International Council of Shopping Centers

UNITED STATES
HOUSE OF REPRESENTATIVES

COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON
COMMERCIAL AND ADMINISTRATIVE LAW

"Circuit City Unplugged: Why Did Chapter 11 Fail to Save 34,000 Jobs?"

STATEMENT OF
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ON BEHALF OF
THE INTERNATIONAL COUNCIL
OF SHOPPING CENTERS

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TESTIMONY OF DANIEL HURWITZ

Good morning, Mr. Chairman and Ranking Member Franks, my name is Daniel Hurwitz and I am President and COO of Developers Diversified Realty Corporation. I am pleased to testify today on behalf the International Council of Shopping Centers. Founded in 1957, ICSC is the premier global trade association for the shopping center industry. Its more than 70,000 members in over 90 countries include shopping center owners, developers, investors, lenders, retailers and other professionals as well as academics and public officials. I have a unique perspective on the topic of the effect of Chapter 11 bankruptcy laws in the Circuit City bankruptcy filing as my company was the largest shopping center landlord of Circuit City and we were members of the Creditors Committee in that case. I look forward to sharing our direct experience with the Subcommittee. I will also discuss more generally the perspective of shopping centers on the current round of retail bankruptcy filings. I have several attachments to my statement and I would ask that they be included in the record.

THE CIRCUIT CITY BANKRUPTCY

Mr. Chairman, Circuit City's liquidation can be directly traced to three principal factors: the company's poor financial results, its inability to obtain realistic credit terms from trade vendors, and the devastating reality that the US financial markets were mired in such profound and unprecedented turmoil that financing - both debtor-in-possession and exit financing - was impossible to secure. Indeed, from our vantage point, Developers

Diversified witnessed firsthand the collapse of this once respected and iconic American brand. I feel we are uniquely qualified to speak to the factors which led to that collapse.

DDR was Circuit City's largest landlord, with approximately 50 leases and at least $38 million in potential unsecured claims. DDR's business representatives had met with Circuit City's management prior to the bankruptcy filing and assured them that DDR stood ready to assist with what was then an out-of-court restructuring plan.

As it does in any bankruptcy case where it has a significant number of leases and potential exposure, DDR actively participated in Circuit City's bankruptcy proceedings. From the outset, our goal -- for broader purposes as well as admittedly self-interested ones -- was to see Circuit City survive. In fact, DDR proactively expressed a desire to extend the deadline to assume or reject leases. Further, along with other shopping center landlords, DDR agreed not to immediately press for post-petition rent in the amount of $25 million. DDR played a significant role in Circuit City's efforts to reorganize, not only in its capacity as Circuit City's largest landlord, but also as a vice chair of the Official Committee of Unsecured Creditors.

At their first joint meeting in Washington in November 2008, we advised the other members of the Creditors' Committee, as well as Circuit City's management and retained professionals, that DDR would proactively seek to extend the 210-day period to assume or reject DDR's leases, even though the actual deadline was not until June 2009. DDR further proposed that it would advocate for extensions from other landlords. We repeated this proposal to counsel for the Committee and Circuit City on several occasions during the first two months of the case. In each instance, the company responded that its critical issues with other stakeholders took priority and would have to be resolved before it could turn to the extensions of time to assume or reject its leases.

Eventually, these other issues—financing, trade credit and business results—overwhelmed and ultimately capsized the company, mooting any discussion of lease assumption deadlines.

While the imminent absence of Circuit City as a fixture on the American retail landscape, coupled with the resulting loss of 34,000 jobs, is an undeniable tragedy, to suggest that the company was forced out of business because of Chapter 11 or the deadline to assume or reject its leases wildly misses the point and overlooks a complex set of factors which actually led to the company's demise.

First, the 210-day period to assume or reject leases is only a deadline if the landlords will not agree to an extension. As I stated, the vast majority of Circuit City's landlords, led by DDR, would have granted an extension, as they had done in the recent retail bankruptcy cases filed by Hancock Fabrics, Linens 'n Things and Movie Gallery.

In Circuit City's case, as we have seen, the deadline was irrelevant. Even without landlord consent, the 210-day period would not expire until June 2009 and the liquidation of the company is already nearly complete as of early March.

We do not deny for a moment 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 simply cannot reorganize.

The Subcommittee 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. Goody's is presently liquidating through its second case.

We have also seen first-hand that some 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 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.

The debtor-in-possession financing product has significantly—and negatively—altered the course of recent retail bankruptcies and this is a fundamental cause of Circuit City's liquidation. Lenders are generally 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. Few debtors can survive these conditions. In fact, no recent significant retail debtor has.

Circuit City entered bankruptcy in November 2008, with a post-petition lending facility that required the company to file of 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 that Circuit City obtained from its lenders 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 by the post-petition lending facility (not the landlords' deadlines) without clear support and participation from Circuit City's suppliers, which it simply was not able to muster. In addition to this formal post-petition financing, the Subcommittee should be aware that Circuit City essentially borrowed $25 million dollars from its landlords, without paying interest, fees or providing any collateral. Circuit City took the position that it would not pay landlords post-petition rent ("stub rent") due from the date it filed for bankruptcy on November 10, 2008, until the end of the month.

LESSONS FROM RECENT RETAIL BANKRUPTCY CASES

So, after these recent experiences, what lessons can be learned about retail bankruptcies in the current economic conditions?

First, we are experiencing a catastrophically difficult business environment that will challenge even the best-run retailers. Bank credit has tightened generally; 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 and confidence are at all-time lows and unemployment has reached levels not seen since the early 1980s. This is a perfect storm. Reduced 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.

Second, the current retail liquidations have little to do with the Chapter 11 process. This is particularly true as to the lease assumption or rejection deadline of 210-

days enacted in 2005. When retailers have asked for extensions, shopping owner owners have overwhelmingly granted those extensions. In fact, in the Circuit City case, landlords agreed not to pursue post-petition or stub rent in an effort to provide additional liquidity to the company. It is telling that when the attorney for Circuit City explained to the bankruptcy court in Richmond, Virginia, on January 16, 2009, the reason why Circuit City was forced to liquidate, he never mentioned the 210-day deadline as a cause. In fact, he specifically told the court that the reason for the liquidation was, in his words, due to "the fact that financing in this market is extremely difficult." This is the hard truth, and it in no way implicates shopping center landlords or Chapter 11.

It is clear that what is pushing retailers into liquidation relates to credit availability and vendor willingness to ship consumer products on reasonable terms. Nothing in the bankruptcy law can change this unfortunate reality.

Third, a retail bankruptcy can have serious negative effects on shopping centers and on other retailers. 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. Also the bankrupt retailer has an unfair competitive advantage over other retailers in the same center. It would be unwise, to say the least, 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. Such a change would do nothing to make vendors ship products on friendly terms. The only effect is to put others at risk.

CONCLUSION

In conclusion, Mr. Chairman, my experience with multiple retail bankruptcies in recent years plainly shows that the 210-day period for assuming or rejecting leases has not been a factor in the fate of retailers who file Chapter 11. The cause of recent job losses and business liquidations is quite simply the poor economy and tight credit. Troubled retailers will only be able to reorganize successfully when these negative market conditions change. No reform of Chapter 11 would have induced trade creditors in Korea to ship consumer electronics to Circuit City. No reform of Chapter 11 would have lessened tight lending standards.

I want to finish my remarks by restating the obvious fact that the success of shopping center landlords depends on having tenants who pay rent. Shopping center owners have a vested interest in the financial success of the retail sector. Especially now, as the landlord conduct in the Circuit City case shows, landlords are taking extraordinary steps in order to assist our retail tenants. As I said earlier, we agreed not to immediately press for payment of post-petition "stub" rent amounting to $25 million. 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.

I look forward to answering any questions you or other Members of the Subcommittee may have.