

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

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In re: : Chapter 11
: :
: Case No. 16-10527 (MFW)
TSAWD HOLDINGS, INC., *et al.*,¹ : Jointly Administered
: :
Debtors. : Re: Docket No. 2746
: :
: **Hearing Date: August 31, 2016 at 11:30 a.m.**
: **Obj. Deadline: August 24, 2016 at 4:00 p.m.**
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**OBJECTION OF THE UNITED STATES TRUSTEE TO THE DEBTORS’ MOTION FOR ORDER (A) APPROVING
MODIFIED EXECUTIVE INCENTIVE PROGRAM AND AUTHORIZING PAYMENTS THEREUNDER AND (B)
AUTHORIZING THE DEBTORS TO FILE THE UNREDACTED MODIFIED KEY EMPLOYEE INCENTIVE
PROGRAM UNDER SEAL
(D.I. 2746)**

Andrew R. Vara, the Acting United States Trustee for Region 3 (the “U.S. Trustee”), through his undersigned counsel, hereby objects to the Debtors’ Motion for Order (A) Approving Modified Executive Incentive Program and Authorizing Payments Thereunder and (B) Authorizing the Debtors to File the Unredacted Modified Key Employee Incentive Program Under Seal (D.I. 2746) (the “New Insider Bonus Motion”), and in support of his objection respectfully states as follows:

PRELIMINARY STATEMENT

1. The New Insider Bonus Motion seeks to pay three insiders up to \$1.525 million dollars. This comes after a sale of substantially all of the Debtors’ assets, and when the Debtors are proposing to pay certain administrative creditors and not others and provide no dividend to unsecured creditors. The

¹ The Debtors and the last four digits of their respective taxpayer identification numbers are as follows: TSAWD Holdings, Inc. (9008); Slap Shot Holdings, Corp. (8209); TSAWD, Inc. (2802); TSA Stores, Inc. (1120); TSA Gift Card, Inc. (1918); TSA Ponce, Inc. (4817); and TSA Caribe, Inc. (5664). The headquarters for the above captioned Debtors is located at 1050 West Hampden Avenue, Englewood, Colorado 80110.

New Insider Bonus Motion is devoid of anything but bare statements that its metrics are difficult to achieve and fails to mention that one metric relates to events that have already occurred (and thus is a guaranteed outcome rather than a metric to be achieved). The Debtors appear, once again, to be prioritizing insider executives above all other parties in interest, including unsecured creditors and the thousands of employees who have already lost their jobs. The payments at issue are retention payments, despite the “metrics” set forth in the Insider Bonus Motion. As such, they are impermissible insider retention bonuses, and the motion should be denied.

STANDING

2. Section 307 of the Bankruptcy Code confers upon the U.S. Trustee the broad right to raise, appear and be heard on any issue in any case or proceeding under the Bankruptcy Code. 11 U.S.C. § 307. The U.S. Trustee is not required to demonstrate any pecuniary or other interest. *See United States Trustee v. Columbia Gas Sys., Inc. (In re Columbia Gas Sys., Inc.)*, 33 F.3d 294, 295-96 (3d Cir. 1994) (Congress was cognizant that the U.S. Trustee would have no pecuniary interest when it enacted Section 307 and conferred standing based upon traditional notions of public interest standing).

BACKGROUND AND FACTS

3. On March 2, 2016, the above-captioned debtors (the “Debtors”) filed chapter 11 petitions in this Court. The U.S. Trustee appointed an official committee of unsecured creditors (the “Committee”) on March 10, 2016.

4. The Court entered an order approving bid procedures in connection with the sale of substantially all of the Debtors’ assets on April 14, 2016. Bids were due with respect to the “main auction” of the Debtors’ assets on May 11, 2016, with the hearing to approve the sale of such assets on May 24, 2016. The Debtors did not receive any going concern bids for their assets on an enterprise level, and at the conclusion of the Auctions, the Debtors accepted the bid submitted by a contractual joint venture composed of (i) Gordon Brothers Retail Partners, LLC, (ii) Hilco Merchant Resources, LLC,

and (iii) Tiger Capital Group LLC (collectively, the “Agent”) for their Retail Inventory. In addition, the Debtors entered into numerous assignment agreements and lease termination agreements disposing of valuable leasehold interests, which generated significant proceeds for the estates.

5. At a hearing on July 15, 2016, the Debtors sought, and were granted, authority to sell their remaining intellectual property, leases for which they received interest, and other miscellaneous assets.

6. Upon information and belief, by July 31, 2016, the Debtors’ liquidation will be substantially complete.

7. On July 12, 2016, the Debtors filed the Insider Bonus Motion, which contains a request to seal and a motion to seal certain information contained in the Insider Bonus Motion.² See Docket No. 2480.

8. After argument at a hearing on August 2, 2016, the Court denied the Insider Bonus Motion.

9. Undaunted, the Debtors filed the New Insider Bonus Motion on August 10, 2016.

10. The Debtors’ proposed bonuses are based on two alleged “metrics”: (i) the extent to which the Debtors trigger the profit-sharing provision of their inventory liquidation agreement (with respect to inventory liquidation sales *that have already concluded*) and (ii) whether “Controllable Costs” are minimized. New Insider Bonus Motion, ¶17.

11. In total, the Debtors seek authority to pay up to \$1.5255 million.

² The seal motion seeks approval to seal the names of the executives receiving the bonuses, the metrics, and the bonus amounts. As a result, this Objection will not refer to that exhibit with any specificity.

OBJECTION

A. *The KEIP Contains Illusory Metrics, Is Imprudent and Unreasonable, and Should Be Denied.*

12. Transfers to insiders must be reviewed under 11 U.S.C. § 503(c). If a transfer to an insider is for the purpose of inducing the insider to stay with the Debtors, the transfers are allowable only under Section 503(c)(1), even if the transfers are otherwise in the ordinary course of the Debtors' business. *Nellson Nutraceutical*, 369 B.R.787, 800-01 (Bankr. D. Del. 2007).

13. Section 503(c) of the Bankruptcy Code provides in pertinent part:

Notwithstanding subsection (b), there shall neither be allowed, nor paid

—

(1) a transfer made to, or an obligation incurred for the benefit of, an insider of the debtor for the purpose of inducing such person to remain with the debtors' business, absent a finding by the court based on evidence in the record that

(A) the transfer or obligation is essential to retention of the person because the individual has a bona fide job offer from another business at the same or greater rate of compensation;

(B) the services provided by the person are essential to the survival of the business; and

(C) either —

(i) the amount of the transfer made to, or obligation incurred for the benefit of, the person is not greater than an amount equal to 10 times the amount of the mean transfer or obligation of a similar kind given to nonmanagement employees for any purpose during the calendar year in which the transfer is made or the obligation is incurred; or

(ii) if no such similar transfers were made to, or obligations were incurred for the benefit of, such nonmanagement employees during such calendar year, the amount of the transfer or obligation is not greater than an amount equal to 25 percent of the amount of any similar transfer or obligation made to or incurred for the benefit of such insider for any purpose during the calendar year before the year in which such transfer is made or obligation is incurred.

11 U.S.C. § 503(c).

14. Congress added section 503(c) to the Bankruptcy Code as one of the BAPCPA amendments in 2005, to “eradicate the notion that executives were entitled to bonuses simply for staying with the Company through the bankruptcy process.” *In re Global Home Prods., LLC*, 369 B.R. 778, 783-84 (Bankr. D. Del. 2007). The intent of section 503(c) is to “limit the scope of ‘key employee retention plans’ and other programs providing incentives to management of the debtor as a means of inducing management to remain employed by the debtor.” 4 Alan N. Resnick & Henry J. Sommer (eds.), *Collier on Bankruptcy* ¶ 503.17 (15th ed. rev. 2007); *see also In re Foothills Texas, Inc.*, 408 B.R. 573, 577 (Bankr. D. Del. 2009).

15. Section 503(c) restricts debtors from making retention or severance payments to insiders unless its applicable requirements are satisfied. *In re AMR Corp.*, 497 B.R. 690, 696 (Bankr. S.D.N.Y. 2013) (finding that the language of Section 503(c) is prohibitive; if payments to insiders do not comply with the applicable 503(c) provisions, they “shall neither be allowed, nor paid”).

16. Section 503(c) establishes specific evidentiary standards that must be met before a bankruptcy court may authorize payments to an insider for the purpose of inducing such person to remain with a debtor’s business or payments made on account of severance. *In re Dana Corp.*, 351 B.R. 96, 102 (Bankr. S.D.N.Y. 2006) (“*Dana I*”); 11 U.S.C. § 503(c)(1). By enacting the BAPCPA, Congress put into place “a set of challenging standards” and “high hurdles” for debtors to overcome before retention bonuses could be paid. *In re Mesa Air Grp., Inc.*, Case No. 10-10018 (MG), 2010 WL 3810899, *2 (Bankr. S.D.N.Y. Sept. 24, 2010) (citations omitted). The proponent of a bonus plan has the burden of showing that the plan is not a retention plan governed by Section 503(c)(1). *In re Hawker Beechcraft, Inc.*, 479 B.R. 308, 313 (Bankr. S.D.N.Y. 2012).

17. Where section 503(c)(1) applies, the transfer cannot be justified solely on the debtor's business judgment. See *In re Borders Grp., Inc.*, 453 B.R. 459, 470-71 (Bankr. S.D.N.Y. 2011). If a proposed transfer falls within section 503(c)(1), then the business judgment rule does not apply, irrespective of whether a sound business purpose may actually exist. *Id.*; *Dana I*, 351 B.R. at 100; 11 U.S.C. § 503(c)(1).

18. To show that a bonus plan is not governed by section 503(c)(1), the debtors must prove by a preponderance of the evidence that the bonuses are part of a "pay for value" plan that offers incentives based on performance rather than a "pay to stay" plan. *Global Home Prods.*, 369 B.R. at 783; *accord Residential Capital, LLC*, 478 B.R. 170 (Bankr. S.D.N.Y. 2012). If the debtors fail to meet their burden of proof, then the bonus plan cannot be approved. In addition, although any payment to an employee, including regular wages, has at least a partial purpose of retaining the employee, for bonus plans to fall outside the purview of section 503(c)(1), they must be primarily incentivizing. *In re Nellson Nutraceutical*, 369 B.R. 787, 802 (Bankr. D. Del. 2007) (bankruptcy court construed section 503(c)(1) to mean "'a transfer to ... an insider of the debtor for the primary purpose of inducing such person to remain with the debtor's business.'") (citation omitted).

19. Further, a debtor's label of a plan as incentivizing to avoid the strictures of section 503(c)(1) must be viewed with skepticism; the circumstances under which the proposal is made and the structure of the compensation package control. *In re Velo Holdings, Inc.*, 472 B.R. 201, 209 (Bankr. S.D.N.Y. 2012) ("Attempts to characterize what are essentially prohibited retention programs as incentive programs in order to bypass the requirements of section 503(c)(1) are looked upon with disfavor, as the courts consider the circumstances under which particular proposals are made, along with the structure of the compensation packages, when determining whether the compensation programs are subject to section 503(c)(1).") (internal quotation marks and citations omitted); see also *Residential Capital*, 478 B.R. at 161 (finding that an incentive plan "should incentivize employees for

their post-petition efforts, not compensate them for the work they did before the bankruptcy filing.”); *Hawker Beechcraft*, 479 B.R. at 313 (“The concern in the type of motion presented ... is that the debtor has dressed up a KERP to look like a KEIP in the hope that it will pass muster under the less demanding ‘facts and circumstances’ standard in ... § 503(c)(3).”); *Dana I*, 351 B.R. at 102 n. 3 (“If it walks like a duck (KERP) and quacks like a duck (KERP), it’s a duck (KERP).”).

20. In the present case, the Debtors’ “incentive” label should be viewed with skepticism. Of the two program pieces, the first piece is clearly retentive, in that it relates to triggering profit sharing with respect to liquidation sales *that have already concluded*. The second alleged metric too vague to be a meaningful, aspirational, target. The Debtors provide no information regarding how the insiders’ services are related to the alleged metrics. These metrics, therefore, do not appear to be true incentives.

21. The first metric piece depends triggering profit sharing under the Debtors’ agency agreement with (i) Gordon Brothers Retail Partners, LLC, (ii) Hilco Merchant Resources, LLC, and (iii) Tiger Capital Group LLC (collectively, the “Agent”) for the liquidation of inventory and furniture, fixtures, and equipment (the “Inventory”). The Debtors’ Inventory sales concluded on July 31, 2016. Therefore, this metric is not an aspirational target, but relates to a sale that has already concluded. Not only that, but the Debtors provide no information regarding how the proposed insider recipients of the bonus payments had any influence over store-level inventory liquidation. Thus, the first “metric” is not a metric at all, but a retention payment in disguise.

22. As in the original Insider Bonus Motion, the New Insider Bonus Motion contains a second metric piece, which is related to “controllable” wind down costs. And, again, the New Insider Bonus Motion contains only a brief, vague description of what “controllable” wind-down costs are, or how the insider bonus program recipients control or influence them. Yet again, it is entirely possible that such costs could be “controlled” by, for example, objecting to and refusing to pay the fees of

Committee counsel, or by objecting to or refusing to pay certain categories of claims (e.g., §503(b)(9) claims, WARN Act claims).

23. The retentive nature of the program, coupled with the lack of meaningful metrics, removes the proposal from the “incentive” category, and places it firmly in the “retention” category, thus triggering review pursuant to § 503(c)(1). Under § 503(c)(1), to obtain approval of its proposed insider bonus program, the Debtors must, “based on evidence in the record,” demonstrate all three of its required elements. These include showing a “bona fide job offer from another business at the same or greater rate of compensation” and that the payment does not exceed specified amounts. The New Insider Bonus Motion lacks any of this information, and therefore, the Debtors have not and cannot meet § 503(c)(1)’s stringent requirements. If a proposed bonus to insiders, like the one in the New Insider Bonus Motion, is truly an incentive plan, rather than a retentive plan, then it nonetheless must meet the standard set forth in § 503(c)(3). That section requires the Debtors to demonstrate that the proposed incentive payments are either in the ordinary course of business, or that they are justified by “the facts and circumstances of the case.” 11 U.S.C. § 503(c)(3). The payments here do not appear to be in the ordinary course of business, and the Debtors have not alleged that they are. As a result, the Debtors must demonstrate that such payments are justified by the facts and circumstances of the case. The Debtors have not done so.

24. In *In re Dana Corp., (Dana II)*, 358 B.R. 567, 576-77 (Bankr. S.D.N.Y. 2006), Judge Lifland listed several factors that courts consider when determining if the structure of a compensation proposal and the process for its development satisfy §503(c)(3):

- Is there a reasonable relationship between the plan proposed and the results to be obtained, *i.e.*, will the key employee stay for as long as it takes for the debtor to reorganize or market its assets, or, in the case of a performance incentive, is the plan calculated to achieve the desired performance?

- Is the cost of the plan reasonable in the context of the debtor's assets, liabilities and earning potential?
- Is the scope of the plan fair and reasonable; does it apply to all employees; does it discriminate unfairly?
- Is the plan or proposal consistent with industry standards?
- What were the due diligence efforts of the debtor in investigating the need for a plan; analyzing which key employees need to be incentivized; what is available; what is generally applicable in a particular industry?
- Did the debtor receive independent counsel in performing due diligence and in creating and authorizing the incentive compensation?

358 B.R. at 576–77 (emphasis in original). See *Global Home*, 369 B.R. at 786 (evaluating an incentive plan under the business judgment standard of section 363 by applying the factors listed above); *Borders*, 453 B.R. at 474 (same); but see *In re Pilgrim's Pride Corp.*, 401 B.R. 229, 236-37 (Bankr. N.D. Tex. 2009) (standard for approval under section 503(c)(3) is higher than the business judgment test; if payments to employees outside the ordinary course were only subject to the business judgment test, then the language of section 503(c)(3) would ostensibly be rendered meaningless).

25. The Debtors have failed to meet section 503(c)(3)'s standards. Under the standards articulated in *Dana*, the proposed plan does not appear to be either reasonable or fair. The Debtors have put forward no evidence regarding the relationship between the proposed plan and the results they seek, other than to allege that the targets are challenging and they will present evidence proving this at a hearing. This is insufficient. Second, in light of the admitted administrative insolvency of these cases (the settlement currently proposed, as noted, pays only some administrative creditors), paying three executives \$1.525 million does not appear reasonable, fair, or prudent. Third, only three people are eligible for a vast sum of money, in a case where thousands of employees have lost their jobs and there are potential WARN claims. Fourth, the Debtors provided no information regarding whether

industry standards would support the proposed plan. Finally, the proposed metrics are, at best, only tangentially related to circumstances within the proposed recipients' control. It is extremely unlikely that these three insiders are personally responsible for entering data related to "final reconciliation and recoveries for the Debtors" from the liquidation sales, or "archiving critical data", "rationalizing the IT systems", and "erasing personally identifiable information". The metrics, therefore, are objectionable not only because they appear unreasonable, but because they give large bonuses to insiders for work that is going to be done by other people.

26. Under the totality of the facts and circumstances presented, the proposed insider bonus plan should be denied. As the court noted in *In re U.S. Airways, Inc.*, 329 B.R. 793, 797 (Bankr. E.D. Va. 2005), management bonus plans "have something of a shady reputation All too often they have been used to lavishly reward — at the expense of the creditor body — the very executives whose bad decisions or lack of foresight were responsible for the debtor's financial plight. But even where external circumstances rather than the executives are to blame, there is something inherently unseemly in the effort to insulate the executives from the financial risks all other stakeholders face in the bankruptcy process."

27. After the Debtors' original Insider Bonus Motion was denied, the Debtors and the insiders appear to have concentrated their efforts on devising another way for the insiders to be paid, rather than focusing on remaining tasks. The scant information provided by the Debtors indicates that a large portion of the insiders' fiduciary duties and job responsibilities already include items for which they are supposedly receiving "incentive" bonuses, such as reconciliation of accounting issues, minimizing costs to the estates, and maximizing value. The Debtors have failed to demonstrate why it is fair and prudent to give three insiders over a million dollars to complete tasks for which they are already responsible or for work that other people will actually be doing (presumably while the insiders "manage" or "supervise" the process). Here, the proposed bonuses are indeed unseemly.

B. The Debtors' Request to Seal the KEIP Exhibit Is Not Supported by Law and Should Not Be Granted.

28. The Debtors have also moved to seal the identity of the proposed recipients of the bonuses. The Supreme Court stated in *Nixon v. Warner Communications, Inc.*, 435 U.S. 589, 591 (1978), that “[i]t is clear that the courts of this country recognize a general right to inspect and copy public records and documents, including judicial records and documents.” Unanimity in the case law demonstrates that there is a common law right of access to judicial proceedings and to inspect judicial records in civil matters. In *Orion Pictures Corp. v. Video Software Dealers Assoc.*, 21 F.3d 24 (2d Cir. 1994), the Court stated the general rule as: “...a strong presumption of public access to court records.... This preference for public access is rooted in the public’s first amendment right to know about the administration of justice. It helps safeguard the ‘integrity, quality, and respect in our judicial system.’” 21 F. 3d 24, 26 (citations omitted)). See also *In re Continental Airlines*, 150 B.R. 334 (D. Del. 1993), where the court noted “...the strong presumption in favor of public access to judicial records and papers....” Accord, *In re Foundation for New Era Philanthropy*, 1995 WL 478841 (E.D. Pa. 1995); *In re Barney’s Inc.*, 201 B.R. 703 (Bankr. S.D.N.Y. 1996).

29. In the bankruptcy context, the right of public access is prescribed by the Bankruptcy Code. 11 U.S.C. § 107(a) is “a codification of the common law general right to inspect judicial records and documents.” *In re Alterra Healthcare Corp.*, 353 B.R. 66, 75 (Bankr. D. Del. 2006). Section 107 provides in pertinent part that “except as provided in subsections (b) and (c) of this section and subject to section 112, a paper filed in a case under this title and the dockets of a bankruptcy court are public records and open to examination by an entity at reasonable times without charge.” 11 U.S.C. § 107(a). Congress has, also, codified a few limited exceptions to this general rule in Section 107(b) and (c). *Alterra*, 353 B.R. at 75.

30. As such, the Debtors must demonstrate one of the limited exceptions to the general rule of public access, either in 11 U.S.C. Sections 107(b),³ 107(c) (not at issue in the Seal Motion), or FED. R. BANKR. P. 9018.⁴ The Debtors cannot do so, and therefore the information should not be sealed.

31. Here, the Debtors are seeking to allow payment of compensation, outside of the ordinary course of business, of a substantial amount of money, to a very few, select, insider executives. The Debtors have not disclosed those executives' salaries, and want to seal their employees' identities. This is not reasonable. These cases are liquidating and, in fact, are substantially liquidated. The proposed compensation payments will not provide competitors with any sort of advantage; they will only serve to hide the identities of insiders receiving funds so that there are no consequences. The exhibit to the original Insider Bonus Motion was only sealed because it related to a program that was not approved; not because the Court found that sealing the information was reasonable. The presumption of access, and permitting parties in interest the ability to review and potential object to the program, outweighs any interest in secrecy.

³ Section 107(b) provides in relevant part :

On request of a party in interest, the bankruptcy court shall, and on the bankruptcy court's own motion, the bankruptcy court may - (1) protect an entity with respect to a trade secret or confidential research, development or commercial information.

⁴ Fed.R.Bankr.P. 9018 provides:

On motion or on its own initiative, with or without notice, the court may make any order which justice requires (1) to protect the estate or any entity in respect of a trade secret or other confidential research, development, or commercial information. . . .

WHEREFORE, the U.S. Trustee respectfully requests that the Court deny the New Insider Bonus Motion and for such other and further relief deemed fair, just and appropriate.

Respectfully submitted,

ANDREW R. VARA
ACTING UNITED STATES TRUSTEE

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Dated: August 22, 2016

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE**

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 : Case No. 16-10527 (MFW)
 TSAWD HOLDINGS, INC., *et al.*,¹ : Jointly Administered
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 : **Hearing Date: August 31, 2016 at 11:30 a.m.**
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CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT ON AUGUST 23, 2016, THE OBJECTION OF THE UNITED STATES TRUSTEE TO THE DEBTORS' MOTION FOR ORDER (A) APPROVING MODIFIED EXECUTIVE INCENTIVE PROGRAM AND AUTHORIZING PAYMENTS THEREUNDER AND (B) AUTHORIZING THE DEBTORS TO FILE THE UNREDACTED MODIFIED KEY EMPLOYEE INCENTIVE PROGRAM UNDER SEAL (D.I. 2746) WAS CAUSED TO BE SERVED UPON THE FOLLOWING PARTIES VIA REGULAR MAIL:

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