Docket #1106 Date Filed: 5/19/2013

IN THE 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
	:	**Related Docket Nos.: 862, 864, 1072**

SUPPLEMENTAL OBJECTION OF CERTAIN HOLDERS OF CONVERTIBLE NOTES TO DEBTORS' AMENDED JOINT PLAN OF REORGANIZATION UNDER CHAPTER 11 OF THE BANKRUPTCY CODE AND TO DEBTORS' DISCLOSURE STATEMENT AND REQUEST FOR ADJOURNMENT BASED ON DEBTORS' FAILURE TO DISCLOSE MATERIAL ELEMENTS OF THEIR PLAN

The holders identified below (collectively, the "Objecting Noteholders")[2] of convertible subordinated debentures due 2016 (the "Convertible Notes"), hereby submit this supplemental objection (the "Supplemental Objection") to the Debtors' Amended Joint Plan of Reorganization Under Chapter 11 of the Bankruptcy Code (the "Plan") and to the disclosure statement (the "Disclosure Statement") and request for adjournment of the confirmation hearing due to the Debtors' failure to disclose material elements of their Plan. In support of the Supplemental Objection, the Objecting Noteholders aver as

[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.

[2] As reflected on their Supplemental Verified Statement of the Disenfranchised Holders of School Specialty, Inc. 3.75% Convertible Subordinated Notes Due 2026 Pursuant to Bankruptcy Rule 2019 (the "Supplemental 2019 Statement"), filed May 13, 2013 as Docket No. 1032, the Objecting Noteholders and the face amount of Convertible Notes they hold are: Koyote Trading, LLC ($2,700,000), Singer Children Management Trust ($3,250,000), Varana Capital Master, LP ($500,000), James Pallotta ($3,000,000), William A. Inglehart III Non-Exempt Trust ($2,089,000), RBF Capital LLC ($3,500,000), and Deutsche Bank Securities Inc. ($2,000,000). The foregoing list of Objecting Noteholders may be supplemented as appropriate. The Objecting Noteholders hold no short position with respect to their holdings of Convertible Notes.

follows:

NEW FACTS

1. Debtors' Continued Non-Disclosure of the Crux of the Plan:

   a. On Monday May 13, 2013, some of the Objecting Noteholders and their attorneys spoke to some of the Debtors' management and the Debtors' attorneys about the offer made by the Objecting Noteholders to pay off the DIP loan on better terms for prepetition creditors than the DIP lenders had offered. The Debtors claimed they did not know how much of the DIP loan would have to be converted into ownership of the reorganized Debtors rather than repaid in cash, because the Debtors did not know, among other things, the size of their exit facility. The Debtors opined, however, that the amount to be converted to ownership would be greater than $50 million, perhaps $59 million to $79 million. The Objecting Noteholders stated their ability and willingness to provide more than $50 million and asked to see the data provided to the DIP lenders and to meet with senior management for 3 hours.

   b. Debtors' Refuse to Meet. As of Sunday, May 19, 2013, the Debtors' senior management has refused to meet with the Objecting Noteholders. A member of the Objecting Holders, who is subject to an NDA, has offered to meet at the Debtors' offices at all his available times before the May 23 confirmation hearing,

which availability has been since last Monday, May 13 through Sunday, May 19, 2013, and he has been rebuffed by the Debtors. In the meantime, nondisclosure agreements were signed and said Objecting Noteholder has done the limited due diligence available to him. But, the Debtors have denied to the Objecting Noteholders the most basic element of due diligence, to meet in person with the CEO and CFO of the entity they want to buy and the key people heading the Debtors' most critical subsidiaries' operations and businesses.

c. Continued Concealment of the Deal through Sunday, May 19, 2013. As of Friday evening May 18, 2013, the Debtors could not and/or would not disclose to the Objecting Noteholders the amount of the DIP loan being converted to ownership of the reorganized Debtors under the Plan. Moreover, rather than opine that the amount would be greater than $50 million, the Debtors explained they were requesting a larger exit facility. Accordingly, the amount of the DIP loan that will not be repaid in cash may be more or less than $50 million. It is now only 4 days (including Sunday) before the new date of May 23, 2013 for the confirmation hearing, and the economics of the Plan are undisclosed. Remarkably, the 52-page Debtors' Memorandum in Support of Confirmation (the "Confirmation Brief") [D.I. 1103] still fails to state the economic terms of the transaction to be effectuated by the Plan.

d. On May 18, 2013 the Debtors Advised the Objecting Noteholders it was Too Late to Entertain Better Offers. After the Objecting Noteholders advised the Debtors of their continued ability and willingness to make a superior offer, on Friday May 17, 2013 the Debtors advised them that it would be too much bother. The Debtors said they would have to go back to their exit lenders (with whom they were obviously still negotiating since the amount of the exit facility was unresolved) and get them comfortable with different owners, namely the Objecting Noteholders (or a combination of the Objecting Noteholders and the DIP lenders given that the Objection Noteholders' offer allowed other convertible noteholders to participate). No explanation was given as to why that is too much trouble! Moreover, given the requirements of Bankruptcy Code sections 363 and 364, it is the Debtors' duty to determine whether there are better offers. Yet the Debtors have completely failed to do so.

e. Late Partial Disclosure of Directors and What Management is Promised while it Rebuffs the Objecting Noteholders. The Objection pointed out that the Debtors had not disclosed in the Plan Supplement what they are supposed to disclose, namely how much stock is being given to management, terms of employment, and the identities of all the directors (other than the CEO). All of that was undisclosed when the Objecting Noteholders filed their

Objection on May 16, 2013. Late in the day on May 17, 2013, the Debtors filed their Third Amended Supplement to the Plan [D.I. 1099] where, for the first time, it was revealed how much stock was being reserved for management (up to 8%) and further identified two more of the five directors leaving two still undisclosed as of the filing of this objection.

f. Adjourning the Confirmation Hearing to May 23, 2013 Did Nothing to Satisfy Bankruptcy Rule 2002 and Basic Fairness. For their own reasons, the Debtors moved the confirmation hearing from May 20 to May 23. The Objecting Noteholders' reasons for asserting the confirmation hearing could not be held on May 20 are consistent with due process and Bankruptcy Rule 2002, are equally applicable to May 23. As of now, the Debtors have not disclosed the economic deal underlying the Plan and rebuff the Objecting Noteholders, and the facts underlying deemed substantive consolidation. Additionally, there is no time to carry out the requirements of Bankruptcy Code sections 363 and 364 to determine whether better refinancing and sale offers are available. Instead, the Debtors are simply plowing forward with their proposed private, inside refinancing and sale to the DIP lenders.

g. No Bankruptcy Code Section 1145 Exemption for DIP Lenders. In the Objecting Noteholders' discussions with the Debtors and their advisors, the Objecting Noteholders learned the DIP lenders are

interested in a quick sale after confirmation. The DIP Lenders' conversion of their existing DIP loan repayable only in cash, into a new loan repayable partially in stock they want to sell quickly, renders them underwriters ineligible for the section 1145 exemption according to the terms of section 1145(b)(1)(A).[3] The Bankruptcy Court should not issue any findings or determinations that the DIP lenders qualify for the section 1145 exemption.

h. The Debtors' should Not be Permitted to Cram This Plan Down For the Sole Benefit of The DIP Lenders. Class 5, the trade class, has rejected the Plan. Class 7, the class comprised of Convertible Noteholders which is dominated in amount by the DIP Lenders has accepted the plan. That is understandable and to be expected because they voted not as noteholder creditors but rather as lender/acquirers. Their votes are subject to designation because the DIP Lenders who are convertible Noteholders voted for the Plan specifically because it is a bad plan for Convertible Noteholders

[3] Bankruptcy Code section 1145(b)(1) provides:

> **(b) (1)** Except as provided in paragraph (2) of this subsection and except with respect to ordinary trading transactions of an entity that is not an issuer, an entity is an underwriter under section 2(a)(11) of the Securities Act of 1933, if such entity—
> **(A)** purchases a claim against, interest in, or claim for an administrative expense in the case concerning, the debtor, if such purchase is with a view to distribution of any security received or to be received in exchange for such a claim or interest;
> **(B)** offers to sell securities offered or sold under the plan for the holders of such securities;
> **(C)** offers to buy securities offered or sold under the plan from the holders of such securities, if such offer to buy is—
> **(i)** with a view to distribution of such securities; and
> **(ii)** under an agreement made in connection with the plan, with the consummation of the plan, or with the offer or sale of securities under the plan; or
> **(D)** is an issuer, as used in such section 2(a)(11), with respect to such securities.

but an extraordinary plan for the DIP Lenders. The Objecting Noteholders are entitled to move to designate those votes now that the votes have been disclosed. Clearly, this cannot be done by May 23, 2013.

i. The Plan Has Not Been Accepted. The Plan does not classify creditors in separate classes for each Debtor. Notwithstanding the Debtors' efforts to convince this court that nonconsensual deemed substantive consolidation is appropriate in this case, they cannot evade the strictures of the Third Circuit's decision in *In re Owens Corning*, 419 F.3d 195 (3d Cir. 2005). Notably, the Debtors' first citation in their Confirmation Brief in support of substantive consolidation refers to *Eastgroup Properties v. Southern Motel Assoc., Ltd.*, 935 F.2d 245 (11th Cir. 1991). However, *Owens Corning* expressly disavows *Eastgroup*. *See Owens Corning*, 419 F.3d at 209 n.15 ("Thus we disagree with the assertion of a 'liberal trend' toward increased use of substantive consolidation—e.g., *Eastgroup*, 935 F.2d at 248 (describing 'a 'modern' or 'liberal' trend toward allowing substantive consolidation')"). The Debtors took the risk of soliciting a plan based on the unreasonable expectation that this court could order deemed substantive consolidation over the Objecting Noteholders' objection, or that of any other creditor. But the facts still have not changed and deemed substantive consolidation still remains unavailable as a remedy,

convenient as it might be to those who will benefit from the private sale to be accomplished by the Plan. For this reason alone the Plan should not be confirmed.

j. Request that Debtors Produce Witnesses and Documents at Confirmation Hearing. As explained in the Objection, the Objecting Noteholders contend the Debtors' request for deemed substantive consolidation must be dismissed for failure to state a claim. There is no motion or complaint requesting it. The Plan pleads nothing to support it. If, however, the Court allows the Debtors to try to prove a case for deemed substantive consolidation at the confirmation hearing (whenever that occurs), the Objecting Noteholders request that the Debtors produce the following individuals the Objecting Noteholders will call as witnesses in respect of all their objections including their objection to deemed substantive consolidation: (i) the Debtors' CEO, (ii) the Debtors: CFO, (iii) the Debtors' head of marketing, (iv) the Debtors' head of sales, (v) the Debtors' chief compliance officer, (vi) the Debtors' chief accounting officer, and (vii) the Debtors' chief legal officer. To facilitate a more efficient confirmation hearing, and as a courtesy to the Court and to the Objecting Noteholders, the Objecting Noteholders request that the Debtors produce by Tuesday, May 21st, all bylaws, minutes (minutes from January 1, 2012 through May 19, 2013), and charters of the Debtors' and their

subsidiaries' boards of directors and of such boards' subcommittees and special committees, and all projections made available to the exit lenders.

CONCLUSION

Based on the foregoing, the Objecting Noteholders respectfully request that the Court enter its Order: (i) sustaining their Objection and this Supplemental Objection; (ii) revoking its conditional approval of the Disclosure Statement, (iii) adjourning the confirmation hearing for at least 14 days after May 23, 2013 so that Bankruptcy Code sections 363 and 364 may be carried out, (iv) denying confirmation of the Plan, (v) ruling the non-debtor releases in the Plan are outside the power of the Bankruptcy Court to grant, (vi) ruling there is no basis to release the CEO and CFO pursuant to section IX.I of the Plan, (vii) denying or refraining from finding the DIP lenders qualify for the section 1145 exemption, and (viii) granting the Objecting Noteholders such other and further relief as is just.

Dated: May 19, 2013
Wilmington, DE

BAYARD, P.A.

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that on the 19th day of May, 2013, copies of the **Supplemental Objection of Certain Holders of Convertible Notes to Debtors' Amended Joint Plan of Reorganization under Chapter 11 of the Bankruptcy Code and to Debtors' Disclosure Statement and Request for Adjournment Based on Debtors' Failure to Disclose Material Elements of Their Plan** were served upon the following persons or entities via electronic mail:

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