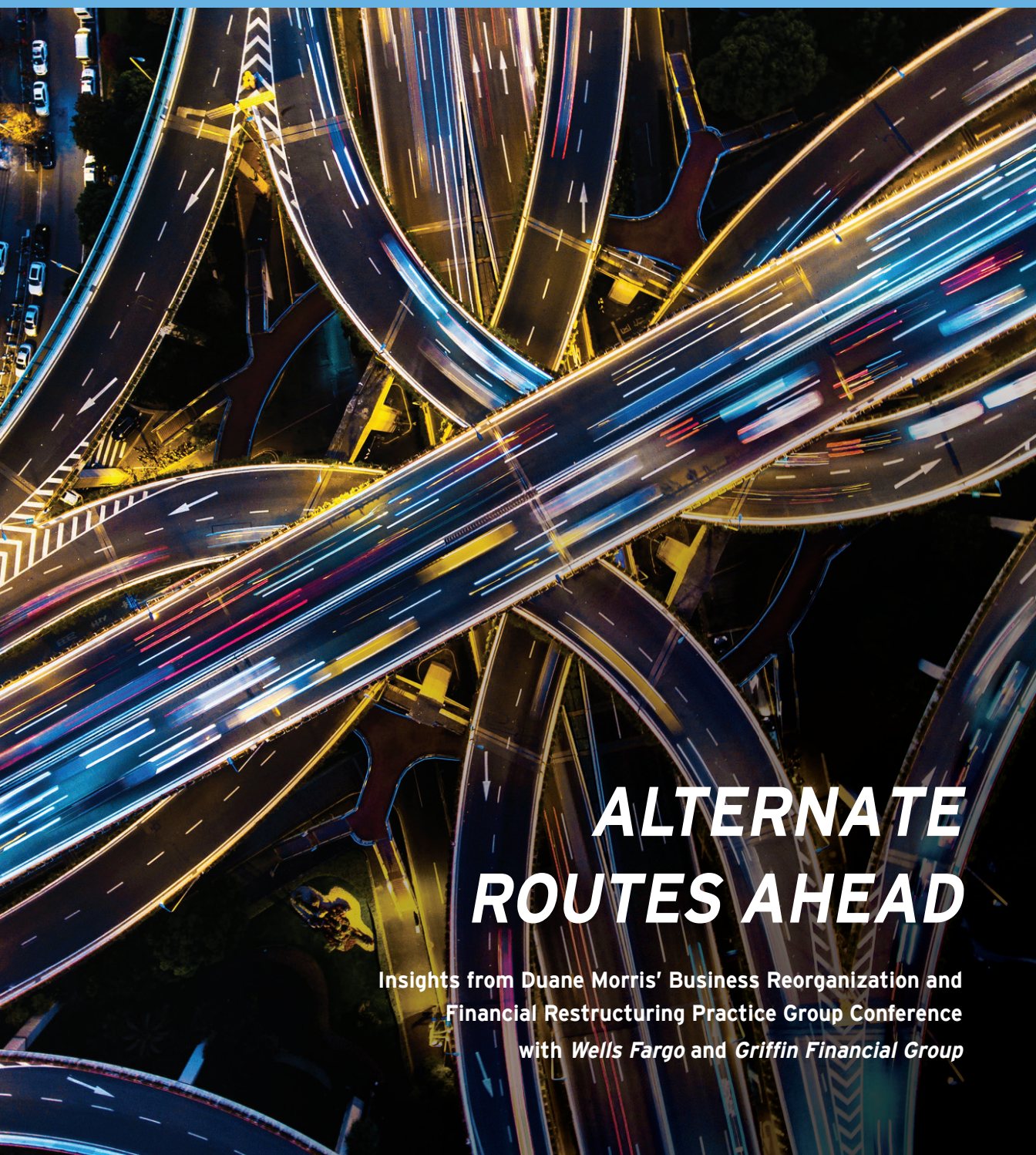


# OPTIMIZE

VALUE FROM DISTRESSED ASSETS



## ALTERNATE ROUTES AHEAD

Insights from Duane Morris' Business Reorganization and  
Financial Restructuring Practice Group Conference  
with *Wells Fargo* and *Griffin Financial Group*

## ALTERNATE ROUTES AHEAD

Succeeding in business requires having some measure of comfort with unpredictability.

Markets and politics fluctuate, new technologies emerge, consumer demand changes and legal standards are in flux now more than they have been in a generation. To grow and prosper, businesses, investors and commercial lenders must aim always to mitigate risk by finding predictability within these ever-evolving forces.

Beneath continued positive signs on GDP growth, low unemployment and positive stock market returns, lurks a sense of deep anxiety among us all on discerning the major factors that will lend order to the commercial era that lies ahead. As we enter the time within which these forces will settle and sort priorities for the new economic era, all sides turn for guidance from the law and legal and business advisors who share a sense of where we have been and where best practices have yet to take us.

## TABLE OF CONTENTS

02	LETTER FROM THE EDITORS
04	THE STATE OF COMMERCIAL FINANCE
04	HEALTHCARE'S UNPREDICTABLE ROAD AHEAD
07	BANKRUPTCY PROTECTION IN THE CANNABIS INDUSTRY
09	RETAIL'S START-STOP TRAFFIC
10	COMMERCIAL REAL ESTATE
11	ALTERNATE ROUTES FOR CHAPTER 11
13	MARKET SIGNPOSTS
14	SPEAKER PROFILES
17	ABOUT DUANE MORRIS

## LETTER FROM THE EDITORS

Each year, we bring clients and leaders from the financial industry together to share insights on the state of commercial finance. Our annual Business Reorganization and Financial Restructuring Practice Group conference, which took place in Philadelphia in November 2018, included a panel discussion with Wells Fargo and Griffin Financial Group on the dynamics of business bankruptcies and restructurings. We were delighted to share some insights with seminar participants and with all of our friends receiving news of the seminar in this issue of *Optimize*.

We look forward to seeing you again in New York and Philadelphia later this year, and will be in touch soon on the dates and times for our upcoming 2019 series of seminars.



*Jim Holman*

**JAMES J. HOLMAN**

*Co-chair, Business Reorganization and Financial Restructuring Practice Group*



*M. Leary*

**MEAGEN E. LEARY**

*Co-chair, Business Reorganization and Financial Restructuring Practice Group*



*Carl B. Heitz*

**CATHERINE BEIDEMAN HEITZENRATER**

*Partner, Duane Morris Business Reorganization and Financial Restructuring Practice Group*

*Jim Holman, co-chair of Duane Morris' Business Reorganization and Financial Restructuring Practice Group, poses a question to Wells Fargo's Patrick McGovern, Duane Morris' Catherine Beideman Heitzenrater and Griffin Financial Group's Tom Whalen.*



## THE STATE OF COMMERCIAL FINANCE

Whether you are starting a new venture in a novel industry or trying creative strategies in a bankruptcy or restructuring context, keeping up with the laws surrounding these issues can be challenging.

Like your daily commute, arriving at your chosen destination sometimes requires rerouting. The right commercial finance advisor comes equipped with an inner-compass-like aptitude for navigating any situation.

Jim Holman, co-chair of Duane Morris' Business Reorganization and Financial Restructuring Practice, led our panel discussion with a focus on the impact of this tug and pull of business and the law.

“Law and business work best when they work together. One of the biggest anxieties that companies, consumers and investors face is when that balance is off.”

“Law and business work best when they work together,” he said. “One of the biggest anxieties that companies, consumers and investors face is when that balance is off.”

## HEALTHCARE'S UNPREDICTABLE ROAD AHEAD

Changes in the law and business trends have left the healthcare industry feeling stressed, said panelist Tom Whalen, senior managing director and co-head of the Financial Restructuring Group at Griffin Financial Group. Particularly in the areas of skilled nursing and rural hospitals, the impact of lower reimbursement rates, shorter facility stays due to better treatments, wage increases and lease structures have taken a toll. For example, at the larger end of the skilled nursing sector, where landlords tend to be REITs, there is little room to renegotiate the cost of operating in a facility.

While large, national players in the skilled nursing space are grappling with costs, smaller microhospitals, which can deliver a high level of care in a facility that is easier to navigate,





are popping up around the country. A few years ago, there was a lot of M&A happening in the skilled nursing area, which levered up balance sheets. Now the industry is observing real disruption that is driving patients to alternative facilities.

Whalen said there have been a number of large restructurings. "Industry players are optimistic. They're finally starting to believe that the 'silver wave' of older Americans will soon cause an uptick in occupancy."

The political football that is the Affordable Care Act (ACA) is another variable in the viability of these healthcare entities. "There's obviously a lot of bluster going back both ways," he said. With the power dynamic in the current Congress, Whalen expects, "we're not going to see a lot of movement in terms of ACA or repeal or replace. Maybe there will be a little bit of movement on the fringes where people can get together, but there hasn't been a whole lot of getting together lately" in terms of Congress setting a strategy.

In healthcare state regulatory issues are much less onerous than the federal ones. Nevertheless, there is a lot of anxiety around both. "Facilities are so worried about the federal regulatory scheme, reimbursement delays and other uncertainties. They want to know what's coming. These are the conversations we're having," he said.

## BANKRUPTCY PROTECTION IN THE CANNABIS INDUSTRY

Despite the rapid spread of cannabis legalization in the United States, there is no clear road map to success in this growing industry. Highly regulated medical and adult-use cannabis businesses must navigate federal, state and local laws and regulations, and so must the commercial banks and other lenders that invest in or do business with them.

"As you who work for commercial banks know," Holman said on the dais, "the federal government has not recognized the legality of marijuana usage, and in fact has been somewhat hostile and threatening, not just to individuals, but to states that have legalized it."

“When the proceeds of the underlying business could be illegal, companies could be involved in a whole host of ‘federal crimes’ without even realizing it.”

Individuals and investors who want to become involved in this new industry take on risks for which they may not be prepared. "When the proceeds of the underlying business could be illegal, companies could be involved in a whole host of 'federal crimes' without even realizing it," said Holman.

## CANNABIS' RISKY BUSINESS

With spending on legal cannabis expected to hit \$57 billion by 2027, investors seeking to do business with growers, dispensaries and other frontline players stand to profit. Of course, that profit comes with a wide range of risks. Case in point: It remains unclear if those dealing with cannabis businesses will have protection in federal bankruptcy courts.

In *Garvin v. Cook Investments Northwest*, a case pending in the U.S. Court of Appeals for the Ninth Circuit, the Office of the United States Trustee is seeking to keep a landlord who rents property to a commercial grower of marijuana from confirming a plan of reorganization under Chapter 11. The government argues that the landlord's petition should have been denied for "gross mismanagement of the estate" because the tenant violates the Controlled Substances Act, which prohibits selling a federally illegal substance.

The case could have far-reaching implications. According to a 2018 study by the Treasury Department, more than 400 banks and credit unions in the U.S. actively operate accounts for marijuana businesses, up more than 20 percent from 2016, despite the risk of running afoul of federal laws.

If the government is successful in the Ninth Circuit, those entities doing business with cannabis companies could be prohibited from seeking relief in bankruptcy courts.

This underscores the tensions in an industry that faces dissonance between federal and state laws. It's yet another example in which the laws may not be keeping pace with business trends.

## RETAIL'S START-STOP TRAFFIC

"The retail apocalypse that some predicted would happen in 2018 didn't happen," said Duane Morris partner Catherine Beideman Heitzenrater. While more high-profile retail bankruptcies are in the pipeline, how they will proceed is uncertain.

"There seem to be two options," said Heitzenrater, with respect to how retailers reorganize. "One is a very quick in and out, prepackaged plan, as we expect to see in Mattress Firm and have seen in cases like Gymboree," which has now filed for bankruptcy protection twice. The second is a piecemeal liquidation which we are seeing in cases like Toys R Us and, more recently, Payless.

Some large retailers showing signs of risk are shrinking their brick-and-mortar footprint, she said. "Lowe's shut down its Orchard Supply Hardware stores, which the company purchased out of bankruptcy in 2013 for \$205 million. They are also closing another 51 actual Lowe's locations."

Guest speaker and Duane Morris partner John Weiss added, "You're going to have a couple of dark spaces in malls that are anchored by lower-end stores. Malls anchored by higher end retailers are still doing fine." As interest rates tick up over the next year or two, said Weiss, so will distress in the commercial real estate market, particularly affecting retailers with brick-and-mortar exposure.





## COMMERCIAL REAL ESTATE

Weiss, who focuses his practice in the area of commercial mortgage backed securities (CMBS), noted that issuances ticked up in the past year. “So on the front end of securitizations, there is plenty of money out there chasing the yields that those securities offer. As a general rule, default rates are down,” he said, “so you’re not seeing a wave of commercial insolvencies, workouts and bankruptcies.”

“Bottom line is: Commercial real estate will remain distressed, but that will be asset-class specific.”

## ALTERNATE ROUTES FOR CHAPTER 11

The expenses and headaches that come with Chapter 11s have pushed debtors towards creative solutions to achieve the best possible results at the lowest cost. Those solutions have included questionable end-runs.

“For a long time,” explained Heitzenrater, “they were doing that through so-called ‘structured dismissals’ as an end-run around the statutory priority rules. This process typically involved a sale followed by a liquidation that often came with what amounted to basically a gift, so to speak, from the lenders to the unsecured creditors basically to buy the committee’s approval,” she said. “The debtor then filed a settlement motion in the hopes of getting it approved by the court with a dismissal.”

Structured dismissals sometimes violated the absolute priority rule of the Bankruptcy Code. The Supreme Court in *Czyzewski v. Jevic Holding Corp.* put the kibosh on the tactic, ruling that courts must apply the priority of distribution scheme to a structured dismissal.

Debtors, creditors and lenders, which can no longer rely on the structured dismissal method, are going to the courts with settlement motions that effectively set terms of a plan and mitigate the strenuous review process of a Chapter 11.

Said Heitzenrater, after the court approves the settlement agreement, the debtor files the plan. “That plan could arguably violate the absolute priority rule in some ways, but because the court approved the settlement agreement, it confirms the plan regardless.

“It will be interesting to see which bankruptcy judges will spot these kinds of violations when the settlement motion first comes in,” said Heitzenrater.

One thing is certain: Bankruptcy lawyers will find new, creative strategies to generate efficiencies for clients navigating a distressed situation.



The number of loans that are in special servicing and commercial mortgage-backed securities is trending down as well. Weiss added, “However, when you dig a little deeper into the numbers and by asset class, you see the exceptions. Special servicing loans in healthcare and retail are up.” With interest rates rising, Weiss noted, “commercial real estate is more sensitive to that than perhaps any other sector. Bottom line is: Commercial real estate will remain distressed, but that will be asset-class specific.”

## MARKET SIGNPOSTS

- ▶ **No-drama interest rates:** Although there were four interest rate hikes in 2018, which caused some volatility in the markets, the increases did not bring “cataclysm and stress, at least not on the front-end commercial side,” said Holman. “The results have been relatively tepid.”  
Patrick McGovern, senior vice president at Wells Fargo, noted: “In the lower end of middle market, those with floating rates are going to have some issues.” As liquidity is getting tighter and their payments go up, “they can be slower to react.”
- ▶ **Unemployment rates:** The U.S. unemployment rate is at a 50 year low. “Real wage growth, which is really the crucial factor,” said Holman, “is now increasing at the highest annual rate in nine years. Jobs are not just abundant, but they’re also becoming more meaningful to the people that hold them.”
- ▶ **Lending trends:** “Equity sponsors are no longer going to save the day,” said McGovern. “Stressed companies that can’t get funding end up selling at a point when the company isn’t stabilized.”
- ▶ **Chapter 11:** “Companies are doing everything they can to avoid filing,” said Heitzenrater, because Chapter 11 cases “are very expensive and more painful than in the past.” However, when things get bad enough, filing is inevitable. ■



## SPEAKER PROFILES

### MODERATOR

**James J. Holman** is co-chair of the firm's Business Reorganization and Financial Restructuring Practice Group. Holman represents institutional lenders, trust companies, insurance companies and businesses in a broad spectrum of transactions, including corporate finance, business restructuring and bankruptcy.

### PANELISTS

**Patrick McGovern**, senior vice president at Wells Fargo, is a longstanding leader of the bank's national Credit Recovery Group, responsible for the Northeast United States. He regularly consults on major commercial credits nationwide.

**Thomas G. Whalen**, senior managing director and co-head of the Financial Restructuring Group at Griffin Financial Group, provides investment banking services, including the placement of senior debt, mezzanine and private equity financing for middle-market companies. He also provides both buy-side and sell-side merger and acquisition advisory services in and out of Chapter 11 cases.

**Catherine Beideman Heitzenrater**, partner at Duane Morris, practices in the areas of bankruptcy, corporate reorganization, creditors' rights, commercial finance and secured transactions. She represents insurance companies, secured creditors, Chapter 11 debtors-in-possession, Chapter 11 trustees, Chapter 7 trustees, liquidating trustees and creditors' committees in all aspects of a bankruptcy case.

### GUEST SPEAKER

**John R. Weiss**, partner at Duane Morris, focuses his practice on corporate restructurings and recapitalizations, loan defaults, workouts and bankruptcies. He represents both creditors and debtors in complex matters.



## ABOUT DUANE MORRIS

With experienced bankruptcy and restructuring lawyers across our domestic and global platform, coupled with the deep capabilities of more than 800 lawyers across all practice areas, Duane Morris offers the resources to optimize our clients' interests. From creditor to debtor, and trustee to committee, our bankruptcy practice is regularly recognized as one of the most active for both case volume and value of liabilities. We leverage our core experience in bankruptcy law, creditors' rights and asset recovery actions, and the full range of services for commercial mortgages and other asset classes, working with banks, nonbank lenders, special servicers, debt purchasers and asset buyers. On the distressed deal side, our lawyers have negotiated and brokered major transactions in such industries as manufacturing, real estate, telecommunications and retail. Five of the practice group's former attorneys are, or have been, sitting United States Bankruptcy Court judges, and another is a judge on the United States Court of Appeals for the Third Circuit.





Duane Morris - Firm and Affiliate Offices | New York | London | Singapore | Philadelphia | Chicago | Washington, D.C.  
San Francisco | Silicon Valley | San Diego | Los Angeles | Taiwan | Boston | Houston | Austin | Hanoi | Ho Chi Minh City  
Shanghai | Atlanta | Baltimore | Wilmington | Miami | Boca Raton | Pittsburgh | Newark | Las Vegas | Cherry Hill  
Lake Tahoe | Myanmar | Oman | Duane Morris LLP - A Delaware limited liability partnership

---

This publication is for general information and does not include full legal analysis of the matters presented. It should not be construed or relied upon as legal advice or legal opinion on any specific facts or circumstances. The invitation to contact the attorneys in our firm is not a solicitation to provide professional services and should not be construed as a statement as to any availability to perform legal services in any jurisdiction in which such attorney is not permitted to practice. © Duane Morris LLP 2019.