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J.Crew Just First In Expected Flood Of Retail Bankruptcies

By **Vince Sullivan**

Law360 (May 4, 2020, 9:24 PM EDT) -- Clothing retailer J.Crew has become the first large retailer to succumb to the challenges thrust upon the industry as a result of the COVID-19 outbreak, but bankruptcy and industry professionals say it won't be the last, as mounting lease obligations may soon outstrip the patience of landlords.

The company had been struggling financially for the last few years, and while the coronavirus restrictions put in place to stem the spread of the disease pushed it into bankruptcy, it wasn't the sole cause, industry observers say.

Alan Behr, partner in the corporate and business law department at Phillips Nizer LLP and chairman of the firm's fashion practice, said many retailers have been laboring under highly leveraged balance sheets in recent years, and that an overnight elimination of their revenue streams spelled disaster for the most vulnerable companies, including J.Crew.

"When you have an up market, which we had for some time, you can squeeze by," Behr said of overleveraged companies. "But the moment things go bad, it's the companies that have poor cash positions that fall. And something bad happened in the market."

J.Crew had been pushing for an out-of-court restructuring for several years and reached terms with lenders in December 2019 for a refinancing of more than $400 million of debt, but the turmoil wrought by the COVID-19 outbreak derailed those plans, according to the company's court filings. It came into bankruptcy Monday with a plan to swap $1.65 billion of debt into equity in a reorganized, operating company.

Other longtime retailers like Neiman Marcus and J.C. Penney, which are also saddled with billions of dollars of debt, are on the precipice of insolvency after the outbreak worsened their already-strained financial situations.

While they may not have the same structural problems that J.Crew did before its filing, Behr said all have suffered from the loss of revenue. Companies without a robust online commerce platform are most likely earning no money at all which, combined with either a heavy debt load or some other unique problem, will likely condemn them to bankruptcy.

He added that the longer the crisis continues and stay-at-home orders remain in effect throughout the country, the more companies won't survive without in-court restructuring cases.

"There could very well be more of these [cases] if you can't open your store," Behr said. "If you can't open the place where you're doing business, how can you do business?"

When the restrictions started, landlords for many of the country's largest retailers indicated they would be very lenient in enforcing their rights under leases in recognition of the far-reaching implications of the crisis. Bob Bartell, global head of the corporate finance unit of Duff & Phelps LLC, said there is no telling how long that light touch might last, and that some heavy burdens might come due for struggling retailers.

Restrictive business rules went into effect in mid-March for most of the country, and seven weeks later, many retailers have missed two months of lease payments, and it's too early to guess when or if landlords might start enforcing lease terms.

"We're just at the beginning of even answering that question," Bartell said. "The landlords have been by and large, from what we've heard, patient and compassionate. However, they have a business to run themselves."

Landlords often have to answer to their own financiers and may be forced to come up with creative solutions on leases with companies that aren't currently making any money, Bartell said. Eviction is not an attractive option because, unlike in a stable, robust economy, there are no tenants lined up to take the place of an evicted retailer.

"In today's market, with COVID-19 the question will be what are the landlords' alternatives? Do they want to be patient so they can help these companies survive and be viable and then get paid in the future through equity or some kind of performance enhancement lease payment?" Bartell said.

Bankruptcy allows debtors to negotiate with their creditors, including landlords, on concessions and relief from debt, but Gayle R. Klein, a principal at McKool Smith PC, said the lenders backing the landlords might not be amenable to such deals.

"The landlords have themselves financed their properties," Klein said. "There are debt covenants in financing agreements that landlords have with their lenders that they would not be in compliance with if they give concessions to their tenants. It creates a vicious cycle."

An inability to obtain or continue rent concessions with landlords may be what tips some large retailers into bankruptcy that didn't previously have significant debt problems, she said.

That possibility differs from previous recessionary periods where retailers were forced to alter their business models to improve their revenue flow, through pricing changes, footprint and staff reductions, or cutting costs. Now, there is no immediate prospect to improve cash flow because there is no cash flow at all, she said.

Behr said every enterprise involved in retail is facing the same problems, whether it be the retailer itself, the landlords, the lenders or the property financiers, and that the optics of kicking out a struggling tenant with potentially hundreds of employees are not good for anyone.

"You're going to look pretty bad if you come on heavy-handed no matter who you are or what part of the market you might be inhabiting," he said. "That's not a happy experience."

The post-crisis prospects of retailers can't be nailed down at the moment, as professionals' opinions vary widely. But Behr is confident that established brands, even those that resort to bankruptcy filings, will emerge from the crisis.

"There is still a place for retail. It's more service-oriented, much faster and much more sensitive to customer needs and preferences," he said. "It's there, and it will be there, especially in the higher end of the market."

--Editing by Philip Shea and Brian Baresch.