

Retail Apocalypse Part II?

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WHAT TRADE CREDITORS AND LANDLORDS CAN DO TO PROTECT THEMSELVES

At the outset of the COVID-19 pandemic, some commentators were preparing for a mass extinction event in the retail industry, characterized by hundreds of brick-and-mortar store closings, massive job losses, and numerous insolvencies. This Retail Apocalypse, however, was temporarily paused, thanks in large part to government stimulus under the CARES Act. Now that Paycheck Protection Program (PPP) funds have dried up and consumer spending continues to shrink in anticipation of a potential recession, retail bankruptcies are likely to increase in frequency.

For instance, it is being widely reported that national retailer Bed Bath & Beyond (BB&B) will file for Chapter 11 bankruptcy imminently. On January 9, 2023, news broke that BB&B retained restructuring advisors AlixPartners in anticipation of the filing. BB&B also announced the closing of 70 stores across the country, adding to the list of 56 store closings announced in September 2022.

For BB&B's unsecured creditors—including trade creditors, landlords and consumers—this is bad news, and unfortunately, if BB&B is the leading edge of a larger retail bankruptcy wave, it is bad news that will be heard over and over again. But it's also a reminder to businesses and individuals with exposure to the retail sector to examine risk with a closer eye toward managing that exposure. Knowing your rights and remedies *before* a retailer files bankruptcy can dramatically help mitigate losses and improve the likelihood of a meaningful recovery in bankruptcy.

What can trade creditors do before bankruptcy?

Pre-bankruptcy, your rights are generally controlled by state law or contract. If you have a contract, you should review it to understand what rights and remedies are available. If there is an option to terminate the agreement upon default, and a default has occurred, then you should consider exercising that right immediately. Bankruptcy can frustrate your ability to terminate a bad contract, even one in default. However, if you don't have a contract, then the options listed below provide a fairly high-level overview of common ways to protect yourself before bankruptcy.

Protect ongoing and future business

If you continue to do business with a retailer, then there are ways to ensure that you can receive payment without clawback or preference risk. The easiest way to do so is to insist that all future transactions be made subject to payment in advance or collection upon delivery (COD). When a customer is likely to file bankruptcy, payment in advance or COD becomes critical for two reasons. First, it ensures that you will get paid for the goods you deliver, because as an unsecured creditor in bankruptcy you are unlikely to receive full payment (if any). Second, the money you receive from the retailer in advance or COD would not be subject to potential clawback or preference litigation.

Stop goods in transit

If the debtor refuses to provide acceptable terms (pay in advance or COD), you should stop goods in transit, so long as the goods have not been delivered to the debtor or its agent. While the goods you provide to the retailer in the 20 days before bankruptcy might receive elevated payment priority under the Bankruptcy Code, you don't necessarily know when the filing will occur, and there is no guaranty that priority payments will be paid in full. You have leverage while the goods are in transit—use it!

Seek a third-party guarantor or other adequate assurance of payment

While BB&B's financial distress has played out conspicuously in the media and its bankruptcy filing appears imminent, that might not be the case for other retailers. If you start to see warning signs, consider other creative ways to guaranty payment. Perhaps there is a principal or investor who would be willing to guaranty the retailer's debt. Each supplier is different and operates under its own imperatives, but if a key customer's bankruptcy imperils your own business, more aggressive and proactive measures might be necessary.

Seek to be included on the critical vendor list

In a Chapter 11 case, you may be able to obtain payment for some or all goods and services provided to the customer before the bankruptcy filing if the customer considers you a "critical vendor" and obtains bankruptcy court authority to pay critical vendors. Critical vendors are those vendors so vital to the debtor's continued operations that their refusal to continue supplying the debtor might result in

the cessation of those operations and the inability to reorganize. When a retailer's bankruptcy filing is expected, you can be proactive and let the retailer know that you won't continue to do business during the case without such protections.

Contact your credit insurer

If you have insurance against credit risk, review your policy and understand your rights. If it is appropriate, notify your insurer of the anticipated bankruptcy filing and work with them to guaranty that they won't attempt to deny coverage.

What can landlords do before bankruptcy?

The bankruptcy code provides commercial landlords with some significant protections and, more importantly, in many cases a reasonable shot at having the tenant emerge from the process with its business and lease intact. This is especially true if the tenant is looking to reorganize its business through a Chapter 11 proceeding and keep the store subject to the lease. In this scenario, the debtor will assume the lease and—at least in theory—make the landlord whole. That is because for a lease to be assumed, payment arrears and lease defaults must be cured, or the landlord must be provided with “adequate assurance” of cure, and there must be “adequate assurance of future performance.”

If the debtor, however, is not looking to reorganize or keep the store subject to the lease, a landlord will be treated as an unsecured creditor and likely receive minimal distributions on account of any unpaid rent. In addition, the landlord will be faced with the prospect of having the premises unoccupied after the debtor leaves.

While commencing an eviction proceeding is always available to landlords when a tenant is in default, it may make little sense for large tenant retailers. Eviction proceedings take a significant amount of time. Once the bankruptcy is filed, any proceedings against the debtor—including an eviction—will be subject to the Bankruptcy Code's automatic stay. For that reason, it may be wiser for landlords to focus on preparing to find new tenants in an effort to mitigate losses in the event the debtor rejects (e.g., terminates) the lease in bankruptcy.

Finally, as with trade creditors, seeking to add a guarantor to the lease is another way landlords can protect themselves in the event of a bankruptcy. A guarantor to a lease is still liable for the obligations of the debtor even if the tenant files for bankruptcy. While this may not be possible in the BB&B case, it may be an option when the landlord is aware that a tenant is struggling financially but has an insider willing to guarantee the obligations.

What this means to you

After a short hiatus, many expect retail bankruptcies to increase, particularly if current macroeconomic trends persist or worsen. The more you do to protect yourself now, the better off you'll be once a filing occurs.

Contact us

For more information regarding creditors' rights or how to manage risk associated with the insolvency, please contact Michael Brandess, Iana Vladimirova or a member of Husch Blackwell's Insolvency & Commercial Bankruptcy team.