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## USA: Everything Must Go: Retail Chapter 11 filings

**The global retail sector is struggling. Throughout the world, previously successful and storied retailers and brands are facing increasing pressure from the "online" retailers.**

Some are succumbing to these pressures and becoming insolvent, including filing for Chapter 11 protection in the U.S. The U.S. retailers source products globally. AlixPartners 2017 North American restructuring experts survey reports that 67% of respondents said the retail industry would be the most likely to see distress in 2017, taking the top spot from the oil and gas industry in 2015 and 2016. Indeed, recent Chapter 11 retail filings include Sports Authority, Linens & Things, The Limited, Wet Seal, and most recently Radio Shack's "Chapter 22" and electronics retailer hhgregg with 220 U.S. store locations, filed in Indiana.

> "A RESTRUCTURING EXPERTS SURVEY REPORTS THAT 67% OF RESPONDENTS SAID THE RETAIL INDUSTRY WOULD BE THE MOST LIKELY TO SEE DISTRESS IN 2017"

One reason that Chapter 11 is an attractive alternative for struggling retailers are Sections 365 (Sale of Assets) and 365 (Executory Contracts) of the Bankruptcy Code. Under Section 363, a debtor may sell its assets ("property of the estate") free and clear of liens, with liens attaching to proceeds. In this fashion, and consistent with the "practice" in many Chapter 11 cases, a debtor may sell assets quickly, usually within 60-120 days after a Chapter 11 filing. In the most truncated sales process ever, the Lehman Brothers brokerage business was sold to Barclays in five days.

In theory, a quick sale allows for the preservation of going concern value and avoids on-going operating losses. Parties can allocate the sale proceeds later, based on the parties' respective priorities and rights. In most Chapter 11 cases recently the secured debt to asset values ratio is quite high, and thus Section 363 sales primarily benefit the secured lenders.

There is inherent tension between secured lenders and the unsecured trade creditors, normally represented by the unsecured creditors' committee, who may be "out of the money" at the outset. The creditors' committee normally seeks to realize value for its constituents by "enhancing" the value of the debtors' assets, or by pursuing claims against third parties. Often the administrative expenses associated with pursuing this strategy do not justify the actual benefit to creditors. Lenders, by contrast, seek to sell assets quickly to cover the secured debt, with as little administrative cost as possible. Since "time is money", lenders push for a quick Section 363 sale.

Section 365 of the Bankruptcy Code regarding executory contracts is another powerful tool that makes Chapter 11 attractive to struggling retailers. Under Section 365, a debtor enjoys the right to decide, to assume or reject executory contracts, which include store leases. In the context of store closings, if the debtor rejects a store lease, the landlord's breach of contract claim is generally limited to one year's rent, and is deemed a prepetition general unsecured claim. Such claims are usually of little value in Chapter 11 cases, thus making store closings relatively cheap and easy for retailers.

With these powerful tools available to financially distressed retailers, it is predictable that more retailers will choose the Chapter 11, as AlixPartners predicts. The impact will reverberate in the U.S. and also in the global supply chain. It is no wonder that Radio Shack recently filed "Chapter 22", or its second Chapter 11 case, less than two years after its first filing.