Financial Distress in the Retail Industry

BY NICHOLAS F. KAJON, OCTOBER GUEST EDITOR

Nicholas F. Kajon is a shareholder of Stevens & Lee, P.C., and a member of the Bankruptcy and Financial Restructuring Group practicing in the firm's New York City office. He concentrates his practice on corporate restructuring and represents both plaintiffs and defendants in insolvency-related litigation. Kajon can be reached at nfk@stevenslee.com or 212-537-0403.

Even though default rates and corporate Chapter 11 filings remain at historic lows, several industries have been experiencing financial distress. Chief among them is the retail industry, which has been enduring a relentless onslaught from the internet. Overcapacity in the industry, an anemic economy, and overleveraged consumers add to retailers' woes and ensure that the retail industry will continue to experience financial distress.

In fact, since the onset of the 2008 financial crisis, we have witnessed many venerable retailers file Chapter 11 merely to conduct an orderly liquidation, including Coldwater Creek, Loehmann's, Circuit City, Linens 'n Things, Borders, Goody's, Daffy's, and Dots. Undoubtedly, many more marquee names will face that outcome. However, while competition from the internet is unlikely to recede, innovative retailers will likely survive.

Foremost among the survivors will be those retailers that reinvent themselves by implementing business plans suitable for the internet age. Some of these survivors may execute turnaround plans or financial restructurings without court supervision. Other retailers, however, may need to use Chapter 11 to rid themselves of underperforming stores, limit landlord rejection damages claims, implement cost-saving measures, and reduce debt to manageable levels. And even those retailers that can restructure outside of Chapter 11 will have to negotiate with key constituencies based on what the outcome would be if the company were forced to file for bankruptcy protection.

Chapter 11 is a wonderful tool to fix both operational and financial issues, but it is fraught with peril for the uninitiated. Therefore, we have put together a distinguished panel of authors to discuss some of the issues most likely to arise in the Chapter 11 case of a retailer.

Three prominent authors provide perspectives from the points of view of some of the most important players in a retail bankruptcy. Neil E. Herman of Morgan Lewis analyzes the intricacies of a retail Chapter 11 case from the perspective of the debtor. Kelly Beaudin Stapleton of Alvarez & Marsal explains the role of the official creditors' committee in a retail bankruptcy case, while Dan Lowenthal of Patterson Belknap Webb & Tyler discusses how trade creditors can maximize their recoveries.

My partner Joe Huston from our Wilmington office analyzes Section 503(b)(9) of the U.S. Bankruptcy Code, which gives administrative expense status to certain suppliers of goods that were received within 20 days before the commencement of the bankruptcy case. This provision can wreak havoc on retailers and imperil their ability to reorganize under Chapter 11. Huston demonstrates how prepetition suppliers who appear to be in similar positions can be treated very differently because of various quirks in how Section 503(b)(9) is construed, which raises serious questions about whether it's time for the section to be tweaked or repealed.

Finally, Steve Moore of Tortola Advisors analyzes operational issues that recur in distressed retail businesses. Moore demonstrates how a troubled retailer can achieve a turnaround by overcoming resistance to change and focusing on speed and the core customer and product offering.

I hope you will find these articles as interesting and informative as I have.