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The Future of Retail Bankruptcies

David L. Pollack, Moderator
Ballard Spahr LLP; Philadelphia

Hon. Clifton R. Jessup, Jr.
U.S. Bankruptcy Court (N.D. Ala.); Decatur

Hon. Sean H. Lane
U.S. Bankruptcy Court (S.D.N.Y.); New York

Hon. Wendelin I. Lipp
U.S. Bankruptcy Court (D. Md.); Greenbelt

Melanie L. Cyganowski, Facilitator
Otterbourg P.C.; New York

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RECENT RETAIL BANKRUPTCIES: AN OVERVIEW

By Hon. Melanie L. Cyganowski (Ret.)

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RECENT RETAIL BANKRUPTCIES: AN OVERVIEW

By Hon. Melanie L. Cyganowski (Ret.)[1]

I. The State of Play

By all indications, retail bankruptcies are on the rise.[2] A confluence of excess space and the popularity of online purchasing have thrown the retail market into turmoil. According to published reports, Amazon now accounts for 53 percent of growth in e-commerce sales.[3] At the same time, excess retail capacity has injected added stress into what can only be described as a competitive market, with Cleveland, Memphis, and Chicago as the leading metropolitan areas where retail development has outpaced demand.[4] As Bloomberg framed retailing in Cleveland: "while the new stores were moving in, the shoppers were moving out. The metro area's population declined by more than 90,000 over a similar period, and it became a stomping ground for students of the dying American mall."

These developments have left their mark in the form of a marked rise in retail bankruptcies.[5] According to BankruptcyData, Q2 2017 witnessed a year-over-year jump of more than one-third in retail service and real estate bankruptcies, with small business representing the majority of bankruptcy filings. By contrast, fewer publicly traded companies sought bankruptcy protection during the same period.

Although this may represent a silver lining for the bankruptcy bar, it is not good news for mall developers. Indeed, there is no indication that these trends will abate in the near future. According to the three charts below, online sales, store closures, and retail capacity are all expected to continue climbing.

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[1] Former Chief Judge Melanie Cyganowski served a full 14-year term in the Eastern District of New York before retiring from the bench in 2007. She is currently the Chair of the Bankruptcy Practice at Otterbourg P.C. in New York where she has been a member of the firm since 2008. She gratefully acknowledges the assistance of Lloyd M. Green and Jennifer S. Feeney, Senior Counsel at the firm.

[2] http://www.bankruptcydata.com/p/q2-2017-business-filings-report.

[3] https://www.bloomberg.com/news/articles/2017-04-07/stores-are-closing-at-a-record-pace-as-amazon-chews-up-retailers https://www.bloomberg.com/amp/news/articles/2017-06-12/what-s-killing-american-retail-take-a-look-at-this-chart-for-a-start.

[4] https://www.bloomberg.com/amp/news/articles/2017-06-12/what-s-killing-american-retail-take-a-look-at-this-chart-for-a-start.

[5] http://www.bankruptcydata.com/p/q2-2017-business-filings-report.

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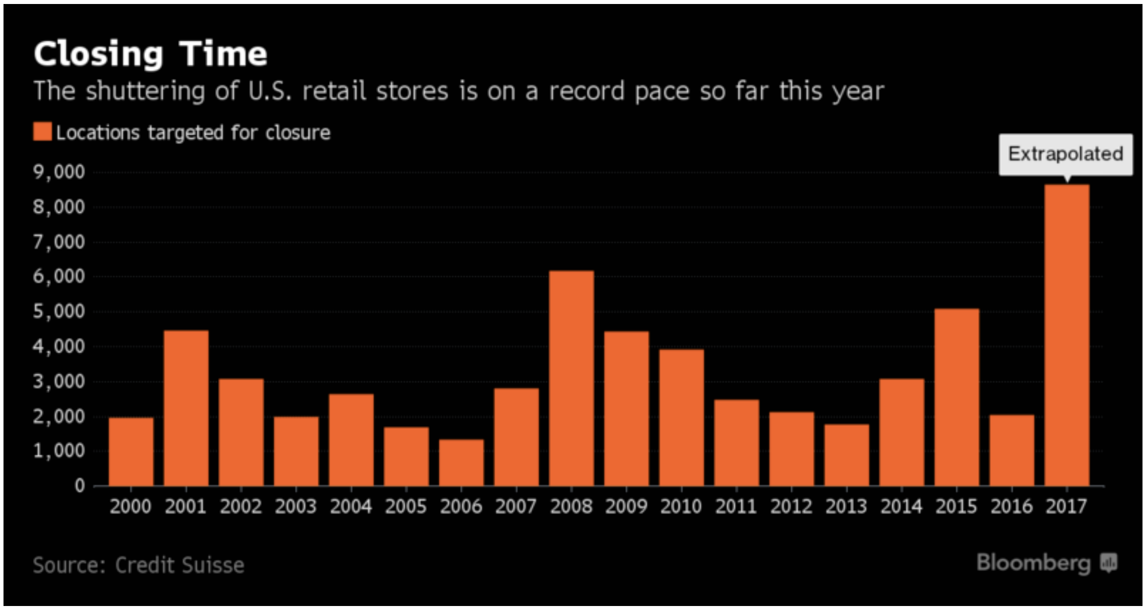
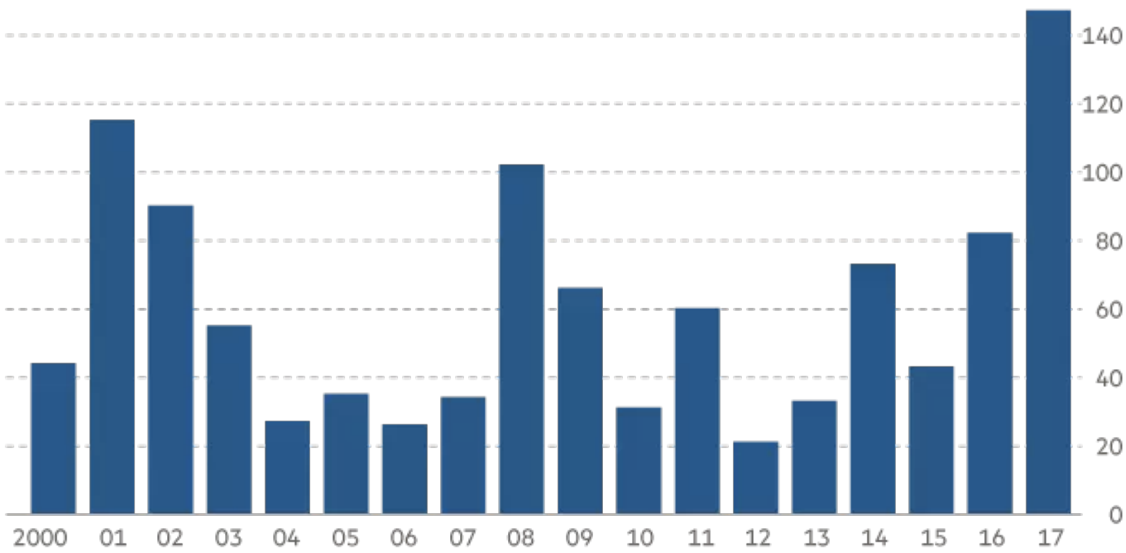


US retail space set to accelerate

Retail store closings by square footage (millions)



Source: Credit Suisse
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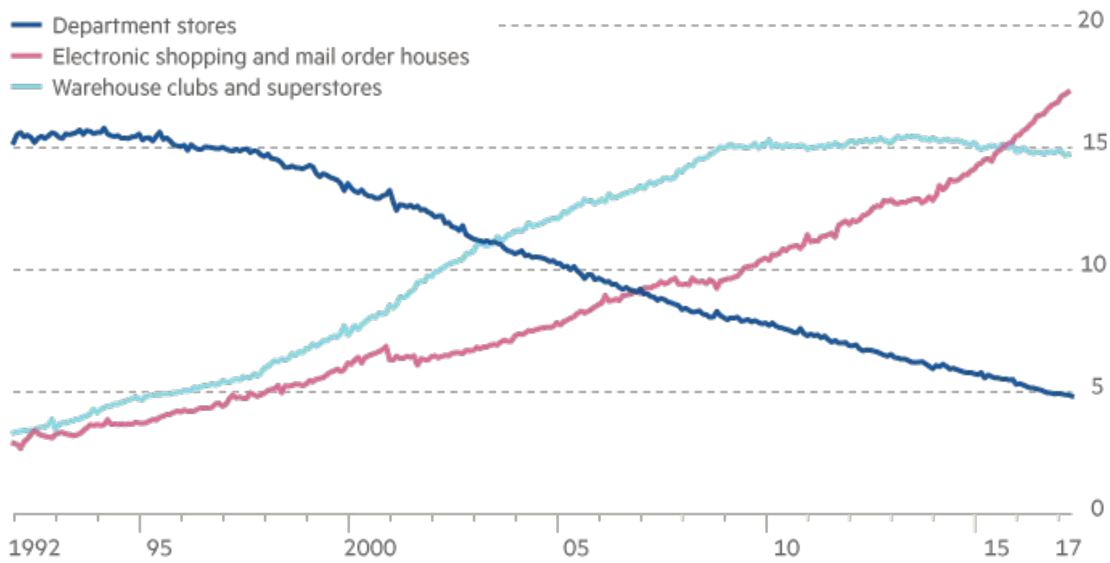
American online retailing is growing rapidly

% of core retail sales



Sources: Haver; IIF
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The developments also have occurred against the backdrop of the 2005 amendments to the Bankruptcy Code, and to Section 365 in particular that governs the assumption and rejection of leases. Suffice to say, these changes have been met with a mixed reception by bankruptcy constituencies.

Briefly, the Bankruptcy Code previously provided retailers with 60-days to decide which store leases to assume or reject. That deadline could be extended for cause, often until the effective date of reorganization. That flexibility is now gone. [6] Now, Section 365 of the Code provides 120 days to assume or reject leases, subject to a 90-day extension for cause. Practically speaking, a debtor confronts a 210-day limit to assume or reject leases.

In 2009, a subcommittee of the House Judiciary Committee heard testimony on what amended Section 365 had wrought, at a hearing titled "Circuit City Unplugged: Why Did Chapter 11 Fail to Save 34,000 Jobs?".[7] The subcommittee's chair, Rep. Steve Cohen, posed the question as follows:

[6] https://www.cfa.com/eweb//docs/tsl_archives_pdf/jan06_pg016.pdf.
[7] https://www.gpo.gov/fdsys/pkg/CHRG-111hhrg47924/pdf/CHRG-111hhrg47924.pdf.

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> The goal of Chapter 11 is to give businesses at least a fighting chance to reorganize so they can reenter the marketplace and save jobs.
>
> Some of us feel, however, that Chapter 11 is no longer working as Congress intended it to, especially in light of the 2005 amendments to the Bankruptcy Code. [8]

Ultimately, no legislative action resulted from the hearing.[9]

In an attempt to better convey these trends, below is a summary of recent retailer filings. To give a greater sense of the events leading up to these bankruptcies, the summaries directly refer to pertinent declarations, among other relevant sources, and provide a brief description of the debtors' respective businesses.

II. Case Summaries

a. The Limited

The Limited comprises a multi-channel retailing company, that specialized in the sale of women's clothing. At its peak, the company operated approximately 750 retail brick and mortar store locations in the United States, but in recent years, prior to liquidation, its operations declined to approximately 250 retail locations across 42 states, as well as an e-commerce channel.[10]

The declaration of the company's Chief Restructuring Officer states that the company faced operational challenges, including declining mall traffic and lower-than-projected sales, resulting in a drop in EBITDA over the course of the last several years through 2016.[11] In December 2016, the company commenced inventory liquidation sales in their brick and mortar stores.[12] By January 8, 2017, the company had sold substantially all of its brick and mortar inventory, and had ceased operations at all of its stores and delivered possession of each store to the respective landlord prior to the January 17, 2017 petition date.[13] The company also ceased operations of its e-commerce business prior to the petition date.[14]

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[8] https://www.gpo.gov/fdsys/pkg/CHRG-111hhrg47924/pdf/CHRG-111hhrg47924.pdf.
[9] http://www.washingtonpost.com/wp-dyn/content/article/2009/03/11/AR2009031104102.html.
[10] Declaration of Timothy D. Boates of Limited Stores Company, LLC, in Support of Debtors' Chapter 11 Petitions and First Day Motions at 2, *In re: Limited Stores Company, LLC, et al.*, Case No. 17-10124 (Bankr. D. Del. 2017) (Doc. 12).https://dr201.s3.amazonaws.com/limited/17-10124/dk000012-0000.pdf?AWSAccessKeyId=AKIAJJA7FW4EU3WZG4DQ&Expires=1501000565&Signature=d6xZMzfSc7LDNa7WdtK2mGbVn8E%3D.
[11] Id.
[12] Id. at 4.
[13] Id.
[14] Id.

The company filed a sale motion contemporaneously with the chapter 11 petition seeking approval of the sale of the company's Intellectual Property and certain related e-commerce assets.[15] Private-equity firm Sycamore Partners won an auction for the company's brand name in February with a $26.75 million offer.[16]

b. rue21

The company is a specialty fashion retailer of apparel and accessories for young adults.[17] As of the May 15, 2017 petition date, the company had approximately 1,179 stores in various strip centers, regional malls, and outlet centers throughout the continental United States.[18] The company sells its merchandise online and at brick-and-mortar locations".[19]

rue21 cited multiple factors that led to the commencement of the chapter 11 cases, including the general downturn of the retail industry, decreased sales and increased operating costs, the shift away from brick-and-mortar retail sales to online channels, the tightening of trade credit in the months prior to the petition date, and the company's outgoing third-party outsourcing services provider.[20] Notwithstanding these financial difficulties, the company asserted that it remained a valuable and iconic brand with a large and loyal customer base.

The bankruptcy court approved rue21's disclosure statement and scheduled an August 29, 2017 hearing to consider its joint plan of reorganization, with objections due by August 21, 2017.[21] Under the plan, rue21 will have reduced about $700 million in funded debt from its balance sheet, providing it with the necessary capital for ongoing operations.[22]

After exiting Chapter 11, the reorganized company's capital structure is expected to consist of a $125 million exit ABL facility and a $50 million exit term loan facility, plus the amount of any unpaid and accrued interest under the DIP facility as of the effective date of the plan.[23]

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[15] Id.
[16] Lillian Rizzo, Sycamore Partners Wins The Limited Brand at Auction, Wall St. J., Feb. 21, 2017 (https://www.wsj.com/articles/sycamore-partners-wins-the-limited-brand-at-auction-1487702476).
[17] Debtors' Emergency Application for Entry of an Order Pursuant to 28 U.S.C. § 156(c) Approving the Appointment and Retention of Kurtzman Carson Consultants LLC as the Claims and Noticing Agent to the Debtors, Effective *Nunc Pro Tunc* to the Petition Date at 3, *In re: rue21, inc., et al.*,Case No. 17-22045 (Bankr. W.D. Pa. 2017) (Doc. 7) (https://www.kccllc.net/rue21/document/1722045170515000000000007).
[18] Id.
[19] Id. at 7.
[20] Id. at 13.
[21] Brandy Chetsas, rue21 Disclosure Statement Approved, Bankrupt Company News July 17, 2017 (http://bankruptcompanynews.com/rue21-bankruptcy-7-17-17/). As of the date of the writing of this article, the confirmation hearing had not yet taken place.
[22] Id.
[23] Id.

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c. Payless

The company offers a wide range of shoes and accessory items at affordable prices. The company filed a voluntary petition under chapter 11 of the Bankruptcy Code on April 5, 2017. Payless cites the shift to online shopping as a reason for restructuring, along with antiquated systems and processes in 2015 that enabled it to buy too much inventory as another reason.[24]

To address its financial difficulties prepetition, the company closed 128 brick-and mortar stores, terminating approximately 145 employees from its corporate offices and support organization, and pursuing rent concessions across remaining stores.[25] Payless has only closed a portion of its 4,400 locations, distinguishing it from other retailers that have entered bankruptcy.[26]

The company's reorganization plan will allow it to eliminate 40% of its $838 million in funded debt by giving lenders equity stakes in the company in exchange for debt forgiveness.[27] Senior lenders who are owed $506 million will share a 91% equity stake in the reorganized company.[28] Junior lenders, who are owed $145 million, will take the remaining 9%.[29] Until late June 2017, the unsecured creditors' committee opposed the plan due to the small recovery it offered the group.[30] The conflict ended following negotiations that led to a higher recovery for the unsecured creditors.[31]

At the outset of the bankruptcy, unsecured creditors expected a payout of just pennies on the dollar. Ultimately, those same creditors are now expecting a recovery of between 17 and 21 cents for each dollar owed.[32]

The plan won court approval on July 24, 2017.[33] The company will now be under the control of its senior and junior lenders, which include GSO Capital Partners, Alden Global Capital LLC, Axar Capital Management LP, Credit Suisse Asset Management and Octagon Credit Investors LLC.[34]

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[24] Declaration of Michael Schwindle in Support of Debtors' Chapter 11 Proceedings and First Day Pleadings at 17, In re: *Payless Holdings LLC, et al.*, Case No. 17-42267(659) (Bankr. E.D. Mo. 2017)(Doc. 34) (file://nyprof01/users$/kmcgonig/Downloads/Bankr.E.D.Mo._4-17-bk-42267_34.pdf) .
[25] Id. at 19.
[26] Lillian Rizzo, Payless Reorganization Plan Wins Court Approval, Wall St. J. July 24, 2017 (https://www.wsj.com/articles/payless-reorganization-plan-wins-court-approval-1500930784) .
[27] Id.
[28] Id.
[29] Id.
[30] Id.
[31] Id.
[32] https://www.reuters.com/article/us-payless-bankruptcy-privateequity-idUSKBN19C05W.
[33] Id.
[34] Id.

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d. Gymboree

The company is a children's retailer. As of the petition date, June 12, 2017, the company had approximately $1.1 billion in total funded debt obligations,[35] consisting of approximately $81 million outstanding under the senior secured asset-based revolving credit facility, $48 million outstanding under the company's senior secured asset-based term loan, $789 million in aggregate principal amount outstanding under the company's senior secured term loan, and $171 million in unsecured senior notes.[36]

Leading up to the chapter 11 filing, the company faced major debts starting to come due in December, earnings in decline, and vendors demanding tighter payment terms.[37] All of these factors contributed to Gymboree's liquidity issues.[38] The company's Chief Restructuring Officer blamed a heavy dependence on store traffic for the 24% decline in EBITDA from 2015-2016.[39] The company began wholesaling two of their lines to larger merchants, such as T.J. Maxx and Amazon in 2016.[40]

Much of the company's debt stems from private-equity firm Bain Capital's $1.8 billion leveraged buyout of the retailer in 2010.[41] Following this buyout, Gymboree launched a global expansion of the brand, and as of the end of April 2017, Gymboree operated nearly 1,300 stores.[42] Bain Capital and Gymboree's other private equity owners will relinquish their holdings under the chapter 11 plan.[43]

The company envisions closing 350 stores as part of its restructuring plan.[44] Critical suppliers will be paid in full, but the restructuring plan offers nothing to general unsecured creditors.[45] Lenders of Gymboree's $789 million secured term loan have agreed to cast votes in support of the plan, and will get control of the post-bankruptcy Gymboree.[46] A board of directors with appointees of Carriage House Capital

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[35] Declaration of David Kurtz in Support of the Debtors' Motion for Entry of Interim and Final Orders at 4, In re: THE GYMBOREE CORPORATION, *et al.*, No. 17-32986 (2017) (Doc. 32) (file://nyprof01/users$/kmcgonig/Downloads/188030765641-rep-1206060224.pdf).
[36] Id.
[37] Lillian Rizzo and Peg Brickley, Gymboree Files for Chapter 11 Bankruptcy to Slash Debts, Wall St. J. June 12, 2017 (https://www.wsj.com/articles/gymboree-files-chapter-11-cfo-leaves-1497268737).
[38] Id.
[39] Declaration of James A. Mesterharm, Chief Restructuring Officer of the Gymboree Corporation, in Support of Chapter 11 Petitions and First Day Motions at 4, In re: *The Gymboree Corporation, et al.*, Case No. 17-32986 (Bankr. E.D. Va. 2017) (Doc. 30) (file://nyprof01/users$/kmcgonig/Downloads/188030765635-rep-1206051351.pdf).
[40] Id. at 42
[41] Maria Armental, Gymboree to Close About 350 Stores in Restructuring Effort, Wall St. J. July 11, 2017 (https://www.wsj.com/articles/gymboree-to-close-about-350-stores-in-restructuring-effort-1499812556).
[42] Rizzo and Brickley, supra note 39.
[43] Id.
[44] Id.
[45] Id.
[46] Id.

Advisors, Bridge Capital Management, Oppenheimer Funds Inc. and Searchlight Capital Partners will run the post-bankruptcy company.[47]

The court approved the plan disclosure statement on July 24, 2017, and is scheduled to consider plan confirmation on September 7, 2017.

e. hhgregg

The company is a retailer that provides a selection of appliances, consumer electronics, home products and computers.[48] As of the date of the petition on March 7, 2017, the company had 220 brick and mortar stores in 19 states, and operated the website hhgregg.com.[49] The company also sells services including third-party premium service plans, delivery and installation, and in-home repair and maintenance.[50]

Prior to the petition date, the company determined to close 88 underperforming locations in an effort to improve operating efficiency.[51] Following the completion of the store closing sales, the company intends to reject the leases for dark stores and use the proceeds from the sales to reduce secured debt, and for operations in accordance with the DIP loan and related budget.[52]

In describing the circumstances leading to the commencement of the chapter 11 cases, the Chief Financial Officer cited competition as a major factor.[53] The company's stores compete against consumer electronics retailers, home furnishing retailers, specialty home office retailers, mass merchants, home improvement superstores, and internet based businesses, as well as independent dealers, regional chain discount stores, wholesale clubs and other specialty single- and multi-unit retail stores.[54] The first day declaration also points to the same causes that have plagued other retailers: declining retail traffic, fast-changing trends, expensive commercial leases, and the proliferation of online shopping.[55]

After being unable to obtain a buyer for its business as a going concern, hhgregg determined that the best way to continue maximizing value for the benefit of all parties was to conduct an orderly wind-down of its business operations.[56] The

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47 Id.

48 Declaration of Kevin J. Kovacs in Support of Chapter 11 Petitions and Requests for First Day Relief at 4, *In re: hhgregg, Inc., et al.*, Case No. 17-01302-11 (Bankr. S.D. Ind. 2017) (Doc. 19) (https://dr201.s3.amazonaws.com/hhg/17-01302-11/dk000019-0000.pdf?AWSAccessKeyId=AKIAJJA7FW4EU3WZG4DQ&Expires=1501162378&Signature=2trIpfn6eQaN3zrQRRCmr4l7spE%3D).

49 Id.

50 Id. 5.

51 Id. at 9.

52 Id.

53 Id. at 8.

54 Id.

55 Id. at 9.

56 Brandy Chetsas, hhgregg Bankruptcy Big Procedures Approved, Bankrupt Company News July 12, 2017 (http://bankruptcompanynews.com/hhgregg-retail-bankruptcy-7-12-17/).

bankruptcy court approved the company's motion for an order authorizing and approving bid procedures, scheduling a sale hearing and authorizing the sale of the debtors' class action assets.[57]

f. Gander Mountain

Gander Mountain Co. sells hunting, camping, fishing and other outdoor-related gear from stores across the country.[58] The company had revenue last year of more than $3 billion.[59] The company struggled following an expansion adding about 50 new stores.[60] As of the March 10, 2017 petition date, the company owed a total of approximately $424.5 million in principal plus accrued interest on prepetition secured obligations.[61]

In connection with its bankruptcy filing, the company auctioned its 160 stores.[62] Camping World Inc. and a group of firms, Gordon Brothers Group LLC and Hilco Merchant Resources LLC, won the auction for the company's assets with a bid valued at $390 million to $400 million.[63] Camping World won the assets of Gander Mountain and its boating business, Overton's, and the firms won the rights to sell off the inventory in Gander Mountain's stores.[64] Camping World's CEO committed to keeping 17 stores open, but also expressed hope that as many as 70 may remain open.[65]

g. Ignite Restaurants (Joe's Crab Shack)

The company operates two restaurant brands, Joe's Crab Shack and Brick House Tavern + Tap.[66] As of the petition date, June 6, 2017, the company operated 137 restaurants and had three international franchise locations, and employed

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57 Id.

58 Jacqueline Palank, Gander Mountain Files for Chapter 11, Wall St. J. Mar. 10, 2017 (https://www.wsj.com/articles/gander-mountain-files-for-chapter-11-1489173758).

59 Id.

60 Id.

61 Debtors' Motion for Interim and Final Orders at 12, *In re: Gander Mountain Company*, Case No. 17-30673 (Bankr. D. Minn. 2017) (Doc. 26); In re: Overton's, Inc., Case No. 17-30675 (Bankr. D. Minn. 2017) (Doc. 26) (https://dr201.s3.amazonaws.com/gmc/17-30673/dk000026-0000.pdf?AWSAccessKeyId=AKIAJJA7FW4EU3WZG4DQ&Expires=1501642801&Signature=Bm4iMk5c5A04dApnfULWd4G6Bgg%3D).

62 Patrick Fitzgerald, Camping World Throws Lifeline to Bankrupt Outdoor Retailer Gander Mountain, Wall St. J. Apr. 30, 2017 (https://www.wsj.com/articles/camping-world-throws-lifeline-to-bankrupt-outdoor-retailer-gander-mountain-1493576170).

63 Id.

64 Rick Romell, Gander Mountain Likely to Close Many More Stores, USA Today May 2, 2017 (https://www.usatoday.com/story/money/business/2017/05/02/gander-mountain-may-close-many-stores/101188510/).

65 Fitzgerald, supra note 63.

66 Declaration of Jonathan Tibus in Support of Chapter 11 Petitions and First Day Motions at 3, *In re: Ignite Restaurant Group, Inc., et al.,*Case No. 17-33550 (Bankr. S.D. Tex. 2017) (Doc. 4) (http://docket_pdfs.gcg.net/IRG/17-33550/4_33550.pdf).

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approximately 8,400 employees.[67] The company is party to a $30 million prepetition revolving credit facility and a $165,000,000 prepetition term loan.[68] Both mature on February 13, 2019.[69] The company listed roughly $153 million in assets and $197 million in debt.[70]

In April 2017, the company defaulted on its obligations under the prepetition credit agreement.[71] The first day declaration cites declining same store sales trends, the degradation of restaurant-level margins, and broader concerns regarding the casual dining and restaurant sector as a whole.[72]

After the debtor secured a stalking horse bidder for the sale of assets of its assets,[73] Landry's Inc. emerged as the winner of the bidding process with a $57 million bid. The offer exceeded the stalking horse bid at the bankruptcy auction by $7 million.[74]

h. Aéropostale

The company is a retail chain with stores located in all 50 states, as well as Puerto Rico and Canada, employing approximately 14,500 persons as of the bankruptcy filing.[75] The company's brands are also licensed internationally and sold in over 300 additional locations in 17 different countries.[76] On the date of filing, May 4, 2016, the company sought approval of procedures to effectuate the immediate closing of 154 stores.[77]

As of the petition date, the company estimated that approximately $23 million of merchandise and trade debt was due and outstanding, of which $2.5 million related to goods provided to the debtors in the 20 days before the petition date.[78] The company operated exclusively in leased facilities, and maintained over 800 real property leases.[79]

In his first day declaration, the Chief Financial Officer cited declining mall traffic, a highly competitive teen retail environment, and a shift in customer demand away from apparel to technology and personal experiences as contributors to the company's declining financial performance.[80] The company closed 122 stores in the

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[67] Id.
[68] Id. at 7.
[69] Id. at 4.
[70] Jack Witthaus, Joe's Crab Shack Parent Co. Filed for Bankruptcy, Lines up Likely Buyer, Houston Business Journal June 6, 2017 (https://www.bizjournals.com/houston/news/2017/06/06/joes-crab-shack-parent-co-files-for-bankruptcy.html).
[71] Declaration, supra note 70 at 8.
[72] Id. at 9.
[73] Id.
[74] https://www.law360.com/articles/954581/landry-s-wins-ch-11-auction-for-joe-s-crab-shack-taverns
[75] Declaration of David J. Dick Pursuant to Rule 1007-2 of the Local Bankruptcy Rules for the Southern District of New York at 2, In re: *Aéropostale, Inc., et al.*, Case No. 16-11275 (Bankr. S.D.N.Y. 2016) (Doc. 4) (file://nyprof01/users$/kmcgonig/Downloads/M126116450715-rep-0405022131.pdf).
[76] Id.
[77] Id.
[78] Id.
[79] Id.
[80] Id. at 20.

US and Canada during fiscal year 2014, and 50 more stores in 2015.[81] The company has also changed the store format and reduced corporate headcount.[82]

The company has contended that Sycamore Partners, a private equity firm that was one of the company's largest backers, used its control to force the bankruptcy filing.[83] Sycamore denied the allegations, saying such action would be counterproductive to their significant financial investment in the company.[84] Sycamore also owns MGF Sourcing, which manufactures clothing for Aéropastale.[85]

Ultimately, landlords, liquidators, and a licensing firm, Authentic Brands Group, were declared the winners of the bid to purchase the company's assets with an offer of $243.3 million.[86] The terms of the deal call for at least 229 stores to be kept in operation. The plan was approved by a federal judge in September 2016, and was hailed as a model for future restructurings by one of Aéropastale's lawyers.[87]

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81 Id.
82 Id. at 21.
83 Peg Brickley, Aéropostale Duels With Sycamore Over Bankruptcy, Wall St. J. Aug. 23, 2016 (https://www.wsj.com/articles/aeropostale-duels-with-sycamore-over-bankruptcy-1471992938).
84 Peg Brickley, Aéropostale Files for Bankruptcy Protection as Charges Fly, Wall St. J. May 4, 2016 (https://www.wsj.com/articles/aeropostale-files-for-bankruptcy-protection-1462339757).
85 Id.
86 Brickley, supra note 100.
87 Phil Wahba, Aéropostale Won't Go Out of Business After All, Fortune Sep. 13, 2016 (http://fortune.com/2016/09/13/aeropostale-bankrupcty/).