

Sbarro's Latest Bankruptcy Can't Be Reheated Version Of 1st

By **Natalie Rodriguez**

Law360, New York (March 10, 2014, 8:49 PM ET) -- If Sbarro Holdings LLC hopes to make its second bankruptcy go-around more successful — and lasting — than its previous trip, the chain must dig in deep to carve off a chunk of its lease burdens, rework its bloated organizational structure and eke out new concessions from already burned creditors, experts say.

The troubled restaurant chain, which is crashing back into bankruptcy just two years after exiting Chapter 11 protection, is offering up a new debt-for-equity swap deal to lenders. But attorneys warn that for Sbarro to avoid ending up back in bankruptcy a third time, the company is going to have to make serious operational changes and have some tough talks with its unsecured creditors.

“You need to restructure not just financially, but also restructure and refocus the business. That may have been what was missing the first time around,” said David Rosendorf, a shareholder with Kozyak Tropin & Throckmorton PA.

The biggest factor will be how much Sbarro can cut down its expansive portfolio. Last month, the company announced it would cull another 155 from its 400 restaurants — but some say the Italian-food chain may have to cut even deeper to come out in fighting shape.

“I think it will come out [of bankruptcy] again, but it will come out considerably more lean than it was coming in,” said Thomas Fawkes, a bankruptcy attorney in the food industry team at Freeborn & Peters LLP.

The company also needs to transition away from its focus on mall locations — which no longer get the kind of foot traffic they used to before the recession — to more stand-alone operations, several experts noted.

“I think in order for Sbarro to survive, they're going to have to start looking at new locations,” Fawkes said.

While the company seems to be at least beginning to rejigger its real estate portfolio, it's less clear whether the company is prepared to rework its operational structure and refresh its branding to compete against new rivals, according to experts.

“I just don't know if they used the prebankruptcy period to look at, and modify, how they operate,” said Brent Weisenberg, an attorney with Ballard Spahr.

At first glance, the bankruptcy proceedings seem to be focused on balance sheet restructuring, with the company's debtors agreeing to let Sbarro reduce its outstanding secured debt by about 80 percent and extending some \$20 million in debtor in possession financing.

While these steps may make it easier for the company to achieve an operating profit, experts say filing for Chapter 11 bankruptcy so soon after exiting — a phenomenon some in the industry dub a “Chapter 22” filing — does not bode well for the company's future.

“Chapter 22 cases are usually liquidations, but this one is not structured that way: It is a prepackaged deleveraging,” Lisa Hill Fenning of Arnold & Porter, a former California bankruptcy judge, said. “Although the sample set is pretty small, Chapter 22 reorganizations do not have a high success rate in the long term.”

The company is also in a sticky situation with lenders that have already been asked in the not-too-distant past to make concessions for the good of the restaurant chain, according to experts.

“Most creditors came away empty-handed. Even the first lien holders didn't recover in full,” Fawkes said. “I would think that in a second Chapter 11 filing, unsecured creditors burned in the first go-around will be less willing to make concessions unless they see something for themselves at the end of the day.”

Because of Sbarro's new repeat offender status, suppliers will probably ask for cash in advance or extremely short payment terms to try to protect themselves, according to Fawkes. And the terms under which Sbarro obtains financing are probably going to be more expensive, Hahn said.

But while such quick returns to bankruptcy court often open a company up to claims of a bad faith filing from creditors, Ken Russak of Frandzel Robins Bloom & Csato LC said the prepackaged nature of the case may keep Sbarro safe.

“If there truly is a 'prepackaged' plan in place, the 'bad faith' argument probably won't be made at all, because prepackaged means that sufficient votes to accept the plan have been lined up in each class of creditors so that a 'cramdown,' [or] contested confirmation battle, can be avoided,” Russak said.

Even if a group of minority creditors starts crying foul, the judge would likely overrule if there is overwhelming support from other creditors, experts say. Furthermore, Edwards Wildman partner Jonathan Young pointed out that alongside the debt-for-equity swap, Sbarro has also proposed an open auction for its operating assets.

“Thus, in addition to virtually unanimous lender support, Sbarro can also point to the fact that it has subjected its proposed restructuring to the market, and, absent an overbid, demonstrated the reasonableness of its valuation assumptions,” Young said.

And those about to take ownership of Sbarro hopefully will take advantage of the benefits of hindsight, some say.

“The second cycle of bankruptcy is usually not any better for unsecured creditors than the first,” Rosendorf said. “But there can be lessons learned, so there's an opportunity here for whoever takes ownership of the reorganized entity ... to try to reposition the business.”

The prepackaged bankruptcy will likely mean a speedy proceeding — even as short as a handful of weeks, according to some experts.

“I suspect that you'll see a relatively quick bankruptcy where the debtor's balance sheet will be restructured and the company's store footprint will be reduced,” Weisenberg said. “Sbarro will use this as an opportunity to modify their leases, and landlords that don't play ball may face a closure of their store.”

Probable side litigation with landlords over proposed lease rejections and related damage claims, however, could trample Sbarro's hopes to exit bankruptcy in the early summertime, according to Young.

Nevertheless, its heavy emphasis on malls may work in Sbarro's favor in negotiations, as a common company will be holding many of its leases. “You can approach them as a package and say we would like to treat your leases uniformly,” said Patton Hahn, co-chair of Baker Donelson Bearman Caldwell & Berkowitz PC's financial institutions litigation subgroup.

In the end, the company will have to emerge from bankruptcy a much slimmer and more competitive company to survive.

“The bankruptcy will fix the company's balance sheet and footprint, but the question is whether this will fix the company's real problems or just the symptoms,” said Andrew Glenn, a partner with Kasowitz Benson Torres & Friedman LLP's bankruptcy practice.

—Additional reporting by Dan Ivers. Editing by Kat Laskowski and Chris Yates.