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Business Track

The Walking Dead: How (and When) to Address Post- Pandemic Debt Zombies

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CONCURRENT SESSION

2021



The Walking Dead:
Zombie Companies Survive Pandemic to
Feed on Excess Market Liquidity



What is a “Zombie Company” and how did the past year breed them?

Inability to earn enough to cover obligations but with ready access to credit markets.

May service bank, bond, and/or preferred share debt by issuing additional debt.

Low interest rates, other federal/government measures (including post-COVID stimulus) may provide favorable credit environment leading to false sense of vitality.



Too much money chasing too few assets created “zombie” companies

“We expect the trailing 12-month global speculative –grade corporate default rate to fall to 1.8% by the end of 2021, down from 4.9% in May.”

Moody’s, “Corporate defaults tumble as global economic recovery continues,” 08 June 2021



How were Zombies fed? First came the crisis.

Mandatory shut downs in Q1-Q2 2020 led to a variety of outcomes

- ***Companies with access to undrawn lines of credit; soft landing:***
 - Debtors that had excess borrowing availability entered Chapter 11 with cash collateral on hand, giving them flexibility
e.g., In re Ascena Retail Group, et al. (Bankr. EDVA Case No. 20-33113 (KRH))
 - Others negotiated DIP-to-exit agreements to support restructuring
e.g., In re Tailored Brands, Inc., et al. (Bankr. SD Tx Case No. 20-33900 (MI))



Companies employed strategic liquidity plays in pandemic bankruptcy cases

Companies with less access to liquidity:

As the pandemic hit, multiple cases filed (and received approval for) liquidity-savings motions such as rent deferral motions in order to ride out what was then considered to be a short-term pandemic shut down. *See In re Modell's Sporting Goods, Inc., et al.*, (Bankr. D. NJ Case No. 20-14179 (VFP)); *In re Pier One Imports, Inc. et al.*, (Bankr. EDVA Case No. 20-30805 (KRH)); *In re Art Van Furniture, LLC* (Bankr. D. Del Case No. [20-10553] (CSS)); *True Religion Apparel, Inc.* (Bankr. D. Del. Case No. 20-10941 (CSS)), *Craftworks* (cite).



Pandemic outcomes for companies largely depended on continued access to liquidity

Outcome: Liquidation

Some companies entered bankruptcy in the middle of the pandemic in what was hoped to be a short-term shut down with potential sale and/or restructuring prospects for emergence, but ultimately the length and severity of the pandemic forced those companies to jettison those plans and liquidate. *See Lord & Taylor, Pier One.*

Others sought refuge in chapter 11 to liquidate their assets and wind down operations. *In re Stein Mart, Inc. et al.*, (Bankr. MD Fla. Case No. 20-02387 (JF)) *In re Century 21 Department Stores, LLC, et al.*, (Bankr. SDNY Case No. 20-12097 (SCC)).



Pandemic outcomes for companies largely depended on continued access to liquidity

Outcome: Restructuring

Still others were able to survive (and draw down existing credit facilities) during the early stages of the pandemic shut downs, but ultimately liquidity constraints forced them into bankruptcy proceedings in "quick" processes geared at restructuring balance sheets to emerge with committed exit facilities during what was hoped to be an end to the pandemic shut downs in early 2021. *See Guitar Center (cite), In re Belk Department Stores, Inc.* (Bankr. S.D. Tx. Case No. [21-----] (MI)).



Stop-gap measures kept some companies out of bankruptcy, though at times on life support

Companies that received relief from existing lenders

Forbearance Agreements

- “Amend and extend”
 - More frequently used in first half of 2020
 - Sometimes included anti-cash-hoarding provisions to prevent draws on lines of credit and entering bankruptcy with cash collateral cushion
 - Many of the more protective provisions did not survive to the 2021 market with increased liquidity



Stop-gap measures kept some companies out of bankruptcy, though at times on life support (cont.)

CARES Act PPP Loans

- Qualifying companies were able to access PPP funding for certain permitted expenses such as rent and payroll. (CARES act cite)
- SBA administrative guidance initially rendered debtors ineligible for PPP loans. *See Paycheck Protection Program Loans (Frequently Asked Questions)* (SBA) (“PPP FAQ”); Interim Final Rule 13 CFR 120-21. This guidance was later clarified to permit Debtors exiting chapter 11 to access PPP loans (cite)



Stop-gap measures kept some companies out of bankruptcy, though at times on life support (cont.)

Courts split over ability of debtors to access PPP loans prior to SBA clarification

See e.g. *Hidalgo Cnty. Emergency Serv. Found. V. Carranza* (Case No. 19-20497, A.P. No. 20-2006 (Bankr. S.D. Tex. 2020); *In re Cosi, Inc., et al.* (Bankr. D. Del. Case No. 20-10417, A.P. No. 2050591 (BLS). [additional cites]



Increased liquidity in 2021 led to steep year-over-year drop in corporate chapter 11 filings

“U.S. corporate bankruptcies reached their worst levels in 10 years in 2020 as the coronavirus pandemic upended global industries and struggling companies faced their breaking point.”
S&P Global, Market Intelligence, 5 Jan. 2021

“New commercial filings increased from May to June[2021], however **commercial filings overall remain down more than 30 percent year-over-year**”

Epiq Corporate Restructuring (epiq news, 2 July 2021) (reporting the “[l]owest total new bankruptcy filings since 2006)



What is on the horizon for the Zombies?

Faculty

Jack Bradley is a member of Capstone's Financial Advisory Services group in Boston and initiates and negotiates complex transactions, including debt-restructurings and acquisitions. He has extensive merger & acquisition experience, including due diligence, valuation, terms and deal structure. Before joining Capstone Headwaters, Mr. Bradley ran a solo consulting practice for over five years. Before starting his firm, he created and ran a consulting practice for a national law firm for 14 years and served as a director of M&A for seven years for one of the world's leading financial institutions. Mr. Bradley is a member of the Turnaround Management Association. He received his B.S. in business administration from Salem State University.

Brent P. Hazzard heads Citizens Bank's Asset Based Lending, Asset Finance and Transitional finance teams in Boston and has more than 30 years of experience as a lender. He's responsible for working with more than 150 bankers managing \$10 billion in commitments and driving approximately \$1.5 billion in annual new business by satisfying customers financing needs. Mr. Hazzard joined Citizens in 2016 to build its transitional finance lending business to source new restructuring-based financings. In 2018, Citizens added the asset-based business to his responsibilities, and he added the Asset Finance team to his responsibilities in 2021. Mr. Hazzard's notable past leadership responsibilities include building and managing structured finance for Shawmut Bank, as well as originations leader for GE Capital's ABL team for the East, Midwest and Canada. Additionally, he was a leader in distressed-debt and restructuring at GE Capital and was a participant in the credit committee for each of these leadership roles. Mr. Hazzard has been a member of the adjunct faculty of the University of Connecticut's School of Business M.B.A. program for the past 17 years and has designed and taught courses on mergers & acquisitions, restructuring, marketing and sales leadership. He received his Bachelor's degree in business administration from the University of Connecticut and his M.B.A. from the University of Hartford. He also has completed the coursework at the Stonier Graduate School of Banking and is a graduate of GE's Global Management Development program and Harvard's Executive Development Program.

Rudy Morando, CIRA, CTA is a managing director with Berkeley Research Group, LLC in Boston and provides leadership to businesses during times of transition. He leverages BRG's resources to advise stakeholders in developing tactical plans to improve profitability, liquidity and capital structure efficiency. Mr. Morando focuses on strategic and financial planning, and he is experienced in financial analysis and diligence, operational assessments and process improvements, working-capital improvement, cash management, M&A and stakeholder communications. In 2015, he was selected as one of M&A Advisor's "40 Under 40." Mr. Morando is a committee member of TMA Global's Certification Oversight Committee and a frequent speaker, author and panel member on the topic of business transition. He received his B.S.B.A. with a concentration in finance and insurance in 2001.

Hon. Ann M. Nevins is a U.S. Bankruptcy Judge for the District of Connecticut in New Haven, appointed in 2015. During her 10 years in private practice, her work involved bankruptcy debtors, creditors, lenders, investors including hedge funds and private-equity firms, banks, pension funds, unions, trade creditors, government creditors and regulatory agencies, insurance companies and bankruptcy trustees. She also represented clients in complex corporate and real estate transactions,

including large commercial financings, acquisitions, dispositions, commercial leasing and business restructurings. From 1999 through her appointment to the bankruptcy court, Judge Nevins served as an Assistant U.S. Attorney with the U.S. Attorney's Office in the District of Connecticut. She principally represented the U.S. in civil bankruptcy cases, but also prosecuted bankruptcy-related crimes, including bankruptcy fraud, bank fraud and wire fraud. From 2005-07, Judge Nevins served as a Senior Litigation Counsel for the U.S. Attorney's Office. In 2011, she was named the Assistant-in-Charge of the U.S. Attorney's Office's Bridgeport, Conn., office. Judge Nevins received her undergraduate degree from the University of Michigan and her J.D. from Boston University School of Law, where she served as a case editor on the *American Journal of Law and Medicine* from 1987-89.