

**Wednesday, October 23, 2019
3:30 p.m. – 4:45 p.m.**

Workshop 5

Retail Bankruptcy: If Only I Knew Then What I Know Now.....

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I. PROS AND CONS OF BANKRUPTCY

A. PROS

- the Automatic Stay – provides a much needed breathing spell from creditors
- Ability to reject burdensome leases and contracts pursuant to Section 365
- If Company over expanded and needs to “right the ship,” then ability to reject burdensome and unnecessary real estate leases
- Reject or restructure union obligations (if applicable)
- Sell assets “free and clear” of liens pursuant to Section 363
- Restructure debt; perhaps convert debt to equity
- Ability to recover certain pre-bankruptcy payments (e.g., preference payments or fraudulent transfers)
- Transparency – ability to see and know what is really going on

B. CONS

- Upset your trade vendors – they put you on C.O.D. or will no longer do business with you
- Stigma of being a bankrupt entity and reputational damage to the brand
- Costly – Very expensive process with professionals being paid at the top and lots of them (debtor’s professionals and unsecured creditors’ committee professionals)
- The Amendments of 365 with respect to the timing to assume or reject leases may be too tight and onerous to manage
- The inability to secure postpetition financing
- Equity usually gets wiped out
- It is not a solution, but a process – not having an “Exit Strategy” upon entering bankruptcy

II. Recent Major Retail Bankruptcies From 2015 to Today¹

2019



2018



CBINSIGHTS

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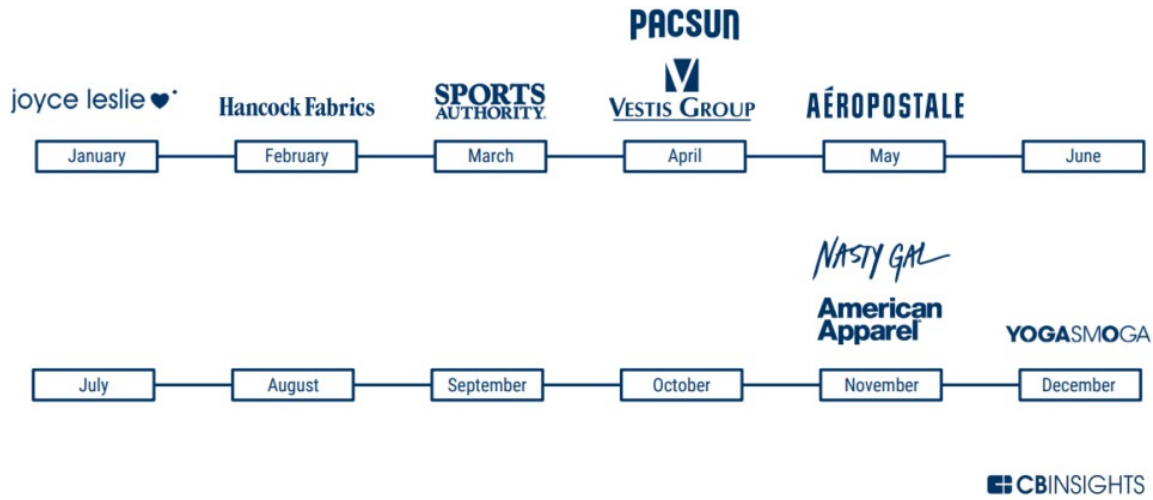
2017



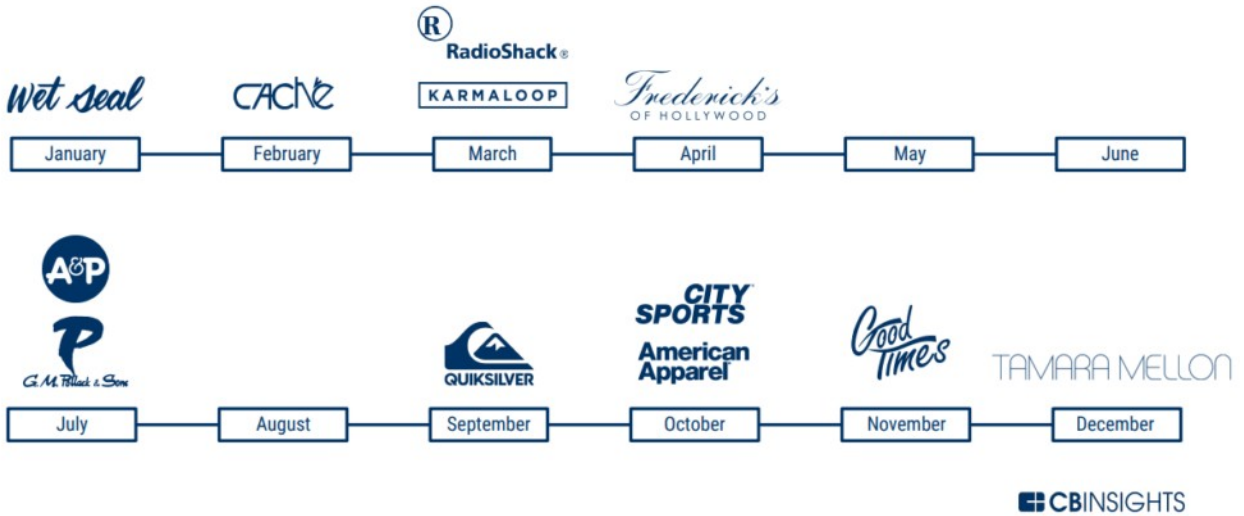
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¹ Infographics taken from *Here's A List Of 68 Bankruptcies In The Retail Apocalypse And Why They Failed*, CB Insights Research Brief dated March 12, 2019. <https://www.cbinsights.com/research/retail-apocalypse-timeline-infographic/> (hereinafter, "CB Insights Retail Apocalypse").

2016



2015



III. Select Cases: Why Did These Retailers File, and Did Bankruptcy Help or Harm?²

A. RadioShack (2015 and 2017)

Date: March 2017 (second bankruptcy)

Category/Product(s): Electronics

Summary: RadioShack originally filed for bankruptcy in 2015 to right-size their chain, and closed over 1000 stores. They also partnered with Sprint to help RadioShack better compete and Sprint to scale its own business. Unfortunately, the partnership failed, and RadioShack declared bankruptcy for the second time in March 2017.

RadioShack exited bankruptcy earlier in November 2017 with hopes of operating as an online retailer with a limited physical footprint of authorized retailers and mini stores.

Discussion: RadioShack's initial bankruptcy facilitated its exit from thousands of unprofitable leases and other contracts, and theoretically provided a path forward with Sprint. Alas, as is often the case, the post-bankruptcy company was unable to thrive, and ended up in a "Chapter 22".

B. Aeropostale (2016)

Date: May 2016

Category/Product(s): Teen apparel

Summary: Teen retailer Aeropostale faced similar challenges to other mall-based retailers and declared bankruptcy in May 2016. The company exited bankruptcy after shedding a significant percentage of store. The reorganized company kept 230 stores open after a buy out by mall operators Simon Property Group and General Growth Properties (GGP). Since then, the company has reopened over two-thirds of its closed stores under new leadership and is focused on refreshing its brand.

Discussion: Aeropostale was on the brink of liquidation when the proposal from Simon and GGP, two members of the Official Committee of Unsecured Creditors, came and eventually saved the company. The leverage facilitated by the bankruptcy process allowed new company to exit many leases, although many of those stores were eventually reopened. Query whether some or all of this transaction could have been accomplished out of court.

C. Sports Authority (2016)

Date: March 2016

Category/Product(s): Sportswear and Sporting Goods

Summary: Sporting goods retailer Sports Authority declared bankruptcy in March 2016 with intentions of finding a buyer and closing only 140 of 450 stores. After failing to find a buyer to keep the business alive, the company liquidated and sold all its assets in May 2016.

Discussion: Sports Authority ran into trouble with many of its vendors immediately upon the filing of the bankruptcy. Sports Authority had a disproportionate number of consignment vendors, and those consignment vendors took an early and active role in the bankruptcy cases, attempting to protect their interests. This conflicted with the company's lenders, who were looking to the proceeds of those goods to pay off their secured debts. This tension resulted in Sports Authority having to almost immediately commence suit against over 100 vendors at a time when vendor support was needed most. Query whether Sports Authority would have needed to liquidate if its issues with its lenders and consignment vendors had been addressed prior to the filing, and thus its entry into bankruptcy less chaotic.

² Descriptions of these cases were modified from descriptions in *CB Insights Retail Apocalypse*

D. Hancock Fabrics (2016)

Date: February 2016 (second bankruptcy)

Category/Product(s): Fabrics

Summary: Mississippi-based Fabric retailer Hancock Fabrics first declared bankruptcy in 2007, but it emerged over a year later after closing several hundred stores, and paying its unsecured creditors 100 cents plus interest on their allowed claims. However, a difficult retail environment amidst competition from Jo-Ann Fabric and others forced the company to declare a second bankruptcy in February 2016. Unable to find a buyer, Hancock sold its branding rights and IP to arts and crafts retailer Michaels, allowing the company to leverage Hancock's customer data to get into the sewing business. Hancock Fabrics ultimately went out of business completely and closed all 185 of its stores nationwide in 2016.

Discussion: Hancock Fabrics is an example of both bankruptcy success and failure. Their initial bankruptcy in 2007 was an unmitigated success and allowed the company to continue in business for almost another decade. Unfortunately, their second bankruptcy failed to attract a buyer, and the chain liquidated.

E. Toys "R" Us (2017)

Date: September 2017

Category/Product(s): Children's toys

Summary: Toys "R" Us was the third largest bankruptcy in the US (after KMart in 2002 and Federated Department Stores, now Macy's, in 1990). Following a leveraged buyout by a few private equity firms in 2005 which left the company with significant debt, competition from Amazon and other online merchants caused Toys "R" Us' ongoing crisis, which culminated in a Chapter 11 filing in September 2017. Despite hopes of a turnaround or going-concern sale, in March 2018, the company ultimately decided to close all of its stores, after a disappointing holiday sales period.

Discussion: Toys "R" Us is an example of how bankruptcy can not only fail pre-bankruptcy creditors, but also post-bankruptcy creditors. In the run-up to the 2017 holiday season, Toys "R" Us purchased hundreds of millions of dollars of goods on trade credit from the same vendors to which they still owed money. This resulted in the "administrative insolvency" of the bankruptcy, where the company was unable to even pay for the goods they purchased during the bankruptcy, and those post-bankruptcy creditors also faced the prospect of receiving pennies on the dollar for their claims.

F. Nine West Holdings Inc.

Date: April 2018

Category/Product(s): Shoes, fashion, accessories

Summary: Shoe retailer Nine West Holdings Inc. filed for bankruptcy in April 2018, owing more than \$1B to as many as 50,000 creditors. In June 2018, the company sold off its namesake brand, along with its handbag brand Bandolino, for \$340M. Although the company announced it would operate as usual through the bankruptcy, it asked investment bank Lazard Ltd to help explore a sale for its remaining assets, which include its jewelry and jeans ware businesses, as well as its women's clothing lines, Kasper and Anne Klein. In late February 2019, the footwear brand received court approval to proceed with its plan to restructure and reduce its debts by over \$1B.

Discussion: Nine West is a good example of how creditors who might believe that they are "similarly situated" can actually be treated very differently. In selling off its less profitable shoe and handbag lines, Nine West paid its shoe and handbag vendors only pennies on the dollar, while the manufacturers and vendors who made and sold to its jewelry and jeans divisions were often paid in full on their claims.

G. Sears (2018)

Date: October 2018

Category/Product(s): Retail chain

Summary: Retail giant Sears filed for Chapter 11 bankruptcy protection in October 2018, following years of financial struggles. Despite reducing assets and selling real estate over the years, the company was unable to pay off \$134M worth of debt. By the end of 2018, the company was looking to shutter at least 188 stores out of the nearly 700 that remained.

In February 2019, a New York court approved a \$5.2B bid by Sears Chairman Edward Lampert to buy the company. Now that it has shed debt and pension obligations while closing unprofitable stores, the retailer faces many of the same challenges it once did — personalizing the customer experience and leveraging AI to improve operational efficiency, for example — but with fewer financial constraints holding it back. Sears will now operate 223 Sears and 202 Kmart stores, down from 687 stores in 2018 and 1,672 stores in 2016, and may continue closing stores.

Discussion: Sears is a bankruptcy success story, at least for now. Notwithstanding an aggressive and well-represented creditors' committee who was pushing for an immediate liquidation of all remaining stores (rather than, they suggested, kicking the can down the road for 1-2 more years), the bankruptcy judge approved a sale of the company to its former CEO Eddie Lampert, preserving hundreds of stores and thousands of jobs — at least for now.

H. Payless

Date: February 2019 (Second bankruptcy)

Category/Product(s): Footwear

Summary: After closing over 400 stores and emerging from its first bankruptcy in late 2017, Payless filed for bankruptcy once more on February 18, 2019. Struggling with the challenging retail environment and significant debt from its first Chapter 11 (while managing a massive footprint of about 3,400 stores in 40 countries), Payless announced it would be closing all 2,350 of its remaining stores in the US, Canada and Puerto Rico. Payless represents one of the one of the largest retailer liquidations to date.

Discussion: Its original Chapter 11 proceeding allowed Payless to remain in business in North America for less than 18 months before having to file for bankruptcy again, but it did also preserve the company which still operates thousands of stores and franchised locations outside of North America.

I. Things Remembered

Date: February 2019

Category/Product(s): Gifts

Summary: Facing steep competition from online retailers and shouldering a \$144M debt load, Things Remembered filed for bankruptcy on February 6, 2019. Shortly thereafter, the company obtained court approval to close a majority of its 400 stores as part of a sale of most of its business to Enesco, an Illinois-based company that specializes in giftware, home decor, and accessories. The transaction closed in March 2019, and Things Remembered will continue to operate 176 stores under its brand.

Discussion: Bankruptcy again allowed this retailer another chance at life, albeit with fewer than half of its original stores, through a rapid Chapter 11 sale.

J. FullBeauty Brands

Date: February 2019

Category/Product(s): Beauty

Summary: FullBeauty Brands entered and exited bankruptcy in record time. The company filed for Chapter 11 on February 3, 2019 and emerged with court approval for its reorganization plan *in less than 24 hours*. Having struggled with financial difficulties and increased competition, the New York City-based online retailer of plus-sized women's clothing had carried a debt burden of \$1.3B prior to bankruptcy. It was able to eliminate about \$900M of debt by turning over company ownership to its creditors. FullBeauty Brands has since secured \$35M in new financing.

Discussion: FullBeauty Brands is an extreme example of just how quick and powerful bankruptcy can be at eliminating existing debt and giving a company a possible new lease on life.

IV. Can We Blame This All on Section 365(d)(4) of the Bankruptcy Code?

BAPCPA was a series of amendments to the Bankruptcy Code that went into effect in 2005, and included a revision to Section 365(d)(4), which governs the amount of time that a Chapter 11 debtor has to assume or reject leases.

Revised section 365(d)(4) limits the time period for a debtor to decide whether it will assume or reject a non-residential real property lease to 120 days (extendable 90 days without landlord consent to a total of 210 days), but not extendable thereafter without express written landlord consent, thereby giving landlords significant leverage in the bankruptcy process.

Some commentators believe that this revised section of the Bankruptcy Code provides insufficient time for retailers to reorganize before having to commence store closing sales to protect their secured lenders, and thus has led to many more full-chain liquidations that perhaps would have occurred prior to the enactment of BAPCPA.

Below is data from *The Disappearance of Retail Reorganization Under the Amended Section 365(d)(4)*, Written testimony of L. Gottlieb for the ABI Commission to Study the Reform of Chapter 11, analyzing pre- and post-BAPCPA bankruptcy outcomes for retailers.

| | POST-BAPCPA | PRE-BAPCPA |
|---|-------------|------------|
| Total number of cases analyzed: | 25 | 20 |
| Number of cases where plan of reorganization was approved: | 3 (12%) | 10 (50%) |
| Number of cases where the debtor(s) liquidated: | 12 (48%) | 7 (35%) |
| Number of cases resolved pursuant to a 363-sale: | 10 (40%) | 3 (15%) |
| Average sale/liquidation/reorganization period: | 3 months | 12 months |
| The number of cases where the sale/liquidation/reorganization period exceeded 210 days: | 0 (0%) | 13 (65%) |
| The average duration of cases where debtor(s) reorganized: | 99 days | 576.5 days |
| The average duration of cases where the debtor(s) liquidated: | 93.4 days | 122.3 days |
| The average duration of the cases resolved pursuant to a 363-sale: | 81.7 days | 236.7 |
| The average recovery for general unsecured creditors (as set forth in the disclosure statements): | 16.3% | 33.6% |

V. OUT-OF-COURT RESTRUCTURINGS

Unfortunately, many companies, at one point or another, run into severe financial difficulties, and one of the ways to address those financial difficulties, in lieu of a formal bankruptcy filing, is to seek to conduct an out of court restructuring with the creditors

A. What Is Out-Of-Court Debt Restructuring?

Out-of-court restructuring is, as noted above, a bankruptcy alternative that allows you to carry out negotiations with creditors in order to find solutions that will put your company back on the right track. The discussions are held in an informal environment, outside the court, thus the name “out of court restructuring.” The purpose is to reach an agreement regarding the company's debts. Depending on the size and complexity of the financial difficulties, informal restructuring is usually the best-case scenario for companies who face financial distress and are trying to avoid bankruptcy. Communication, openness and a willingness to be transparent are key aspects to any successful out of court restructuring. You usually start with the process with the company's key (and often largest and/or most aggressive) creditors. Out of court restructuring is also known as “workout.” If the procedure works out, the company may continue its activity without any court involvement.

B. How to Go About a Workout?

An out-of-court restructuring can be carried out in a variety of ways; this is no one standard procedure. However, there are some common components to a successful workout.

- Don't wait too long; i.e., don't wait until you are defaulting on loans and cannot make payroll
- Get a financial consultant or restructuring professional retained early to assist in the process
- Prioritize your debt and problems
- Be focused early on with respect to which stores/locations should be closed and
- Enter a standstill/forbearance agreements to prevent creditors' enforcement action
- Start seeking to liquidate unnecessary assets
- Downsize payroll or management

C. Advantages of Opting for Out-Of-Court Restructuring.

Out-of-court restructuring is the least severe method that can save a company from financial collapse. Here are some of the advantages:

- Avoids the costs and time of a formal bankruptcy proceeding for both the company and its creditors
- Provides a degree of flexibility you would not have in bankruptcy; company and the creditors have more control of the disposition of assets.
- Avoids the stigma attached to a bankruptcy
- Provides a more private environment (less public) for dealing with the creditors
- You still maintain the right to file for bankruptcy if necessary

D. Disadvantages of Out of Court Restructuring.

- Usually will not work if the company has too many creditors
- There is no “automatic stay” to stop creditors and provide the breathing spell to negotiate with creditors.
- May, depending on the nature of the claims, provide less leverage than a bankruptcy.
- Absent some form of Article 9 sale, no real means to liquidate and sell assets “free and clear” of liens.