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Retail, Energy Sector Woes to Continue, Experts Say

REITs, Healthcare and Pharma Among Must Watch

by Christopher Patalinghug

A slight uptick in Chapter 11 bankruptcy filings and a record number of store closures are among the highlights in the restructuring industry for the past year.

Commercial chapter 11 filings rose to 5,502 during calendar year 2019, representing a 0.36% increase from the 5,482 commercial chapter 11 filings in 2018, the American Bankruptcy Institute says, citing data provided by Epiq Systems, Inc. After declining for eight consecutive years, according to ABI, total bankruptcy filings during calendar year 2019 increased 0.28% from 2018. Data refined by *Troubled Company Reporter* editors, to exclude contemporaneously filed cases

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Order Denying Stay Relief "Final" & "Imediately Appealable," SC Rules

by Frauline S. Abangan

Is a bankruptcy court order denying relief from the automatic stay always a final order? Yes, a unanimous Supreme Court held last week.

Ritzen Group Inc., a creditor in the bankruptcy case of Jackson Masonry LLC, asked the Supreme Court to answer this question in order to clarify the opposing views of lower courts. The Supreme Court heard the parties' arguments in November and it will reportedly issue a decision in the summer.

Based in Nashville, Tennessee, Jackson entered into a real estate contract with Ritzen in March 2013. Ritzen agreed to buy real property from Jackson for $1.55 million but the sale fell through and it led to a breach of contract lawsuit. Ritzen claimed Jackson failed to provide certain documentation while Jackson claimed that Ritzen failed to secure financing and appear at the closing.

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being jointly administered, show that about 1,914 of the corporate Chapter 11 cases filed in 2019 involved debtors with more than $1 million in assets. According to TCR, there were 1,719 corporate Chapter 11 filings by debtors with more than $1 million in assets in 2018 and 1,836 the year before.

Meanwhile, U.S. retailers closed or announced plans to close more than 9,300 stores in the past year, data from global marketing research firm Coresight Research show, easily surpassing the 5,864 closures in 2018. Last year's figure also topped the roughly 8,000 store closings in 2017—the previous record—according to a Business Insider report. Investment firm UBS predicts 75,000 more stores that sell clothing, electronics and furniture will close by 2026.

Beyond the numbers, how did 2019 restructuring activity compare to prior years? What were the significant events? Moreover, with all that's happened, what can we expect in the new year? What events or key sectors should we keep an eye on?

We ask six bankruptcy experts to reflect on 2019 and share to us their outlook for the new year: **William (Bill) A. Brandt**, Executive Chairman of turnaround firm Development Specialists, Inc.; **Jonathan Carson**, CEO at bankruptcy administration and technology firm Stretto; **Maria Ginzburg**, partner at Selendy & Gay, PLLC; **George Panagakis**, deputy practice leader of the Corporate Restructuring Group at Skadden, Arps, Slate, Meagher & Flom LLP; and **Aparna Yenamandra** and **Ross Kwasteniet**, partners at Kirkland & Ellis LLP.

Over all, what did the restructuring activity look like in 2019?

Brandt, DSI: Overall, our firm had one of its best years ever. Based upon the number of assignments generated and the volume of revenue experienced, we think that we're on the cusp of a very strong 2020, with a number of new matters already flowing in for next year during these last few weeks of December.

Carson, Stretto: In 2019, we saw a slight upswing in corporate restructuring filings and we can expect filings to continue climbing upward in the New Year given certain leading indicators (e.g., weakness in rail and trucking freight) trending toward recessionary levels. Decreased mid-year interest rates in 2019 sustained many distressed companies that might have otherwise been forced to undergo corporate restructuring to resolve their debt obligations. As a result, we did not see the higher number of filings that were expected, but that is likely to change in the coming year.

Panagakis, Skadden: The economy remained strong in 2019 and interest rates held low and steady. As a result, overall restructuring activity remained relatively soft, as was the case in 2018. Certain industries such as retail, health care, and energy remain stressed, but overall activity has stayed well below Great Recession levels. That being said, restructuring professionals are keenly aware of ever-increasing corporate debt levels—i.e., large companies in the U.S. owe approximately $10 trillion in corporate debt, which is 47% of the country's GDP (the highest ratio of corporate debt to GDP in U.S. history). We also saw an inverse yield curve in 2019—a primary indicator of a recession—suggesting increased restructuring activity in the near future.

Yenamandra, Kirkland: Overall, 2019 saw another wave of retail filings. But, while 2018 was all about retail, we saw a lot of other sectors with bankruptcy activity in 2019, including telecom, oilfield services, and the chemical industry. We also started seeing activity again in the mass tort space, specifically with respect to the opioid epidemic being a more national issue.

What was the biggest story in the past year? How were you or your firm involved?

Brandt: The sheer amount of growing cross-border matters and our firm's involvement in many of them, typified by our firm's involvement in the world's largest current pending cross-border matter, China Fishery Group.

Carson: One of the biggest stories in 2019 that impacted the restructuring community revolved around interest rates. Coming into 2019, interest rates were expected to climb on the back of a healthy economy as the Federal Reserve was on the path to raise rates. With this, many expected that companies would face challenges in securing financing, which would have

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further pushed them into distress. Instead, we saw a dramatic shift with a downward trend of decreasing interest rates, which allowed companies to refinance and move away from a distressed status. We also saw uncertainty regarding tariffs and potential trade challenges with China. The confluence of these two factors created a very challenging business climate for companies already facing significant headwinds.

Kwasteniet, Kirkland: One of the biggest stories this past year has been the chapter 11 filing of Murray Energy, which is the largest privately owned coal company in the U.S. (and fourth largest overall). The last several years have been difficult for companies in the coal industry, given the competition from less expensive natural gas and improvements in clean energy technology, among other macroeconomic factors. While the Murray filing was in many ways expected, in the last few weeks of the year congress passed legislation as part of the omnibus government funding bill that provides a federal government backstop for the UMWA's 1974 Pension Plan and for retiree healthcare obligations owed to Murray retirees as well as the retirees of Mission Coal and Westmoreland. This is a big deal for Murray, which had more than $8 billion in exposure to pension and retiree health obligations, but could also be something that other industries try to emulate, given the pervasive pension problems that threaten many sectors of the economy.

Panagakis: The Third Circuit's decision in the *Millennium [Lab Holdings II, LLC]* case upholding the constitutionality of non-consensual third-party releases was among the most significant developments in 2019. Skadden represented *Millennium* in its chapter 11 case back in 2016, constructing and confirming the chapter 11 plan that incorporated the non-consensual third-party releases at issue. Practitioners will be closely watching to see whether this issue ends up in the Supreme Court in 2020.

Were there cases that took an unexpected or surprising turn last year? How?

Brandt: Yes. We were surprised by the sheer amount of cases with financial irregularities and financial fraud that showed up at our door over the past year or so. Huge cases like *1st Global, Woodbridge* and *Highland* are indicators, we believe, of the substantial faith many in the industry have in the very unique set of experiences our firm has had in these types of matters as well as the particular attributes arising from this experience which our firm can bring to its ability to handle and resolve these intricate and difficult cases.

Ginzburg, Selendy: Net-short debt activism made headlines in 2019. In one such case *(U.S. Bank Nat'l Ass'n v. Windstream Servs., LLC)*, activist hedge fund Aurelius Capital Management directed an indenture trustee to sue Windstream Services LLC for defaulting on certain notes. Media speculation arose that Aurelius was really motivated by a much deeper CDS short position rather than its position as a creditor.

Windstream sought to cure its default through a new lending transaction that would have a majority of creditors waive the default, but the Court ruled for the trustee and issued a no-nonsense decision, upholding the black-letter terms of the indenture and ordering Windstream to pay over $300 million on its debt. Windstream immediately filed for bankruptcy.

Aurelius' reported strategy generated both criticism and support: on the one hand, the fund was upholding creditors' rights to remedy a default; on the other hand, a company was forced into bankruptcy because a creditor may have been motivated by profits on its separate CDS position. As a result, corporations must now consider drafting their lending agreements around this potential scenario, restricting creditors' voting rights to investors who do not simultaneously own CDS.

Activist investors look for these types of opportunities in deteriorating markets, where defaults can be triggered and profits can be made. If lenders continue to be under economic pressure next year, we are sure to see additional opportunistic plays by market participants.

Kwasteniet: The case everyone has been watching in 2019 is PG&E. The size of the company, the regulatory environment in which PG&E operates, the number of different stakeholder groups, and the complexity of the restructuring

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in light of the fire litigation has made it one of the most complicated restructurings in recent years. Given all that complexity, I think a lot of people in the restructuring world were surprised when exclusivity was terminated and a dual track plan process commenced. Now that the PG&E Debtors have worked to bridge the gap with the competing plan proponents, I think everyone is waiting to see what the CPUC does from a regulatory perspective.

Panagakis: In the retail sector, we have seen a trend toward more administratively insolvent cases, with debtors employing unconventional techniques to address this challenge. For example, some retailers turned to opt-in mechanisms for creditors to receive payment in full on their administrative claims to allow the retailers to confirm their plans. These outcomes will likely affect distressed retailers' access to trade credit. On the international front, the sudden liquidation of Thomas Cook Travel was surprising given its size and number of displaced travelers.

What presented your greatest challenge in 2019?

Brandt: Again, it was accommodating all the cross-border work, which required routine appearances in courts not only in the U.S., but continuing and repeated appearances in courts in Hong Kong, Singapore, Namibia and London, and the ability to oversee and operate businesses in Peru, Southeast Asia, Europe and Africa.

Carson: 2019 was a milestone year for Stretto as we launched an expanded portfolio of corporate restructuring services in conjunction with our rebranding. We faced and met the challenge of launching our new service offerings and hit the ground running to become fully operational within a nine-month period. This entailed hand-selecting a high-powered consulting team of over 60 professionals to advise our corporate restructuring clients and building a robust technology platform. As a result, we have been able to establish a market presence in 2019 and position ourselves for growth in 2020 and beyond.

Panagakis: The continued use of liability management transactions presented both challenges and opportunities in 2019. Given the prevalence of borrower-favorable credit documents, companies have had the flexibility to execute potential turnarounds without implementing a full-scale restructuring. Meanwhile, debtholders have become increasingly proactive in attempts to influence the path a distressed company might take in managing its obligations. Balancing these company/creditor tensions should present challenges if this trend continues.

Yenamandra: E&P companies this summer were in a really difficult spot. The vast majority of distressed E&P companies are not built to sustain a drop of more than $5-$15 per barrel for a prolonged period of time, and oil and natural gas prices were fairly volatile over the summer. It definitely added a level of complexity from a restructuring perspective. On the one hand, the Bankruptcy Code requires a plan proponent to prove that the plan is feasible. On the other hand, feasibility under these circumstances is materially impacted by an unpredictable commodity price market. The challenge here was to do our best as professionals to preserve the value of the company in a sustained downward cycle in an environment where industry headwinds were continuing to worsen. It's a challenge that will continue into 2020.

The retail sector has been battered in recent years, with retailers shutting down close to 10,000 brick-and-mortar stores this past year, according to a CoreSight Research report. How will this spill over in 2020?

Brandt: It will just continue and the impact will spread even further, like a cancer, into the real estate arena, with the health of many shopping malls and strip centers measurably affected by the growing retail vacancy rates.

Carson: Brick-and-mortar retail continued to face challenges this year, and while high-end retailers have remained relatively unscathed in previous years, we are starting to see these companies become more distressed. For example, Barney's filed for Chapter 11 in the fourth quarter indicating that now high-end retailers are not immune to the challenges facing the retail sector, and that this fragility is now impacting the full spectrum of retail businesses.

Panagakis: The trend of brick-

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and-mortar store closings will continue as internet sales grow even more robust. Synergies between physical locations and internet platforms will evolve, particularly as landlords look to re-purpose their properties from the former mall layout to a more diverse mix.

Yenamandra: We expect to see retail continue to be distressed in 2020, as the trend towards e-commerce continues and industry headwinds don't show signs of slowing down. There will likely be several spillover effects as a result. First, we will probably also see more stable retail companies proactively take steps to reduce their debt, extend out upcoming maturities, and/or reduce their physical footprint in order to avoid the need for any kind of bankruptcy proceeding. Second, we also expect to see distress in the REIT space (i.e., as a result of bankrupt retailers rejecting leases through the bankruptcy process) and that's certainly a market we're actively monitoring. Third, I think we'll also start to potentially see vendors whose operations primarily consist of supplying retailers start to re-evaluate how they do business, in terms of supplying brick and mortar stores versus stores with a strong online presence. Taking all that together, I think the distressed retail space and the spillover effects of distressed retail companies will continue to be active in 2020.

The energy sector is another industry that continues to face headwinds. What's the industry's outlook for 2020?

Brandt: As long as the price of oil stays within the range it has been trading at over the past few years, the dilemma in the energy industry will continue unabated. As well, as the number of coal fired plants continues to decrease, the outlook for the specific coal industry as a subset of the larger energy industry field will only continue to get more grim.

Panagakis: With oil prices remaining low, energy restructurings, both inland and offshore, will continue in 2020. Whereas the wave up to this point has largely consisted of balance sheet improvements, going forward we are likely to see more industry consolidation.

Yenamandra: Oil and gas companies continue to face the same challenges that have plagued the industry for

Retail Sector's Natural Evolution

Steve Horwitz, Distinguished Professor of Free Enterprise, Miller College of Business, at Ball State University, isn't surprised with the staggering number of store closures by brick-and-mortar retailers.

"These closures are part of an ongoing larger process of economic transformation as we move from old-school brick and mortar retail to firms who can best figure out how to leverage not just online but the platform economy type processes—pick up at the store and/or quick delivery to the home—for their specific industries," Prof. Horwitz said in a statement provided to *Turnarounds & Workouts*. "We are living through a major transformation in the way people buy things and some companies haven't figured out how to meet the way people want to shop now. Target and Costco are thriving. Kroger has figured it out. They win. Those other guys lose."

"It's also [a]n ongoing part of the 'dematerialization' of the economy as consumers seem less interest[ed] in 'things' than experiences. Certainly, this describes both of my 20-something adult kids."

Prof. Horwitz also points out that while Pier 1 Imports, Sears, Kmart and Walgreens are slashing retail stores, other smaller companies are opening in larger numbers in other sectors—particularly technology. And, these new companies and their small staff rarely make the headlines—at first.

"We tend to overlook that a new web design firm just opened because [it] isn't very interesting, nor is it a story when a local restaurant hired two additional cooks and some serving staff," Prof. Horwitz said. "And, it's not a big story when a financial services company hires new accountants or opens a new branch. Those, even if they get reported, get buried."

He says startups are a risky business no matter the industry.

"New firms opening are a crapshoot. Only 1 in 5 restaurants survives. Not much better for other service firms. How can we know what the big story is when a new firm opens? A local man who builds computers in [a] garage is not a story, but when that company is worth trillions 40 years later? That's the whole point after all—markets are a discovery process."

Founded in 1918 and located in Muncie, Ball State University is one of Indiana's premier universities and an economic driver for the state.

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years—unpredictable commodity prices, supply and transportation challenges, and liquidity challenges for companies that predominantly rely on reserve-based lenders. A number of these companies also have maturities coming up over the next 2-3 years, which means a number of them will start thinking about in-court and out-of-court restructuring strategies in 2020. In addition, we continue to see companies in this space that aren't fully hedged against crude oil prices and when you combine that with the highly levered nature of this business, that creates a real need for a comprehensive restructuring.

Apart from retail and energy, which sectors will see activity or challenges this year?

Brandt: Transportation and financial services are two obvious sectors, as are problems for service firms such as, specifically, law firms.

Carson: We can expect to see increased restructuring activity in the healthcare space, as well as among businesses with widespread litigation exposure and mass-tort related liabilities. For these companies, corporate bankruptcy provides a tool to navigate the financial burdens of litigation settlements and their legacy obligations.

Kwasteniet: It's interesting because while 2018 was all about retail and energy, the largest cases in 2019 came from different industries—utilities, oilfield services, travel, mortgage finance, telecom, etc. I think we'll continue to see challenges across all those industries in the coming year. We've also seen some activity in the opioid-related bankruptcy space, both in terms of companies that have actually filed for chapter 11 and other companies that are regularly showing up on distressed watch lists, so that will likely also continue to be active in 2020. Another industry we're continuing to monitor closely is the automotive industry; again, there have been some in-court restructurings and some out-of-court deleveraging that have occurred in the last year and the highly leveraged nature of the business suggests that this industry will continue to be active into 2020.

Panagakis: Retail bankruptcies will continue as well as healthcare and pharmaceuticals. It's also possible that auto sales may have reached their peak and, with uncertainty around tariffs, potential industry disruptors such as the electric car and, to a lesser extent, autonomous vehicles, we could see a pick-up in automotive industry restructurings toward the end of 2020.

Any case or cases to watch this year?

Brandt: The pharmaceutical cases arising out of the opioid crises could really snowball in the coming year. Much of that will depend on how the Purdue Pharma case plays out in front of Judge Drain in the SDNY over the next few months.

Carson: In 2020, we will continue to see high-profile retail and energy cases, as well as new cases filed by companies seeking to manage the fallout from litigation liabilities. With the public policy challenges in California and the impact of skyrocketing insurance claims, PG&E will continue to unfold as a milestone case to watch. We are also monitoring selected industries including pharmaceuticals. The opioid crisis continues to make headlines weekly and we expect public policy and sentiment to continue to shape pharmaceuticals entwined in the fallout in 2020 and beyond.

Kwasteniet: A lot of people are closely following Windstream and its pending recharacterization complaint related to the Uniti spinoff, which is set for trial in March of 2020. I also think people will be closely following PG&E's bankruptcy in 2020, particularly given the regulatory complications. Purdue is also one of the first opioid-related bankruptcy filings from 2019, so people will be closely watching that unfold in 2020, particularly to the extent other similarly situated companies find themselves considering a chapter 11 filing.

Panagakis: Given the national scope of the opioid crisis and the multitude of parties involved, people will be watching the Purdue Pharma case closely. Practitioners will also be following the PG&E case, and the impact that might have on mass tort cases in the future. ¤