise defined herein shall have those meanings ascribed to them in the Plan or the Disclosure Statement (as defined below), as applicable.

[2] The Debtors reserve the right to file an omnibus reply to objections to confirmation (the "Omnibus Reply") prior to the Confirmation Hearing, which will address specific objections to confirmation of the Plan that are not otherwise addressed herein.

Education Corp., ClassroomDirect.com, LLC, Delta Education, LLC, Frey Scientific, Inc., Premier Agendas, Inc., Sax Arts & Crafts, Inc., and Sportime, LLC (collectively, the "Debtors"), filed voluntary petitions for relief under chapter 11 of the Bankruptcy Code (the "Chapter 11 Cases") with the United States Bankruptcy Court for the District of Delaware (the "Court"). The Debtors continue to manage their business as debtors-in-possession. No request has been made for appointment of a trustee or examiner. On February 5, 2013, the Office of the United States Trustee (the "U.S. Trustee") appointed the Official Committee of Unsecured Creditors (the "Creditors Committee"), which was amended on February 27, 2013. [Docket Nos. 110, 330].

B. The Plan and the Disclosure Statement

The Debtors have worked diligently to formulate a plan of reorganization in these Chapter 11 Cases that will rehabilitate the Debtors such that the Reorganized Debtors will be viable going concerns following emergence, and distribute the value of the Debtors' estates in a fair and equitable manner consistent with applicable law. To accomplish these goals, the Debtors have endeavored to achieve consensus among their key creditor constituencies regarding the form and substance of the restructuring and the Plan.

The resulting Plan contemplates that the Ad Hoc DIP Lenders will receive New SSI Common Stock on account of their claims, in addition to certain cash payments. All other secured debt, as well as all priority and administrative claims, will be paid in full in cash on or as soon as reasonably practicable following the Effective Date. Thus, those classes of claims are unimpaired. In contrast, the Debtors' various unsecured creditor classes are impaired under the Plan, and will receive the following treatment: holders of Noteholder Unsecured Claims will receive equity in Reorganized SSI; and holders of General Unsecured Claims and Trade Unsecured Claims will receive a deferred payment in cash on account of their respective

Allowed Claims, unless they opt-in to the Convenience Class. Holders of small unsecured claims will automatically fall into the Convenience Class and will receive a one-time payment in cash on account of their claims as soon as practicable following the Effective Date. Finally, no distributions will be made on account of Equity Interests in SSI. A chart summarizing the material terms, treatment and distributions to holders of Allowed Claims against, and Equity Interests in, the Debtors under the Plan is included in Article II of the Disclosure Statement.

On March 19, 2013, the Debtors filed the *Debtors' Joint Plan Under Chapter 11 of the Bankruptcy Code* and accompanying Disclosure Statement [Docket Nos. 599, 600]. On April 19, 2013, the Debtors filed *Blackline Versions of the Plan and Disclosure Statement* [Docket No. 838]. On April 23, 2013, the Debtors filed the amended Plan and an amended Disclosure Statement [Docket Nos. 862, 864]. Hearings to consider approval of the Disclosure Statement were held on April 22, 2013 and April 24, 2013 (together, the "Disclosure Statement Hearings").

On April 24, 2013, the Court entered its *Order: (A) Conditionally Approving Disclosure Statement; (B) Fixing Voting Record Date; (C) Approving Solicitation Materials and Procedures for Distribution Thereof; (D) Approving Forms of Ballots and Establishing Procedures for Voting on Plan Tabulating Votes; (E) Scheduling Hearing and Approving Notice and Procedures for Filing Objections to (I) Confirmation of the Plan, and (II) Proposed Cure Amounts Related to Contracts and Leases Assumed Under the Plan; and (F) Granting Related Relief* [Docket No. 902] (the "Disclosure Statement Approval Order"). Pursuant to the Disclosure Statement Approval Order, the Court, among other things, (i) conditionally approved the Disclosure Statement as containing adequate information within the meaning of section 1125 of the Bankruptcy Code, and, on a final basis, (ii) approved the form and manner of various

notices, ballots and the procedures for tabulating votes, and (iii) established various deadlines, including May 16, 2013, at 4:00 p.m. prevailing Eastern Time as the deadline by which all ballots must be received by the Debtors' Claims and Noticing Agent (the "Voting Deadline"). The Court also scheduled a hearing to consider confirmation of the Plan on May 20, 2013, at 1:30 p.m. prevailing Eastern Time (the "Confirmation Hearing"), which was rescheduled for May 23, 2013 at 2:00 p.m. prevailing Eastern Time [Docket No. 1086].

In anticipation of the Confirmation Hearing and the Debtors' emergence from Chapter 11, the Debtors have undertaken several important steps in furtherance of confirmation and implementation of the Plan, including, without limitation:

- Negotiating exit financing in the form of both an ABL exit facility and a term loan exit facility;
- Soliciting votes to accept the Plan from holders of Claims in Impaired Classes that were entitled to vote on the Plan;
- Providing holders of Class 6 Claims with the Trade Election forms on a rolling basis; and
- Beginning the process of negotiating Customary Trade Terms with Trade Claimants.

On May 9, 2013, May 15, 2013, and May 17, 2013, the Debtors filed their Plan Supplements [Docket Nos. 1026, 1044, 1056, and 1099], which identify or otherwise provide information regarding the following: (i) the Reorganized Debtors' amended governance documents, including the certificates of incorporation and bylaws; (ii) the Reorganized Debtors' boards of directors and officers; (iii) the rights, duties and powers of the Ombudsman; (iv) the ABL Exit Facility documents and a term sheet for the Term Loan Exit Facility; (v) the executory contracts and unexpired leases to be rejected and to be assumed; and (vii) information regarding the Management Incentive Plan.

C. Plan Solicitation and Results Thereof

On or about April 26, 2013, the Debtors began soliciting votes on the Plan by distributing the Disclosure Statement and related materials to holders of Claims in Impaired Classes that were entitled to vote under the Plan. The Classes entitled to vote under the Plan (the "Voting Classes") are Class 5 (General Unsecured Claims), Class 6 (Trade Unsecured Claims), Class 7 (Noteholder Unsecured Claims), and Class 8 (Convenience Class Claims). Specifically, the Debtors transmitted a solicitation package (the "Solicitation Package") to known holders of Claims in Classes 5, 6, and 8, as of April 24, 2013, containing (i) the Confirmation Hearing Notice setting forth details regarding the solicitation process and applicable deadlines; (ii) a CD-ROM containing the Disclosure Statement Order (without exhibits) and a copy of the Disclosure Statement (together with the Plan and other exhibits annexed thereto); and (iii) the appropriate Ballot to accept or reject the Plan and a postage prepaid, self-addressed, return envelope. Holders of Claims in Classes 5, 6 and 8 could also return their Ballot via electronic mail. With respect to holders of Claims in Class 7, the Claims Agent served the contents of the Solicitation Packages on the appropriate Nominee, who then distributed the Solicitation Packages to the Noteholders. In addition, pursuant to the Disclosure Statement Order, the Debtors published notice of the Confirmation Hearing in the national edition of *The New York Times* on May 3, 2013 [Docket No. 1014].

Pursuant to paragraph 21 of the Disclosure Statement Order, the deadline for returning ballots accepting or rejecting the Plan was set for 4:00 p.m. prevailing Eastern Time on May 16, 2013 (the "Voting Deadline"). Thus, the voting parties were given at least seventeen days to vote on the Plan, and holders of Claims in Classes 5, 6 and 8 could also return their Ballot via electronic mail.

As set forth below, the Debtors received overwhelming acceptances from three of the four Voting Classes. Class 5 did not accept the Plan. *See Certification of P. Joe Morrow IV with Respect to the Tabulation of Votes on the Debtors' Amended Joint Plan of Reorganization Under Chapter 11 of The Bankruptcy Code* (the "Voting Declaration") [Docket No. 1011].

VOTING RESULTS **Total Ballots Received**			
Accept		**Reject**	
Number	**Amount**	**Number**	**Amount**
Class 5 – General Unsecured Claims			
29 (76.32%)	$2,641,943.76 (62.38%)	9 (23.68%)	$1,593,218.06 (37.62%)
Class 6 – Trade Unsecured Claims			
344 (88.21%)	$24,895,896.17 (93.72%)	46 (11.79%)	$1,668,065.62 (6.28%)
Class 7 – Noteholder Unsecured Claims			
46 (86.79%)	$104,897,189.00 (92.41%)	7 (13.21%)	$8,620,000.00 (7.59%)
Class 8 – Convenience Class Claims			
308 (95.95%)	$296,350.94 (95.45%)	13 (4.05%)	$14,112.65 (4.55%)

Under the Plan, Class 9 Equity Interests will receive no distributions. Therefore, the holders of such Equity Interests are deemed to have rejected the Plan, and no votes were solicited with respect to these Equity Interests.

The Debtors received seven objections to the Plan (collectively, the "Confirmation Objections") from the following parties: (i) Michigan Department of Treasury (the "Michigan Treasury") [Docket No. 957]; (ii) Texas Comptroller of Public Accounts (the "Texas Comptroller") [Docket No. 979]; (iii) Internal Revenue Service (the "IRS") [Docket No. 1057]; (iv) Tennessee Department of Revenue ("TDOR") [Docket No. 1052]; (v) Comerica

Bank [Docket No. 1070]; (vi) certain Noteholders [Docket No. 1072]; and (vii) the U.S. Trustee [Docket No. 1077].[3]

The Debtors have attempted to resolve the Confirmation Objections without the need for litigation. The Debtors have also worked (and continue to work) diligently to resolve informal objections concerning the Plan. Of the seven Confirmation Objections that were filed, the Debtors believe that they have resolved or will resolve the vast majority prior to the Confirmation Hearing.[4]

With respect to those Confirmation Objections that the Debtors have been unable to resolve, the Debtors are preparing the Omnibus Reply, which will supplement this memorandum and specifically address certain of the issues raised in the Confirmation Objections. A status chart that identifies each of the Confirmation Objections and the Contract/Lease Objections with a short summary of the substance of each and the status of the Debtors' attempt to resolve each such Confirmation or Contract/Lease Objection (the "Objections Status Chart") will be filed in advance of the Confirmation Hearing. To the extent any Confirmation Objections remain unresolved at the time of the Confirmation Hearing, the Debtors believe that they should be overruled.

For the reasons set forth below, the Debtors submit that the Plan satisfies all of the confirmation standards under section 1129 of the Bankruptcy Code, is in the best interest of all creditors, and should be confirmed by the Court.

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[3] In addition, the Debtors received various objections regarding the assumption of executory contracts or cure amounts related thereof (collectively, the "Contract/Lease Objections"). *See* Docket Nos. 1054, 1061, 1064, 1068, 1069, 1073, 1075 and 1088. As of the date hereof, the Debtors have resolved or agreed to adjourn all but one of the Contract/Lease Objections.

[4] As of the date hereof, the Debtors have resolved the Confirmation Objections filed by: Michigan Treasury, the Texas Comptroller, the IRS, TDOR and Comerica Bank.

D. Modifications to the Plan Do Not Materially or Adversely Affect Any Holders of Claims or Require Resolicitation for the Plan

The Debtors have modified certain provisions of the Plan and the proposed Confirmation Order to make technical, non-material or beneficial changes and to address Objections or concerns filed or asserted by various parties (the "Plan Modifications"). Those modifications include:

- Revising the definition of Record Date to be the Effective Date for the purpose of making Distributions under the Plan on account of Allowed Claims;
- Revising Article VII.D to clarify that, to the extent that a holder of an Allowed Claim arising from the rejection of executory contracts is a party with whom the Reorganized Debtors continue to do business after the Effective Date, such holder shall be treated as the holder of a Trade Unsecured Claim; and
- Revising the exculpation provision in Article IX.K and the release provision in Article IX.I to resolve concerns raised by the U.S. Trustee.

Pursuant to section 1127(a) of the Bankruptcy Code, a plan proponent may modify the plan "at any time" prior to entry of a confirmation order so long as the modified plan meets the requirements of sections 1122 and 1223 of the Bankruptcy Code. Section 1127(d) of the Bankruptcy Code provides that all stakeholders that previously accepted the plan should also be deemed to have accepted the modified plan. Courts routinely allow plan proponents to make non-material or beneficial changes to a plan without requiring the proponent to re-solicit the plan for acceptances.[5] The Debtors submit that the Plan Modifications do not materially and adversely affect the recoveries of any creditors.[6]

[5] *See, e.g., In re New Power Co.*, 438 F.3d 1113, 1117-18 (11th Cir. 2006) ("the bankruptcy court may deem a claim or interest holder's vote for or against a plan as a corresponding vote in relation to a modified plan unless the modification materially and adversely changes the way that claim or interest holder is treated"); *In re Calpine*, 2007 WL 4565223, at *6 (Bankr. S.D.N.Y. Dec. 19, 2007) (approving immaterial modification to plan without requiring the debtors to resolicit the plan); *In re Kmart Corp.*, 2006 WL 952042, at *27 (Bankr. N.D.

The Debtors submit that the Plan can be confirmed without re-solicitation for Plan acceptances, and that all creditors in Voting Classes that previously voted to accept the Plan should be deemed to accept the Plan as modified. *See* 11 U.S.C. § 1127(d).

III.
ARGUMENT

To confirm the Plan, the Court must find that the Debtors have satisfied the provisions of section 1129 of the Bankruptcy Code by a preponderance of the evidence.[7] As proponents of the Plan, the Debtors bear the burden of establishing that all elements necessary for confirmation of the Plan under section 1129 of the Bankruptcy Code have been met.[8]

As discussed in detail below, the Plan satisfies all of the applicable requirements of section 1129(a) of the Bankruptcy Code, other than 1129(a)(8) of the Bankruptcy Code with respect to Classes 5 and 9 (the "Rejecting Classes"). Pursuant to section 1129(b)(1) of the Bankruptcy Code, the Plan may be confirmed notwithstanding this fact, because the Plan is "fair and equitable" with respect to the Rejecting Classes and does not unfairly discriminate against the Rejecting Classes. As set forth herein and in the *Declaration of David Vander Ploeg in Support of Confirmation of the Debtors' Amended Joint Plan of Reorganization Under Chapter*

Ill. Apr. 11, 2006) (if modification does not adversely change the treatment of claims, then resolicitation is not required); *In re Winn-Dixie Stores, Inc.*, 356 B.R. 813, 823 (Bankr. M.D. Fla. 2006) (same).

6 Courts have held that a modification is material and adverse "if it so affects a creditor or interest holder who accepted the plan that such entity, if it knew of the modification, would be likely to reconsider acceptance." *In re American Solar King Corp.*, 90 B.R. 808, 823 (Bankr. W.D. Tex. 1988); *see also In re Boylan Int'l, Ltd.*, 452 B.R. 43, 51 (Bankr. S.D.N.Y. 2011) (same).

7 *See In re Armstrong World Indus.*, 348 B.R. 111, 120-22 (D. Del. 2006); *In re Genesis Health Ventures, Inc.*, 266 B.R. 591, 616, n.23 (Bankr. D. Del. 2001), appeal dismissed, *In re Genesis Health Ventures, Inc.*, 280 B.R. 339 (D. Del. 2002); *see also In re Bally Total Fitness of Greater New York, Inc.*, No. 07-12395, 2007 WL 2779438, at *3 (Bankr. S.D.N.Y. Sept. 17, 2007) ("The Debtors, as proponents of the Plan, have the burden of proving the satisfaction of the elements of Sections 1129(a) and (b) of the Bankruptcy Code by a preponderance of the evidence.").

8 *See Heartland Fed'n Sav. & Loan Ass'n* v. *Briscoe Enters. Ltd. II (In re Briscoe Enters., Ltd. II)*, 994 F.2d 1160, 1165 (5th Cir. 1993) (stating that the bankruptcy court must find that the debtors have satisfied the provisions of section 1129 of the Bankruptcy Code by a preponderance of the evidence).

11 of the Bankruptcy Code, filed contemporaneously herewith (the "Vander Ploeg Declaration"), the Debtors submit that the Plan satisfies these requirements, complies with all relevant sections of the Bankruptcy Code, Bankruptcy Rules, and applicable non-bankruptcy law, as modified by the Disclosure Statement Approval Order, and should therefore be confirmed.

A. The Plan Complies with Applicable Provisions of the Bankruptcy Code (Section 1129(a)(1))

Section 1129(a)(1) of the Bankruptcy Code requires that a plan of reorganization comply with the applicable provisions of the Bankruptcy Code.[9] A principal objective of this section is to ensure compliance with the sections of the Bankruptcy Code governing classification of claims and interests and the contents of a plan of reorganization.[10] Accordingly, the determination of whether the Plan complies with section 1129(a)(1) of the Bankruptcy Code requires an analysis of the Debtors' compliance with sections 1122 and 1123 of the Bankruptcy Code. As explained below, the Plan complies with both sections in all respects.

1. The Plan Properly Classifies Claims and Equity Interests Under Section 1122 of the Bankruptcy Code

Section 1122(a) of the Bankruptcy Code provides that a plan may place a claim or an interest in a particular class only if it is "substantially similar" to the other claims or interests in that class.

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[9] Any requirement of section 1129(a) of the Bankruptcy Code not specifically discussed herein is not applicable to the Debtors.

[10] *See Kane* v. *Johns-Manville Corp.*, 843 F.2d 636, 648-49 (2d Cir. 1988) (suggesting that Congress intended the phrase "'applicable provisions' in this subsection to mean provisions of Chapter 11 . . . such as section 1122 and 1123"); *In re Mirant Corp.*, 2007 WL 1258932, at *7 (Bankr. N.D. Tex. Apr. 27, 2007) (objective of 1129(a)(1) is to assure compliance with the sections of the Bankruptcy Code governing classification and the contents of a plan of reorganization); S. Rep. No. 989, 95th Cong., 2d Sess., at 126 (1978); H.R. Rep. No. 595, 95th Cong., 1st Sess., at 412 (1977).

However, all claims or interests within a particular class need not be identical.[11] Section 1122 of the Bankruptcy Code likewise does not require classifying claims together simply because they may share some attributes.[12] Instead, section 1122 of the Bankruptcy Code provides a plan proponent with significant flexibility and discretion in classifying claims so long as some reasonable basis exists for the classification or if the creditor or interest holder consents to the classification.[13] Courts have identified several grounds justifying separate classification, including where members of a class possess different legal rights[14] and where there are good business reasons for separate classification of claims.[15]

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[11] *See In re DRW Prop. Co. 82*, 60 B.R. 505, 511 (Bankr. N.D. Tex. 1986).

[12] *See, e.g.*, *In re Jersey City Med. Ctr.*, 817 F.2d 1055, 1060 (3d Cir. 1987) ("The express language of this statute explicitly forbids a plan from placing dissimilar claims in the same class[.]").

[13] *See John Hancock Mutual Life Ins. Co.* v. *Route 37 Bus. Park Assocs.*, 987 F.2d 154, 158-59 (3d Cir. 1993) (as long as each class represents a voting interest that is "sufficiently distinct and weighty to merit a separate voice in the decision whether the proposed reorganization should proceed," the classification is proper); *Jersey City*, 817 F.2d at 1060-61 ("Congress intended to afford bankruptcy judges broad discretion [under section 1122] to decide the propriety of plans in light of the facts of each case"); *In re U.S. Truck Co., Inc.*, 800 F.2d 581, 585 (6th Cir. 1986) ("Section 1122(a) specifies that only claims which are 'substantially similar' may be placed in the same class. It does not require that similar claims *must* be grouped together, but merely that any group created must be homogenous.") (emphasis in original); *In re Atlanta W. VI*, 91 B.R. 620, 626 (Bankr. N.D. Ga. 1988) ("flexibility [in claims classifications] both promotes the rehabilitative purposes of Chapter 11 reorganization and enables plan proponents to deal with the complex commercial realities which debtor estates often confront").

[14] *See In re Heritage Org., L.L.C.*, 375 B.R. 230, 298 n.86 (Bankr. N.D. Tex. 2007) (finding that if creditors had different legal rights under equitable subordination, then separate classification would be appropriate); *Mirant Corp.*, 2007 WL 1258932, at *7 (permitting separate classification because holders of claims had different legal interests in the debtor's estate); *In re Kaiser Aluminum Corp.*, 2006 WL 616243, at *4-6 (Bankr. D. Del. Feb. 6, 2006) (permitting classification scheme after consideration of the diverse characteristics of each class and creditors' legal rights).

[15] *See In re Chateauguay Corp.*, 89 F.3d 942, 949 (2d Cir. 1996) (finding that the debtor must have a "legitimate reason supported by credible proof" to justify separate classification of similar, unsecured claims); *In re Chateauguay Corp.*, 10 F.3d 944, 956-57 (2d Cir. 1993) (finding separate classification appropriate because classification scheme had a rational basis; separate classification based on bankruptcy court-approved settlement); *In re Avia Energy Dev., L.L.C.*, 2007 WL 2238039, at *2 (Bankr. N.D. Tex. Aug. 2, 2007) (permitting separate classification based on valid business, factual and legal reasons); *In re Magnatrax Corp.*, 2003 WL 22807541, at *4 (Bankr. D. Del. Nov. 17, 2003) (permitting separate classification based on valid business, factual, and legislative reasons).

The Plan's classification scheme is summarized as follows:

SUMMARY OF CLASSIFICATION, STATUS AND VOTING RIGHTS		
Class	**Designation**	**Impairment**
Unclassified	Administrative Claims	Unimpaired
Unclassified	Fee Claims	Unimpaired
Unclassified	Priority Tax Claims	Unimpaired
Unclassified	ABL DIP Financing Claims	Unimpaired
Unclassified	Ad Hoc DIP Financing Claims	Unimpaired
Unclassified	Bayside DIP Financing Claims	Unimpaired
Class 1	Other Priority Claims	Unimpaired
Class 2	Prepetition ABL Facility Claims	Unimpaired
Class 3	Prepetition Term Loan Claims	Unimpaired
Class 4	Other Secured Claims	Unimpaired
Class 5	General Unsecured Claims	Impaired
Class 6	Trade Unsecured Claims	Impaired
Class 7	Noteholder Unsecured Claims	Impaired
Class 8	Convenience Class Claims	Impaired
Class 9	Equity Interests in School Specialty, Inc.	Impaired

The Plan's classification of Claims and Equity Interests satisfies the requirements of section 1122 of the Bankruptcy Code because the Claims or Equity Interests in each Class are substantially similar to the other Claims or Equity Interests in such Class, and all Claims or Equity Interests in each Class differ from the Claims and Equity Interests in each other Class in a legal or factual nature or based on other relevant criteria. In general, the Plan's classification scheme is fairly simple and follows the Debtors' capital structure: secured debt is classified separately from unsecured debt and unsecured debt is classified separately from equity interests. *See* Plan Article IV.

Different types of secured and unsecured claims are then classified separately. Such differentiation is appropriate where there is a legitimate basis for doing so.[16] Here, the Debtors' various secured debt issuances, whose holders each have their own distinct rights, are classified in their own classes. Similarly, the Plan separately classifies unsecured claims into four Classes: General Unsecured Claims, Trade Unsecured Claims, Noteholder Unsecured Claims, and Convenience Class Claims (for such Claims below a $3,000 threshold amount). *See* Plan Article IV.H. Noteholder Unsecured Claims, representing claims arising from an unsecured note issuance, will receive their pro rata Distribution of New SSI Common Stock. General Unsecured Claims and Trade Unsecured Claims, which represent the majority of the Debtors' other unsecured claims, in contrast, will receive deferred Cash Distributions on account of their Allowed Claims. Of this group, those creditors who represent the Debtors' vendor base and with whom the Debtors continue to do business fall into Class 6, and are therefore eligible to participate in the Trade Election pursuant to which such holders can receive an increased Distribution in exchange for providing Customary Trade Terms to the Reorganized Debtors for a specified period of time after the Effective Date. Finally, small unsecured claims that would have fallen into Classes 5 or 6 are separately classified so these claims can be quickly resolved.

[16] Similar claims may be placed in different classes so long as a legitimate reason exists for the classification and the classification is not designed for the purpose of manipulating class voting. *In re FF Holdings Corp.*, 1998 U.S. Dist. LEXIS 10741, at *16 (D. Del. Feb. 17, 1998) ("Numerous courts have held that separate classification and treatment of necessary trade claims from other unsecured creditors is acceptable if the separate classification is justified by a 'reasonable purpose,' legitimate basis, or necessary business objective."); *see also in In re Armstrong World Indus.*, 348 B.R. 136, 147 (Bankr. D. Del. 2006) (noting that the "classification scheme was not proposed to create a consenting impaired class or to manipulate class voting" and therefore allowing separate classification of the asbestos personal injury claims and the other unsecured claims). For example, courts routinely approve the separate classification of bonds from general unsecured claims and the creation of a class for claims under a certain threshold amount for administrative convenience. *See In re Wash. Mut., Inc.*, 2012 Bankr. LEXIS 895, at *39 (Bankr. D. Del. Feb. 23, 2012) (separately classifying convenience claims and bond claims from other general unsecured claims); *In re Kaiser Aluminum Corp.*, 2006 WL 616243, at *5 (separately classifying convenience claims from other general unsecured claims).

In sum, the Debtors have valid business reasons for separately classifying each Class, including the holders of Trade Unsecured Claims. These separate Classes were not created to affect the outcome of voting on the Plan, as evidenced by the fact that three of the four unsecured classes have voted overwhelmingly to accept the Plan and that no party has objected to the Plan's classification. Additionally, the Claims or Equity Interests in each particular Class are substantially similar. Thus, the Plan satisfies section 1122 of the Bankruptcy Code.

2. The Plan Satisfies the Seven Mandatory Plan Requirements of Sections 1123(A)(1)-(A)(7) of the Bankruptcy Code

The Plan meets the seven mandatory requirements of section 1123(a) of the Bankruptcy Code, which specifically require that a plan:

(1) designate classes of claims and interests;

(2) specify unimpaired classes of claims and interests;

(3) specify treatment of impaired classes of claims and interests;

(4) provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim agrees to a less favorable treatment of such particular claim or interest;

(5) provide adequate means for implementation of the plan;

(6) provide for the prohibition of nonvoting equity securities and provide an appropriate distribution of voting power among the classes of securities; and

(7) contain only provisions that are consistent with the interests of the creditors and equity security holders and with public policy with respect to the manner of selection of the reorganized company's officers and directors.

Articles II-IV of the Plan satisfy the first three requirements of this section by: (i) designating Classes of Claims and Equity Interests, as required by section 1123(a)(1) of the Bankruptcy Code; (ii) specifying the Classes of Claims and Equity Interests that are unimpaired under the Plan, as required by section 1123(a)(2) of the Bankruptcy Code; and (iii) specifying the

treatment of each Class of Claims and Equity Interests that is Impaired, as required by section 1123(a)(3) of the Bankruptcy Code.

The Plan also satisfies section 1123(a)(4) of the Bankruptcy Code because the treatment of each Claim or Interest within a Class is the same as the treatment of each other Claim or Interest within that Class. While holders of Class 5 and 6 Claims may receive different recoveries under the Plan by virtue of the elections they choose, these elections – a convenience election, whereby a holder can voluntarily reduce the Allowed amount of its Claim to be treated as Class 8, and the Trade Election, whereby holders of Class 6 Claims may choose to provide the Reorganized Debtors with Customary Trade Terms in exchange for an increased recovery – are available to all members within a given Class. Therefore, all members of Class 5 and all members of Class 6 receive the same treatment as all other members of their respective Classes.[17]

Article V of the Plan and various other provisions of the Plan provide adequate means for the Plan's implementation, thus satisfying section 1123(a)(5) of the Bankruptcy Code.[18] Specifically, Article V of the Plan provides for, among other things:

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[17] While the Code does not define equal treatment, "the most conspicuous inequality that § 1123(a)(4) prohibits is payment of different percentage settlements to co-class members. The other side of the coin of unequal payment, however, has to be unequal consideration tendered for equal payment." *In re Resorts Int'l*, 145 B.R. 412, 447 (Bankr. D.N.J. 1990). In fact, it is "disparate treatment when members of a common class are required to tender more valuable consideration . . . for the same percentage of recovery." *Id.* Here, however, Trade Claimants will provide additional consideration to the Reorganized Debtors in the form of the Customary Trade Terms in exchange for an enhanced recovery and therefore does not constitute disparate treatment. *See e.g.*, *In re Wash. Mut., Inc.*, 442 B.R. 314, 335-36 (Bankr. D. Del. 2011) (overruling the trustee's objection that the plan violated section 1123(a)(4) in providing varying distributions to creditors within the same class based on each creditor's election to settle certain claims and holding that "[w]hat is important is that each claimant within a class have the same opportunity to receive equal treatment"); *In re Aleris Int'l, Inc.*, 2010 Bankr. LEXIS 2997, at *50 (Bankr. D. Del. May 3, 2010) (finding the plan did not violate section 1123(a)(4) since "[e]ach member of each Class receives the same treatment as any other member within the same Class [and that] [t]o the extent a Backstop Party receives additional or different consideration under the Plan, the Backstop Party receives such consideration in exchange for the [additional] commitments of the Backstop Party").

[18] Section 1123(a)(5) of the Bankruptcy Code specifies that adequate means for implementation of a plan may include: (a) retention by the debtor of all or part of its property; (b) the transfer of property of the estate to one or more entities; (c) cancellation or modification of any indenture; (d) curing or waiving any default;

- Deemed substantive consolidation of the Debtors, which shall not affect the extent or validity of any Lien or encumbrance;
- General settlement of claims and equity interests;
- Nonconsensual confirmation in the event any Impaired Class of Claims or Equity Interests does not vote to accept the Plan or is otherwise deemed to reject the Plan;
- Intercompany claims to be eliminated by offset, distribution, cancelation, assumption or contribution; and
- Release, termination or extinguishment of Liens or encumbrances securing secured Claims upon the treatment or satisfaction of such secured Claim.

Article V also provides for specific measures to implement the reorganization, including:

- Entering into the Exit Facilities;
- Issuing of New SSI Common Stock and New Subsidiary Equity Interests;
- Amending the articles of incorporation of SSI and its subsidiaries;
- Identifying senior executive officers and directors; and
- Granting powers of officers to execute any documents or agreements that they deem reasonable and appropriate to effectuate the terms of the Plan.

Finally, Article V of the Plan and various Plan Supplements detail additional terms of the Class 5 and 6 Distributions, including the appointment of an Ombudsman to monitor the Trade Election and mediate and resolve any disputes arising concerning the Customary Trade Terms.

(e) amendment of the debtor's charter; and (f) issuance of securities for cash, for property, or for existing securities, in exchange for claims or interests or for any other appropriate purpose.

The Debtors and their advisors have worked diligently with, among others, the Creditors Committee, the Ad Hoc DIP Lenders, the ABL DIP Lenders and various other stakeholders regarding each of the foregoing terms, and believe that these transactions, including entry into and implementation of the various agreements and other documents contemplated in the Plan, will enable the Debtors to successfully and efficiently consummate the Plan. The proposed implementation steps, in particular, the implementation of the Exit Financing Facilities and the Trade Election, have been carefully developed to ensure that the Debtors have the financial ability to fund their obligations under the Plan and operate as a viable going concern after emergence. The Debtors believe that, through these steps and transactions, the Plan provides more than adequate means for its implementation.

The sixth requirement of section 1123(a) of the Bankruptcy Code (*i.e.*, that a plan prohibit the issuance of nonvoting equity securities) is satisfied because the New SSI Common Stock will constitute voting securities. The Debtors have also filed with the Court forms of Amended Certificates of Incorporation and Bylaws for the Reorganized Debtors as part of the Plan Supplements that include, without limitation, a prohibition against the issuance of non-voting equity securities. *See* Docket Nos. 1026, 1099. The Plan thus satisfies the requirements of section 1123(a)(6) of the Bankruptcy Code.

Finally, the Plan satisfies section 1123(a)(7) of the Bankruptcy Code, which requires that the Plan "contain only provisions that are consistent with the interests of creditors and equity security holders and with public policy with respect to the manner of selection of any officer, director, or trustee under the plan." Pursuant to Article V.H of the Plan, the Ad Hoc DIP Lenders and the Debtors have selected the initial board of directors of Reorganized SSI and the Reorganized Subsidiaries. The identity of the directors and officers of Reorganized SSI and the

Reorganized Subsidiaries that are known were set forth in the Plan Supplements filed with the Court on May 9, 2013 and May 17, 2013. *See* Docket Nos. 1026, 1099. Except as otherwise set forth in the Plan Supplements, the directors and officers of each of the Subsidiaries shall continue to serve in such capacities with respect to the Reorganized Debtors after the Effective Date.

The Debtors understand that the manner of selecting the officers and directors of Reorganized SSI and the other Reorganized Debtors is consistent with public policy and the interests of the Debtors' creditors and equity security holders. The relevant corporate governance documents for the Reorganized Debtors also are set forth in the Plan Supplements. Therefore, the Plan satisfies the requirements of section 1123(a)(7) of the Bankruptcy Code.

3. The Discretionary Contents of the Plan Are Appropriate

Section 1123(b) of the Bankruptcy Code contains various discretionary provisions that may be included in a plan of reorganization. For example, a plan may impair or leave unimpaired any class of claims or interests and provide for the assumption or rejection of executory contracts and unexpired leases. A plan also may settle or adjust any claim or interest held by the debtor or the debtor's estate or provide for the debtor's retention and enforcement of any such claim or interest. 11 U.S.C. § 1123(b)(3)(A), (B). Likewise, a plan may modify the rights of secured creditors or unsecured creditors, or leave unaffected the rights of creditors in any class of claims. *Id.*

Here, the Plan contains a variety of such provisions. For example, Article IV of the Plan leaves certain Classes of Claims unimpaired and impairs certain other Classes of Claims and Equity Interests. Through the Schedule of Rejected Executory Contracts and Unexpired Leases, the Plan provides for the rejection of certain executory contracts and unexpired leases.

The Plan provides that the remainder of the Debtors' executory contracts and unexpired leases will be assumed under the Plan. *See* Plan Article VII.A. In addition, the Plan provides for a bar date for Administrative Claims, procedures for the Reorganized Debtors to settle and prosecute certain Claims, and mechanics to govern distributions to the Debtors' secured and unsecured creditors. *See* Plan Article III and IV.

Section 1123(b)(6) of the Bankruptcy Code provides that a plan may "include any other appropriate provision not inconsistent with the applicable provisions of [the Bankruptcy Code]." In that regard, Article XI of the Plan provides that, among other things, the Court shall retain jurisdiction over all matters arising out of, or related to, the Chapter 11 Cases. This provision is appropriate because the Court otherwise has jurisdiction over all of these matters during the pendency of the Chapter 11 Cases, and case law establishes that a bankruptcy court may retain jurisdiction over the debtor or the property of the estate following confirmation.[19]

Additionally, Article V.H.2 of the Plan provides for the issuance of New SSI Common Stock. Article XII.H of the Plan, in turn, provides that, pursuant to section 1145 of the Bankruptcy Code, the offering, issuance, and distribution, of any securities contemplated by the Plan (including, without limitation, the New SSI Common Stock) shall be exempt from the registration requirements of section 5 of the Securities Act and any other applicable law requiring registration or qualification prior to the offering, issuance, distribution, or sale of securities.

[19] *See In re Jewekor Inc.*, 150 B.R. 580, 582 (Bankr. M.D. Pa. 1992) ("There is no doubt that the bankruptcy court's jurisdiction continues post confirmation to 'protect its confirmation decree, to prevent interference with the execution of the plan and to aid otherwise in its operation.'") (citations omitted).

The Plan also contains a variety of releases. As more fully discussed below, these releases are supported by valuable consideration, are essential components of the Plan and are consistent with applicable Third Circuit law.

4. The Discharge, Injunction, Release and Exculpation Provisions Embodied in the Plan Are Permissible and Should Be Approved

Article IX of the Plan includes customary discharge, release, exculpation, and injunction provisions that are typically afforded to debtors, reorganized debtors and certain third parties. These discretionary provisions are appropriate because, among other things, they are (i) integral to the terms, conditions and settlements contained in the Plan; (ii) fair, equitable and reasonable and in the best interests of the Debtors and their estates; (iii) the product of extensive arm's length negotiations among sophisticated parties; and (iv) supported by fair consideration. Furthermore, creditors support the Plan overwhelmingly, and, with one exception, no creditors have objected to these provisions of the Plan. With limited exceptions,[20] the releases were consented to by all Voting Classes – the only creditors who would stand to benefit from any potential litigation among the Debtors and the Released Parties. Such support further justifies approval of these provisions.

The Plan's release, exculpation and injunction provisions will eliminate the costs and risks of litigation and allow, among other things, the principals of the Reorganized Debtors to focus entirely on operations after emergence. The release, exculpation and injunction provisions (as modified with respect to exculpation, as discussed below) have been critical to obtaining the support of the ABL DIP Lenders and the Ad Hoc DIP Lenders, and, with one exception, no party with an economic stake in the Debtors' distributable value has objected to

[20] As set forth in the Voting Declaration, only six Noteholders with Claims in the amount of $1.56 million opted out of the third-party releases.

them. The Debtors submit that the release, exculpation and injunction provisions of the Plan are necessary and appropriate under the circumstances and are not inconsistent with the Bankruptcy Code. As such, the requirements of section 1123(b) of the Bankruptcy Code are satisfied.

(a) The Injunction and Discharge Provisions Set Forth in Articles IX.D and IX.E of the Plan Comply with the Bankruptcy Code

Article IX.E of the Plan provides for an injunction which, in general, enjoins all Persons that have held, currently hold, or may hold a Claim or other debt or liability that is discharged or an Interest or other right of an equity security holder that is terminated pursuant to the Plan from taking certain actions against the Debtors, the Reorganized Debtors or their respective property on account of such Claims, Equity Interests or other obligations. This injunction is necessary to preserve and enforce the releases in the Plan and the exculpation provisions and it is narrowly tailored to achieve that purpose. Accordingly, the Debtors submit that the injunction provision should be approved.

Article IX.D of the Plan provides for the broad discharge contemplated by section 1141 of the Bankruptcy Code, which provides, in relevant part:

> the provisions of a confirmed plan bind the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor, whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired under the plan and whether or not such creditor, equity security holder, or general partner has accepted the plan.

11 U.S.C. § 1141(a).

As evidenced by the votes accepting the Plan, the Debtors respectfully submit that the discharge and injunction provisions contained in the Plan are reasonable and appropriate, consistent with the Bankruptcy Code, and should be approved.

(b) The Releases by the Debtors in Article IX.I of the Plan Are Fair, Reasonable, and in the Best Interests of the Estates

Article IX.I of the Plan provides for releases of Claims and causes of action belonging to each of the Debtors, the Reorganized Debtors and their Estates (the "Debtor Releases"), as of the Effective Date, by such parties against the Released Parties.[21] A debtor may release claims in a plan "if the release is a valid exercise of the debtor's business judgment, is fair, reasonable, and in the best interests of the estate."[22] In determining whether the exercise of that business judgment is valid, courts consider the "specific facts and equities of each case," typically by reference to the five factors outlined in *In re Zenith Electronics Corp.*, 241 B.R. 92 (Bankr. D. Del. 1999).[23] Those factors are: (i) an identity of interest between the debtor and non-debtor, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate; (ii) a substantial contribution to the plan by the non-debtor; (iii) the necessity of the release to the reorganization; (iv) the overwhelming acceptance of the plan and release by creditors and interest holders; and (v) the payment of all or substantially all of the

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[21] The "Released Parties" are (a) the officers, directors, employees, partners, advisors, attorneys, financial advisors, accountants, and other professionals of the Debtors who served in such capacity on or after the Petition Date; (b) the members of the Creditors Committee, the DIP Agents, the DIP Collateral Agents, the Bayside DIP Agent, the DIP Lenders, the Notes Indenture Trustee, the Prepetition Agents, the Prepetition Lenders and the Noteholders; and (c) the officers, directors, principals, members, employees, partners, subsidiaries, affiliates, advisors, attorneys, financial advisors, accountants, and other professionals of the parties set forth in clause (b). However, to resolve the objection by the U.S. Trustee, the Creditors Committee is no longer seeking to be included among the Released Parties in Article IX.I of the Plan.

[22] *U.S. Bank Nat'l Assoc.* v. *Wilmington Trust Co. (In re Spansion, Inc.)*, 426 B.R. 114, 143 (Bankr. D. Del. 2010) (citing *In re DBSD North America, Inc.*, 419 B.R. 149, 217 (Bankr. S.D.N.Y. 2009)). *See also* 11 U.S.C. § 1123(b)(3)(A).

[23] *See Spansion*, 426 B.R. at 142-43 (citing *Zenith*, 241 B.R. at 110).

claims of the creditors and interest holders affected by the releases under the plan.[24] This five-factor test is not a list of conjunctive requirements, nor is it an exhaustive list of considerations.[25]

Here, each of the *Zenith* factors is satisfied. *First*, there is an identity of interest among the Debtors and many of the non-Debtor Released Parties arising out of the shared "common goal" of confirming the Plan and implementing the Plan.[26] Moreover, the Debtors submit that the Released Parties share an identity of interest with the Debtors such that a claim against any of the Released Parties would be, in essence, a claim against the Debtors. Certain of the Released Parties (such as the Debtors' employees, directors and officers, as well as the DIP Agents, the DIP Collateral Agents, the Bayside DIP Agent, the DIP Lenders, the Notes Indenture Trustee, the Prepetition Agents and the Prepetition Lenders) are entitled to indemnification arising out of certain indemnity relationships.[27] Under these indemnity agreements, any claim asserted against a Released Party that the Debtors are obligated to indemnify would essentially be a claim against the Debtors. Therefore, any such claim, even if ultimately unsuccessful, would further deplete the Estates' finite resources. Accordingly, the Released Parties all have an identity of interest with the Debtors.

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[24] *See Zenith*, 241 B.R. at 110; *see also In re Wash. Mut., Inc*., 442 B.R. at 348-50. The *Zenith* factors had been previously enunciated in *In re Master Mortgage Invest. Fund, Inc.*, 168 B.R. 903 (Bankr. W.D. Mo. 1994).

[25] *Master Mortgage*, 168 B.R. at 935. *See also Indianapolis Downs, LLC*, 486 B.R. 286, 304 (Bankr. D. Del. 2013) (approving the releases although the third and fifth *Zenith* factors were not met where the record reflects overwhelming creditor support of the plan); *Spansion*, 426 B.R. at 143, n. 47 (referring to the *Master Mortgage* factors as "helpful in weighing the equities of the particular case after a fact-specific review").

[26] The *Zenith* Court granted the releases sought by the debtor, holding that the various released parties had an identity of interest on the basis that they were instrumental in formulating the plan of reorganization. *Zenith*, 241 B.R. at 110; *see also In re Tribune Co.*, 2011 Bankr. LEXIS 4128, at *153 (Bankr. D. Del. Oct. 21, 2011) (holding that the debtors and their secured lenders "share the common goal of confirming the [] Plan" and implementing the consummation thereof, thus giving rise to an identity of interest between those parties).

[27] The Debtors' pre-petition lenders and DIP Lenders enjoy a right to contractual indemnity under the Debtors' credit facilities. Similarly, the Debtors' officers and directors enjoy a right of contractual indemnity under the applicable organizational documents that govern their service to the Debtors.

Second, the Released Parties all made important contributions to these Chapter 11 Cases including, among other things, negotiating and formulating the Plan and agreeing to various compromises necessary to achieve consensus regarding its terms. In addition, each of the Released Parties has provided other specific and substantial consideration to the cases:

- The Debtors' officers, directors, and employees have made extraordinary efforts on behalf of the Debtors both prior to and during the Chapter 11 Cases to navigate the Debtors to this juncture. These efforts go well beyond their regular duties in operating the business, and constitute significant and meaningful contributions to these Chapter 11 Cases. Indeed, these efforts have required in many instances significant personal sacrifices since the Debtors have frozen salaries and, during the Chapter 11 Cases, been unable to pay certain bonuses that have been earned. Finally, the majority of the Debtors' officers and directors have agreed to remain with the Debtors after emergence from chapter 11, notwithstanding the fact that no incentive compensation programs have been authorized or approved. In light of their institutional knowledge of the Debtors' business operations and the contemplated post-emergence structure of the Reorganized Debtors, these Released Parties are essential to the Reorganized Debtors' success and this agreement therefore constitutes a substantial contribution. They have agreed to remain in their positions and have been able to properly focus on the myriad tasks during these cases in reliance on the fact that, among other things, they would be released under the Plan.[28]

- The Ad Hoc DIP Lenders have agreed to convert a significant portion of their DIP Financing Claims into equity in Reorganized SSI. This equitization has enabled far greater recoveries to the Debtors' unsecured creditors than would otherwise be possible and played a critical role in achieving consensus and agreement among the Debtors' key creditor groups regarding the terms of the Plan. This financial contribution is a substantial contribution.

- The ABL DIP Lenders have provided a number of material concessions throughout the Chapter 11 Cases that have enabled the Debtors to develop the Plan and gain widespread support thereof. They have repeatedly agreed to modify various terms and milestones in their financing agreement as requested by the Debtors. They also consented to the payment of up to $14.5 million in prepetition amounts to certain critical vendors and other essential parties.[29] Moreover, when the Ad Hoc DIP Lenders replaced the existing Bayside DIP Facility a few weeks after the Petition Date, the ABL DIP Lenders not only consented to the substitution of this new lender group into their existing Intercreditor agreement, but agreed to modify the milestones

[28] *See Zenith*, 241 B.R. at 111 (officers and directors made substantial contributions by designing and implementing the operational restructuring and negotiating the financial restructuring with the party who funded the plan).

[29] *See* Docket No. 277.

in their agreement to enable the Debtors to explore a restructuring option alongside a sale option. These accommodations constitute a substantial contribution.

- Bayside similarly contributed to these Chapter 11 Cases. In addition to providing the Debtors with DIP financing, they also agreed to serve as the stalking horse bidder for a proposed sale of the Debtors' assets. Even though the Debtors ultimately declined to pursue the sale path to an auction, and terminated the asset purchase agreement with Bayside, this agreement was critical at the outset of the cases to obtaining DIP financing and providing the Debtors with a path through chapter 11. This agreement was the springboard off of which the Debtors and their stakeholders were eventually able to pursue a reorganization.

- Additionally, the various prepetition lenders agreed to the use of cash collateral.

Without the releases, many of the Released Parties would have been unwilling to contribute to the Plan process, which would have reduced the enterprise value available for distribution to creditors and would have negatively impacted the Debtors' restructuring.

Third, the discharges, injunctions, releases, and exculpations are integral to the Plan as a whole, which will ultimately result in meaningful distributions to the Debtors' creditors. The threat of litigation – and any litigation that ultimately came to fruition, no matter how baseless – would be a significant distraction to the Released Parties, the result of which would be the incurrence of potentially tremendous cost, time and labor, all of which would be better spent on developing the Debtors' business post-emergence. Indeed, without the Releases, the Debtors' officers and directors would be unable to focus the appropriate attention on exercising their fiduciary duties and returning the Reorganized Debtors to a profitable and successful enterprise. Moreover, the Debtors, who have a fiduciary obligation to maximize value for their Estates, have determined after reasonable inquiry that, to the best of their knowledge, information and belief, no valid claims or causes of action exist against any of the Released Parties for which releases are being granted.

Fourth, the Debtors' creditors overwhelmingly accepted the Plan.[30] As noted above, the Debtors' Voting Classes are the only parties that are arguably affected by the release of any underlying claims or causes of action and have accepted the Plan and the Releases, and only one group of creditors have objected to this provision. Consequently, the fourth *Zenith* factor weighs in favor of granting the Debtors' Releases.

Fifth, the Plan provides for distributions on account of all or substantially all of the Claims held by the Released Parties, including all Unclassified Claims, along with all other Claims in Classes 1 through 4. Furthermore, through the Plan, holders of Allowed General Unsecured Claims, Trade Unsecured Claims, Noteholder Unsecured Claims and Convenience Claims will receive meaningful distributions, which, as set forth herein, would not be available in a liquidation.[31]

Accordingly, the Debtors believe that, under the specific facts and equities of these Chapter 11 Cases, the Debtor Releases constitute a valid exercise of the Debtors' business judgment and should be approved.

(c) The Third-Party Releases Set Forth in Article IX.J of the Plan Are Appropriate and Consistent with Established Precedent and Therefore Should Be Approved

The Plan does not include non-consensual, third-party releases of Claims against the Released Parties. Rather, Article IX.J of the Plan provides for consensual releases only by those holders of Claims who (i) actually voted to accept the Plan and did not mark their ballots to

[30] Only one Voting Class did not accept the Plan, and, as set forth in the Voting Declaration, in this Class, only a small number of class members submitted ballots.

[31] *See Zenith*, 241 B.R. at 111 (explaining that the fifth factor was met because "the Plan does provide a distribution to the creditors in exchange for the Releases" and supporting that conclusion by explaining that creditors received more under the plan than they would have in a liquidation); *see also In re Exide Techs.*, 303 B.R. 48, 74 n.37 (Bankr. D. Del. 2003) (noting that the fifth factor may be satisfied "upon presentation of a consensual plan, in the absence of objection to the release/injunction provisions, or upon a [] meaningful distribution to unsecured creditors").

indicate a refusal to grant such releases or (ii) are presumed to have voted to accept the Plan under section 1126(f) of the Bankruptcy Code. Thus, the releases in Article IX.J of the Plan do not apply to any Person that exercised its election in accordance with Article IX.J of the Plan to withhold granting a release in favor of those Released Parties by checking the appropriate box on its respective Ballot.

Courts have held that an "affirmative agreement" from an affected creditor will render a release consensual.[32] Although the parameters of what constitutes "affirmative agreement" are fact specific, courts have held that by simply voting in favor of a plan with non-debtor releases a creditor will be found to have affirmatively agreed to such releases.[33]

As noted above, the Plan goes one step further and provides the members of the Voting Classes with an express right to opt out of the releases. Indeed, the release in Article IX.J of the Plan does not apply to those creditors that received a Ballot if they elected, in accordance with Article IX.J of the Plan, to withhold granting a release in favor of those Released Parties. By checking the appropriate box, such creditor is deemed to preserve whatever direct (and therefore, non-derivative) claims it may have against the non-Debtor third parties under applicable law. With respect to those creditors that received a Ballot and did not exercise the option to preserve any direct claims they may have against third parties, the releases are

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[32] *See Zenith*, 241 B.R. at 111.

[33] *See Spansion*, 426 B.R. at 144 ("a third party release may be included in a plan if the release is consensual and binds only those creditors voting in favor of the plan") (citation omitted); *In re Coram Healthcare Corp.*, 315 B.R. 321, 336 (Bankr. D. Del. 2004) ("to the extent creditors or shareholders voted in favor of the Trustee's Plan, which provides for the release of claims they may have against Noteholders, they are bound by that"); *Zenith*, 241 B.R. at 111 (approving non-debtor releases for creditors that voted in favor of plan); *In re West Coast Video Enter., Inc.*, 174 B.R. 906, 911 (Bankr. E.D. Pa. 1994) (stating that "each creditor bound by the terms of the release must individually affirm same, either with a vote in favor of a plan including such a provision or otherwise") (citation omitted).

consensual.[34] With respect to holders of Claims who are presumed to have voted to accept the Plan under section 1126(f) of the Bankruptcy Code, such holders are receiving payment in full on account of their Claims as consideration for granting a release in favor of the Released Parties.[35] Accordingly, the Debtors submit that the third-party releases in Article IX.J of the Plan should be approved.

(d) The Exculpation Provision Set Forth in Article IX.K of the Plan Are Appropriate and Consistent with Established Precedent and Therefore Should Be Approved

It is well established in the Third Circuit that exculpation is appropriate for fiduciaries in a bankruptcy case, including the debtors' officers, directors, employees and professionals and a creditors' committee, its members and advisors.[36] As a result, the exculpation provision set forth in Article IX.K of the Plan is appropriate with respect to those Released Parties serving as officers, directors and employees of the Debtors and members of the Creditors Committee, as well as the Debtors' and Creditors Committee's respective professionals.

With respect to the remaining Released Parties, in response to concerns raised by the U.S. Trustee, the Debtors have agreed to modify certain language in the exculpation provisions in Article IX.K. Specifically, they have revised (i) the definition of "Released Parties" solely for the purposes of such provision to exclude the Reorganized Debtors and Notes Indenture Trustee and (ii) the scope of this provision to include only those acts or omissions during the period starting on the Petition Date and ending on the Effective Date.

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[34] *See, e.g., In re Monroe Well Service, Inc.*, 80 B.R. 324, 334-35 (Bankr. E.D. Pa. 1987) (noting that releases were consensual when creditors had the option of granting them).

[35] *See Spansion*, 426 B.R. at 145 ("The unimpaired classes are being paid in full and have received adequate consideration for the release.").

[36] *In re PWS Holding Corp.*, 228 F.3d 224, 245-47 (3d Cir. 2000).

B. The Debtors Have Complied with the Applicable Provisions of the Bankruptcy Code (Section 1129(a)(2))

The Debtors have satisfied section 1129(a)(2) of the Bankruptcy Code, which requires that the proponent of a plan of reorganization comply with the applicable provisions of the Bankruptcy Code. The cases and legislative history discussing this section indicate that it principally requires compliance with the disclosure and solicitation requirements of sections 1125 and 1126 of the Bankruptcy Code.[37] The Debtors have satisfied section 1129(a)(2) of the Bankruptcy Code by distributing the Disclosure Statement and soliciting acceptances of the Plan through their Claims and Noticing Agent pursuant to the procedures authorized by the Disclosure Statement Approval Order.

The Debtors have complied with all solicitation and disclosure requirements set forth in the Bankruptcy Code and the Bankruptcy Rules, modified by the Disclosure Statement Approval Order, governing notice, disclosure, and solicitation in connection with the Plan and the Disclosure Statement.[38] The Court conditionally approved the Disclosure Statement as containing adequate information. In the Disclosure Statement Approval Order, the Court also approved, on a final basis, *inter alia*, the procedures for soliciting acceptances and rejections to the Plan (the "Solicitation Procedures"), including the Solicitation Package. The Solicitation Procedures set forth, among other things: (a) the method of distribution of the Solicitation Package; (b) procedures for the temporary allowance of Claims for voting purposes; (c) the

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[37] *See PWS*, 228 F.3d at 248; *In re Worldcom, Inc.*, 2003 WL 23861928, at *49 (Bankr. S.D.N.Y. Oct. 31, 2003) (stating that section 1129(a)(2) requires plan proponents to comply with applicable provisions of the Bankruptcy Code, including "disclosure and solicitation requirements under sections 1125 and 1126 of the Bankruptcy Code"); *In re Lapworth*, 1998 WL 767456, at *3 (Bankr. E.D. Pa. Nov. 2, 1998) ("The legislative history of § 1129(a)(2) specifically identifies compliance with the disclosure requirements of § 1125 as a requirement of § 1129(a)(2)."); S. Rep. No. 989, 95th Cong., 2d Sess., at 126 (1978); H.R. Rep. No. 595, 95th Cong., 1st Sess., at 412 (1977).

[38] As modified by the Bankruptcy Court, as the Debtors sought and obtained shortened time for solicitation in the Disclosure Statement Approval Order, which was necessary to ensure that the Debtors had the opportunity to emerge from chapter 11 prior to its peak business season. *See* Docket No. 902.

method of distribution of notices to non-voting creditors and other interested parties; (d) the qualifications for creditors entitled to vote on the Plan; and (e) procedures for tabulating the ballots and master ballots submitted to the Claims Agent.

On or about April 24, 2013, the Debtors caused the Solicitation Package to be mailed to holders of Claims in Classes 5, 6, 7 and 8 whose Claims were Allowed or deemed to be Allowed for voting purposes.[39] The Debtors also made the Plan, Disclosure Statement, Disclosure Statement Approval Order and certain related materials available to creditors, other interested parties and the public generally by posting it on the website http://www.kccllc.net/SchoolSpecialty. Hence, the Debtors solicited and tabulated votes on the Plan in accordance with the Solicitation Procedures approved by the Court. The Debtors also timely mailed notice, in the form approved by the Court in the Disclosure Statement Approval Order, to non-voting creditors and other parties entitled to receive such notice as described in the Solicitation Procedures. Thus, the Solicitation Package was transmitted in compliance with the Disclosure Statement Approval Order. Accordingly, the Debtors have satisfied the requirements of section 1129(a)(2) of the Bankruptcy Code.

C. The Plan Has Been Proposed in Good Faith and Not by Any Means Forbidden by Law (Section 1129(a)(3))

Section 1129(a)(3) requires that a plan of reorganization be "proposed in good faith and not by any means forbidden by law." The Bankruptcy Code does not define "good faith" as that term is used in this section. Courts in this district have indicated that "for purposes of determining good faith under section 1129(a)(3) . . . the important point of inquiry is the plan itself and whether such a plan will fairly achieve a result consistent with the objectives and

[39] *See* Affidavits of Service filed reflecting compliance with the notice and solicitation requirements of the Disclosure Statement [Docket Nos. 1035, 1051, 1078 & 1092].

purposes of the Bankruptcy Code" in light of the particular facts and circumstances of the case.[40] This inquiry typically focuses on whether a plan has been proposed with a legitimate purpose and with a basis for expecting that reorganization consistent with the Bankruptcy Code's objectives can be effectuated.[41]

"[D]enial of confirmation for failure to satisfy section 1129(a)(3) should be reserved for only the most extreme of cases."[42] Good faith is not lacking simply because a plan "may not be one which the creditors would themselves design and indeed may not be confirmable."[43]

Fundamentally, the good faith standard does not demand that a debtor offer more to its creditors than the Bankruptcy Code requires.[44] "In enacting the Bankruptcy Code, Congress made a determination that an eligible debtor should have the opportunity to avail itself

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[40] *In re Combustion Eng'g, Inc.*, 391 F.3d 190, 247 (3d Cir. 2004); *Armstrong World Indus.*, 348 B.R. at 164; *In re PWS Holding Corp.*, 228 F.3d at 242 (quoting *In re Abbotts Dairies of Pa., Inc.* 788 F.2d 143, 150 n. 5 (3d Cir. 1986) and *In re Madison Hotel Associates*, 749 F.2d 410, 424-25 (7th Cir. 1984)); *In re Burns & Roe Enter.*, 2009 U.S. Dist. LEXIS 13574, at *78 (D.N.J. Feb. 20, 2009).

[41] *See, e.g.*, *Zenith*, 241 B.R. at 107-08 (quoting *In re Sound Radio, Inc.*, 93 B.R. 849, 853 (Bankr. D.N.J. 1988)) (finding good faith where the plan was "proposed with the legitimate purpose of restructuring [the debtor's] finances to permit [the debtor] to reorganize successfully…exactly what chapter 11 of the Bankruptcy Code was designed to accomplish"); *In re Surfango, Inc.*, 2009 WL 5184221, at *8-9 (Bankr. D.N.J. Dec. 18, 2009) (In determining good faith, "[t]wo relevant inquiries deserve focus: (1) whether the plan serves a valid bankruptcy purpose, e.g., by preserving a going concern or maximizing value, and (2) whether the plan is proposed to obtain a tactical litigation advantage"); *see also NLRB* v. *Bildisco & Bildisco*, 465 U.S. 513, 528 (1984) (recognizing that "[t]he fundamental purpose of reorganization is to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources").

[42] 7 Collier on Bankruptcy § 1129.02; *see also In re Sound Radio, Inc.*, 93 B.R. 849 at 853 ("To find a lack of 'good faith' courts have examined whether the debtor intended to abuse the judicial process and the purposes of the reorganization provisions. A finding of a lack of good faith is especially appropriate when no realistic possibility of an effective reorganization exists and it is evident that the debtor seeks to delay or frustrate the legitimate efforts of secured creditors to enforce their rights").

[43] *In re T-H New Orleans Ltd. P'ship*, 116 F.3d 790, 803 (5th Cir. 1997) (bankruptcy court's finding of good faith upheld against allegations that debtor did not effectively market the property so as to produce a bidder who would compete against lender at confirmation hearing); *In re Montgomery Court Apartments, Ltd.*, 141 B.R. 324, 329 (Bankr. S.D. Ohio 1992) ("The Court fails to see how Greyhound's unhappiness with the Plan's terms can give rise to a finding of bad faith on the part of the Debtor under 11 U.S.C. § 1129(a)(3). Chapter 11 plans routinely alter the contractual rights of parties"); *Zenith*, 241 B.R. at 107 (fundamental fairness not offended by one group receiving better treatment than another under plan).

[44] *See In re G-1 Holdings Inc.*, 420 B.R. 216, 262 (D.N.J. 2009).

of a number of Code provisions which adversely alter creditors' contractual and nonbankruptcy rights . . . The fact that a debtor proposes a plan in which it avails itself of an applicable Code provision does not constitute evidence of bad faith."[45]

Here, the Plan's purpose and contents are honest, legitimate and viable. The Plan's paramount objectives are the reorganization of the Debtors' existing business as a going concern, the restructuring of the Debtors' liabilities and the preservation and maximization of the value of the Debtors' estates that allows creditors to realize a fair and meaningful recovery on their Claims. The Plan preserves jobs and puts the Reorganized Debtors in a position to be competitive in the supplemental education products industry, to the benefit of customers and suppliers alike. The Plan satisfies these objectives, and is in no way an attempt to abuse the judicial process or delay or frustrate the legitimate efforts of creditors to enforce their rights.[46] In short, the Plan accomplishes the very goals of the Bankruptcy Code.

Moreover, the Plan is the product of extensive arm's length negotiations among the Debtors and their key creditor constituencies. As discussed above, the Debtors negotiated extensively with the Creditors Committee, the ABL DIP Lenders, and the Ad Hoc DIP Lenders regarding the terms of the Plan. The overwhelming support for the Plan received from almost all of the Voting Classes provides independent evidence of good faith. For these reasons, the Plan was filed in good faith to promote the rehabilitative objectives and purposes of the Bankruptcy Code, and therefore satisfies the requirements of 1129(a)(3) of the Bankruptcy Code.

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[45] *Platinum Capital, Inc.* v. *Sylmar Plaza, L.P. (In re Sylmar Plaza, L.P.)*, 314 F.3d 1070, 1075 (9th Cir. 2002) (quoting *In re PPI Enter., Inc.*, 228 B.R. 339, 344-45, 347 (Bankr. D. Del. 1998).

[46] *See In re Sound Radio, Inc.*, 93 B.R. at 853.

D. The Plan Provides for Bankruptcy Court Approval of Certain Administrative Payments (Section 1129(a)(4))

Section 1129(a)(4) of the Bankruptcy Code requires that all post-petition professional fees promised or received in the Chapter 11 Cases remain subject to the Court's review.[47] Courts have construed this provision to require that all payments of professional fees using funds from estate assets be subject to review and approval by the Court as to their reasonableness.[48]

In accordance with section 1129(a)(4) of the Bankruptcy Code, all payments made or to be made by the Debtors for services rendered and expenses incurred in connection with the Chapter 11 Cases prior to Confirmation, including, without limitation, all Claims for professional fees, will be paid only after allowance of such Claims by the Court to the extent not already approved and paid in accordance with orders of the Court. Plan Article XII. In addition, the Court will retain jurisdiction after the Effective Date to grant or deny applications for allowance of Claims for professional fees or reimbursement of expenses authorized pursuant to orders of the Court, the Bankruptcy Code or the Plan. Thus, the Plan complies with the requirements of section 1129(a)(4) of the Bankruptcy Code.

E. The Debtors Have Disclosed All Necessary Information Regarding the Debtors' Post-Emergence Directors and Officers and Their Appointment Is Consistent with Public Policy (Section 1129(a)(5))

Section 1129(a)(5)(A) of the Bankruptcy Code requires that, prior to confirmation, the Debtors disclose the identity and affiliations of the proposed officers and directors of the Reorganized Debtors and that the appointment or continuance of such officers

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[47] *See In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. 723, 760 (Bankr. S.D.N.Y. 1992).

[48] *See In re Chapel Gate Apartments, Ltd.*, 64 B.R. 569, 573 (Bankr. N.D. Tex. 1986) (Before a plan may be confirmed, "there must be a provision for review by the Court of any professional compensation.").

and directors be consistent with the interests of creditors and equity security holders and with public policy. In addition, the Debtors must disclose the identity of any "insider" (as defined by 11 U.S.C. § 101(31)) to be employed or retained by the reorganized debtors and the "nature of any compensation for such insider."[49] 11 U.S.C. § 1129(a)(5)(B). The Plan satisfies these requirements because the Plan Supplements disclosed (i) the identities and affiliations of any known Person designated to serve as an officer or director of the Reorganized Debtors and (ii) that the officers would be compensated on substantially the same terms as prior to the Petition Date.[50]

The appointment of the proposed directors of the Board of Reorganized SSI also complies with section 1129(a)(5)(A)(ii) of the Bankruptcy Code because the appointment of the proposed directors is in the best interests of creditors and equity security holders and conforms with public policy. This section asks a court to ensure that the post-confirmation governance of the reorganized debtors are in "good hands," which courts have concluded to mean experience in the reorganized debtors' business and industry[51] and experience in financial and management matters.[52] The proposed directors and officers of the Reorganized Debtors easily satisfy this standard.

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[49] *See In re NH Holdings, Inc.*, 288 B.R. 356, 363 (Bankr. D. Del. 2002); *Drexel*, 138 B.R. at 760 (Section 1129(a)(5)(13) "requires a plan to disclose the identity of any 'insider' to be employed or retained by the reorganized debtor.").

[50] *See* Docket Nos. 1026, 1099.

[51] *See Drexel*, 138 B.R. at 760; *In re Rusty Jones, Inc.*, 110 B.R. 362, 372 (Bankr. N.D. Ill. 1990); *In re Toy & Sports Warehouse, Inc.*, 37 B.R. 141, 149 (Bankr. S.D.N.Y. 1984).

[52] *See In re Stratford Assocs. Ltd. P'ship*, 145 B.R. 689, 696 (Bankr. D. Kan. 1992); *In re Sherwood Square Assocs.*, 107 B.R. 872, 878 (Bankr. D. Md. 1989).

F. The Plan Does Not Require Governmental Regulatory Approval (Section 1129(a)(6))

Section 1129(a)(6) of the Bankruptcy Code requires that any regulatory commission that will have jurisdiction over the debtor after confirmation approve any rate change provided for in the debtor's plan. Section 1129(a)(6) is inapplicable to these Chapter 11 Cases because the Debtors' business does not involve the establishment of rates subject to approval of any governmental regulatory commission.

G. The Plan Is in the Best Interests of Creditors and Interest Holders (Section 1129(a)(7))

Section 1129(a)(7) of the Bankruptcy Code – the "best interests test" – requires that, with respect to each class, each holder of a claim or an equity interest in such class either:

> (i) has accepted the plan; or
>
> (ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtors liquidated under chapter 7 of [the Bankruptcy Code] on such date.

11 U.S.C. § 1129(a)(7)(A)(i)-(ii).

The best interests test applies to individual dissenting holders of claims and interests and is generally satisfied through a comparison of the estimated recoveries for a debtor's stakeholders in a hypothetical chapter 7 liquidation of that debtor's estate against the estimated recoveries under that debtor's plan of reorganization. As section 1129(a)(7) of the Bankruptcy Code makes clear, the best interests test applies only to non-accepting holders of impaired claims or interests.

The Plan contemplates distributions to four Impaired Classes as well as four unimpaired Classes. The Plan also contemplates no distributions to holders of Equity Interests in SSI in Class 9. Therefore, to satisfy the best interests test, the Debtors must demonstrate that

each Person holding Claims or Equity Interests in these Classes will receive at least as much under the Plan as they would receive in a chapter 7 liquidation.[53]

Here, the Plan satisfies the best interests test as demonstrated by comparing the Plan's projected recoveries, set forth in Article X of the Disclosure Statement and in the Financial Projections, attached as Exhibit B to the Disclosure Statement, with the Debtors' liquidation analysis (the "Liquidation Analysis"), attached as Exhibit C to the Disclosure Statement.

As described in the Disclosure Statement and the Vander Ploeg Declaration, the Liquidation Analysis is the product of careful analysis by the Debtors and Alvarez and Marsal North America, LLC ("A&M") of, among other things, the liquidation value of the Debtors' assets, the time it would take a chapter 7 trustee or similar liquidating agent to monetize such assets, and the increase in claims against the Debtors' estates that would arise upon a liquidation. The methodology used and assumptions made therein were carefully constructed and are consistent with industry practice for this type of valuation.

The Liquidation Analysis was prepared using the Debtors' books and records, unaudited financial information, certain independent appraisals prepared in conjunction with financings and valuation information prepared in conjunction with the Plan. It is based on a number of estimates and assumptions that are inherently subject to significant economic, competitive and operational uncertainties and contingencies. Further details concerning the Liquidation Analysis are set forth in the Disclosure Statement.

[53] *See In re Lason, Inc.*, 300 B.R. 227, 232 (Bankr. D. Del. 2003) ("Section 1129(a)(7)(A) requires a determination whether 'a prompt chapter 7 liquidation would provide a better return to particular creditors or interest holders than a chapter 11 reorganization.'").

Subject to the qualifications and assumptions stated in the Liquidation Analysis and the Disclosure Statement, the Debtors and A&M estimate that the midpoint net liquidation proceeds of the Debtors is $148.5 million – approximately $100 million less than the midpoint reorganization value of the Debtors on a going concern basis. Furthermore, allowed claims against the Debtors on a liquidation basis are estimated to be approximately $25 million higher than under a going concern scenario due to, among other things, the severance obligations that would be owed to all employees in the event of a liquidation. After payment of pre-petition secured and post-petition administrative and priority claims, the Liquidation Analysis shows that there are insufficient funds to provide any recovery to holders of unsecured Claims or Equity Interests.

Based on the Liquidation Analysis, the Debtors believe that the Plan provides equal or superior recovery to holders of Impaired Claims than would be available in a liquidation of the Debtors' estates. Simply put, the Liquidation Analysis shows no recoveries for such holders; as a result, the recoveries to holders of Claims in Classes 5, 6, 7 and 8 under the Plan are therefore superior. Class 9 Equity Interests will receive no distributions under either the Plan or the Liquidation Analysis. Accordingly, the Plan satisfies the best interests test.

H. Acceptance of Impaired Classes (Section 1129(a)(8))

Section 1129(a)(8) of the Bankruptcy Code, when read together with section 1129(b)(1) of the Bankruptcy Code, requires that each class of claims or interests must either accept a plan or be unimpaired thereunder, or the debtor must satisfy the so-called "cramdown" provisions of section 1129(b) with respect to such claims or interests. Pursuant to section 1126(c) of the Bankruptcy Code, a class of impaired claims accepts a plan if the holders who vote to accept the plan constitute (i) at least two-thirds in dollar amount and (ii) more than

one-half in number of the claims in that class that actually vote to accept or reject the plan. A class that is not impaired under a plan, and each holder of a claim or interest in such class, is conclusively presumed to have accepted the plan. Conversely, a class is conclusively deemed to have rejected a plan if the plan provides that the claims or interests of such class do not receive or retain any property under the plan on account of such claims or interests.

As set forth in the Voting Declaration, three of the four Impaired Classes of Claims that are entitled to vote to accept or reject the Plan have voted overwhelmingly to accept the Plan pursuant to section 1126(c) of the Bankruptcy Code. However, Class 5 did not vote to accept the Plan and, because the Plan provides that holders of Equity Interests in Class 9 will not receive any distributions or retain any property under the Plan, holders of Equity Interests in such Class are conclusively deemed to have rejected the Plan pursuant to section 1126(f) of the Bankruptcy Code. The Debtors seek confirmation of the Plan despite the rejection by Class 5 and the deemed rejection by Class 9 pursuant to section 1129(b) of the Bankruptcy Code, as described below.

I. The Plan Provides for Payment in Full of All Allowed Priority Claims (Section 1129(a)(9))

Section 1129(a)(9) of the Bankruptcy Code requires a chapter 11 plan to provide that all persons holding claims entitled to priority under section 507(a) of the Bankruptcy Code will be fully compensated for their claims in cash unless the holder of a particular claim agrees to a different treatment with respect to such claim. As required by section 1129(a)(9) of the Bankruptcy Code, Article III.A of the Plan provides for full payment in Cash of all Allowed Administrative Claims and Article III.C of the Plan provides for full payment of Allowed Priority Tax Claims. Therefore, the Plan complies with section 1129(a)(9) of the Bankruptcy Code.

J. At Least One Impaired Class of Claims Has Accepted the Plan, Excluding the Acceptances of Insiders (Section 1129(a)(10))

Section 1129(a)(10) of the Bankruptcy Code requires that to the extent there is an impaired class of claims under the Plan, at least one impaired class of claims must accept the Plan, excluding the votes of any insider. As described in the Voting Declaration, three of the four Voting Classes voted to accept the Plan by far more than the requisite majority. Accordingly, the Plan satisfies section 1129(a)(10) of the Bankruptcy Code.

K. The Plan Is Feasible (Section 1129(a)(11))

Section 1129(a)(11) of the Bankruptcy Code requires that the bankruptcy court find that a plan is feasible as a condition precedent to confirmation. Specifically, the bankruptcy court must determine that:

> Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.

11 U.S.C. § 1129(a)(11).

A debtor must prove a chapter 11 plan's feasibility by the preponderance of evidence.[54] To demonstrate that a plan is feasible, however, it is not necessary that success be guaranteed.[55] Rather, a bankruptcy court must determine whether a plan is workable and has a reasonable likelihood of success.[56] The key element of feasibility is whether there is a reasonable likelihood that the provisions of the plan can be performed and that the debtor will be

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[54] *See In re Briscoe Enters.*, 994 F.2d at 1165 (rejecting "clear and convincing" as the applicable standard); *CoreStates Bank N.A.* v. *United Chem. Tech., Inc.*, 202 B.R. 33, 45 (E.D. Pa. 1996).

[55] *See In re U.S. Truck*, 47 B.R. 932, 944 (E.D. Mich. 1985).

[56] *Mercury Capital Corp.* v. *Milford Conn. Assocs., L.P.*, 354 B.R. 1, 9 (D. Conn. 2006) (A "'relatively low threshold of proof' will satisfy the feasibility requirement.") (quoting *In re Brotby*, 303 B.R. 177, 191 (B.A.P. 9th Cir. 2003)).

commercially viable after the plan's effective date.[57] As demonstrated below, the Plan is feasible within the meaning of section 1129(a)(11) of the Bankruptcy Code.

In evaluating a plan's feasibility, courts have considered the following factors as probative: (i) the adequacy of the capital structure; (ii) the earning power of the reorganized debtor; (iii) economic and market conditions; (iv) the ability of management and the likelihood that the same management will continue; and (v) any other related matter that determines the prospects of a sufficiently successful operation to enable performance of the provisions of the plan.[58]

Here, the Financial Projections attached as Exhibit B to the Disclosure Statement, together with the Vander Ploeg Declaration, demonstrate that the Plan is feasible. The Debtors have thoroughly analyzed their ability to meet their obligations under the Plan and to continue as a going concern without further financial reorganization, and have carefully negotiated and developed the various transactions and ancillary documents, such as the Trade Election and the Exit Facilities, to ensure the successful implementation of the Plan and the Debtors' subsequent emergence. The Debtors anticipate that the Reorganized Debtors will be able to return to normalized trade terms with their vendors and suppliers through, among other things, the Trade Election.

The Debtors have also entered into the Exit Facilities to ensure their successful reorganization post-emergence. As set forth in the Plan Supplements, the Exit Facilities are composed of the ABL Exit Facility and the Term Loan Exit Facility, which, together, will be

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[57] *In re Texaco Inc.*, 84 B.R. 893, 910 (Bankr. S.D.N.Y. 1988) ("All that is required is that there be a reasonable assurance of commercial viability.").

[58] *See, e.g.*, *In re Prussia Assocs.*, 322 B.R. 572, 584 (Bankr. E.D. Pa. 2005); *In re Greate Bay Hotel & Casino*, 251 B.R. 213, 226-27 (Bankr. D.N.J. 2000) (*citing In re Temple Zion*, 125 B.R. 910, 915 (Bankr. E.D. Pa. 1991).

secured by a first priority lien in substantially all of the Reorganized Debtors' assets. The Debtors submit that the terms of the Exit Facilities are fair, just and reasonable under the circumstances, reflect the Debtors' exercise of their prudent business judgment consistent with their fiduciary duties, and are supported by reasonably equivalent value and fair consideration. The terms and conditions of the Exit Facilities have been negotiated in good faith and at arm's length. As a result, the Debtors submit that the Plan meets the feasibility requirement set forth in section 1129(a)(11) of the Bankruptcy Code. The Debtors believe that Confirmation is not likely to be followed by the need for further financial reorganization or liquidation.

Under the Plan, the Debtors have certain payment obligations due on or as soon as practicable after the Effective Date, including cash distributions to the Debtors' secured lenders, payments to holders of Allowed Administrative, Priority and Convenience Claims, and, in the months following the Effective Date, payment of additional professional fees. To make these payments and to fund their ongoing working capital needs, the Debtors' emergence from the Chapter 11 Cases is predicated on funding from: (a) Cash on hand as of the Effective Date and (b) the Exit Facilities. As demonstrated by the Financial Projections, the Debtors believe that these two funding sources will provide the Reorganized Debtors with sufficient capital and liquidity to make required payments under the Plan and successfully operate outside of bankruptcy protection.

The Debtors have established by a preponderance of the evidence that confirmation of the Plan is not likely to be followed by liquidation or the need for further reorganization of any or all of the Reorganized Debtors. For all the reasons set forth above, the Debtors submit that the Plan satisfies the feasibility requirement of section 1129(a)(11) of the Bankruptcy Code.

L. The Plan Provides for the Payment of all Fees Under 28 U.S.C. § 1930 (Section 1129(a)(12))

Section 1129(a)(12) of the Bankruptcy Code requires the payment of all fees payable under 28 U.S.C. § 1930. Article XII of the Plan provides that all such fees will be paid on and after the Effective Date as appropriate. The Plan, therefore, complies with section 1129(a)(12) of the Bankruptcy Code.

M. The Plan Satisfies the "Cram Down" Requirements (Section 1129(b))

Section 1129(b) of the Bankruptcy Code provides that if all applicable requirements of section 1129(a) are met, then – notwithstanding the existence of a class of impaired claims or interests that has not accepted the plan, so that the plan does not comply with section 1129(a)(8) – the plan may be confirmed so long as it does not discriminate unfairly and is fair and equitable with respect to each class of claims and interests that is impaired and has not accepted the plan. 11 U.S.C. § 1129(b)(1). Thus, to confirm a plan that has not been accepted by all impaired classes, the plan proponent must show that the plan "does not discriminate unfairly" against, and is "fair and equitable" with respect to, the non-accepting impaired classes.[59] Here, the Debtors satisfy the "cram down" requirements in section 1129(b) of the Bankruptcy Code necessary to confirm the Plan over the rejection by Class 5 and the deemed rejection by Class 9.

1. The Plan Is Fair and Equitable with Respect to the Rejecting Classes

Section 1129(b)(2) of the Bankruptcy Code provides that a plan is fair and equitable with respect to a particular class of unsecured claims or impaired interests if the holder of any claim or interest in a class junior to the claims or interests of that particular class will not

[59] *See John Hancock Mutual Life Ins. Co.*, 987 F.2d at 157 n.5.

receive or retain property under the plan on account of such junior claim or interest. *See* 11 U.S.C. § 1129(b)(2)(B)(ii) and (C)(ii). This central tenet of bankruptcy law – the "absolute priority rule" – requires that, if the holders of claims or interests in a particular class that vote to reject a plan receive less than full value for their claims or interests, no holder of claims or interests in a junior class may receive or retain any property under the plan.[60] Another condition under the absolute priority rule is that senior classes cannot receive more than a 100% recovery for their claims.[61]

The Plan satisfies the absolute priority rule with respect to the Rejecting Classes. *First*, no Class of Claims or Equity Interests junior to the Rejecting Classes will receive or retain any property under the Plan. *Second*, no Class of Claims will receive or retain property under the Plan that has a value greater than 100% of such Class's Claims. Accordingly, the Plan satisfies the requirements of sections 1129(b)(2)(B) and 1129(b)(2)(C)(ii) and, therefore, is fair and equitable with respect to such Rejecting Classes.

2. The Plan Does Not Unfairly Discriminate with Respect to the Rejecting Classes

The Plan does not discriminate unfairly with respect to the Rejecting Classes. The Bankruptcy Code does not provide a standard for determining when "unfair discrimination"

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[60] *See Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197, 202 (1988) (the absolute priority rule, "provides that a dissenting class of unsecured creditors must be provided for in full before any junior class can receive or retain any property [under a reorganization] plan.") (citations omitted); *Bank of Am.* v. *203 North LaSalle St. Ltd. P'ship*, 526 U.S. 434, 441-42 (1999) ("As to a dissenting class of impaired unsecured creditors, such a plan may be found to be 'fair and equitable' only if the allowed value of the claim is to be paid in full, § 1129(b)(2)(B)(i), or, in the alternative, if 'the holder of any claim or interest that is junior to the claims of such [impaired unsecured] class will not receive or retain under the plan on account of such junior claim or interest any property,' § 1129(b)(2)(B)(ii). That latter condition is the core of what is known as the 'absolute priority rule.'").

[61] *See In re Exide Technologies*, 303 B.R. at 61 ("[A] corollary of the absolute priority rule is that a senior class cannot receive more than full compensation for its claims."); *Genesis*, 266 B.R. at 612 (same). As set forth in the Plan, no senior class shall receive more than a 100% recovery on account of its claims.

exists.[62] Rather, courts typically examine the facts and circumstances of each particular case to determine whether unfair discrimination exists.[63] At a minimum, however, the unfair discrimination standard prevents creditors and interest holders with similar legal rights from receiving materially different treatment under a proposed plan without sufficient justifications for doing so.[64]

Here, the Plan's treatment of holders of General Unsecured Claims in Class 5 does not unfairly discriminate against such holders: these creditors will receive precisely the same treatment as holders of Trade Unsecured Claims in Class 6 who do not make the Trade Election. This is more than fair and reasonable because such holders are classified in Class 5, rather than Class 6, on the basis that they are not eligible for the Trade Election since they are not vendors with whom the Reorganized Debtors continue to do business. Moreover, those holders in Class 6 who make the Trade Election will not receive additional consideration on account of their Claims due to their status as vendors; rather, they will receive the Trade Payment because

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62 *See In re 203 N. LaSalle St. Ltd. P'ship.*, 190 B.R. 567, 585 (Bankr. N.D. Ill. 1995), *rev'd on other grounds*, 526 U.S. 434 (1999) (noting "the lack of any clear standard for determining the fairness of a discrimination in the treatment of classes under a Chapter 11 plan" and that "the limits of fairness in this context have not been established.").

63 *See In re Bowles*, 48 B.R. 502, 507 (Bankr. E.D. Va. 1985) ("[W]hether or not a particular plan does so [unfairly] discriminate is to be determined on a case-by-case basis."); *see also In re Freymiller Trucking, Inc.*, 190 B.R. 913, 916 (Bankr. W.D. Okla. 1996) (holding that a determination of unfair discrimination requires a court to "consider all aspects of the case and the totality of all the circumstances").

64 *See In re Ambanc La Mesa Ltd. P'ship*, 115 F.3d 650, 655 (9th Cir. 1997); *In re Aztec Co.*, 107 B.R. 585, 589-91 (Bankr. M.D. Tenn. 1989); *In re Johns-Manville Corp.*, 68 B.R. 618, 636 (Bankr. S.D.N.Y. 1986). A presumption of unfair discrimination only arises if the dissenting class receives a materially lower percentage recovery. *In re Armstrong World Indus.*, 348 B.R. at 121. Generally, courts have found that a plan does not discriminate unfairly where the difference in recovery between classes with similar legal rights is less than 50% *or* where a legitimate reason exists for a greater percentage difference. *In re Tribune Co.*, 472 B.R. 223, 243 (Bankr. D. Del. 2012) ("Courts considering the issue of unfair discrimination have roundly rejected plans proposing grossly disparate treatment (50% or more) to similarly situated creditors[.]"); *In re Creekstone Apartments Ass'n, L.P.*, 168 B.R. 639, 644-45 (Bankr. M.D. Tenn. 1994) (holding that no unfair discrimination existed where trade creditors received 100% of their claims and other unsecured creditors received only 10% because the enhanced recovery for trade creditors was necessary to ensure their continued business with the debtor). Further, a debtor can overcome the presumption of unfair discrimination if it can show that "the alleged preferred class had infused new value into the reorganization which offset its gain." *In re Armstrong Indus.*, 348 B.R. at 121.

they are agreeing to provide material economic consideration to the Reorganized Debtors in the form of fixed, agreed-upon Customary Trade Terms. Thus, the Trade Election offered to holders of Trade Unsecured Claims in Class 6 does not render the treatment of other unsecured creditors under the Plan unfairly discriminatory.[65] Thus, the Plan's treatment of Class 5 is proper.

Additionally, the Plan's treatment of Equity Interests is proper because there is no other class of equity interests. Indeed, all other Classes under the Plan are composed of creditor Claims. Thus, all similarly situated equity holders will receive substantially similar treatment in Class 9. Accordingly, the Plan does not unfairly discriminate with respect to the Rejecting Classes, and the cram down test of section 1129(b) of the Bankruptcy Code is satisfied.

N. The Plan Satisfies the "Only One Plan" Requirement (Section 1129(c))

Section 1129(c) of the Bankruptcy Code provides that "the court may confirm only one plan, unless the order of confirmation in the case has been revoked under section 1144" of the Bankruptcy Code. No other plan has been confirmed in these Chapter 11 Cases, and therefore section 1129(c) is satisfied.

O. The Plan Satisfies the "Principal Purpose of the Plan" Requirements (Section 1129(d))

Section 1129(d) of the Bankruptcy Code provides that "on request of a party in interest that is a governmental unit, the court may not confirm a plan if the principal purpose of

[65] Courts have upheld plan provisions providing different recoveries to claimants with similar legal rights, even within the same class based on a claimant's election of a certain treatment. *See e.g.*, *In re Wash. Mut., Inc.*, 442 B.R. at 335-36 (overruling the trustee's objection that the plan violated section 1123(a)(4) in providing varying distributions to creditors within the same class based on each creditor's election to settle certain claims and holding that "[w]hat is important is that each claimant within a class have the same opportunity to receive equal treatment"); *In re Aleris Int'l, Inc.*, 2010 Bankr. LEXIS 2997, at *50 (finding the plan did not violate section 1123(a)(4) since "[e]ach member of each Class receives the same treatment as any other member within the same Class [and that] [t]o the extent a Backstop Party receives additional or different consideration under the Plan, the Backstop Party receives such consideration in exchange for the [additional] commitments of the Backstop Party"). As discussed above, the Debtors had legitimate reasons to classify members of Class 5 and Class 6 separately: Class 5 Claimants are not in a position to provide such additional consideration. *See, e.g.*, *Creekstone Apartments*, 168 B.R. at 644-45 (holding that no unfair discrimination existed where the enhanced recovery for trade creditors was necessary to ensure their continued business with the debtor).

the plan is the avoidance of taxes of the avoidance of the application of section 5 of the Securities Act of 1933." No governmental unit has requested that the Plan not be confirmed on the grounds that the primary purpose of the Plan is the avoidance of taxes or the avoidance of the application of section 5 of the Securities Act of 1933, and the primary purpose of the Plan is not the avoidance of taxes of avoidance of the requirements of section 5 of the Securities Act of 1933. Accordingly, the Plan satisfies the requirements of section 1129(d).

P. Deemed Substantive Consolidation Is Appropriate

The Plan is predicated upon the substantive consolidation of the Debtors' Chapter 11 Cases, solely for the purposes of the Plan, distributions thereunder, and all actions with respect to confirmation and consummation thereof. The Debtors believe that such substantive consolidation is fair, appropriate and necessary, and should be approved.

Although the power to substantively consolidate bankruptcy estates is not explicitly authorized by any provision of the Bankruptcy Code, it is well established that bankruptcy courts may use their equitable powers under section 105 of the Bankruptcy Code to consolidate cases involving related debtors.[66] The Third Circuit has held that substantive consolidation is warranted where there is a pre-petition disregard of corporate separateness or postpetition scrambling of assets and liabilities.[67] In doing so, the Third Circuit explained that, unlike the substantive consolidation tests in other circuits, the Third Circuit has no set list of factors that it uses in determining if substantive consolidation is appropriate; rather, "what must

[66] *See, e.g.*, *Eastgroup Props.* v. *Southern Motel Assoc.*, 935 F.2d 245, 248 (11th Cir. 1991); *In re Stone & Webster, Inc.*, 286 B.R. 532, 539 (Bankr. D. Del. 2002); *In re Leslie Fay Cos.*, 207 B.R. 764, 779 (Bankr. S.D.N.Y. 1997); *Bruce Energy Ctr. Ltd.* v. *Orfa Corp. of Am. (In re Orfa Corp. of Phila.)*, 129 B.R. 404, 413-14 (Bankr. E.D. Pa. 1991) ("[T]he court's power to substantively consolidate cases is derived from its general equitable powers under 11 U.S.C. § 105[.]").

[67] *In re Owens Corning*, 419 F.3d 195, 205 (3d Cir. 2005) ("Substantive consolidation . . . emanates from equity [and] 'treats separate legal entities as if they were merged into a single survivor left with all the cumulative assets and liabilities'") (quoting *In re Genesis Health Ventures, Inc.*, 402 F.3d 416, 423 (3d Cir. 2005)).

be proven (absent consent) concerning the entities for whom substantive consolidation is sought is that (i) prepetition they disregarded separateness so significantly their creditors relied on the breakdown of entity borders and treated them as one legal entity, or (ii) postpetition their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors."[68]

Courts, including courts interpreting *Owens Corning*, have concluded that substantive consolidation is appropriate where the factual record shows that all debtors (i) have the same officers, same directors and shareholders, (ii) conduct the same general business operations under very similar names, (iii) conduct intercompany dealings without the usual corporate formalities, (iv) do not charge each other for all services which they rendered to one another and (v) move profits between and among the debtors.[69] These courts have also noted that substantive consolidation may be appropriate where debtors are viewed as a single entity for the purposes of secured lending, and unsecured creditors view the debtors as a single entity when

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[68] *Id.* at 210-11. Importantly, in *Owens Corning*, the Third Circuit denied deemed substantive consolidation where the debtors' goal was to use substantive consolidation "offensively" to achieve an advantage over the secured lenders in the plan negotiation process, rather than for its proper purpose of remedying identifiable harms. Additionally, the Third Circuit found that: (i) the objecting secured lenders relied on the separateness of each debtor entity when they agreed to extend credit; (ii) each subsidiary debtor was established to provide a particular benefit to Owens Corning, such as limiting liability concerns or obtaining tax benefits; and (iii) corporate separateness was maintained such that it was clear which debtor owned which principal assets and had which material liabilities. No such facts are present here.

[69] *In re Lisanti Foods, Inc.*, 241 Fed. Appx. 1, 2-3 (3d Cir. 2007) (applying the test articulated in *Owens Corning* and finding substantive consolidation appropriate based on such facts "under the first prong (creditor reliance on pre-petition disregard of separateness)"). The Second Circuit has distilled the considerations pertinent to substantive consolidation into two "critical factors" which are similar to the factors articulated in *Owens Corning* and *Lisanti Foods*; namely, "(i) whether creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending credit, . . . or (ii) whether the affairs of the debtors are so entangled that consolidation will benefit all creditors." *In re Augie/Restivo Baking Co., Ltd.*, 860 F.2d 515, 518 (2d Cir. 1988) (internal citations omitted); *see also Alexander* v. *Compton (In re Bonham)*, 229 F.3d 750, 766-67 (9th Cir. 2000) (applying the Second Circuit's *Augie/Restivo* test and finding that substantive consolidation was appropriate between the debtor and non-debtor entities because the entities commingled assets, used their names interchangeably, and lacked independent financial statements or corporate tax returns); *Windels Marx Lane & Mittendorf, LLP* v. *Source Enters. (In re Source Enters.)*, 392 B.R. 541, 553-54 (S.D.N.Y. 2008) (analyzing *Owens Corning* and *Augie/Restivo* and holding that that substantive consolidation was appropriate where (i) creditors dealt with entities as a single economic unit, (ii) the debtors operated as a single economic entity, and (iii) creditors "used the various debtors' trade names interchangeably" and that the second factor was satisfied where the debtors' books could not be untangled).

extending credit terms.[70] Here, the applicable facts closely mirror the facts in such cases and therefore satisfy the requirements of substantive consolidation.

The Debtors operate on a consolidated basis. They maintain a corporate headquarters in Greenville, Wisconsin, where a single group of senior management and administrative staff at SSI performs all administrative and overhead functions, including human resources, treasury and information technology services, for the entire corporate group. Yet the subsidiary Debtors do not pay management fees to SSI for these shared functions, and costs are not otherwise allocated on a per-Debtor basis. Similarly, these individuals are responsible for negotiating agreements and obtaining services for the company as a whole, where one provider can render services to multiple business segments and legal entities. Thus, SSI regularly issues purchase orders and receives inventory on behalf of various business segments, which may span multiple legal entities. Further, the Debtors utilize the same warehouses and other facilities for multiple segments and legal entities.

As a result, the Debtors believe that the third parties with whom they interact treat the Debtors' operations as unitary and analyze the Debtors' credit worthiness on a consolidated basis. Not only do most purchase orders come from SSI regardless of what business segment the goods are for, but the Debtors also provide financing information to third parties only on a consolidated basis. Thus, when the Debtors are required to provide financial or business information to third parties, whether to the Securities Exchange Commission as part of their historic public company reporting obligations, to potential secured lenders, or to potential new customers and vendors as proof of the company's credit worthiness, they do so collectively:

[70] *In re Lisanti Foods, Inc.*, 241 Fed. Appx. at 3; *In re Source Enters.*, 392 B.R. at 553 (explaining that substantive consolidation was appropriate because, among other relevant facts, "the record reflect[ed] that creditors . . . dealt with the entities as a single economic unit and did not rely on their separate identities in extending credit").

financial statements, tax returns, bank accounts, officer and director listings – all are provided on a unified basis for the company as a whole. Therefore, the Debtors believe that it is simply not possible for the Debtors' creditors to assess the financial condition of the Debtors on an entity-by-entity basis and that their creditors do not do so. This is confirmed by the fact that almost all of the Debtors have historically been co-borrowers on the company's secured financings, including the various financings that are satisfied under the Plan. The only Debtor entities who are not borrowers under these financing agreements are entities that do not have material business operations or assets and are therefore listed only as guarantors.

The Debtors' internal systems are set up on a consolidated basis as well. As explained to the Court in the *Debtors' Motion for an Order (I) Approving Continued Use of the Debtors' Existing Cash Management System, (II) Authorizing Use of Existing Bank Accounts and Checks, and (III) Waiving the Requirements of 11 U.S.C. § 345(B) on an Interim Basis, and (IV) Granting Administrative Expense Status to Postpetition Intercompany Transactions* [Docket No. 8], the Debtors utilize a consolidated cash management system where all funds flow up to and from the parent entity, SSI. And while the Debtors' cash management system tracks certain intercompany transactions and debts, such amounts are not netted or settled out. Moreover, it is not possible for the Debtors to allocate and reconcile the majority of their assets and liabilities on a per-entity basis. Their internal systems are simply not designed to do so, which means that any attempt would require a manual, line-by-line effort to review and categorize records of millions of individual transactions to trace such transactions back to the proper entity. In particular, since purchase orders regularly cover goods for more than one segment and legal entity, each purchase order and invoice would need to be reconciled on a per-item basis to match each specific product in a given purchase order with its corresponding segment and legal entity.

Furthermore, both the Debtors and their customers and vendors identify the Debtors' various subdivisions by segments and trade names, rather than by their corporate identities. Thus, the Debtors have two reportable segments for purposes of their public reporting, both of which are contained within the SSI corporate entity. When they allocate company overhead, they do so by division – not by legal entity. Similarly, the Debtors' customers and vendors generally identify themselves as working with a particular segment by trade name, not corporate entity. Moreover, trade names for divisions or segments do not reliably correlate with the corporate entity that owns the division or segment. By way of example, while the SPARK division is a division of Sportime, LLC, SPARK's vendors can provide goods to, and transact with, both Sportime, LLC and SSI. Finally, the Debtors have the substantially all of the same officers and directors.

For these reasons, the Plan proposes to make Distributions to all creditors on a consolidated basis, rather than attempt to allocate distributions on a debtor-by-debtor basis. The Debtors submit that substantive consolidation of all assets and liabilities of the Debtors for Plan purposes will not prejudice any party in these Chapter 11 Cases because the collective assets of each entity that actually has assets are fully encumbered under the ABL DIP Facility and Ad Hoc DIP Facility. Moreover, any attempt to allocate on a Debtor-by-Debtor basis would be, at best, cumbersome, expensive and time consuming, thus potentially adversely affecting Plan distributions both in scope and nature, for questionable benefit. In fact, in light of the Debtors' internal systems, there is no guarantee that this would even be feasible.[71] Therefore, substantive

[71] Only one exception exists to the fully consolidated nature of the Debtors described herein: Debtor Subsidiary Califone International, Inc. ("Califone"). For various reasons, Califone is the only Debtor not on the centralized Oracle cash management system. Moreover, Califone has a vendor base comprised almost entirely of foreign vendors and therefore typically negotiates with its vendors independently from the other Debtors. As such, it is possible to track certain of these payments as being payments owed by Califone alone. However, the majority of Califone's prepetition outstanding accounts payable was satisfied through payments made pursuant to the

consolidation will in no way adversely affect the recovery that creditors would otherwise receive if each estate was valued and distributions were made solely on account thereof.

Additionally, the Debtors presently intend to merge or consolidate some or all of their domestic subsidiaries into SSI as part of, or soon after, the Debtors' emergence from chapter 11. This process is intended to make the Debtors' corporate structure more accurately reflect the consolidated nature of the Debtors' operations and financial systems, and is consistent both with section 1123(a)(5)(C) of the Bankruptcy Code, which contemplates the merger or consolidation of debtors as a means for the implementation of a Chapter 11 plan, and Article V.H.6 of the Plan, which envisioned similar transactions. This fact underscores that substantive consolidation of the Estates for Plan purposes is appropriate and is not designed to accomplish any impermissible purpose.[72]

Accordingly, for the reasons set forth above, the Debtors submit that substantive consolidation should be approved as in the best interests of the Debtors, their estates and their creditors.

Interim and Final Orders Authorizing the Debtors to Pay Prepetition Claims of Certain Critical Vendors, Foreign Suppliers, Freight Carriers, and Section 503(b)(9) Claimants [Docket Nos. 79, 277] (collectively, the "Critical Vendors Orders"). The Debtors believe that, as of the date hereof, approximately $1 million in open accounts payable remains unpaid, and they believe that approximately $640,000 of that amount will be entitled to payment in full pursuant to section 503(b)(9) of the Bankruptcy Code. Of the remaining prepetition claims, the Debtors believe that substantially all of that amount is owed to a single vendor, which has voted to accept the Plan. Therefore, even when Califone is considered on its own – which is the only Debtor subsidiary for which it is at all possible to do so – the creditors of Califone are not adversely affected by substantive consolidation under the Plan and have consented to it.

[72] *See Owens Corning*, 419 F.3d at 215 (stating that "substantive consolidation should be used defensively to remedy identifiable harms, not offensively to achieve advantage over one group in the plan negotiation process").

IV.
CONCLUSION

For the reasons set forth herein, the Debtors submit that the Plan fully satisfies all applicable requirements of the Bankruptcy Code and respectfully request that this Court confirm the Plan.

Dated: Wilmington, Delaware
May 17, 2013

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