

FORENSIC FILES/CRF EDITION: CATCHING AND EVADING DANGEROUS CUSTOMERS

Presentation for:

2026 August Forum and Expo

Sponsored by:

Credit Research Foundation

August 11, 2026

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WARNING SIGNS OF FUTURE CUSTOMER'S BANKRUPTCY

- A financially distressed customer's bankruptcy filing **should come as no surprise***

Challenge:



Identify Bankruptcy Warning Signs
and Take Steps to Mitigate Risk

*Fraud cases may come with little or no warning (see, e.g., *First Brands Group*)

SEEING THE FOREST FROM THE TREES

MACROECONOMIC RISK FACTORS, GENERALLY

- Changes in overall demand / economic activity
 - Recessions
 - Unanticipated shocks (war, embargoes, Covid shutdowns)
 - U.S-Iran war-impact on
 - Inflation risk
 - Energy and other product prices
- Monetary policy
 - Interest rates directly impact borrowing costs
 - Interest rates indirectly impact customer demand
 - Exchange rates can impact competitiveness in industries with foreign trade
- Regulation



WARNING SIGNS OF FUTURE BANKRUPTCY SEEING THE FOREST FROM THE TREES

CURRENT MACROECONOMIC FACTORS

- High interest rates
- Tariffs
- Many overleveraged and zombie companies
- Upcoming debt/maturity wall – refinancing risks
- Headwinds facing certain industries
 - Manufacturing
 - Transportation
 - Healthcare
 - Retail
 - Commercial Real Estate
 - Restaurants and Hospitality
- Deterioration of consumer balance sheets/excessive credit card debt



SEEING THE FOREST FROM THE TREES

TARIFFS AND IMPACT ON GLOBAL TRADE

- Tariffs are priming financial markets for next wave of corporate defaults
 - Fitch ratings lifted its predictions for default rates in leverage finance both in U.S. and Europe due to global trading war risks
 - New default predictions “sharply exceed already steep increases Fitch previously expected”
- Tariffs are disrupting global trade and supply chains, increasing costs, and contributing to rising corporate bankruptcy filings
- Industries most affected
 - Automotive
 - Retailers relying on imports
 - Manufacturing
 - Farmers/Agriculture
 - Solar
- U.S. small businesses also at risk of financial distress due to tariff policy



SEEING THE FOREST FROM THE TREES

INDUSTRY WARNING SIGNS

- Declining overall demand / supply overcapacity
- Shifts in customer needs and wants
- Competition from imported alternatives
- Consolidation among competitors
- Business failures among competitors



SEEING THE FOREST FROM THE TREES

CUSTOMER BALANCE SHEET WARNING SIGNS

- Upcoming debt maturities and debt service payments
- Declining liquidity
- Excessive leverage
- PIK (“Paid-in-Kind”) debt
- Covenant breaches
(not as common with Covid-era debt)
- Aggressive private lenders with “loan to own” ambitions
- Announced or completed liability management exchange transactions to add more secured debt and rearrange priorities among lenders or bondholders
 - Priming or dropdown LMTs resulting in litigation to restructure debts



SEEING THE FOREST FROM THE TREES

CUSTOMER OPERATION WARNING SIGNS

- Declining sales and gross margin
- Increased operating expenses
- Weak or negative operating cash flow
 - Sale of capital assets or issuance of new stock or debt to offset operating cash burn
- Unusually large orders
 - Distressed customer may try to purchase goods “for free” by placing orders shortly before a bankruptcy filing with no intention to pay
- Failure to invest in maintenance and capital expenditures necessary to support operations and fuel growth
- Declining product quality, customer dissatisfaction
- Increase in product returns
- Shrinking market share



WARNING SIGNS OF FUTURE CUSTOMER BANKRUPTCY

OPERATIONAL CONCERNS

- Costly and/or troubled launches of new products
- Quality and delivery issues
- Changing market conditions
 - Dramatically increased costs
 - Reduced demand for product or service
- Increased competition
 - New and more innovative companies cutting into suppliers' market share, reducing revenue
- Loss of key employees
- Loss of key suppliers
- Loss of key customers
- Liquidity issues hindering capex, maintenance, and growth



WARNING SIGNS OF FUTURE CUSTOMER BANKRUPTCY

THIRD-PARTY ASSESSMENT OF CREDIT QUALITY

- Reduction/Loss of credit insurance and accounts receivable put coverage (the stressed customer)
- Credit (downgrade) to a tier below investment grade
- Trading prices of bonds / loans
 - Can be a useful proxy for potential trade recoveries
 - Secured debt trading under par
 - Unsecured debt trading under par
- Institutional holders and insiders selling significant blocks of stock
 - Of particular note: private equity portfolio companies with publicly traded equity



WARNING SIGNS OF FUTURE CUSTOMER BANKRUPTCY

FINANCIAL REPORTING, MANAGEMENT, AND RESTRUCTURING ADVISORS

- Delayed SEC filings
- Qualified audit opinion
 - Going concern qualification in financial statements
- Change in auditor
 - Often (though not always) results from prior auditor's unwillingness to give unqualified opinion
- Unexpected resignation of CEO, CFO and/or other key officers
- **Retention of restructuring counsel/advisors**
- Unexpected resignation of board members
 - *Appointment of new board members with insolvency / restructuring backgrounds*



WARNING SIGNS OF FUTURE CUSTOMER BANKRUPTCY

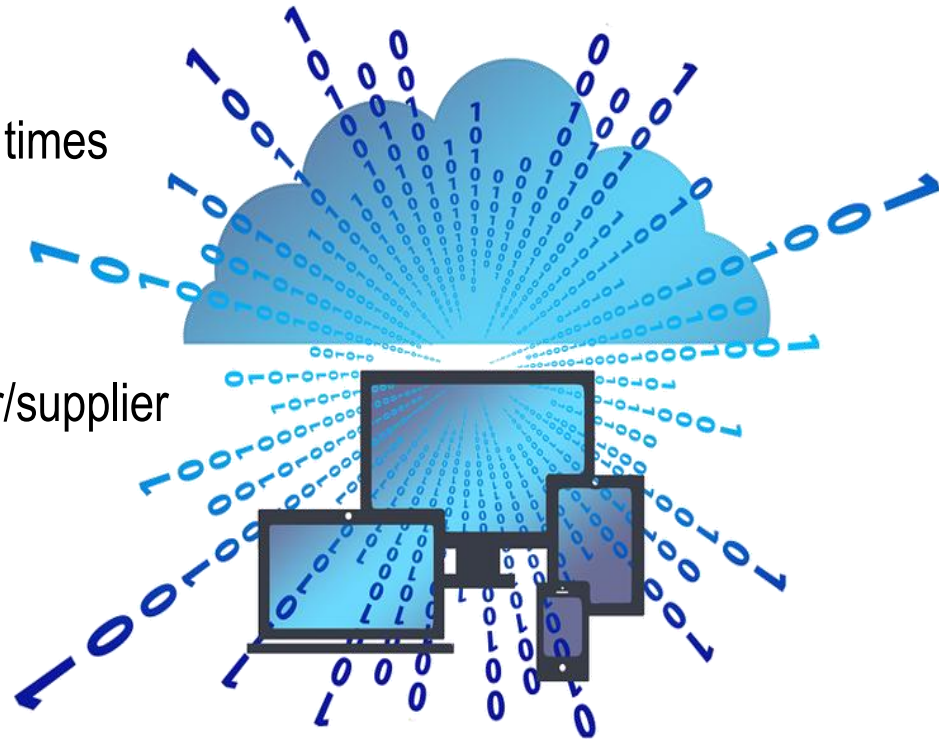
UPSTREAM SUPPLIER RISKS

- Risk of suppliers seeking cancellation, suspension or delayed deliveries on purchase orders or contracts
- Risk of stopping or slowing down production because of delayed deliveries of key goods/services, making it hard or impossible to
 - Fulfill current projects and orders, or Meet targets
- Difficulty in Obtaining New Suppliers
- Reach Credit Limits with Current Suppliers
- Expand Suppliers, Higher Costs
 - Need to find new supplier who
 - May not offer good prices or credit terms
- Can adversely impact cash flow/financial results
- Inefficient
 - Switching to new supplier typically involves a transition period to get set up on new systems and get used to working together



| SOURCES OF INFORMATION

- You!
 - Know your customer
 - Stay close to your customer in difficult times
- Your salesforce
- Your credit group
- Other companies dealing with the customer/supplier
- Agency credit rating
- National/Local publications/Websites
- SEC filings
- Industry reports
- Analyst reports
- Web: (e.g., Google)/social media searches



| SOURCES OF INFORMATION

- **Call Lowenstein! We live in this space and have access to industry reporting subscription services**
 - Our contacts (including you!)
 - Debtwire
 - Octus
 - Markit
 - Shows syndicated loan pricing
 - Bloomberg Terminal
 - Shows bond prices
 - The Deal
 - Distressed Company Alert
 - WSJ Pro Bankruptcy
 - Distressed Analysts on X (f/k/a Twitter)



CASE STUDY: THE DESCENT OF *ASCEND PERFORMANCE* MATERIALS



THE CONFESSION TAPES: *FACTORS LEADING TO THE FILING (AS TOLD BY THE DEBTOR)*

- **Prolonged PA66 market trough and demand softness**
 - Since 2022, global destocking, inflation, labor shortages, and supply-chain issues suppressed demand; average PA66 prices fell ~45% from COVID-era peaks, compressing margins to near decade lows and driving a ~56% decline in EBITDA.
- **Aggressive Chinese competition and oversupply**
 - Rapid capacity additions in China and price-cutting (including below-cost/subsidized sales) eroded pricing power and forced Ascend to match prices or lose customers
- **Uneconomic take-or-pay contracts**
 - Legacy long-term supply agreements turned loss-making in the current price environment, further undercutting margins.



The Debtors' "First Day Declaration" (Docket No. 24 in Bankr. S.D. Tex. Case No. 25-90127)

THE CONFESSION TAPES: FACTORS LEADING TO THE FILING (AS TOLD BY THE DEBTOR)

- **Tightening liquidity despite cost actions**
 - Extensive cost and footprint rationalization (e.g., headcount reduction >24%, ~\$100M fixed manufacturing cost cuts, facility consolidations) and liquidity levers (sale-leasebacks ~\$250M, receivables factoring, inventory reductions) could not offset persistent pricing pressure and falling cash collections
- **One-time operational shocks intensified the crunch**
 - A Pensacola plant fire (Dec. 2024), a Texas freeze that shut Chocolate Bayou (Jan. 2025), and the Wilson Lock barge closure forced costly market purchases and trucking substitutions, lengthened transit times, and reduced Q1 2025 EBITDA by ~\$21M.
- **Vendor pressure and trade tightening**
 - Payment deferrals swelled past-due payables to >\$110M, prompting vendors to demand cash-in-advance, tighten terms, threaten equipment removals, and in some cases cease supply – creating risk of facility shutdowns.



The Debtors' "First Day Declaration" (Docket No. 24 in Bankr. S.D. Tex. Case No. 25-90127)

THE CONFESSION TAPES: FACTORS LEADING TO THE FILING (AS TOLD BY THE DEBTOR)

- **Credit downgrades worsened liquidity stress**
 - S&P cut the rating to CCC+ (Feb. 18, 2025) and Moody's followed with a negative outlook, triggering further vendor demands (cash-in-advance, LCs) and tightening liquidity.
- **Borrowing base compression and lender forbearances**
 - Reduced receivables and inventory squeezed ABL availability; the ABL entered cash dominion and forbearance in late March 2025, heightening near-term liquidity pressure.
- **Limited out-of-court options; bridge/DIP as the viable path**
 - Equity could not fund a timely capital solution; emergency bridge financing from term lenders averted an immediate shutdown but underscored the need for a comprehensive, court-supervised deleveraging supported by ~\$900M of DIP facilities (including \$250M new money).



The Debtors' "First Day Declaration" (Docket No. 24 in Bankr. S.D. Tex. Case No. 25-90127)

THE DESCENT OF ASCEND IN THE MEDIA: CLUES BEFORE THE FILING

- 2/29/24 S&P downgrades to B based on continuing non-performance and negative outlook
- 3/28/24 Moody's downgrade to B-1 and negative outlook
- 9/29/24 Moody's downgrade to B-2 based on weak operating performance; negative outlook
- 1/18/25 Lenders engage advisors to address debt maturity
 - ❖ Debtors represented by Kirkland & Ellis and PJT
 - ❖ Lenders represented by Gibson Dunn & Crutch
- 1/24/25 Lenders engage Evercore
 - ❖ **First lien term loan quoted at 66/68 (compared to 84.9/87.75 at beginning of 2025)**
- 2/18/25 S&P downgraded to CCC+ based on upcoming debt maturity (first lien term loan in the amount of \$1.3 billion maturing in August 2026 and becoming current in August 2025) + elevated leverage

Debtwire (unless otherwise indicated)

THE DESCENT OF ASCEND IN THE MEDIA: CLUES BEFORE THE FILING

- 3/5/25 Moody's downgrades to CAA2 and negative outlook based on weak performance and financing challenges
- 3/7/25 Debtors obtain \$100 million priming term emergency financing (\$40 million committed; \$60 million uncommitted)
 - ❖ **First lien term loan quoted at 37.35/40.75**
- 3/25/25 Per Octus, Ascend explores restructuring options, including bankruptcy
- 4/1/s25 \$100 million superpriority senior secured term loan applied CAA1 rating per Moody's based on weak credit metrics, cash flow, and refinancing challenges
- 4/14/25 Lenders set to roll into DIP financing to fund imminent bankruptcy filing
 - ❖ **First lien term loan quoted at 19.9/24.2**
- 4/21/25 Ascend and affiliates file chapter 11 in S.D. Texas bankruptcy court, with no restructuring support agreement or proposed plan (i.e., a "freefall" case)

Debtwire (unless otherwise indicated)

ASCEND'S EMERGENCE FROM CHAPTER 11

- ***Ascend***
 - Chapter 11 plan of reorganization confirmed on December 9, 2025, and went effective on December 19, 2025 (eight months after the petition date). The Plan provides for an anticipated 25% recovery for trade creditors defined as “Go Forward Vendors”.



THE RESPONSE PLAYBOOK



CONTRACT REVIEW

| KNOW YOUR CUSTOMER DILIGENCE

- Verify customer's correct legal name
- Is your customer part of a group of affiliated entities?
 - Where are the assets?
 - Is your customer's affiliate paying your invoices?
 - Do you need a guarantee from a solvent or paying affiliated entity?



| CONTRACT REVIEW

- Identify contracts with financially distressed customers
 - Supply agreement
 - Consignment agreement
 - Security agreement
 - UCC filings
 - Purchase orders
 - Treatment as executory contracts in customer bankruptcy
- Review and fix mistakes



CONTRACT REVIEW: UCC FILINGS

- Review Agreements and UCC-1 filings
- Fix any potential errors
 - Is there an operative, non-expired UCC-1 filing?
 - Is the operative filing in the correct jurisdiction?
 - Does the operative UCC-1 need to be amended?
 - Is the customer's name correct?
 - *Importance of correct legal name*
 - *Track changes in customer name through M&A, spinoffs, reorganizations*
 - *Necessity for timely UCC amendment to reflect customer's correct legal name*
 - Is the collateral description correct?
 - Does the operative UCC-1 filing need to be continued?
- Obtaining Additional Collateral/Backstop
- Preference Risk: UCC-1 filings and security interests perfected in the 90 days before a bankruptcy filing may be subject to avoidance!



CONTRACT REVIEW: RELEVANT PROVISIONS

- Credit terms; ability to modify or terminate?
- Events of default; acceleration provision?
- Bankruptcy/Insolvency default provisions unenforceable in bankruptcy
- Termination provision
 - Bankruptcy/insolvency provisions unenforceable in bankruptcy
 - Other grounds require relief from bankruptcy stay
- Anti-assignment provision unenforceable in bankruptcy
 - Safe Harbor exception





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**CREDIT RESEARCH
FOUNDATION**

SETOFF AND RECOUPMENT RIGHTS



PROTECTIVE MEASURES

SETOFF RIGHTS

- Creditor's state-law right to offset amounts owed to a customer against amounts owed by that customer
- **Requirements**
 - Obligation to be set off is Debtor's property
 - Existing indebtedness by Debtor is due and owing
 - Mutuality of obligation between parties
 - Both debts must be between the same parties
 - Both debts must be prepetition or postpetition
- Avoids the absurd result of making A pay B when B owes a debt to A
- Claim subject to valid setoff rights are preserved (§553) and treated as **Secured Claim** (§506(b)) under the Bankruptcy Code
- Setoff is subject to the automatic stay in bankruptcy, requiring court permission

PROTECTIVE MEASURES

SETOFF TRIANGULAR SETOFF

- Creditor dealing with multiple affiliated debtors
- Company A's obligations to Company B cannot be setoff against affiliated Company C's indebtedness to A, unless otherwise permitted by agreement between A, B, and C
- Southern District of New York and Delaware decisions reject contractual triangular setoff provision as lacking in mutuality and, therefore, unenforceable in bankruptcy
 - *In re Orexigen Therapeutics, Inc.*, U.S. Bankruptcy and District Courts, Delaware, recently affirmed by U.S. Third Circuit Court of Appeals
 - *In re Lehman Brothers Inc.*, U.S. Bankruptcy Court, Southern District of New York
 - *In re SemCrude, L.P.*, U.S. Bankruptcy Court, District of Delaware, affirmed by U.S. District Court, Delaware
 - *In re American Home Mortgage Holdings, Inc.*, U.S. Bankruptcy Court, District of Delaware

PROTECTIVE MEASURES

RECOUPMENT

- Common law equitable principle that nets out creditor's claim against indebtedness to its customer
 - Must arise from a single or integrated transaction
 - E.g., creditor's obligation to pay rebates and similar charges under supply agreement
- Bankruptcy Code Section 553's limits on setoff do not apply to recoupment
 - No mutuality requirement: e.g., creditor can apply its prepetition claim to reduce its post-petition credits, deductions, rebates, and other obligations to a Debtor
 - Creditor need not seek stay relief to effectuate recoupment
- When in doubt as to whether setoff of recoupment is at issue, seek stay relief!



| *UNIFORM COMMERCIAL CODE REMEDIES*



ADEQUATE ASSURANCE OF PERFORMANCE

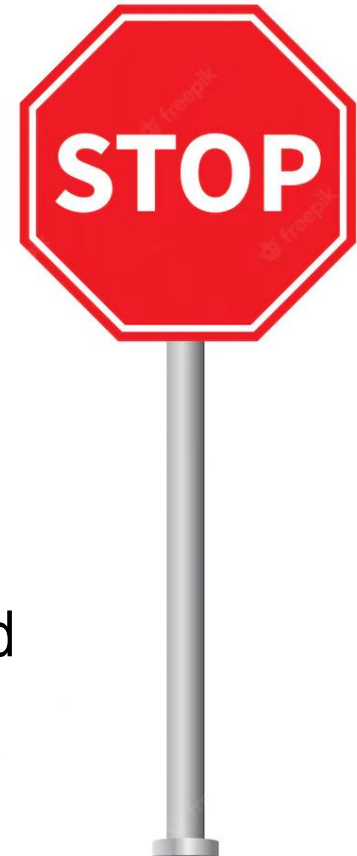
- UCC §2-609 governs for goods sellers
 - Sales by suppliers
 - Sales to customers
- Upon reasonable grounds for insecurity, a contract party can demand adequate assurance of performance from financially distressed party
- Reasonable grounds for insecurity
 - Determined by “commercial standards” as between merchants
 - Customer/supplier past due on its debts
 - Supplier P.O. cancellations, delayed deliveries
 - Warning signs of future customer/supplier bankruptcy

ADEQUATE ASSURANCE OF PERFORMANCE

- What constitutes adequate assurance of performance
 - Revoke credit terms and switch to cash in advance (distressed customer)
 - Collateral security
 - Letter of credit
- Pending receipt of adequate assurance, creditor can suspend performance
- Debtor's failure to provide adequate assurance within reasonable time not exceeding 30 days results in repudiation of contract
- Beware of contract provisions limiting adequate assurance rights

| STOPPAGE OF DELIVERY

- Creditor's right to stop delivery of goods to customer due to insolvency or breach governed by UCC §§2-702, 2-703 and 2-705
 - Debtor's insolvency
 - Balance Sheet: Liabilities exceed assets
 - Equity: Failure to pay debts as they mature
- Withholding delivery of goods in creditor's possession and switching to cash terms going forward



| STOPPAGE OF DELIVERY



- Stopping delivery of goods in possession of carrier/warehouse/other third party
- Notice must be given to carrier/warehouse and Debtor
- Carrier acknowledging holding goods for Debtor by reshipping/warehousing
 - Seller responsible for charges of carrier/warehouse holding goods prior to release to Debtor or return to creditor

| STOPPAGE OF DELIVERY

- Right of stoppage of delivery cut off by any of the following:
 - Debtor's receipt of goods
 - Warehouse/Bailee acknowledging holding goods for Debtor
 - Carrier acknowledging holding goods for Debtor by reshipping/warehousing
 - Endorsement to Debtor of negotiable document of title covering goods
- Stoppage of delivery rights not impacted by passage of title/risk of loss
- Enforceable stoppage of delivery rights have priority over secured inventory lender's rights
 - In contrast, reclamation rights are subordinate to secured inventory lender's rights

AUTOMATIC STAY OF CREDITOR ACTIONS

- **11 U.S.C. § 362:** Automatic Stay arises *automatically* upon filing of the petition and **immediately prevents**, among other things...
 - Termination of an agreement
 - Setoff
 - Foreclosure
 - Commencing or continuing lawsuits
 - Entering/enforcing judgment
 - Taking collateralized property under the UCC
 - Taking back creditor's own property in the Debtor's possession
- Need to obtain court approval before taking any of these actions
- Does the stay prevent a creditor from switching terms to cash in advance post-petition?



STOPPAGE OF DELIVERY: *AFTER BANKRUPTCY FILING*

- Seller retains UCC rights to stop delivery
- Not precluded by automatic stay
- Debtor usually ends up paying for stopped goods
- Seller must seek automatic stay relief in Bankruptcy Court to obtain return of stopped goods



PREFERENCE PLANNING

A TWO-MINUTE PREFERENCE REFRESHER: *WHAT IS A PREFERENCE?*

Elements of a Preferential Transfer

Practical Considerations

A transfer of property of the estate

*Typically but not always a **payment** – check, wire, etc.*

to or for the benefit of a creditor,

on account of an **antecedent debt**,

*No debt, no preference – cash in advance/ prepayments **are not preferences at all***

made while the **debtor was insolvent**,

on or within 90 days before the filing of the petition (one year for insiders)

*Presumption of insolvency for transfers within 90 days is **rebuttable with evidence***

that enables the creditor to receive more than it would in a hypothetical **chapter 7 liquidation** where the **transfer was not made** and the creditor received payment according to the Bankruptcy Code

*If you did not fare better than if the allegedly preferential transfer had not been made, the debtor filed chapter 7, and you were paid pursuant to the Bankruptcy Code, **no preference (i.e., less than 100% recovery under plan)***

Trustee due diligence requirement

Who has the burden of proof?

A TWO-MINUTE PREFERENCE REFRESHER: *COMMON DEFENSES*

Defense	Description
Contemporaneous Exchange of New Value	<i>Payment was intended to be, and was, a substantially contemporaneous exchange of new value</i>
Subsequent New Value	<i>Creditor provided new value – extensions of credit – to the debtor after receiving the preferential transfer.</i>
Ordinary Course of Business	<i>Transfer was payment of a debt incurred in the ordinary course of business or financial affairs of the debtor and creditor, and</i> <i>• Made in the ordinary course of business or financial affairs of the debtor and the creditor (subjective test), <u>or</u></i> <i>• Made according to ordinary business terms (objective test).</i>

| PREFERENCE PLANNING

- The possibility of future preference risk is not the sole driver behind credit decisions made with respect to a financially distressed customer. But it is a factor.
- Creditors can engage in “preference planning” prior to customer’s bankruptcy filing to reduce preference risk
 - Defense preservation!:
 - Be mindful of “collection pressure” when changing terms, stopping deliveries, and communicating with customer
 - Timing new credit sales to follow payment to maximize subsequent new value defense
- Creditors should preserve evidence at inception of bankruptcy case
 - File preservation:
 - Preserve credit and other files – paper/electronic, including emails
 - Preserve telephone logs, recorded phone calls, if any, and cell phone texts/instant messages.



| PREFERENCE PLANNING

- Some of the key preference-related considerations:
 - Potential switch to CIA (and avoid any avoidance risk w/r/t future payments)
 - Impact continued extensions of credit may have on subsequent new value defense and preference exposure
 - Closely monitor timing and manner of payments
 - Changing terms and impact on ordinary course of business (OCB) defense
 - Be aware of industry terms



ADMINISTRATIVE INSOLVENCY RISK IN CHAPTER 11 CASES



| WHAT IS ADMINISTRATIVE INSOLVENCY?

- **Administrative Solvency:** The ability of a Chapter 11 debtor to pay all obligations arising after the bankruptcy petition date in full
- **Administrative Insolvency:** The inability to do so — vendors and service providers are left holding the bag
- **The Policy Bargain:** §503(b) grants priority to postpetition claims; §1129(a)(9) requires full payment of administrative claims for plan confirmation
- **The “Paying the Freight” Doctrine:** Secured lenders historically could not capture all sale proceeds unless the estate was administratively solvent
- **The Erosion:** This doctrine has been gradually weakened; §363 asset sales bypass plan confirmation entirely, removing the statutory safety net



WHY THIS PROBLEM IS GETTING WORSE

- **Crushing Debt Loads:** COVID-era Fed liquidity enabled overleveraged companies to refinance and pile on more debt at record-low rates
- **§363 Sales Dominate:** Asset sales — not reorganization — are the default strategy, bypassing plan confirmation protections
- **Lean Budgets, Harsh Defaults:** DIP lenders demand stringent administrative expense budgets with little room for error
- **Chapter 22 Risk:** Companies emerge from bankruptcy only to file again within months; vendors who normalized credit terms are first casualties
- **No Explicit Statutory Backstop:** When a debtor sells all assets and dismisses or converts to Ch. 7, there is no explicit requirement to pay admin creditors
- **The Trend Is Accelerating:** Toys “R” Us, Sears, Big Lots, Party City, and Rite Aid all left trade creditors with massive losses
- **Recent Moody’s Ratings Analysis:** Elevated interest rates, market volatility and refinancing challenges are increasing risk of re-default for companies that previously engaged in distressed debt exchanges and complex liability management exercises to avoid bankruptcy. They accounted for more than 70% of U.S. defaults since 2022 and have resulted in lower debt recoveries



CASE STUDIES IN ADMINISTRATIVE INSOLVENCY



I TOYS “R” US (2017–2018)

- Filed Ch. 11 in Sept. 2017 with ~\$5B in debt; obtained \$3.1B in DIP financing and encouraged vendors to continue shipping on credit
- **Critical Vendor Trap:** Many vendors entered critical vendor agreements, receiving partial prepetition payments as inducement to keep shipping postpetition goods
- **Hidden Default:** Unbeknownst to trade creditors, Toys “R” Us defaulted on DIP covenants while stockpiling inventory for a full-chain going-out-of-business sale
- **Red Flag Missed:** Delayed filing of mandatory monthly operating reports was a key warning sign before the DIP default became public
- **The Outcome:** Secured lenders were paid through the GOB sale; administrative claimants held \$800M+ in claims but received only 22¢ on the dollar
- **Key Lesson:** Vendors supplied the very merchandise that funded the sale — yet were treated as an afterthought



| SEARS HOLDINGS (2018–2019)

- Filed Ch. 11 in Oct. 2018 with \$11.3B in debt and 100,000+ creditors including Whirlpool, Samsung, Frigidaire, and Black & Decker
- **Vendor Squeeze:** 200+ vendors had already stopped extending credit pre-filing and demanded cash upfront; those who continued shipping bore the risk
- **Insider Acquisition:** Assets sold for \$5.2B to Transform Holdco (ESL/Lampert affiliate) via credit bid — only ~\$1.4B in actual cash
- **Ch. 11 Purgatory:** Case stalled for years as litigation over alleged insider self-dealing delayed plan execution
- **Admin Claims Consent Program:** Opt-in creditors took a 25% haircut; those who did nothing got 20% reduction with delayed payment; opt-out creditors retained full-payment right with no timeline or guarantees
- **Key Lesson:** An insider acquired the business while trade creditors were offered pennies-on-the-dollar settlements

The Sears logo is displayed in a large, blue, stylized font. The letters are bold and have a slight shadow effect, giving it a three-dimensional appearance. The 'S' is particularly large and prominent, followed by 'E', 'A', 'R', and 'S' in a similar but slightly smaller scale.

| PARTY CITY — A CHAPTER 22 (1 OF 2)

- **First Filing — January 2023:** Filed Ch. 11 with ~\$1.7B in debt citing pandemic fallout, supply chain disruption, and consumer spending slowdown
- Emerged in October 2023 after shedding nearly \$1 billion in debt, with a fleet of nearly 800 stores
- **Vendor Recovery in Ch. 11 #1:** Junior creditors, including unpaid trade vendors, received just \$3.5M in cash plus a share of a class-action settlement
- **Post-Emergence Decline:** Comparable store sales declined 9.5% YoY; consumer products sales fell 24.8%; efforts to raise additional capital failed
- **Second Filing — December 2024:** Just 14 months post-emergence, Party City filed Ch. 11 again — this time to liquidate entirely; all ~700 stores commenced GOB sales



| PARTY CITY — A CHAPTER 22 (2 OF 2)

- **The Liquidation Plan (June 2025):** Depends explicitly on administrative and priority creditors accepting less than full payment
- **Coercive Waterfall:** First \$5M distributed pro rata among admin/priority claims; then \$9.8M split between admin/priority and secured noteholders; remainder flows entirely to secured creditors
- **Built-In Pressure:** Plan effectiveness conditioned on non-consenting admin/priority claims not exceeding \$1M — effectively forcing trade creditors to accept haircuts
- **Court Pushback:** The judge required amendments to ensure due process for administrative claimants before approving disclosure solicitation
- **Key Lesson:** Vendors who extended credit through the first bankruptcy and continued post-emergence faced a second admin insolvency scenario with even less to recover



The failure of any Holder of Administrative Claims to object to Administrative/Priority Waterfall Treatment by the objection deadline for Confirmation or otherwise timely return the Administrative / Priority Claim Consent Form and opt out of the Administrative/Priority Waterfall Treatment shall be deemed to be such Holder's consent to receive the Administrative/Priority Waterfall Treatment and accept less than full payment of its Administrative Claim as required by section 1129(a)(9) and as contemplated under sections 1124 and 1123(a)(4) of the Bankruptcy Code, and in full and final satisfaction, compromise, settlement, and release of and in exchange for each Allowed Administrative Claim, each such Holder of an Allowed Administrative Claim shall receive Liquidating Trust Interests entitling such Holder to its Pro Rata share of the Distributable Proceeds pursuant to the Waterfall Recovery. If such Holder does not timely opt out or otherwise object to such the Administrative/Priority Waterfall Treatment, such Holder shall be deemed a Released Party for all purposes hereunder.

| RITE AID — A CHAPTER 22 (1 OF 2)

- **First Filing — October 2023:** Filed Ch. 11 with ~\$4B in debt; obtained \$3.45B in DIP financing; closed hundreds of stores, sold Elixir pharmacy benefits business, resolved opioid litigation
- **Professional Fee Burden:** Professional fees in Ch. 11 #1 alone totaled approximately \$355 million
- **Emergence — September 2024:** Emerged as a private company owned by senior secured lenders, still carrying ~\$2.5B in debt
- **Failed Turnaround:** Recovery plan relied on vendors returning to normal trade credit terms and securing new letter-of-credit facilities
- **Vendors Refused:** Expected \$126M in liquidity from normalized terms; realized only ~\$46M; ~40% of vendor deposits never returned; LC facilities came in at \$66.75M vs. \$166M anticipated
- **Result:** Inventory shortages led to declining sales in high-margin front-end products, creating a liquidity death spiral



| RITE AID — A CHAPTER 22 (2 OF 2)

- **Second Filing — May 2025:** Filed Ch. 11 again less than 9 months after emerging, with \$1B–\$10B in both assets and liabilities
- **Rapid Liquidation:** Obtained \$1.94B in DIP financing; pharmacy assets auctioned within weeks; by October 2025, all retail operations ceased and 1,000+ stores closed
- **Preference Clawbacks:** Nearly 1,000 preference actions filed against trade creditors just ahead of the 2-year statute of limitations — creditors face clawback litigation on top of unpaid receivables
- **Cases Closed Rapidly:** By December 2025, 117 of 118 debtor cases were closed; remaining case open for claims reconciliation
- **Key Lesson:** Worst-case scenario: vendors extended credit through Ch. 11 #1, were pressured to normalize terms post-emergence, watched the company collapse — and are now being sued to return prepetition payments



COMMON THREADS ACROSS ALL FOUR CASES

- **§363 Sales Dominate:** Each debtor sold assets rather than reorganizing, removing the plan confirmation requirement to pay admin claims in full
- **GOB Sales Benefit Secured Lenders:** Vendors supply the inventory that generates GOB sale proceeds, but those proceeds flow to secured creditors — not back to vendors
- **Critical Vendor Programs as Bait:** Promises of priority payment induce vendors to keep shipping, but those programs may not survive admin insolvency
- **Chapter 22 Risk Is Real:** Party City and Rite Aid show emergence is no guarantee of survival; vendors who extend credit post-emergence are first in line for losses
- **Red Flags Are Identifiable:** Delayed operating reports, DIP covenant defaults, declining sales, vendor payment delays, and failed capital raises are all warning signs
- **The Trend Is Accelerating:** In today's distressed environment, administrative insolvency is not an edge case — it is an increasingly common outcome

PROTECTING YOURSELF: PRACTICAL STRATEGIES

- **1. Negotiate Critical Vendor Status:** Seek full payment of prepetition claims, preference waivers, and clear default triggers to stop extending credit if admin insolvency looms
- **2. Monitor Admin Solvency:** Track monthly operating reports, watch for payment delays, and monitor DIP financing compliance and amendments
- **3. Join the Creditors' Committee:** Gain access to updated financials, oppose unreasonable DIP terms, challenge sale processes, and negotiate collectively
- **4. Demand Sale Process Protections:** Insist that any §363 sale leave sufficient funds to pay all administrative claims in full
- **5. Shift to Protective Terms:** Cash on delivery (COD) or cash in advance (CIA) provides the strongest protection when admin solvency is in question
- **6. Request Enhanced Disclosure:** Demand periodic reporting on liquidity, DIP covenant compliance, and sales projections to make informed credit decisions
- **7. Preference Planning:** Good to get preference ducks in a row as preference claims are usually pursued as a funding source in administrative insolvency cases



I QUESTIONS





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Education

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Andrew Behlmann leverages his background in corporate finance and management to approach restructuring problems, both in and out of court, from a practical, results-oriented perspective. With a focus on building consensus among multiple parties that have competing priorities, Andrew is equally at home both in and out of the courtroom, and he has a track record of turning financial distress into positive business outcomes. Clients value his counsel in complex Chapter 11 cases, where he represents debtors, creditors' committees, purchasers, and investors.

Andrew writes and speaks frequently about bankruptcy matters and financial issues. Before becoming a lawyer, he worked in senior financial management at a midsize, privately held company.



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With nearly 45 years of experience in the bankruptcy and insolvency space, Bruce Nathan is a recognized leader in trade creditor rights and the representation of trade creditors in bankruptcy and other legal matters. He has represented trade and other unsecured creditors, unsecured creditors' committees, secured creditors, and other interested parties in many of the larger Chapter 11 cases that have been filed. Bruce also handles letters of credit, guarantees, security, consignment, bailment, tolling, precious metals leases, and other agreements with financially distressed counterparties, as well as other credit-related legal issues for institutional clients.

Bruce's experience spans a broad range of industries, including agriculture, food and beverage, paper, publishing, media, floor covering, furniture, chemicals, manufacturing, and precious metals. His recent creditors' committee engagements include MVK FarmCo (dba Prima Wawona), Pegasus Home Fashions, Nielsen & Bainbridge (NBG Home), and Gold Standard Baking.

BRUCE S. NATHAN

With a national creditors' rights practice, Bruce has recently advised trade and other unsecured creditors in a broad range of complex matters, including:

- Representation of a precious metals lessor in the Instant Brands Chapter 11 case
- Representation of a pipe supplier in conjunction with the enforcement of its statutory mechanic's / materialman's lien rights in the Chapter 11 cases of MDC Energy and EdgeMarc Energy Holdings
- Representation of three major book publishers and two major paper-product manufacturers and distributors in the Chapter 11 cases of LSC Communications.

Bruce is a frequent presenter at industry conferences throughout the country, as well as a prolific author on bankruptcy and creditors' rights topics. His articles frequently appear in publications by the National Association of Credit Management, Credit Research Foundation (CRF), and the American Bankruptcy Institute (ABI). He is a co-author of "Model Business Credit Application and Terms and Conditions of Sale," published by CRF and Lowenstein Sandler in 2023; "A Business Guide to Antitrust for Credit Professionals," initially published by CRF and Lowenstein Sandler in 2020 (updated in 2023); and "Trade Creditor's Risk-Mitigation Tools and Remedies Manual," published by ABI in 2019.

Bruce is a former member of ABI's Board of Directors, former co-chair of ABI's Unsecured Trade Creditors' Committee, and former co-chair of the Avoiding Powers Committee that worked with the ABI Commission to Study the Reform of Chapter 11.



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GIANFRANCO FINIZIO

Gianfranco Finizio focuses his practice on bankruptcy and insolvency matters. He represents a diverse range of clients including official committees of unsecured creditors, indenture trustees, debtors, bank agents, and other major secured and unsecured creditors in complex Chapter 11 bankruptcy cases, out-of-court restructurings, and other distressed situations. Gianfranco's extensive experience spans the pharmaceutical, healthcare, restaurant, and retail industries, to name a few.

Gianfranco has represented or currently represents creditors' committees in several high profile Chapter 11 cases, including Desktop Metals, CHG Holdings LLC dba Planta Group, DRF Logistics, Diamond Comics, Gold's Gym, One Table Restaurants, Taco Bueno Restaurants, Humanigen, Lannett Company, and American Apparel.

He frequently publishes articles on insolvency issues and presents at industry conferences, discussing emerging issues on bankruptcy-specific topics. Gianfranco was listed in the 2021, 2022 and 2023 editions of Chambers USA: America's Leading Lawyers for Business in the area of Bankruptcy/Restructuring. Gianfranco was recognized in 2023 as a "Rising Star" by American Lawyer's New York Law Journal. He was also honored by the American Bankruptcy Institute (ABI) in 2022 as one of its "40 Under 40" Emerging Leaders for his Insolvency Practice.

Committed to pro bono work, Gianfranco provides legal services to children in need through KIND (Kids in Need of Defense), a nonprofit that offers legal counsel to unaccompanied refugees and immigrant children. He also volunteers for Immigrant ARC's Friend of the Court program to assist pro se respondents in navigating the immigration court system.



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