

Loehmann's Department Store: A case study questioning the liquidation narrative of 11 U.S.C. § 365(d)(4) following BAPCPA

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Introduction

In November 2008, Circuit City became the largest retailer to file bankruptcy following the 2005 Bankruptcy Code amendments.¹ Initially, Circuit City sought to sell itself as a going concern but prospects for reorganization quickly diminished as the now defunct retailer was unable to locate a willing buyer.² Instead, Circuit City found itself in a common place for retailers in recent years: a liquidation sale.³ This narrative, a retailer ending in liquidation, has garnered much attention from scholars and lawyers following the amendments to 11 U.S.C. § 365(d)(4).⁴ These scholars and lawyers argue that the pendulum has swung too far in favor of landlords under the § 365(d) timeline for a debtor to assume or reject a lease, thus forcing retailers to liquidate with few other options or time in bankruptcy.⁵ The current Bankruptcy Code conceives of a one-size-fits-all application in chapter 11 cases for retail debtors. This uniformity

¹ See Karen Jacobs, *Circuit City Files for Bankruptcy Protection*, REUTERS (Nov. 10, 2008, 5:00 PM), <http://www.reuters.com/article/2008/11/10/us-circuitcity-idUSTRE4A936V20081110>.

² Miguel Bustillo, *Retailer Circuit City to Liquidate*, WALL ST. J. (Jan. 17, 2009, 12:01 AM), <http://online.wsj.com/news/articles/SB123212123583390511>.

³ *Id.*; see, e.g., *In re Borders* (No. 11-10614) (Bankr. S.D.N.Y. 2011).

⁴ See Nick Brown, *Bankruptcy No Friend to Struggling U.S. Retailers*, REUTERS (Dec. 19, 2013, 6:13 PM), <http://www.reuters.com/article/2013/12/19/us-retail-bankruptcy-idUSBRE9B11E620131219> (“‘The practical reality (for retailers) can be, basically, if you don't already have a buyer lined up going in, you may just not have enough time and money’ to survive.”).

⁵ *Id.*; see, e.g., Brett Berlin, Robert LeHane, Richard Nejame, & Todd Meyers, *Business Bankruptcy Panel: Hot Topics in Retail Bankruptcy* 25 EMORY BANKR. DEV. J. 343 (2009) [hereinafter *Hot Topics in Retail Bankruptcy*] (discussing 11 U.S.C. § 365(d)(4)'s impact on retail bankruptcies).

under the Bankruptcy Code may be unwarranted given the tremendous situational variation among retailers, especially with respect to retailers' non-residential real property leases.⁶

This paper will examine *In re Loehmann's Holdings Inc.* 10-16077 (S.D.N.Y. Bankr. 2010) through the lens of Loehmann's most recent bankruptcy filing in 2013 to question the narrative typically advanced that § 365(d)(4) causes debtors to liquidate due to the short time for a debtor to assume or reject their leases because of landlord leverage. Analysis will proceed in four parts: Part I will briefly address the early leverage debtors had to assume or reject leases; Part II will explore general criticisms associated with § 365(d) post-2005; Part III will use *In re Loehmann's* to counter several of the prevailing assumptions advanced about § 365(d); and Part IV concludes by tying together these contradictory positions to argue that more research should be done regarding the effect of § 365(d)(4) and its intersection with DIP lender behavior.

Part I. History of § 365(d)(4)

Throughout the last thirty-five years, Congress has varied the amount of leverage and control a debtor has over non-residential real property leases in bankruptcy. The 1978 Bankruptcy Code provided arguably the greatest amount of leverage to a debtor by allowing the trustee or debtor-in-possession to “assume or reject an . . . unexpired lease . . . at any time before the confirmation of a plan.”⁷ The only limitation to this provision was that an adverse party to the lease could request the court to set a specific timeline for the debtor to assume or reject a lease.⁸ In response to the seemingly vast power and leverage debtors had over landlords, Congress and

⁶ See Richard Levin & Alesia Ranney-Marinelli, *The Creeping Repeal of Chapter 11: The Significant Business Provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 603, 624 (2005) (“BAPCPA shifts significant leverage to real property lessors, requiring debtors-in-possession to decide quickly which leases to assume or reject, thereby threatening the viability of restructurings of debtors with multiple locations, particularly retailers.”).

⁷ Bankruptcy Reform Act of 1978, Pub. Law No. 95-598, § 365, 92 Stat. 2549, 2575–76 (1978).

⁸ *Id.*

landlords began to push back. The 1984 Leasehold Management Amendments served as a response to the perceived power of debtors over landlords and fixed the timeline for a chapter 11 debtor to assume or reject an unexpired non-residential real property lease to sixty days.⁹ However, this sixty day provision provided little help to landlords as courts uniformly granted extensions to debtors to assume or reject leases until the date of confirmation.¹⁰ At the time, many courts believed that the legislative history supported multiple extensions so long as the original request occurred during the first sixty day period.¹¹ Landlords again perceived these extensions as commonplace and sought more certainty and finality over their leases to curtail expenses associated with lost productivity from their leases.¹² Following this strong push from landlords, Congress reformed § 365(d) to bring certainty and finality to the timeline of assumption and rejection of non-residential real property leases in 2005. Under the current § 365(d)(4) scheme, debtors have 120 days to assume or reject a lease.¹³ This 120 day period can be extended one time for cause for an additional ninety days by the court to a maximum of 210 days.¹⁴ After the 210 day period expires, only a consenting landlord may allow the debtor subsequent extensions to assume or reject a particular lease.¹⁵

⁹ Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. Law No. 98-353 §§ 361–62, 98 Stat. 333, 361–62 (1984).

¹⁰ See, e.g., *In re Victoria Station Inc.*, 88 B.R. 231 (B.A.P. 9th Cir. 1988), *aff'd*, 875 F.2d 1380 (9th Cir. 1989); see also *Retailer Bankr. Primer* J. Bankr. L. 10-6 (2008). (arguing that retailers “routinely . . . retain[ed] the option of assuming or rejecting real property leases for prolonged periods” of time during bankruptcy).

¹¹ See S. Rep. No. 98–65, 98th Cong., 1st Sess. 27, 38 (1983) (“The debtor should . . . be able to make [the assumption or rejection] determination shortly after the petition is filed and certainly within 60 days in all but the most complicated cases. Nonetheless, the court has authority to grant extensions for cause.”).

¹² Brown, *supra* note 4.

¹³ 11 U.S.C. § 365(d)(4) (2012).

¹⁴ *Id.*

¹⁵ *Id.*

Part II. General Criticisms of 11 U.S.C. § 365(d)(4)

The 2005 Code amendments actually increased the initial time for a debtor to assume or reject non-residential real property leases from sixty to 120 days.¹⁶ While this additional time at first glance seems more generous to debtors, the Code provision has dramatically curtailed the debtor's ability to receive long term extensions post-2005.¹⁷ Now under the total 210 day period, debtors have approximately seven months to assume or reject all leases. Indeed, because of this initial time limit, some argue that the changes to § 365(d)(4) make retailers more likely to liquidate.¹⁸ For example, Lawrence Gottlieb, a partner with Cooley LLP, conducted a study of forty-five large retail bankruptcies and found that approximately 50% of retailers after 2005 liquidated compared to about 35% before 2005.¹⁹ In fact, "the general effect of the[] amendments is to force debtors to make early decisions that could prove detrimental to their overall business plans and creditor recoveries."²⁰

Stemming from these arguments are some criticisms and reasons for the possible increased likelihood of liquidation. A major criticism associated with the 210 day hard limit is that it does not offer debtors sufficient time to assume or reject leases for two reasons.²¹ The first is that it severely impacts the ability of a retail debtor to find appropriate DIP financing to

¹⁶ Compare Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. Law No. 98-353 §§ 361–62, 98 Stat. 333, 361–62 (1984) (allowing a sixty day initial timeline with multiple extensions until confirmation) with 11 U.S.C. 365(d)(4) (limiting total lease rejection timeline to 210 days without landlord consent).

¹⁷ See 11 U.S.C. § 365(d).

¹⁸ Nat Wasserstein, *Retailers More Likely to Liquidate in Bankruptcy*, LINDENWOOD ASSOCIATES, (May 13, 2013), <http://www.lindenwoodassociates.com/crisis-management/retailers-more-likely-to-liquidate-in/>; Lawrence C. Gottlieb, *The Disappearance of Retail Reorganizations Under the Amended Section 365(d)(4)*, <http://business-finance-restructuring.weil.com/wp-content/uploads/2013/06/Gottlieb-Paper.pdf> (last visited Feb. 1, 2014).

¹⁹ Brown, *supra* note 4; see also Gottlieb, *supra* note 16.

²⁰ Levin & Ranney-Marinelli, *supra* note 6.

²¹ See *Hot Topics in Retail Bankruptcy*, *supra* note 5, at 349–50.

continue as a going concern.²² Some commentators argue that for retail bankruptcies the process is “more or less ‘over from the start’ ” without a willing buyer.²³ In bankruptcies before 2005, “DIP lenders understood that when they lent into a bankruptcy case, that time for the debtor to make its decision to assume or reject its leases would be continually extended, probably until they could confirm a plan.”²⁴ Now DIP financiers often insist or require the debtor to immediately seek an extension of the 120 day period.²⁵ Because of the decreased confidence that a retailer might be able to continue going forward with their leases due to the short period of time to assume or reject leases, a lender is more likely to “liquidate its collateral if it has to.”²⁶ The lenders are unlikely to bear the costs and “risks associated with reorganization” because the lender’s main protection is holding a liquidation sale from the stores that the debtor currently leases.²⁷ Thus, pre-petition lenders may only be willing to provide funding to the extent necessary to conduct a liquidation, adding a greater incentive for a retailer to avoid bankruptcy.²⁸ Based on these circumstances “retailers simply do not reorganize unless their prepetition lender is interested in owning the company or supporting a reorganization for some other unique reason.”²⁹ There may be some empirical support to this criticism since there has been a 5% decline in the percentage of large public retail bankruptcies filed after BAPCPA.³⁰

²² *Id.* at 350 (arguing that banks that lend to retail debtors will sometimes “back out somewhere between six to twelve weeks before the deadline to conduct their liquidations of their collateral if they need to”).

²³ Brown, *supra* note 4 (quoting Charles Tabb, a professor at the University of Illinois College of Law).

²⁴ *Hot Topics in Retail Bankruptcy*, *supra* note 5, at 349.

²⁵ *Id.* at 350.

²⁶ *Id.*

²⁷ Gottlieb, *supra* note 5, at 5.

²⁸ *See id.*

²⁹ *Id.*

³⁰ *Tables and Graphs: Retail Bankruptcies*, UCLA-LOPUCKI BANKR. RES. DATABASE http://lopucki.law.ucla.edu/tables_and_graphs/Retailer_bankruptcies.pdf (last visited Feb. 1, 2014).

The second reason is that the seven month period does not always allow a retail debtor to make it through the holiday season.³¹ For some debtors, the retailer will be in a cash crunch and will largely be unable to control the timing of the company's filing. Because retail is a highly seasonal business, retailers often argue that they will not be able to examine their businesses fully until "a full twelve-month cycle" has been completed.³² In some instances, "the assumption/rejection deadline [often] occurs after a busy season, which may not be optimal from a business or cash flow perspective."³³ In this criticism, the debtor simply does not have full information to make an informed decision about assuming or rejecting leases.

Part III. Loehmann's as a Case Study

Loehmann's department store, originally founded in 1921, marketed itself primarily as a specialty retailer for women's fashion.³⁴ The company originally filed bankruptcy in 1999, closing twenty-five stores in the process, before successfully emerging from bankruptcy in 2000.³⁵ Loehmann's filed two more bankruptcies in 2010 and 2013 respectively.³⁶ The focus of this paper is on the 2010 bankruptcy but examining it with the hindsight of Loehmann's most recent filing in 2013, which resulted in the company's liquidation.³⁷

Loehmann's 2010 filing was likely due in large part to the economic decline beginning in 2008. The company, citing macroeconomic conditions and declining revenue, filed for

³¹ *Id.*

³² *Id.*; Brown, *supra* note 4 (discussing the lease rejection timeline with Robert LeHane, a partner at Kelley Drye & Warren, who argues that "a 12-to-15-month lease rejection timeframe might be reasonable"). Mr. LeHane served as counsel for the creditor's committee in Loehmann's 2013 bankruptcy.

³³ Levin & Ranney-Marinelli, *supra* note 6.

³⁴ Declaration of Joseph Melvin at 3, *In re Loehmann's Holdings Inc*, No. 10-bk-16077 (Bankr. S.D.N.Y. Nov. 15, 2010).

³⁵ *Id.* at 6.

³⁶ See Declaration of William Thayer at 4, *In re Loehmann's Holdings Inc*, No. 13-bk-14050 (Bankr. S.D.N.Y. Dec. 16, 2013).

³⁷ See generally Order Approving the Bidding Procedures, *In re Loehmann's Holdings Inc*, No. 13-bk-14050 (Bankr. S.D.N.Y. Jan. 7, 2013).

bankruptcy on November 15, 2010.³⁸ Loehmann’s goal in filing for reorganizing, according to its CFO, was to “substantially reduce debt and re-capitalize the company, enhance the company’s liquidity, and solidify the company’s long-term growth prospects and operating performance.”³⁹ Loehmann’s negotiated its case in advance⁴⁰ and was on a “fast track” to approval.⁴¹ As part of the negotiations before the bankruptcy filing, the debtor agreed with its exit financing lenders to complete the confirmation process by March 15, 2011.⁴² Loehmann’s financial backers were Whippoowill and Istithmar who agreed to provide twenty-five million dollars upon the emergence from chapter 11.⁴³ In the interim, Crystal Financial LLC provided the DIP financing of up to forty-five million dollars for Loehmann’s efforts to reorganize.⁴⁴ Loehmann’s entered chapter 11 with a “Restructuring Support Agreement,” which tends to counter the usual assumption that debtors in retail chapter 11 cases simply wait too long to file or do not have sufficient time under § 365 to reorganize properly.

As part of the Restructuring Support Agreement, Loehmann’s was prepared to deal with most of its leases immediately upon filing its case in 2010.⁴⁵ The company leased its distribution center, its headquarters, and all of its store locations.⁴⁶ These leases composed a large portion of Loehmann’s bankruptcy matters that had to be resolved in order to reorganize successfully.⁴⁷ In

³⁸ Declaration of Joseph Melvin, *supra* note 33, at 16–18; *see also* Tiffany Kary, Christopher Scinta, & David McLaughlin, *Loehmann’s Holdings Files for Bankruptcy in New York*, BLOOMBERG NEWS (Nov. 15, 2010, 9:24 PM), <http://www.bloomberg.com/news/2010-11-15/loehmann-s-files-for-bankruptcy-protection-after-failing-to-exchange-notes.html>.

³⁹ Declaration of Joseph Melvin, *supra* note 33, at 3–4.

⁴⁰ Loehmann’s was not a pre-packaged case but was closer to a pre-negotiated bankruptcy.

⁴¹ Kary, Scinta, & McLaughlin, *supra* note 37.

⁴² Declaration of Joseph Melvin, *supra* note 33, Plan Term Sheet at 7.

⁴³ Debtor’s Motion to Extend the Period Within Which the Debtors May Assume or Reject Unexpired Leases of Nonresidential Real Property, *In re Loehmann’s Holdings Inc*, No. 10-bk-16077 (Bankr. S.D.N.Y. Nov. 22, 2010).

⁴⁴ *Id.* at 3.

⁴⁵ *See* Motion Authorizing the Debtors to Reject Certain Unexpired Leases of Nonresidential Real Property, *In re Loehmann’s Holdings Inc*, No. 10-bk-16077 (Bankr. S.D.N.Y. Nov. 15, 2010).

⁴⁶ Declaration of Joseph Melvin, *supra* note 33, at 8.

⁴⁷ *Id.*

Loehmann's first-day motions, the company moved the court under § 365(d) to reject 9 leases.⁴⁸ While the motion stated that the underperforming stores were already closed, the debtor had already been advised "that there [was] no market for assignment in the current market for the Leases."⁴⁹ Loehmann's rejected two additional leases in mid-December 2010 as the retailer continued to evaluate its leases.⁵⁰ Additionally, Loehmann's filed all of its schedules of assumed leases and rejected leases with the court in mid-January, about two months into the bankruptcy.⁵¹

Loehmann's intent to deal quickly and smartly with its leases was evident in two primary ways, which rebuts the argument that debtors have insufficient time to effectively decide what to do with their leases. First, before Loehmann's filed for bankruptcy, it had already engaged in negotiations with several landlords to reduce the rental rates on their leases.⁵² In fact, Loehmann's had successfully reduced its total rental obligations by approximately four million dollars in the two years preceding the bankruptcy petition.⁵³ This evidences Loehmann's pre-bankruptcy attempts to reduce and deal with its rental requirements. Second, as part of the Restructuring Support Agreement, Loehmann's lenders required Loehmann's to seek an extension on the rejection timeline under § 365(d)(4).⁵⁴ While at first blush this looks like it supports the narrative that the debtor was rushed through the lease assumption and rejection process, Loehmann's filed its schedules of assumed and rejected leases by mid-January: only

⁴⁸ *Id.*

⁴⁹ *Id.* at 5.

⁵⁰ See Motion Authorizing the Debtors to Reject Certain Unexpired Leases of Nonresidential Real Property, *In re* Loehmann's Holdings Inc, No. 10-bk-16077 (Bankr. S.D.N.Y. Dec. 13, 2010).

⁵¹ See Schedule of Rejected Unexpired Leases, *In re* Loehmann's Holdings Inc, No. 10-bk-16077 (Bankr. S.D.N.Y. Jan. 18, 2010); Schedule of Assumed Unexpired Leases, *In re* Loehmann's Holdings Inc, No. 10-bk-16077 (Bankr. S.D.N.Y. Jan. 18, 2010).

⁵² *Id.* at 15.

⁵³ *Id.*

⁵⁴ See Debtor's Motion to Extend the Period Within Which the Debtors May Assume or Reject Unexpired Leases of Nonresidential Real Property, *supra* note 41.

about sixty days after declaring bankruptcy.⁵⁵ Loehmann's did not need to use any of its additional time from the extension and even finished analyzing its leases before the original § 365(d)(4) timeline of 120 days expired. Indeed, Loehmann's actions in seeking the extended timeline are more closely aligned with the idea of giving the lender more comfort and control in the case rather than evidence of rushed decisions through bankruptcy. This point is also strengthened when considered in tandem with the fact that Loehmann's rejected the two additional leases in mid-December.⁵⁶ Overall, while Loehmann's acted quickly in assuming and rejecting leases, the department store did not need the additional time extension to decide to assume or reject leases. Instead, it appears that Loehmann's analyzed its leases and secured both DIP and exit financing allowing the company to move quickly but not hurriedly through the bankruptcy process countering the idea that the 210 day total period is inherently too short for retail bankruptcies. While it is possible that the longer period to assume or reject leases pre-2005 could have allowed Loehmann's to be more deliberative, possibly avoiding the 2013 filing, the five month period with no action on leases between Loehmann's submission of its last batch of lease rejections and the 210 day deadline suggests otherwise.

In addition, Loehmann's filed its 2010 bankruptcy shortly before the holiday sales season.⁵⁷ Typically, retailers complain that the § 365(d)(4) timeline does not offer the retailer the ability to go through a twelve-month seasonal cycle to ensure that they know where they will stand after the holiday season. Here, however, the debtor filed before going through the holiday season, not after. Presumably then, there are two contradictory positions that could come from

⁵⁵ See Schedule of Rejected Unexpired Leases, *supra* note 48; Schedule of Assumed Unexpired Leases, *supra* note 48.

⁵⁶ Motion Authorizing the Debtors to Reject Certain Unexpired Leases of Nonresidential Real Property, *supra* note 46.

⁵⁷ Voluntary Chapter 11 Petition, *In re Loehmann's Holdings Inc*, No. 10-bk-16077 (Bankr. S.D.N.Y. Nov. 15, 2010).

such a result. The first is that the Loehmann's petition was filed before the holiday season to allow the debtor to use the bankruptcy as protection during the holiday season. This would allow Loehmann's to evaluate its position during the bankruptcy to determine a further course of action. Such a position is not likely in this case given the "fast track" nature of the case in which Loehmann's already had DIP and exit financing in place.⁵⁸ Instead, the much more tenable conclusion to draw from the petition date is that Loehmann's already had sufficient information and creditor support to reorganize. As part of the Restructuring Agreement between Loehmann's and its lenders, Loehmann's was to finish bankruptcy within six months.⁵⁹ On balance, Loehmann's 2010 petition date tends to counter the idea that § 365(d)(4) is too short as it does not allow a retailer to cycle through an entire year of sales.

Although Loehmann's 2013 bankruptcy resulted in the company's liquidation, the company's CFO indicated that the initial causes appeared to be related to a continued slumping economy and "underperformance of store productivity, reduced margins, lower inventory turnover and lack of liquidity"⁶⁰ not leases or the § 365(d) timeline. Loehmann's initially sought a buyer before filing bankruptcy but was unable to find a willing bidder after soliciting bids from 140 potential investors.⁶¹ It was only after the failed attempt to sell as a going concern that Loehmann's began to pursue liquidation.⁶² While the § 365(d)(4) lease rejection timeline could have been lurking in the background of lenders' minds about a going concern sale, the fact that the bids were originally solicited in early November, about a month before Loehmann's filed their petition, suggests that the lease timeline was not the issue that forced the liquidation.

⁵⁸ See Debtor's Motion to Extend the Period Within Which the Debtors May Assume or Reject Unexpired Leases of Nonresidential Real Property, *supra* note 41, at 2-3.

⁵⁹ Declaration of Joseph Melvin, *supra* note 33, Plan Term Sheet at 7.

⁶⁰ Declaration of William Thayer, *supra* note 35, at 12.

⁶¹ *Id.* at 14.

⁶² *Id.*

Instead, it is more likely that given the two prior bankruptcies and the bleak economic prospects, lenders were unwilling to back a faltering department store. As further evidence that the leases were not critically important in causing Loehmann's 2013 bankruptcy, the debtor did not file a motion to reject leases until over a week into the case.⁶³ Indeed, the debtor proposed a rejection system to continually evaluate and reject individual leases throughout the bankruptcy proceedings.⁶⁴ If the leases and lease timeline were a problem, one would expect the debtor to immediately ask the court for an extension to assume or reject leases. This would give the debtor an additional three months to complete any analysis of whether the company should assume or reject a particular lease if they were struggling in their decision making process.

Part IV. Conclusion

Loehmann's provides a unique case study to analyze the § 365(d)(4) timeline given its successive bankruptcy filings. By using the two bankruptcies together, we can begin to question the narrative that BAPCPA's change in § 365(d)(4) is the driving force behind liquidations. As it currently stands, the cause and effect characterization of the 210 day limit causing retail bankruptcies to be over before they begin needs to undergo further testing and evaluation. The one-size-fits-all bankruptcy system is especially problematic for retailers who need more flexibility given their unique position with non-residential real property leases. Certainly there are cases that the § 365(d)(4) timeline poses large problems for debtors. However, in Loehmann's case the § 365(d)(4) timeline does not appear to have been a major factor in either bankruptcy case. Instead, many of the factors in Loehmann's case seemingly cut against the

⁶³ See Motion to Authorize and Approve Procedures for Rejection of Unexpired Leases 5, *In re Loehmann's Holdings Inc*, No. 13-bk-14050 (Bankr. S.D.N.Y. Dec. 23, 2013).

⁶⁴ *Id.* ("Because there will inevitably be certain Contracts and Leases that the successful purchaser will not designate for assignment and which will no longer provide any benefit to these estates, the Debtors seek to implement the Rejection Procedures in order to facilitate an expeditious and efficient process for the rejection of the Contracts and Leases which will conserve the resources of the estates.").

traditional narrative. While it is certainly possible that the landlord leverage from the hard 210 day timeline played a role, it is more likely that the DIP financing in each case was the bigger issue. Certainly the § 365(d) timeline could contribute indirectly to the amount of leverage DIP financiers hold chapter 11 cases. Indeed, although much has been written and researched about on the amount of leverage that § 365(d)(4) gives to landlords and that it has swung the pendulum too far, perhaps not enough has been done on the intersection between DIP lending and § 365(d)(4), other economic factors generally following the 2008 recession, and the unique individual situations of retail debtors.