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Bankruptcy Cases To Watch In 2019

By **Alex Wolf**

Law360 (January 1, 2019, 12:03 PM EST) -- As the new year unfolds, so to will the bankruptcy case of one of the nation's most iconic retailers, Sears. Meanwhile, the U.S. Supreme Court is expected to resolve a thorny circuit split over licensing intellectual property in Chapter 11, and two top restructuring advisory firms will battle each other in court.

Here, Law360 examines the biggest bankruptcy cases on court dockets going into 2019.

Sears Holdings Corp.

For months, the discussion of Sears filing for bankruptcy was not a matter of "if" but "when." The iconic department store chain **petitioned for Chapter 11** relief in October with more than $11 billion in debt and hundreds of underperforming store locations that it decided to shutter in its effort to reorganize.

While Sears went bankrupt due to many of the same challenges and industry headwinds that have brought down scores of other large retailers, the backstory of the company's insolvency and entanglements with former CEO Eddie Lampert makes its case stand out for more than the sheer magnitude of its assets and liabilities.

Having sold more than 200 of its valuable stores to a real estate investment trust controlled by Lampert's hedge fund in 2015, Sears and some of its largest stakeholders face the prospect of having to litigate creditor claims over insider transactions that siphoned value away from the company.

As Lampert's hedge fund, ESL Investments Inc., **pursues a deal** to purchase hundreds of Sears and Kmart stores out of bankruptcy, it will continue to face scrutiny over prepetition maneuvers that appear to have enriched the former chief at the expense of other creditors.

"The transfers that we're talking about are ones where the ownership structure, Eddie Lampert and his entities, were on both sides of the transaction," said David Wander of Davidoff Hutcher & Citron LLP. "Everyone has been following Sears' slow and steady slide into bankruptcy, and that just means that the transactions that have happened during that time come under that much more scrutiny."

After closing 142 of the 700 Sears and Kmart stores still in business, ESL has offered $4.6 billion for around 500 stores, $1.8 billion in inventory, and its associated business and brands.

Whether or not the sale process and efforts reorganize are successful could depend on what ultimately comes of **an investigation** by the committee of unsecured Sears creditors, which could argue that there is more value to be gained by breaking up the company's classes of assets, according to Joseph Moldovan of Morrison Cohen LLP.

"The continuation of the case and whether it is a success or not is really going to be determined I think by that battle and also the willingness of parties to continue to provide goods for the company to sell," said Moldovan, who represents a Sears vendor in the bankruptcy case.

Also complicating the bankruptcy, which includes dozens of affiliate companies, are billions in unsecured debts led by an amount owed to the Pension Benefit Guaranty Corp. for the company's more-than 90,000 retirees.

Mission Product Holdings Inc. v. Tempnology LLC

The only bankruptcy-focused case currently in front of the U.S. Supreme Court is one over what happens to a trademark license when the brand owner goes belly-up. The case, which the Justices **agreed to hear** in October, will address an issue raised by apparel retailer Mission Product Holdings Inc. of whether a licensor company named Tempnology can use bankruptcy to revoke the right of a licensee to use a trademark.

Mission asked the Supreme Court to review the case after a bankrupt fabric maker won a ruling at the First Circuit allowing it to pull back the use of its marks. That approach, Mission has argued, creates a circuit split and "imposes a burden on American technological development that was never intended by Congress."

The First Circuit's determination that a trademark licensee only has a right to assert an unsecured claim for damages if its licensing agreement is rejected by a bankrupt debtor doesn't come up in every bankruptcy case but "certainly does come up in big cases," Ana Alfonso of Willkie Farr & Gallagher LLP said.

"That's hugely disruptive to the business of somebody who's depending upon that trademark license," she noted.

The circuit split stems from competing views over a provision of the U.S. Bankruptcy Code that exempts deals involving patents, copyrights and other forms of intellectual property from the kinds of contracts a debtor can reject in bankruptcy proceedings.

The problem is that when Congress created that licensing carveout in 1988, it listed the various forms of intellectual property that would be covered without mentioning trademarks. A number of appellate courts have since diverged over the importance of this omission.

A high court decision in the case will certainly ripple across the restructuring practice and affect a number of distressed companies, but could have its most visible and immediate impact on bankrupt retailers that rely on the strength of their brands, said Kramer Levin Naftalis & Frankel LLP attorney Adam Rogoff.

Should the Justices find that trademark agreements are protected by the bankruptcy code "then the debtor has potentially lost a valuable tool" and is locked in to an agreement that may deliver a below-market value return for licensing its marks, he said. But if the court agrees with the First Circuit that these agreements can be rejected in bankruptcy, debtors will have an opportunity to increase returns for licensing their brand, he added.

"Depending upon the results of this decision, you're either going to have an opportunity to make sure that your marks and your brands have the most current market value or you're going to be stuck by the terms of the agreements that you entered into pre-bankruptcy."

Addressing what the International Trademark Association has called "the most significant unresolved legal issue in trademark licensing," the case will be closely tracked by those in the bankruptcy practice and beyond.

Puerto Rico

What amounts to the largest municipal bankruptcy case ever filed remains one to watch in the new year as the commonwealth of Puerto Rico and its public companies continue to restructure a $74 billion public debt load and another $50 billion in pension liabilities.

The bankruptcy-like cases initiated in 2017 under the Puerto Rico Oversight, Management and Economic Stability Act will continue to garner attention from bankruptcy professionals and major municipal investors. And while much of the PROMESA proceedings last year were marked by creditor litigation and debates over the law's limitations, there are early signs that significant resolutions could be reached and realized in 2019.

"There's been a big shift in the attitude of how this should be proceeding," Squire Patton Boggs LLP's Karol Denniston said. "There's an urgency that we didn't see in the first year of the Puerto Rico proceeding."

The notable change in posture is evidenced by **the resolution reached** between municipal bondholders and other creditors over claims to roughly $18 billion in pledged Puerto Rico sales tax collections. First announced in June, the settlement to restructure the Puerto Rico Sales Tax Financing Corp., known as COFINA, was ultimately incorporated in a plan of adjustment for the territory's sales tax corporation that **is scheduled** to go up for court approval later this month.

The commonwealth government has touted the deal as a major achievement, saying COFINA's restructuring would reduce its debt by about 34 percent and that Puerto Rico would save about $435 million per year that could be reinvested in the island and its debt service. The federal board empowered to oversee the island's restructuring process has also lauded the deal as "a significant milestone in resolving Puerto Rico's debt crisis."

In addition, the territory and its creditors also **reached an out-of-court agreement** in 2018 to restructure about $4 billion in debt issued by the island's Government Development Bank.

The progress made so far to lighten Puerto Rico's debt load could go a long way to help bring several outstanding disputes to a close this year, Denniston believes, saying, "Bondholders, especially institutional investors, have recognized that time is their enemy and it's not a value-creating proposition to allow this to continue to sit."

Those seeking to reach consensus on plans of adjustment for the commonwealth and its other public entities this year will thus be keeping an eye on adversary case appeals that have been sent up to the First Circuit, which include challenges to **the constitutional powers** of the federal oversight board and **obligations to pay special revenue bondholders** in municipal bankruptcy cases.

Creditors are also currently staging a more aggressive push to suss out potential claims stemming from the **causes of the island's financial crisis** and reckless accumulation of debt.

Jay Alix v. McKinsey & Co.

After heating up for months in 2018, a multifaceted court fight between McKinsey & Co. and Jay Alix, the founder of restructuring advisory firm AlixPartners, is poised to garner attention from bankruptcy professionals in the new year.

In a collection of legal battles taking shape across federal districts, Alix **has accused** McKinsey Recovery and Transformation Services Inc. of lying in more than a dozen corporate bankruptcy cases to avoid revealing numerous conflicts of interest that should have disqualified it from being brought on to work out reorganization plans.

The restructuring pro sued the global consulting agency for allegedly violating the Racketeer Influenced and Corrupt Organizations Act in May before asking a Virginia bankruptcy judge **to reopen** the Chapter 11 case for Alpha Natural Resources and urging a court in Texas to deny McKinsey's pending application for retention in the ongoing bankruptcy case for Westmoreland Coal Co.

Through an entity called Mar-Bow Value Partners LLC, created "for the sole purpose of redressing McKinsey's illegal disclosure scheme," Alix has argued that McKinsey concealed a relationship between a firm pension plan and senior secured lenders of ANR and that it is seeking permission to advise Westmoreland despite holding "equity interests in the debtors and in interested parties."

While **McKinsey says** Alix's allegations are part of a "meritless" and "malicious anti-competitive campaign," the matter has **attracted attention** on Capitol Hill and led bankruptcy case monitors at the Department of Justice to support Alix's calls to probe McKinsey's conflicts in the bankruptcy cases in which it's been involved. The accusations have also called into question McKinsey's role as a consultant to the federal oversight board for Puerto Rico.

Restructuring advisers will undoubtedly be following the Alix v. McKinsey saga to stay abreast of what the courts conclude is sufficient disclosure, but may also just have general interest in what consequences the consulting firm will ultimately face.

"Being a secured creditor of an entity for which you are supposed to be a disinterested professional is pretty egregious," said Ted Gavin of corporate restructuring firm Gavin Solmonese LLC and current president of the American Bankruptcy Institute. "This could be really bad. People could go to jail for not disclosing things."

Although McKinsey maintains that Alix's claims are rooted in a personal vendetta, it doesn't necessarily mean that they are false or any less alarming, according to Gavin.

"Thus far, the things that have come up in the process of this don't look good for McKinsey," he said.

--Additional reporting by Bill Donahue. Editing by Breda Lund.
