Averting the Pitfalls of Customer Claims, Noticing in Retail Bankruptcies

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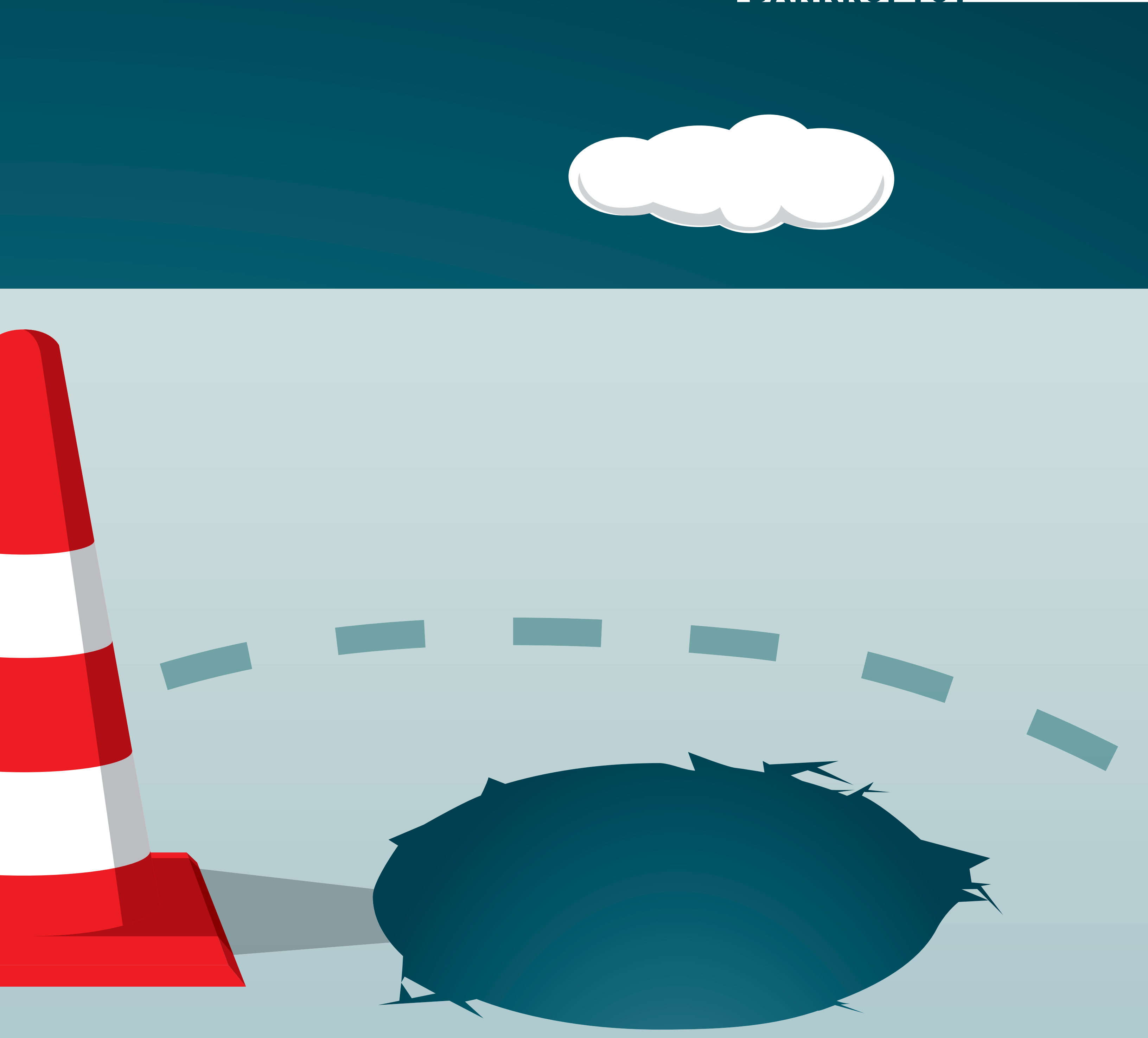
With the number of corporate bankruptcy filings in the retail industry nearly doubling in 2016 and continuing to climb in 2017,[1] retailers and their legal and financial professionals are faced with innumerable challenges in navigating the corporate bankruptcy process successfully in a streamlined and cost-efficient manner. Aside from the substantial task of restructuring debt in a rapid-paced, post-BAPCPA retail environment rife with constant marketplace disruption, retailer bankruptcy proceedings are often plagued with unexpected pitfalls when it comes to handling fallout from the loss of customer confidence



and the potential wide array of claims owed to customers for various financial obligations, including gift cards, warranties, and rebates.

To address these challenges, retail debtors must proactively develop well-planned strategies to manage the intricacies of claims and noticing while efficiently and effectively communicating with creditors throughout their bankruptcy proceedings.

The complexity of identifying and managing customer claims in retail bankruptcies should not be underestimated. While many customers will not require notice if they have simply made purchases in the past, several subsets of the customer population could be eligible for claims as a result of their interactions with the company and the bankruptcy case. While potential creditors may vary from case to case, there are common prefiling preparations that retail debtors and their professionals can undertake to ensure that they appropriately communicate with the various subsets

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of their customer populations and manage their claims effectively.

The Retail Customer Creditor Universe

One of the crucial first steps in mapping out how best to manage potential customer claims is to identify the universe of customers to whom outstanding obligations could be owed and the subsets of this population to whom notice or communication should be provided. In short, retail debtors and their advisors should ask: Who are the customers, and what potential claims might they claim against the debtor's estate? In a 363 sale scenario, certainly the purchasers already have this concern in mind. After all, a continued and loyal customer base is presumably critical to ongoing operations—and the crux of the underlying purchase.

To complicate matters, a significant number of customers typically are unknown, in essence, because there is no record of their contact information or the amount they are owed. For example, retail companies may not have any records pertaining to gift card holders, who have been the subject of much discussion and a handful of class action lawsuits in recent years as retailers in bankruptcy have faced challenges in honoring their obligations to these customers. As the product name implies, purchasers often end up giving the cards to others as gifts and with them the obligation of the debtor, rendering any associated address information captured at the point of sale all but irrelevant.

Encountering unknown populations of potential customer claimants isn't limited to gift card holders. Given the relatively short shelf life of customer data, there is inherent difficulty associated with ensuring the long-term validity of noticing information contained in customer databases, warranties, refunds, lay-away programs, revenue sharing programs, loyalty programs, and financing programs. A litany of others may come into play, too.

These continuing obligations have been most recently evidenced in a number of hospital insolvency matters—after all, patients are basically "customers"—and also in the recent proceedings of a number of solar providers that gave warranties to homeowners who subsequently may have sold or otherwise moved from the properties. If ongoing obligations are owed to customers, this issue must be quickly identified by the debtors and, hopefully, by the purchasers.

The Economics of Noticing Customers

Once the debtor and its professionals have identified the appropriate customer population to which they will be serving notice throughout the bankruptcy proceedings, they must then consider how best to reach unknown creditors. By working with claims and noticing agents and strategic communications professionals, the debtor's counsel can identify the best approach for the specific needs of the case.

While these unknown creditors may appear to be outliers in the grand scheme of things, they can represent a significant threat to the successful outcome of the case if they are not considered as part of the noticing strategy and within other communication efforts to reach the appropriate involved parties. Notwithstanding technological advancements and developments in how customers and consumers receive news, a common approach to dealing with unknown claimant populations remains publication notice.

Publication, however, while often sufficient in the eyes of the court when dealing with unknown claimant populations, can be expensive and thus can pose an issue for retailers with short liquidity runways, which is typically the case for such debtors. It is therefore important that retail debtors and their restructuring professionals anticipate the associated cost concerns at the prepetition stage.

To the extent the company maintains customer email addresses, perhaps a Bankruptcy Court would be willing to bless such service—it is both the quickest and most cost-effective way to notify customers of a bankruptcy scenario. To the extent hard-copy service is preferred, perhaps out of an abundance of caution or because email information was not maintained or was somehow invalidated, counsel and the debtor's noticing agent can work together to put forward motions seeking alternative (and/or limited) noticing procedures on the basis that these would prove more effective at reaching the selected universe of potential claimants.

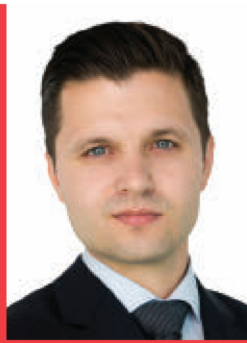
Alternatively, if the amount of potential claims resulting from a pool of customer claimants is known ahead of time to be *de minimis* (admittedly a rare scenario), procedures can be put into place to honor or reserve for the existing obligations at face value for a specified period of time post-petition. It is worth noting that while some goodwill or brand recognition may be maintained by continuing to honor customer programs in a bankruptcy scenario, the potential purchaser's likely (though perhaps secretive) wish is that such existing obligation programs be invalidated or otherwise not recognized as a means of recognizing profits and maintaining sales numbers. In the retail world, this belief would be well-founded, because as much as $130 billion in gift cards went unused in 2015, up from $122 billion in 2014 and $118 billion in 2013.[2]

Considering Anticipated Outcomes

It can be helpful to consider the anticipated outcome of a retail bankruptcy to establish the context for how to approach customer claims and noticing and communications. An increasing number of retailers conclude bankruptcy with a sale rather than emerging as a going concern. In fact, an analysis of resolved retail bankruptcy filings from January 1, 2006, to June 30, 2015, found that 55 percent of retail restructurings concluded with a liquidation.[3]

In a perfect world, the debtor would be able to contact every single creditor to notify them of their potential claim; indeed, this scenario would certainly be applauded by any 363 purchaser. However, the reality is that with an unknown contingency of creditors and the costs of claims, noticing, and communication, debtors must take a measured and prudent approach to planning how best to serve notice to their creditors who are customers.

While a million or more potential claimants could be noticed, perhaps through publication or some other means—*e.g.*, social media are occasionally used as a tool in class action scenarios—does the cost associated with such a noticing strategy outweigh the benefits of the sale? The extent to which a debtor



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anticipates a sale or reorganization at the conclusion of the restructuring should factor into deciding upon the communications strategy.

For example, if a retailer's bankruptcy is ultimately ending in a 363 sale, it is not likely to continue a customer rewards program and therefore should tailor its noticing and communications accordingly and in advance. On the other hand, a debtor that will seek to honor existing customer programs should determine if doing so modifies the required customer noticing population and whether additional customer communications or notices would be beneficial to maintaining customer confidence and existing loyalties and relationships. Those customer programs (*e.g.*, airline miles or hotel chain points) may be crucial to the ongoing significance/lifeblood of the brand; loyal customers expect their preferred brand to remain loyal to them. Should a sale be pursued and the purchaser seek to maintain retail operations in whole or in part, then it may behoove both parties to accept the associated noticing costs as an investment in the long-term preservation of the brand.

Communication with customers, of course, remains paramount. After all, two fundamental valuation components of a retail company are its intangibles, such as copyrights, trademarks, etc., and intellectual property, including customer and mailing lists. Absent a cohesive and modern communication plan, a company's reputation may be tarnished, its customer list devalued, and any market value associated with its trademark brand eroded.

Providing notice to all customers can be costly, and with the limitation of the debtor's estate, a debtor must consider the most cost-effective communication methods for reaching customers. Whether that be through mailed copies, publication, email, virtual press releases, website postings and announcements, ad placements, or even social media avenues, all options should be considered in an effort to produce a deftly navigated and desirable outcome in the retail restructuring space.

While not yet a mainstream practice, social media have been increasingly used not only to reach creditors but also to inform the public at large about a company's progress through the restructuring process. The use of social media and other communications strategies carry importance beyond the notification of creditors. They also serve to buoy a company's reputation as a going concern and to allay customer concerns and perceptions about the bankruptcy process.

As retail companies undergo corporate bankruptcy, there are significant ramifications for the improper handling of customer claims and noticing throughout the process. The failure to adequately prepare can potentially destroy a case and a company's reputation. With careful preparation and the support of a knowledgeable team of professionals to advise on every stage of the process, retail companies can reach their objectives while keeping their past, current, and future customers satisfied.

[1] The Deal/TheStreet, Inc. "U.S. Retail Bankruptcies Skyrocket in 2016; Grim Outlook for the Industry," TheStreet, Inc.

[2] CEB Tower Group Study, "Gift Cards 2015: Digital Tipping Point and the P2P Shift".

[3] AlixPartners Retail Bankruptcy Study. Retrieved from legacy.alixpartners.com/en/Publications/AllArticles/tabid/635/articleType/ArticleView/articleId/1795/AlixPartners-Retail-Bankruptcy-Study.aspx#sthash.CN2A7EGL.dpuf