International Council of Shopping Centers

STATEMENT OF
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ON BEHALF OF
THE INTERNATIONAL COUNCIL
OF SHOPPING CENTERS

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TESTIMONY OF ELIZABETH HOLLAND

I am pleased to submit this testimony on behalf of the International Council of Shopping Centers. Founded in 1957, ICSC is the premier global trade association for the shopping center industry. Its more than 60,000 members in over 90 countries include shopping center owners, developers, investors, lenders, retailers and other professionals as well as academics and public officials. My name is Elizabeth Holland and I am the CEO of Abbell Associates, a seventy-two year-old commercial real estate company specializing in retail and office properties. Prior to Abbell Associates, I was a senior staff attorney with the National Bankruptcy Review Commission and an attorney with the law firm of Skadden, Arps, Slate, Meagher & Flom in New York.

I will discuss generally the perspective of shopping centers on current issues surrounding retail bankruptcy filings, with a focus on the recent economic climate and the way in which the changes to Section 365 made in PL 109-8 have contributed to the stability of the commercial real estate market during challenging financial conditions. We believe that the 2005 changes, which provide shopping center owners with reasonable certainty as to the disposition of leases, have prevented the deterioration in shopping center properties and helped owners have access to credit to finance construction and renovation.

Causes of Retail Failures and the 210-Day Deadline

Unfounded assertions have been made that the 210-day deadline for assumption or rejection of leases established under PL 109-8 has been a primary contributor to recent

retail liquidations. However, the failure of retail bankruptcies, before and after the recent financial troubles associated with the "Great Recession", can be directly traced to several factors that have nothing to do with the 210-day deadline: poor financial results as consumer spending (which normally accounts for 70 percent of the U.S. economy) contracted after the "Great Recession"; unfair price competition confronting bricks and mortar retailers from online retailers that did not pay their fair share of sales/use taxes; inability of underperforming retailers to obtain viable credit terms with their trade vendors; and the fact that the US financial markets were for several years so mired in turmoil that both debtor-in-possession and exit financing -- essential reorganization tools -- were impossible to secure to relieve the liquidity pressure confronting distressed retailers. To suggest, as some have, that otherwise financially sound retailers have been forced out of business because of the deadline to assume or reject non-residential real property leases is a gross misstatement that overlooks the complex set of factors which has actually led to the demise of retailers in recent years.

Although the 210-day period to assume or reject leases was provided for in PL 109-8, the 210-day period has turned out, in practice, to be the exception rather than the rule. The 210-day period is only a true deadline if the landlords will not agree to an extension. As ICSC indicated in its 2009 testimony to Congress, the vast majority of landlords have liberally granted extensions in such prominent cases as *Hancock Fabrics*, *Linens 'n Things* and *Movie Gallery*. Nonetheless, the deadline is often irrelevant to the ability of a distressed retailer to reorganize. In the case of Circuit City, for instance, the

debtor began liquidation well before the 210 day period had expired.[1] In *Linens 'n Things*, the debtor obtained many rounds of voluntary extensions of the 210-day period from almost all of its landlords, but ultimately converted to Chapter 7 due to its poor performance and inadequate vendor support.

We do not deny that amended Section 365(d)(4) has changed the dynamic of retail bankruptcy cases. However, without sufficient liquidity to make post-bankruptcy payments to vendors, landlords, utility providers, and employees, a retailer cannot successfully reorganize.[2]

ICSC has repeatedly seen, first-hand, lenders refuse to permit the use and disposition of their collateral, or to extend additional financing, unless they have confidence in a debtor's ability to reorganize effectively without diminution in the value of their collateral. Not surprisingly, lenders have little economic incentive to participate in a reorganization process that will not result in a repayment of their indebtedness, which in most cases, includes significant pre-petition borrowings.

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[1] *Circuit City* filed Chapter 11 in November 2008, with a post-petition lending facility under which the lender required the company to file a plan of reorganization or close on a sale transaction by January 31, 2009, less than 90 days after the filing date. The post-petition loan provided the company with a mere $50 million in additional liquidity at a cost of *$30 million* in fees. In light of the company's poor post-bankruptcy performance, its lenders were unwilling to extend the deadlines imposed under the post-petition lending facility (not the landlords' deadlines) without clear support and participation from Circuit City's suppliers, which the company simply was not able to muster.

[2] ABI should note that the last reorganization of a significant post-amendment retail bankruptcy was *Goody's*, a regional department store which emerged from bankruptcy in October 2008, only to file a second Chapter 11 bankruptcy case less than four months later, citing restrictive financial covenants and *lack of liquidity* due to its exit financing which essentially ended the possibility of reorganization.

The current debtor-in-possession financing product has significantly—and negatively—altered the course of recent retail bankruptcies and is a fundamental cause of retail liquidations. Lenders are sometimes willing to provide *only* enough financing to position a debtor for a liquidation in the first few months of the case, and then impose restrictive conditions in post-petition financing agreements that either direct an immediate liquidation of the company, or include covenants or borrowing reserve rights that effectively allow the lender to "pull the plug" on the retailer only a few months into the case.

The January 2013 Senior Loan Officer Opinion Survey on Bank Lending Practices from the Federal Reserve indicates that while there has been some easing of lending standards for commercial real estate, bank credit remains tight, bankruptcy debtor in possession ("DIP") lending has specifically tightened and trade vendors are reluctant to provide credit, except on the most onerous of terms. Consumer spending is low and unemployment remains high, despite some recent improvements. This is a perfect storm. Reduced employment and consumer spending reduces retailer profits which, in turn, makes lenders reluctant to lend. Without access to credit, even otherwise well-run retail operations may not be able to survive.

Thus, recent retail liquidations are not driven by the 210-day lease assumption or rejection deadline enacted in 2005. When retailers have asked for extensions beyond the 210-day period, shopping center owners have overwhelmingly granted them. In fact, in one case, landlords agreed not to pursue their post-petition or stub rent claims in an effort to provide additional liquidity to the company. What is pushing retailers into liquidation

relates to credit availability and vendor willingness to ship consumer products on reasonable terms. The current bankruptcy law does not change this unfortunate reality.

As I have mentioned earlier, a retail bankruptcy can have serious negative effects on shopping centers and the health of commercial real estate.[3] The 2005 amendments that created more certainty for shopping center owners now provide an important "firewall" which prevents the failure of one retailer from cascading to other businesses. Under the prior law, lingering uncertainty caused neighboring stores to suffer from reduced traffic and sales while potential new tenants were reluctant to rent space in a shopping center with an uncertain future. For property owners, the contraction in credit has been even more problematic; a bankrupt tenant can cause a shopping center to default on a mortgage with no ability to cure the default. Such defaults include covenants to maintain minimum occupancy and debt service coverage.

"Stub Rent"

[3] In fact, earlier this year, the Office of the Comptroller of the Currency – the primary regulator for national banks – issued a report that suggested banks reduce exposure to commercial real estate loans as the regulators view such loans as excessively risky. See An Analysis of Commercial Real Estate Concentration Guidance, OCC, April 2013.

There is another issue, separate and apart from the 210-day deadline issue, which ICSC believes should be examined and considered at this time – as a matter of fundamental fairness. The issue is commonly referred to as the "stub rent" issue, and relates to the strategic practice of many retail debtors to orchestrate their Chapter 11 filings so that their filing dates fall on a date after the date that the rent for that month is due. If, for example, the rent is due under the lease on the first day of the month, and the retail tenant files its Chapter 11 petition on the second day, the tenant will often refuse to pay **any** rent for that month, contending that all of the rent for the month was a prepetition obligation – even though the tenant has the use of the leased premises for the entire month and generates income essentially on the shoulders of the landlord which has not received rent for the month.

The rent for the period between the filing date and the end of the lease month during which the tenant is open for business but has not yet paid rent is often referred to as "stub rent" -- in essence a forced, interest-free, uncollateralized loan by the landlord to the tenant to finance the tenant's use of its leased premises for what could be as long as 30 days out of a month. Often, this unpaid rent is only paid if the lease for the premises is later assumed, because, upon lease rejection, the more common current scenario, the unpaid lease obligation is converted into an unsecured prepetition claim with little value.

Following the Third Circuit's decision in *CenterPoint Props. v. Montgomery Ward Holding Corp. (In re Montgomery Ward Holding Corp.)*, 268 F.3d 205, 209-10 (3rd Cir. 2001) to adopt the billing date approach to payment of certain lease obligations, stub rent often goes unpaid. A number of other jurisdictions have adopted the Third Circuit's approach, as opposed to the proration approach. The proration approach, consistent with the overall claims priority scheme, requires payment of "stub rent" for each day that rent accrues

during the "stub rent period", after the filing date and through the end of the month. *See, e.g., In re Stone Barn Manhattan LLC, d/b/a Steve & Barry's LLC, et al.*, 398 B.R. 359 (Bankr. S.D.N.Y. 2008). ICSC believes that the Code should be clarified that "stub rents" must be paid as a cost of administration of the estate regardless of the jurisdiction in which the case is filed, in order to avoid the fundamental unfairness that results when an innocent shopping center owner becomes an involuntary lender of last resort. In other words, if the rent is due on January 1 and the case is filed January 2, then it is only fair that rent for 30 of the 31 days of the month must be paid, just as the rent for the remainder of the post-petition period. This result assures consistency and fairness in every jurisdiction and avoids inappropriate windfalls by manipulating the timing of filing.

Conclusion

In conclusion, as my experience with multiple retail bankruptcies in recent years shows, the 210-day period for assuming or rejecting leases has not been a determinative factor in the fate of retailers who file Chapter 11. The cause of recent retail liquidations had been the poor economy, turbulent markets and tight credit. Troubled retailers should be able to reorganize successfully when negative market conditions change and the labor market and consumer spending improve. It would be unwise and unwarranted to revert to a bankruptcy standard which gives tenants an unlimited amount of time to make decisions about assuming or rejecting a shopping center lease, with the corresponding inevitable increase in administrative costs, but no clear exit. Such changes would not improve the business climate for retail tenants. Amendments to the Bankruptcy Code will not improve macro-level business conditions for retailers. As one equity research firm noted as recently as March of 2013, "the overall scenario still appears dismal" for

the retail sector as the unemployment rate has remained range bound since September 2012, with the effect that there is not enough stimulus to boost consumer spending.[4]

Shopping center owners have a vested interest in the financial success of the retail sector. Shopping center owners want retailers to succeed. But repealing or revising the 210-day deadline will not help struggling retailers; it will only harm other retailers and shopping center owners.

In addition, ICSC requests that consideration be given to the uniform payment of "stub rent". Though one month of rent may not seem like a lot, in the context of a month's rent in a large retail case involving hundreds of leases, such rent could aggregate tens of millions of dollars worth of interest-free, unsecured loans forced to be made by landlords with no reasonable prospect of repayment. Fairness to creditors is a fundamental tenet of the Bankruptcy Code. There is nothing fair about compelling a landlord to make an interest-free loan for the benefit of a tenant who is operating its business on the premises and generating income to pay other creditors.

Thank you for considering my testimony today.

[4] Zack's Equity Research, Retail Industry Stock Outlook - March 2013.