Wednesday, October 23, 2019
3:30 PM – 4:45 PM

Workshop 5

Retail Bankruptcy: If Only I Knew Then, What I Know Now…

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PROS AND CONS OF BANKRUPTCY

PROS

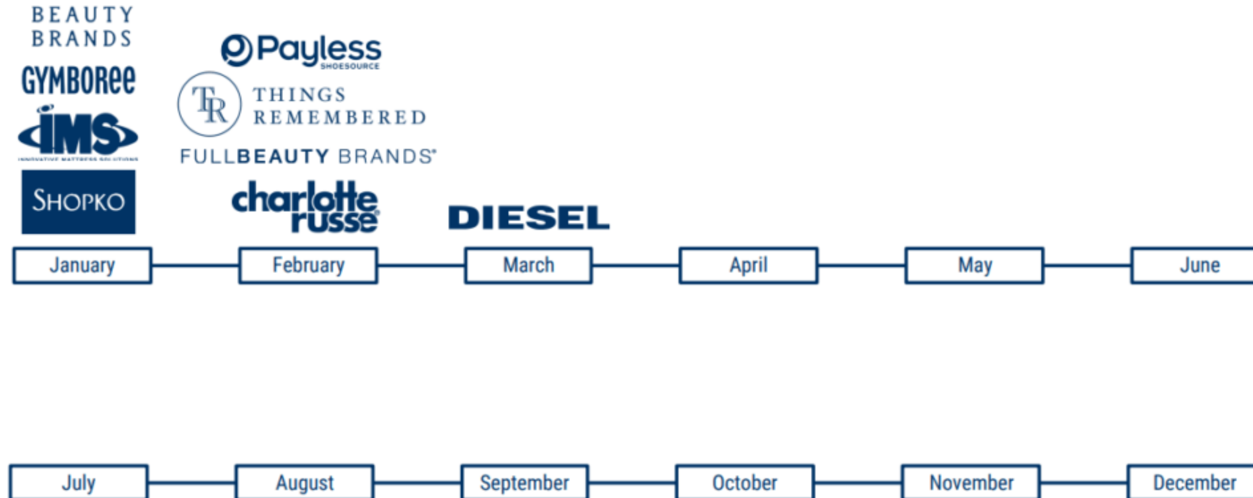
- The Automatic Stay – provides a much needed breathing spell from creditors
- If Company over expanded and needs to "right the ship," then ability to reject burdensome and unnecessary real estate leases and other contracts pursuant to Section 365
- Reject or restructure union obligations (if applicable)
- 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 – Court oversight and the ability to see and know what is really going on

PROS AND CONS OF BANKRUPTCY

CONS

- Costly – Very expensive process with professionals being paid at the top and lots of them (debtor's professionals and unsecured creditors' committee professionals)
- Stigma of being a bankrupt entity and reputational damage to the brand
- Upset your trade vendors – they put you on C.O.D. or will no longer do business with you
- The timing of Bankruptcy Section 365 with respect to assumption or rejection of non-residential real property leases may be too tight and lead to liquidation
- It can be difficult or impossible to secure post-petition financing
- Equity usually gets wiped out
- Bankruptcy is a process, not necessarily a solution – it can be very difficult to exit bankruptcy and reorganize if you do not have an "Exit Strategy" upon entering bankruptcy

Recent Major Retail Bankruptcies From 2015 to Today



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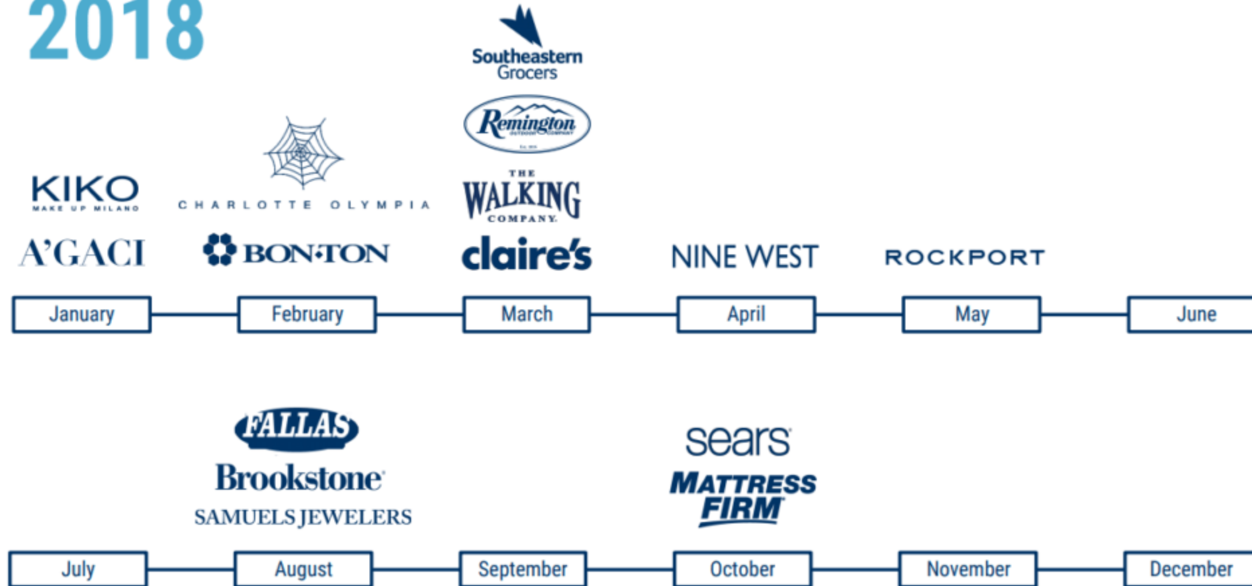

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Select Cases: Why Did These Retailers File, and Did Bankruptcy Help or Harm?

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

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 approximately 230 stores open after a buy-out by new investors, including 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 the new investment consortium, including 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.

C. Sports Authority

- **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 an unusually high 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.

D. Hancock Fabrics (2016)

- **Date**: February 2016 (second bankruptcy)
- **Category/Product(s)**: Fabrics
- **Summary**: Hancock Fabrics first declared bankruptcy in 2007, but 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 liquidated all its remaining 185 stores.
- **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 private equity firms in 2005 which left the company with significant debt, Toys "R" Us filed for Chapter 11 in September 2017 citing online competition and other issues. Despite hopes of a reorganization or going-concern sale, in March 2018, the company ultimately decided to liquidate 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, over the objection of the creditors' committee, the bankruptcy court approved a $5.2B bid by former chairman Eddie Lampert to buy the company and continue operating 223 Sears and 202 Kmart stores, down from 687 total stores in 2018 and 1,672 total stores in 2016. Bankruptcy allowed Sears to shed debt and pension obligations while closing unprofitable stores, however, the retailer still faces many of the same challenges it once did.
- **Discussion:** Sears may be considered a bankruptcy success story, at least for now, although Sears has already announced additional store closings and layoffs exceeding their estimates during the bankruptcy. During the bankruptcy, when arguing in favor of an immediate liquidation, the creditors' committee said that approving the sale to Lampert would merely kick the can down the road for 1-2 more years, and many people believe that a subsequent Sears bankruptcy, a "Chapter 22" is inevitable.

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 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**: Following a buy-out in 2012 by a private equity firm, and an out-of-court debt restructuring in 2016, on February 6, 2019 Things Remembered filed for bankruptcy citing steep competition from online retailers and a heavy $144M debt load. Shortly after filing, 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 and a rapid Chapter 11 sale process allowed Things Remembered another chance at life following arguably unsuccessful private equity and out-of-court restructuring transactions, albeit with fewer than half of its original stores.

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 of its "prepackaged" plan of reorganization *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. The company was able to eliminate about $900M of debt by turning over ownership of the company to its creditors in a debt-for-equity swap. FullBeauty Brands has since secured $35M in new financing.
- **Discussion:** FullBeauty Brands is an extreme example of how quick and powerful bankruptcy can be at eliminating existing debt and giving a company a possible new lease on life.

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 change 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.
- The following slide shows 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%

Out-Of-Court Restructurings

- When companies encounter severe financial difficulties, one alternative to bankruptcy is to seek to conduct an out-of-court restructuring with their lenders and creditors.
- An out-of-court restructuring involves negotiations with lenders and creditors to try and reach an agreement regarding the company's debts and put the company back on the right track without the need for a costly and likely disruptive bankruptcy proceeding. Depending on the size and complexity of the financial difficulties, an out-of-court restructuring can be the best solution for companies facing financial distress.
- Communication, openness, and a willing to be transparent are key aspects to any successful out-of-court restructuring. Companies normally still retain legal counsel, financial advisors, and/or investment bankers to start with the process with the company's key (and often largest and/or most aggressive) creditors. The company will often also pay the professional fees for the negotiating creditors. A success out-of-court restructuring is generally known as a “workout” and can result in significant changes to the debt and equity structure of the company.

Effectuating an Out-Of-Court Restructuring

- An out-of-court restructuring can be carried out in a variety of ways, and although there is no one standard procedure, there are some common components to successful workouts.
- Don’t wait too long; i.e., don’t wait until you are defaulting on loans and can’t make payroll.
- Retain counsel, financial advisors and other restructuring professionals early to evaluate the situation, suggest restructuring options, develop a plan, and begin negotiations with creditors.
- Prioritize your debt and problems, and prepare a proposed post-workout debt and equity structure on which the parties can negotiate.
- Potentially enter into standstill/forbearance agreements to prevent creditors' enforcement actions.
- Be focused early on with respect to which stores/locations should be closed.
- Liquidate unnecessary assets.
- Downsize payroll, management and/or operations.

Advantages of Out-Of-Court Restructurings

- Can be less disruptive than a formal bankruptcy proceeding.
- Can avoid the time and many of the costs of a formal bankruptcy proceeding for both the company and its creditors.
- Provides a more private environment (less public) for dealing with the creditors.
- Provides a degree of flexibility you would not have in bankruptcy; company and the creditors have more control of the disposition of assets.
- Can be less adversarial than a bankruptcy proceeding due to the lack of a creditors' committee and no involvement from the U.S. Trustee (Dept. of Justice).
- Avoids the stigma attached to a bankruptcy.
- The company still maintain the right to file for bankruptcy, if necessary.

Disadvantages of Out-of-Court Restructurings

- May not work or be feasible if the company has too many creditors.
- There is no “automatic stay” to stop creditors and provide the breathing spell to negotiate with creditors.
- Reaching out to lenders and creditors and telling them about financial distress may accomplish the opposite of what the company is trying to do, and may cause those parties to offer less favorable financial terms to the company.
- Depending on the nature of the claims, an out-of-court transaction may provide the company with less leverage than they would have in a bankruptcy.
- No easy way to reject burdensome contract and leases.
- Absent some form of Article 9 sale, no easy way to liquidate and sell assets “free and clear” of liens.
- Potentially less transparency than a public, court-approved restructuring process.

THANK YOU FOR COMING!

ANY QUESTIONS?

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