THE INCREASING FREQUENCY OF GROCERY AND RESTAURANT BANKRUPTCIES: *CANARIES IN AMERICA'S ECONOMIC COAL MINE?*

By: Richard M. Blau, Esq., Chairman
Nationwide Alcohol Beverage and Food Law Department

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The retail food industry comprises foods and beverages sold at food retailers such as grocery stores, mass merchandisers, drug stores, convenience stores and foodservice facilities. Total retail and food service sales in the United States amounted to about 5.75 trillion U.S. dollars in 2017. By the end of 2019, grocery stores and supermarkets alone accounted for revenues of $678 billion dollars. Restaurants in the U.S. were projected to exceed $863 billion in revenues by the end of 2019.

Despite such healthy numbers, several industry metrics suggest the less than rosy economic future. Grocery and restaurant bankruptcies of just the past week, combined with similar events occurring throughout the course of 2019, suggest that the retail food industry may be heading into dangerous operating conditions.

Off-Premise Woes

Lucky's Market, a Colorado-based grocer that bills itself as offering "organic for the 99%," filed for bankruptcy after it began closing most of its stores. About 3,000 jobs are at stake.

Lucky's operated 39 stores before it started winding down and liquidating 32 of them in recent weeks, court papers show. The company listed assets of as much as $500 million and liabilities of at least that amount in a bankruptcy petition filed Monday in Delaware

Offers have been received from third parties for equipment and leases at about 26 stores, with an asset purchase agreement already signed by Aldi Stores and negotiations underway for certain other stores, according to a filing. Terms are being finalized for the sale of the seven stores still operating, Lucky said. Store closings are expected to be completed by the end of February, 2020, with help from liquidation consulting firm Great American Global Partners LLC.

Lucky's obtained a capital infusion from The Kroger Co. in 2016, but the grocery giant said in December of 2020 it would divest and took a $238 million impairment on the stake. Bankruptcy court papers list Kroger as owning 55% of Lucky's Market Parent Company LLC.

Chapter 11 bankruptcy allows a company to continue operating while it works out a plan to pay creditors. According to the company, some Lucky's stores in Colorado, Ohio, Florida, Michigan and Missouri will remain open.

Lucky sought protection from creditors just days after another grocer, New York City's Fairway Group Holdings Corp., fell prey to a high debt load and competition from the likes of Whole Foods Market Inc. Fairway Market is preparing a plan to sell off the business to a number of buyers who have been circling the chain, while currently working to avoid having to close its 14 locations. There is hope that Fairway's failure will not be complete, as it was when another New York grocery chain, Dean & DeLuca, went bankrupt last year and closed all its stores in New York.

It is undeniable that traditional groceries also have come under pressure from home delivery services such as Amazon.com's Prime, as well as competition from food sections at Big Box behemoths such as Walmart, Target and Costco stores. In fact, a primary explanation for the grocery store shake-out voiced by many industry observers focuses on unbeatable competition from the likes of Wal-Mart and Whole Foods/Amazon. The effects of these Big Box retailers extends beyond the retail tier, as suppliers and distributors also are being squeezed. How?

Grocery store chains rely on regional grocery distribution companies. While many chains have their own large distribution centers, they cannot supply everything and are also often just warehouses for the products they buy from regional distributors who actually purchase directly from the farmers/other manufacturers. So, when the Big Box retailers like Wal-Mart and Whole Foods exert their market power to pressure smaller suppliers and regional distributors, those suppliers either cannot, or refuse to, comply. In many instances, that refusal results in a significant hit to the smaller company's bottom line.

On-Premise Pain

Meanwhile, in the on-premise sector of the hospitality industry, **Bar Louie** - a restaurant chain known for its cocktails and high-end gastro-pub food - filed for bankruptcy and closed dozens of locations. The company announced on January 27, 2020, that it filed for Chapter 11 protection. The restaurant chain also came to an agreement with its lenders for an ownership transition of the chain through a bankruptcy sale. Bar Louie said that restaurants will operate in the "normal course of business" and expects to emerge from bankruptcy within 90 days.

Bar Louie has more than 90 locations across the United States. It recently shuttered 38 underperforming locations to "strengthen its operational and financial position." Several locations closed in Ohio, Wisconsin, Michigan and Colorado, according to local media reports. CEO Tom Fricke said in the release the company is profitable and focused on growth despite the closures.

Bar Louie began in Chicago in 1990 before opening locations in 26 states. The locations are primarily located near malls, which are facing problems of their own as customers shift their habits to online shopping. Several mall staples, which try to attract hungry shoppers, are running into problems as fewer people shop at malls. The Cheesecake Factory, for example, reported that its sales in the Third Quarter of 2019 at locations open at least a year were stagnant. The company's earnings were expected to be flat in the Fourth Quarter as well.

Beyond the malls, other long-standing restaurant brands are facing economic downturns. For example, the operator of the **Village Inn** and **Bakers Square** restaurant chains has filed for bankruptcy after years of losses as it faces ongoing pressure from new casual dining brands and larger competitors. Restaurant operator **American Blue Ribbon Holdings LLC** filed for chapter 11 protection on Monday in the U.S. Bankruptcy Court in Wilmington, Del. The bankruptcy filing comes after Blue Ribbon said it closed 33 underperforming restaurant locations and laid off about 1,100 employees.

According to Blue Ribbon's January 27, 2020 press release, the bankruptcy protection will allow the restaurant holding company "to continue operation of its businesses and service to its customers in the ordinary course while it works through the important elements of a plan of reorganization." Blue Ribbon also reported that it has arranged debtor-in-possession financing of $20 million from Cannae Holdings, Inc., its majority equity owner, in support of the filing and plan of reorganization.

WHO'S TO BLAME FOR THESE FAILURES?

BankUnited recently issued an analysis suggesting that restaurant debt in its small business loan portfolios is showing signs of stress, and is blaming food delivery apps like Uber Eats for the problem. As the use of on-demand delivery services like **Uber Eats** and **DoorDash** rises, fewer consumers are visiting restaurants and ordering items that are more profitable for those businesses, like drinks and desserts.

BankUnited holds $360 million in its restaurant portfolio, with executives noting that some of those loans recently moved to criticized or classified status during the Fourth Quarter of 2019. BankUnited's analysis also pointed to previous reports from August of 2019 that similarly warned of stressed restaurant debt and cash flow challenges in the industry linked to labor shortages and raw goods costs.

In addition to BankUnited, lenders including First Financial Bankcorp, Cadence Bancorp and Equity Bancshares have all raised concerns about restaurant bankruptcies in 2019. Other causes for 2019's substantial number of restaurant bankruptcies include many chains also struggled with excessive debt, bad decisions, fast growth, overly aggressive cost cuts, revolving executives and, of course, litigation and related legal costs. Moreover, the impact of on-demand food delivery on the restaurant industry and its cash flow management could continue as more industry players enter the market.

Among the casualties of 2019 are:

- **iPic Entertainment,** the movie theater-restaurant chain that blamed the rising popularity of reclining theater seats for its decision to seek out federal debt protection. The company also had $200 million in secured debt and could not raise enough capital last year to fund its growth.

- **Perkins & Marie Callender's**, the operator of two family-dining chains that were broken up after a tumultuous 13-year marriage. It filed for its second bankruptcy this year with $115 million in debt, despite improving sales at its two brands. Prior to filing, the company operated more than 400 locations in the two brands, including 400 Perkins Restaurant & Bakery locations (134 company and 266 franchised) and 38 Marie Callender's restaurants (8 company and 30 franchised. The company didn't even recover half of that debt in the sale; most of what it did get came from the $51.5 million sale of Perkins to Huddle House.

- **Houlihan's Restaurants** cited third-party delivery in its decision to seek out credit protection, though it had been struggling for some time. The casual-dining chain ultimately sold itself to the Landry's restaurant group for $40 million, less than its $47 million in debt.

- **Kona Grill** went bankrupt in 2019, after having doubled in size between 2012 and 2017, when it had 46 upscale-casual restaurants. The company used debt to build the locations, and when many did not perform as projected, the company started slashing costs. When that failed to correct the restaurant chain's economic situation, the company fired its CEO and ultimately filed a lawsuit against him. The CEO, who resigned just before the chain filed for bankruptcy protection, unsuccessfully tried to buy the chain, which ultimately was sold to the One Group. Kona is now down to 26 locations, wiping out most of its previous growth.

- **Celebrity chef Jamie Oliver** saw his restaurant empire fall to bankruptcy protection in 2019. The court-appointed administrator of the group, accounting and consulting firm KPMG, said in a statement that 22 of Oliver's 25 restaurants have closed and 1,000 positions have been discontinued.

Undercapitalization, excessive debt and fierce competition from super-sized competitors certainly explain a lot of this. But there is a deeper insight to be gained as well.

Writing in *The New Yorker* about the Fairway Market bankruptcy, staff writer Adam Gopnick offered this analysis:

> What went wrong with Fairway will likely be a case study in business schools for years to come. It seems, to the casual observer, to have an ominous overlap with what went wrong with Dean & DeLuca—or, for that matter, with F. A. O. Schwartz—and more broadly with what has gone wrong for so much American retailing. (As of 2018, some twenty per cent of retail space in Manhattan is vacant.) The agonies of Fairway are almost too neatly a lesson for our time. The family opened three more stores, and sold an eighty per cent stake in the company, in 2007, to a private-equity firm that thought it could, so to speak, exploit the social capital—the good will and the reputation for egalitarian excellence—that the firm had built up over time, to vastly expand and make vastly more money. The stores were then passed around like a trinket among a bewildering assortment of other investors. The bankruptcy seems likely to cost the employees far more than it will the investors—not to mention the customers. This, too, is part of our time: a recent report in the Washington *Post* points out that private-equity firms "pooled money—often from pension funds, wealthy investors and financial firms—and relied on large swaths of debt to acquire companies like Mervyn's and Linens 'n Things, with the goal of turning them around. In practice, though, they routinely sold off real estate holdings, cut workers' pay and benefits, and jettisoned jobs to turn a quick profit for investors."
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> In Fairway's case, the expansion was undertaken at the very moment when urban retailing of all kinds was coming under the most intense competitive pressure it has in perhaps a century, from online sources—you can buy groceries from Amazon and FreshDirect—and, indeed, on the street, from national chains, including Whole Foods, which is now owned by Amazon. One can be a fan of the many good things about Whole Foods and Trader Joe's and also recognize that the homogenization of retailing is part of the homogenization of our lives. . . .
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> Every imaginable historical study and set of social-science data shows that the relationship between social capital—all those institutions of common space and trust, of casual encounter and shared memory—and healthy democratic government is as neatly tied, as robustly correlated, as two things can be. So the dislocation of common spaces into the online ether, though it is doubtless capable of being resolved in surprising ways we don't yet know, is a thing that we are right to be concerned about.[1]

Economists are divided as to whether a recession is looming on the horizon. Unemployment remains at a five-decade low, a development that looks to be translating into wage gains, especially for those at the bottom of the income scale. The gains, at about three-percent a year, are modest. Nevertheless, Goldman Sachs economists project they will continue to gain steam, rising to about 3.5 percent by the end of the year. And in a recent Washington Post poll released on January 28, 2020, 56 percent of Americans gave President Trump a thumbs-up on his economic stewardship , ten points higher than the last reading on that question in September and five points above the president's previous record, set in July of 2019.

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[1] Adam Gopnick, "Fairway and What We Mourn in a Store," The New Yorker (Jan. 25, 200); the full text of this article is accessible online at: https://www.newyorker.com/news/daily-comment/fairway-and-what-we-mourn-in-a-store

And yet, many economists estimate fourth-quarter growth will underwhelm, with projections at two percent or worse — far below the 3.5 percent growth or better Trump has promised. Annual growth should clock in around 2.2 percent and is projected to slow further next year. Perhaps most disconcerting of all is a comment that my partner from Gray Robinson's Banking and Finance Department, recently shared with me:

> I have been representing Banks and Financial Institutions for over 25 years and have experienced numerous recessions and economic down cycles. It has been my experience, anecdotal to be sure, that prior to each recession and economic down cycle there has been a spike in litigation by consumers against debt collectors and financial institutions collecting debts. As a nation, and particularly in Florida, we are experiencing a significant spike in claims and lawsuits by consumers related to efforts to collect debts by institutional lenders. In my opinion, consumer debt litigation is one reliable canary in the coal mine when forecasting a looming recession. This makes perfect sense, because consumers complaints about aggressive debt collection tactics indicate the consumers' growing inability to pay bills and creditors' increasing losses due to past due debt. Of course, other market and economic factors drive the depth and length of a recession; also, the timing of a recession can be manipulated by policy implementation and market manipulation. But if history is a guide, it seems a recession is looming.

Nobody knows for sure whether these trends will continue, escalate or subside. But they certainly warrant close attention.