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Private Equity Firms and Hedge Funds' Distressed Investments in JC Penney's Chapter 11 Case and Overview of Distressed Retailers and Malls During the Ongoing COVID-19 Pandemic

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The government bailout of corporate bonds and other distressed securities after the onset of the COVID-19 pandemic led to extreme leveraging and risk taking in the stock market all the while market prices for commercial properties, which became vacant and unused due to the lockdowns imposed in response to the pandemic, went considerably down to pricing levels of distressed assets; in other words, fire sale pricing.¹ Along with the ever increasing use of e-commerce, remote work and remote meetings, a new world emerged; a paradigm shift. This article provides a detailed examination of private equity firms and hedge funds' investments in the distressed retailer JC Penney, a 120-year-old company, in Chapter 11 bankruptcy along with an overview of the distressed investing environment for retailers and malls during the ongoing pandemic. The pandemic's impact on brick and mortar businesses such as retailers and malls has been constant and ongoing since the pandemic began over two years ago in March 2020.

This article tells the story behind the rescue of iconic retailer JC Penney in Chapter 11 bankruptcy in which after several months of contentious

negotiations, the retailer was saved from liquidation, and the inner workings of private equity firms and hedge funds involved in the reorganization process. At one point in the JC Penney case, negotiations became so unproductive that the bankruptcy judge in the case, bluntly told the parties that "[n]egotiating postures and egos" must be set aside so that JC Penney's business could survive; saving 60,000 jobs in the process. JC Penney's Chapter 11 bankruptcy featured three bidders, two feuding ad hoc groups made up of 26 private equity firms and hedge funds, the usual push for recovery from the unsecured creditors committee and a very persistent ad hoc equity committee who fought the depressed valuation of the company's assets to the bitter end.

Valuation is more of an art than a science. Valuation during the ongoing pandemic has been daunting and the lack of commitment from buyers given the uncertainty of the pandemic has consistently resulted in especially low asset prices and valuations. The JC Penney case was no exception. After five months of marketing its real property assets and operating company in a Section 363 auction,² JC Penney was unable to obtain a bid that was satisfactory to JC

Penney's board, secured lenders and the bankruptcy judge; the uncertainty of the pandemic had depressed the amounts that bidders offered. During the pandemic with so much uncertainty as to the future of retail businesses and the reluctance of buyers in 363 assets sales, as in the JC Penney case, valuation posed an even more daunting task than usual.

While mall properties and underlying mortgages prior to the pandemic were trending downward in distress, the pandemic further exacerbated the dire circumstances of malls. So much so that by early 2021, investor Carl Icahn had profited \$1.3 billion by purchasing credit default swaps to "short," meaning to bet on the decline of the index tracking the mortgage-backed securities (MBS) for commercial real estate, which pools the mortgages of malls and other commercial properties. The shorting of the MBS of commercial real estate had a certain déjà vu quality since traders had used credit default swaps to successfully short the MBS of residential real estate in the 2008 crisis. In regards to identifying investment opportunities and investing in distressed Chapter 11 bankruptcies, in his recently released documentary, Icahn remarked that "you have to buy things where the rest of the world are looking at you and thinking you're a little bit crazy. You're going against the trend."³

JC Penney's Chapter 11 Bankruptcy

The bankrupt company, also commonly referred to as the "debtor," in Chapter 11 is known under the US Bankruptcy Code as the "debtor-in-possession" (DIP). DIP loan financing is financing that a lender provides to the debtor during bankruptcy. Detailed disclosures from the Bankruptcy Rule 2019⁴ filings are in Exhibit 1 at the end of this article for both the Ad Hoc First Lien Majority Group and Ad Hoc First Lien Minority Group including the names of 26 private equity firms and hedge funds and their investment positions in the capital structure of JC Penney such as the amounts for each specific tranche of pre-bankruptcy secured debt and the DIP loan tranche.⁵ An official committee of unsecured creditors or equity holders requires the US Trustee to appoint

them. In contrast, an ad hoc group or committee, which is an unofficial group or committee, does not need the US Trustee to appoint them in order to be formed; ad hoc groups or committees are voluntarily created by stakeholders with common objectives. By forming an ad hoc group or committee, hedge funds and private equity firms can pool their debt claims together to collectively engage more effectively in investment strategies such as providing DIP financing to exert control over the reorganization in Chapter 11 and facilitate investment strategies such as a loan-to-own strategy, a blocking position or other investment strategy, as explained below.

Prior to filing for Chapter 11 bankruptcy, JC Penney had been restructuring its business operations for two years in response to the decline in its brick-and-mortar retail sales and had been working with its creditors to restructure its nearly \$5 billion of total secured and unsecured debt.⁶ Then, the pandemic arrived in the United States, and shortly after, in mid March 2020, to protect its customers and employees in response to the pandemic, JC Penney decided to close all of its stores and reduce its supply chain operations.⁷

Two months later, by mid-May 2020, with the sudden lack of revenue and lack of liquidity further exacerbating the company's pre-existing financial distress, JC Penney and its affiliates, collectively "the debtors," filed for Chapter 11 bankruptcy in the US Bankruptcy Court for the Southern District of Texas, with the terms of the restructuring support agreement (RSA) and a DIP loan already agreed on with a majority of its first-lien creditors.⁸ JC Penney stated it needed the DIP loan to reopen stores closed because of the lockdown during the pandemic and urgently needed to reorganize quickly to save "nearly 85,000" jobs.⁹

Prior to the DIP loan hearing, two ad hoc creditor groups, the First Lien Majority Group and the First Lien Minority Group intensely fought over which group should get the financing. The First Lien Majority Group included H/2 Capital Partners LLC and Silver Point LP, while the First Lien Minority

Group included the investor Aurelius Capital Management.¹⁰ The First Lien Majority Group proposed a DIP loan of \$900 million, including \$450 million of new funds, a roll-up of \$450 million; the loan was self priming, which means the loan would not put liens on collateral that already had pre-existing liens from other lenders.¹¹ The First Lien Minority Group's DIP proposal had lower fees and interest rate and did not have a roll-up; however, the loan was not self priming meaning it required a lien be put on collateral that secured the asset based loan facility (ABL Facility), and the proposal did not have a negotiated RSA or business plan.¹²

The First Lien Majority Group's DIP loan provided JC Penney immediately with funds of \$225 million once the court approved and entered the DIP loan order.¹³ The terms of the RSA included two "toggle events" on July 15 and August 15 of 2020. Under the first toggle event, on July 15, the remainder of the DIP loan, \$225 million would be made available if 66.7 percent of the First Lien Majority Group approved JC Penney's business plan.¹⁴ Under the second toggle event, on August 15 of 2020, there was a deadline for JC Penney to obtain binding commitments for all of its third-party financing, which required approval from the First Lien Majority Group.¹⁵

Under the terms of the RSA, if either of the toggle events was not satisfied, JC Penney would then be required to immediately toggle to a 363 asset sale.¹⁶ The RSA provided that JC Penney would place certain retail stores into a real estate investment trust (REIT), which would serve as the landlord to and collect rent from these stores, and the RSA also provided for the creation of a new separate operating company for JC Penney's business operations and that JC Penney would sell its distribution centers.¹⁷

Minority Group's Objection, Expert's Report and DIP Hearing in June

On June 2, 2020, the First Lien Minority Group filed with the court an objection stating that the First Lien Majority Group's terms were "predatory" and come "at the expense of employees, customers,

vendors and other creditors" and objected to the RSA's two toggle events, which the objection characterized as the First Lien Majority Group threatening to use their majority first lien position to "force" JC Penney "into liquidation if they don't get their way"; the majority group held 73 percent of the first lien debt, well over the 2/3 votes needed to have a majority position.¹⁸ Further, the objection claimed the First Lien Majority Group's DIP loan proposal was a "sub rosa plan," in violation of Section 1125 of the Bankruptcy Code, which had the practical effect of dictating the terms of a plan of reorganization in the future prior to a bankruptcy court's approval of a disclosure statement and solicitation of votes for the plan and that courts have ruled sub rosa plans cannot be approved without satisfying the solicitation and plan confirmation requirements of the Bankruptcy Code.¹⁹ The objection also stated that the roll-up and cross-collateralization provisions of the First Lien Majority Group's DIP loan were inappropriate, the loan fees were excessive, the milestones were unreasonably short and that the First Lien Minority Group's DIP loan proposal clearly offered better terms than the Majority Group's proposal.²⁰

In a report filed on June 2, on behalf of JC Penney, an expert stated that the First Lien Majority Group's DIP loan was negotiated in good faith and was the result of arm's length negotiations and that the First Lien Minority Group's proposal would lead to a lengthy and "costly priming fight."²¹ The expert further explained that it would be difficult for a court to confirm a plan of reorganization if the majority group did not support such plan because JC Penney would need to raise enough funds to pay off claims in full, which would be challenging under the circumstances, or obtain sufficient debt to allow for cram down of the plan, which would cause JC Penney to be highly leveraged.²²

During the DIP loan hearing, JC Penney's counsel, Joshua A. Sussberg, stated to the court that the First Lien Minority Group's proposal was not actionable since the ABL Facility lenders, which included Wells Fargo, would not consent to their collateral

being primed; it jeopardized the consensus reached with the First Lien Majority Group, which had 73 percent of the first lien debt and would cause a time consuming and costly priming fight, and also jeopardized JC Penney's only path to keeping 85,000 jobs.²³ JC Penney's counsel also argued that the most favorable economic terms do not, as in this case, mean the best terms and bankruptcy courts have approved less economically favorable DIP loans and deferred to the debtor's business judgment.²⁴ On behalf of JC Penney, at the DIP hearing, an expert testified that JC Penney would run out of money at the end of August 2020 without DIP financing.²⁵ Later in the hearing, JC Penney's counsel stated that the First Lien Majority Group and the First Lien Minority Group had reached a settlement over the DIP financing and that under the settlement terms, the Minority Group would be allowed to participate in the DIP financing and convert \$53 million of its pre-petition debt claims into the post-petition DIP loan, which makes the loan a higher priority of recovery in Chapter 11.²⁶

On June 4, 2020, the court held a five-hour DIP loan hearing, in which JC Penney's counsel and expert witnesses provided the previously explained arguments and evidence and they further reiterated that JC Penney's lack of liquidity required immediate DIP loan financing to keep the business operating as a going concern. After the five-hour hearing, and considering the absence of a feasible alternative DIP loan proposal, Judge David R. Jones acknowledged that approving the DIP loan was "the only path forward" that he could see and approved the First Lien Majority Group's DIP loan and RSA proposals and approved the settlement agreement with the First Lien Minority Group; thus, incorporating the modified terms of the settlement agreement into the DIP loan proposal.²⁷

363 Sale Marketing Process and Bidding

Acting as a single bidder on JC Penney's assets, mall landlords Simon Property Group and

Brookfield Asset Management joined together in a joint venture (hereafter, Simon & Brookfield JV). JC Penney's Chapter 11 case included a five-month marketing process for the 363 sale of assets. In early June 2020, according to reports, private equity firm Sycamore Partners was in preliminary talks to acquire JC Penney.²⁸ Reportedly, in July of 2020, Hudson Bay Co., a retail business company, placed a bid of \$1.7 billion, Simon & Brookfield JV offered a bid of \$1.65 billion, and Sycamore Partners offered the highest bid of \$1.75 billion to acquire JC Penney.²⁹

Sycamore's bid was subject to approval from Judge Jones, JC Penney's secured lenders and board.³⁰ JC Penney never officially announced or acknowledged that Sycamore or Hudson Bay had placed a bid. Sycamore would have rebranded the JC Penney stores it kept into Belk's branded stores and planned to sell the rights to JC Penney's name at a later date, according to sources.³¹ While Sycamore Partners' bid offered a slightly higher amount, Simon & Brookfield JV's bid offered certain concessions over lease agreements that JC Penney and its lenders viewed as providing greater value, according to sources close to the bidding.³² Also, under the terms of Sycamore Partners' bid to buy JC Penney's assets, the assets would have been merged with Belk, a retailer also owned by Sycamore; but would have only kept 250 stores operating, the rest of the stores would have been liquidated and 40,000 jobs would have been eliminated at JC Penney.³³

In August 2020, former and current employees of several private equity owned retailers organized with the organization United for Respect in order to oppose Sycamore's bid and sent a letter to Judge Jones; the letter asked Judge Jones to place a priority on saving jobs in selecting a buyer in the JC Penney's 363 asset sale.³⁴ Moreover, the letter stated that "Sycamore Partners has a history of stripping assets from retailers, leading to store closures and layoffs at retailers like Nine West and Aeropostale... [approving a sale to Sycamore] will shed 44,000 jobs is not what J.C. Penney—or our country—needs right now."³⁵

The negotiations for the sale had dragged on. After a five month sale process in which three bidders failed to produce a satisfactory bid agreeable to JC Penney's board, its secured lenders and Judge Jones, JC Penney's counsel noted that negotiations for the asset sale had reached a point of deadlock and that time was running out for JC Penney to avoid liquidation, the company's secured "lenders are no longer going to be held hostage in negotiations" and that the company intended to negotiate and document the deal within the next 10 days.³⁶ Several of the milestone deadlines that the DIP lenders contractually imposed had passed and been extended.³⁷

Time was running out to keep JC Penney viable as a going concern operating business; a liquidation would end the company's retail operating business and layoff most of its remaining 60,000 employees; when JC Penney filed for bankruptcy it had 85,000 employees.³⁸ Originally, the 363 sale milestone date was August 30 but the parties agreed to extend beyond that date. On August 19, 2020, Judge Jones in a court order for a status conference, remarked that his concern had escalated due to the lack of progress with the asset sale and that "thousands of jobs and the very essence of the country's infrastructure are at risk." Jones added that the "parties have reached the end of the Court's patience. Negotiating postures and egos will be put aside."³⁹ A week and a half later, in a status conference, JC Penney's counsel stated to Judge Jones that problems still remained with negotiations and that "certain negotiating postures and egos, however, have not necessarily been set aside."⁴⁰ On September 10, 2020, the parties finally reached an agreement in principle by entering into a letter of intent in which JC Penney and the First Lien Majority Group agreed to sell the operating business to the Simon & Brookfield JV and the First Lien Majority Group would buy certain real estate properties.⁴¹ This bid was the only bid that J.C. Penney officially announced as a "qualified bid" under the bidding procedures of the asset purchase agreement.

Under the terms of the bid, the First Lien Majority Group would exchange about \$1 billion of debt for ownership of 160 of JC Penney stores and six distribution centers, referred to as "PropCo" in the asset purchase agreement (APA) and Chapter 11 plan of reorganization, and the First Lien Majority Group would receive rent payments from JC Penney, as a tenant; JC Penney's operating assets, referred to as the "OpCo" in the APA and plan would be sold to Simon & Brookfield JV for \$800 million; paying \$300 million in cash and assuming \$500 million in debt.⁴²

Minority Group and Creditor Committee Oppose the Qualified Bid

The First Lien Minority Group argued, in an objection filed with the court, that the First Lien Majority Group's bid grossly undervalued JC Penney's PropCo assets.⁴³ JC Penney and its lawyer were concerned that the First Lien Minority Group's objection could lead to a costly and time consuming battle in court; JC Penney's counsel warned that the sale needed to be closed promptly to preserve the business as a going-concern and avoid liquidation.⁴⁴ The First Lien Minority Group did not oppose the OpCo portion of the proposed sale, in which the Simon & Brookfield JV would acquire JC Penney's business operations, and save about 60,000 jobs and keep the business alive as a going concern avoiding liquidation.⁴⁵ The OpCo portion, for Simon and Brookfield to buy the operating business, of the proposed sale was composed of a cash amount of \$300 million and credit bid of \$500 million and for the PropCo portion, which is included 160 real estate properties and 6 distribution centers, the First Lien Majority Group offered a credit bid of \$1 billion of which \$900 million of it was DIP claims and the remaining \$100 million of it was in first lien debt claims.⁴⁶ Also, the terms of sale provided that JC Penney's real estate would be reorganized into two REITs, one for retail properties and one for distribution centers.⁴⁷ The REITs and the new operating

company would enter into master lease agreements for the properties.⁴⁸

Despite reaching a deal in principle on September 9 just before the deal deadline, the parties still were unable to fully agree on certain details in an October 15 court filing, JC Penney stated that JC Penney, the Simon & Brookfield JV and the First Lien Majority Group continued to be “engaged in mediation discussions regarding certain issues, including those relating to working capital, certain closing adjustments, and key elements of the master lease agreement.”⁴⁹ In an telephonic hearing on October 20, 2020, several attorneys stated that the master lease agreements were still being negotiated and involved complex issues; indeed Judge Jones also acknowledged the complexity of the master lease agreements, which were crucial to complete the asset sale transaction.⁵⁰

In their objection, the First Lien Minority Group argued that the Simon & Brookfield JV and First Lien Majority Group’s bid “grossly undervalue[d] the debtors’ assets in order to deliver outsized recoveries to members of the DIP loan holders and to the detriment of first lien holders.”⁵¹ Indeed, under the terms of the bid, 90 percent, \$900 million, of the First Lien Majority Group’s credit bid of \$1 billion for PropCo was going to DIP loan claims while only 10 percent, \$100 million, was going to first lien holders and the First Lien Majority Group owned 94 percent of the DIP loans while the First Lien Minority Group only owned the remaining 6 percent.⁵² In the objection, First Lien Minority Group proposed a bid of \$1.8 billion for the PropCo and OpCo assets. Under the Minority’s bid terms, the DIP loan lenders and the first lien debt lenders would recover equally. Each lender tranche recovering \$900 million; because the Minority Group held just 6 percent of the DIP loans but held 24% of the total first lien debt under the Minority’s bid terms their recovery would be far greater, recovering an additional \$192 million for their first lien debt position than the First Lien Majority’s bid proposal.⁵³ Exhibit 1 presents a more detailed breakdown of the recovery for the

DIP loan and first lien debt tranches. Such recovery terms were indeed “much higher and much better for creditors,” than the First Lien Majority Group’s initial bid, as the First Lien Minority Group’s attorney stated at a hearing.⁵⁴

By October 26, 2020, at a status conference, JC Penney’s counsel said the master lease agreements, which govern the relationship between PropCo and OpCo, were finalized and the asset sale was ready for the court’s approval.⁵⁵ At the conference, JC Penney’s counsel stated that the First Lien Majority Group’s bid was the only one with a viable path for JC Penney to successfully reorganize and stated that for “five months the process was open to any and all parties.”⁵⁶ We have one bid to save the enterprise from Simon, Brookfield and the first-lien lenders,” and that JC Penney’s board of directors considered the First Lien Minority Group’s bid and determined it would not maximize the value of the assets.⁵⁷ The board of directors has a fiduciary duty to maximize the value of the bankruptcy estate.⁵⁸

Valuation Disputes

Leading up to the 363 sale hearing, the First Lien Minority Group and the equity committee both argued that the bid by the First Lien Majority Group grossly undervalued JC Penney’s assets. The Minority Group argued that the structuring of the sale would result in a disproportionate amount of value going to the Majority Group at the expense of other creditors and that the bid and sale process “evidences a lack of good faith.”⁵⁹ Also, in an objection filed with the court, the ad hoc equity committee argued that the bid grossly undervalued JC Penney assets, which they claimed were worth \$6.6 billion and that the equity alone could be worth as much as \$3.2 billion.⁶⁰ Because about \$5 billion in debt needed to be repaid to creditors before equity holders would be able to recover for their claims, recovery for the equity holders seemed unlikely. At a hearing, in regards to the ad hoc equity committee’s assertion that JC Penney’s value was \$10 billion, JC Penney’s counsel suggested that the amount had no reasonable

basis by stating the amount was “not ground in facts, law or any valuation principles.”⁶¹

Regarding the bid and Chapter 11 plan, the attorney for the ad hoc equity committee stated that there is “no analysis being done whatsoever as to whether this entire transaction actually recovers more for creditors than a Chapter 7 liquidation.”⁶² The First Lien Minority Group’s attorney stated the disclosure statement lacked a liquidation analysis, which is an absolute requirement and meant the disclosure statement should not receive court approval.⁶³ The First Lien Majority Group stated that its bid seeks to provide the highest value possible for the PropCo assets.⁶⁴

The next week in early November, a few days prior to the sale hearing, JC Penney agreed on a settlement agreement of \$40 million with the First Lien Minority Group to resolve the Minority Group’s objection to the sale, and also agreed to a settlement agreement with the unsecured creditor committee, which withdrew its objections to the asset sale in exchange for a \$110 to \$140 million fund for general unsecured creditor claims and \$1.5 million for second lien note claims.⁶⁵ Also, the settlement provided that the First Lien Minority Group would not be liquidated out of the DIP portion of the credit bid.⁶⁶ The settlement also states that neither JC Penney nor the First Lien Majority Group would take any action to dilute or adversely affect the “allocation of value” to the First Lien Minority Group in connection with the asset sale and credit bid, which included future allocations of distributions attributable to earnout provisions in the sale transaction or opportunities to participate in financing transactions in the future.⁶⁷ Under the terms of the settlement agreement with the unsecured creditor committee, JC Penney will pay up to \$6 million in professional fees and expenses that the unsecured creditor committee incurred and the unsecured creditor committee agreed to stop opposing the asset sale and to support consummation of the sale.⁶⁸ The parties to both settlements stated that the US Bankruptcy Judge Marvin Isgur’s mediation of disputes were crucial to reaching the separate settlements

with unsecured creditor committee and the Minority Group.⁶⁹

Prior to the sale hearing, on October 20, JC Penney filed with the court its Chapter 11 plan of reorganization and disclosure statement.⁷⁰ The plan provided that shareholders would not recovery any value for their interests and the stock would cancel; second lien holders and unsecured creditors would not recovery any compensation for their claims.⁷¹ The voting deadline for the plan was about a month later on November 17 and the confirmation hearings with the court were set for November 24 and 25.⁷²

363 Sale Hearing on November 9

After several delays, the consummation of the asset sale came down to the last minute; JC Penney’s financing agreement was scheduled to expire six days later on November 16 and the sale needed to be closed by November 20 to avoid liquidation.⁷³ On November 9, after a sale hearing that lasted nearly 12 hours, Judge Jones approved the 363 sale.⁷⁴ The terms of the asset sale provided that bondholders, vendors, landlords, some uninsured retiree beneficiaries and shareholders would not recovery anything; but the sale saved over 60,000 jobs and allowed JC Penney’s business to continue operating in the future.⁷⁵ The hearing focused on whether the court should approve the sale, which would keep JC Penney’s business operations alive yet leave equity holders without recovering any value.⁷⁶ During the hearing, JC Penney’s counsel and financial advisers argued that the sale was JC Penney’s only hope to survive and without the sale, liquidation would surely be the result.⁷⁷ In approving the asset sale and stating that while he sympathized with equity holders who objected to the sale, the sale gave JC Penney the best chance at remaining a going concern, Judge Jones reasoned, and therefore approved the sale of JC Penney’s operating and real estate assets pursuant to section 363.⁷⁸

At the sale hearing, after the ad hoc equity committee presented their alternative restructuring plan, Judge Jones stated that approving the equity

committee's plan would be "gambling with 60,000 jobs."⁷⁹ Under the approved sale terms, pursuant to a master lease agreement, the real estate assets would be leased back to the operating company, the OpCo, which the Simon & Brookfield JV own.⁸⁰ JC Penney's counsel and expert witnesses stated that the Simon, & Brookfield JV and First Lien Majority Group's bid was the only qualified bid set forth over a five month marketing process and also with the DIP loan maturing November 16th, the holiday shopping nearing, employees leaving and vendors in need of immediate payment, the court needed to immediately approve the sale to avoid liquidation.⁸¹ JC Penney's counsel remarked that it "cannot be overstated these debtors must move forward on an expedited basis. This has taken too long."⁸² The court's approved sale also provides for recovery for claims of the federal Pension Benefit Guaranty Corp., which announced, on November 6, 2020, that it would assume sponsorship of JC Penney's pension plan.⁸³

The equity committee's counsel asserted that the DIP loan turned out be unnecessary since half the DIP loan funds have not been used because JC Penney's cash had been above its original financial projections, and the other half of the DIP loan funds are in an escrow account to the lenders, who neither accepted nor rejected the business plan JC Penney submitted in July as a requirement to be permitted to draw on the second tranche of the DIP loan; rather the DIP loan only served as leverage to force a sub rosa Chapter 11 plan that grossly undervalued the company leaving no recovery for the equity holders, he argued.⁸⁴ Also, the equity committee's counsel argued that JC Penney and the lenders by dragging out the sale negotiations over five months "create[d] their own emergency...[and] put themselves in this position."⁸⁵ Further, he argued that the marketing was not a "fair market test" since it was done at the peak of the pandemic while most of the company's stores were closed, and it was not clear when the stores could open.⁸⁶

At the hearing, Judge Jones stated that the equity holders' value was "gone long before today."⁸⁷ Including the DIP loans of \$900 million, JC Penney had over \$7 billion of outstanding debt. JC Penney's counsel noted the "economic reality" that the global pandemic has "no end in sight" and the company had exhausted "any and all opportunities" in negotiating a sale.⁸⁸ JC Penney managed to gain a consensus of support from the First Lien Minority Group and the unsecured creditors committee including the bondholders and trade vendors by entering into separate settlement agreements prior to the hearing.⁸⁹ After the settlements, both the Minority Group and the unsecured creditors committee filed with the court, statements supporting the 363 sale as the only viable path for survival for JC Penney.⁹⁰

JC Penney's counsel noted that while the company did unfortunately downsize from 80,000 employees to 60,000, the company did utilize the "tools inherent in the Bankruptcy Code...to facilitate what will be a vibrant going-concern business for many years to come."⁹¹ Given that the Chapter 11 process allowed JC Penney to extinguish over \$7 billion of debt and transfer assets "free and clear" under Section 363, close over 200 hundred unprofitable stores by rejecting leases or assuming and assigning leases for value to third parties via Section 365 of the Bankruptcy Code and facilitate settlement agreements with creditors, the unique tools of the Bankruptcy Code did indeed enable thorough restructuring of JC Penney's business giving it a reasonable chance of maintaining a "vibrant going-concern business" in the foreseeable future even in today's rough business environment for retailers.

The equity committee's counsel argued that the First Lien Majority Group engineered the asset sale, which greatly undervalued JC Penney's assets and resulted in no recovery for equity holders. Also, the equity committee's expert proposed JC Penney unwind the DIP and reinstate the secured debt and exchange unsecured debt for equity, and stated that even if the DIP were not unwound, the

DIP could be repaid with cash and new financing.⁹² On cross examination of the expert for the equity committee, JC Penney's counsel stated that the equity committee's higher valuation, which was over four times higher than the qualified bid, assumed a sale at an unknown point in the future after the pandemic ended.⁹³ Further, JC Penney's counsel argued the company's current cash position occurred because vendors were reluctant to sell inventory to JP Penney that it needed and one-time events including clearance sales at locations that are closing and that JC Penney's assets once sold would not be able to cover the \$7 billion in claims required to be paid before equity holders would be able to recover, and, thus "[n]othing changes the economic reality."⁹⁴ There's no recovery for equity," he remarked.⁹⁵ Judge Jones, stated that while the equity committee's expert was persuasive, the expert's proposed plan required too many assumptions to be feasible.⁹⁶

In the 363 asset sale, as part of the process of isolating the assets away from entities affiliated with JC Penney, via the entity Copper Retail JV LLC, Simon & Brookfield JV purchased the OpCo assets, and via the entity Copper BidCo LLC, the First Lien Majority Group purchased the PropCo assets, from the seller, JC Penney. The First Lien Majority Group transferred the PropCo assets to a trust entity, which has four subsidiaries, as shown in Exhibit 1, and discussed further below. Currently, the operating company, Penney OpCo LLC, a private company, is doing business as JC Penney outside of Chapter 11. The entity holding the OpCo assets, has two subsidiary entities, one entity, SPV-RE, which acquired JC Penney's remaining owned and ground leased properties as well as related assets and, the second entity, SPV-IP, which acquired JC Penney's intellectual property assets.⁹⁷ At the closing of the 363 sale of OpCo and PropCo assets, a separate entity, a liquidation company acquired certain debt claims of JC Penney that relate to MasterCard, Visa and related litigations and rights to any amounts returned from the Synchrony reserve.⁹⁸

Per the asset sale and master lease agreements, Simon & Brookfield JV agreed to assume the master leases for 20 years plus five options of renewing each five years in length and will pay annually \$121.2 million for the retail leases and \$35.4 million for the distribution center leases.⁹⁹ Analysts have estimated that JC Penney stores are in about half of Simon's malls. JC Penney is recognized as an influential anchor tenant and, according to retail analysts, Simon and Brookfield, independently as separate mall owners, need JC Penney to survive as a brick-and-mortar retailer since JC Penney's powerful advertising drives customers to Simon and Brookfield's malls, and thus, Simon and Brookfield need JC Penney retail stores to remain operating so other tenants stay in their malls and to encourage new tenants to sign leases for their malls.¹⁰⁰

As to the valuation of JC Penney's assets, which meant no recovery for the shareholders, bondholders and other stakeholders, Judge Jones stated that "the evidence is overwhelming."¹⁰¹ At the sale hearing, JC Penney's investment banker testified that during the five month sale process, 100 parties had looked at JC Penney and no party was willing to pay more for JC Penney than the court approved bid.¹⁰²

In court filings and hearings, the equity committee argued the sale process was designed in a manner that prevented recovery for unsecured creditors and equity holders and argued that JC Penney had overstated its financial distress.¹⁰³ Also, the equity committee, in court filings, stated that JC Penney's DIP loan turned out to not be necessary and that the DIP lenders used their position to negotiate a deal that disproportionately benefits them at the expense of other creditors.¹⁰⁴

JC Penney argued, in a court filing, that "[n]o one is willing to clear the first-lien debt to acquire the debtors, let alone provide a recovery to second-lien holders, unsecured creditors, or shareholders—who are billions out of the money... the debtors' ABL lender [Wells Fargo] is only willing to support the go-forward company with the deleveraged capital structure contemplated by the anticipated sale

and plan.”¹⁰⁵ The valuation dispute demonstrates the conflict in many bankruptcy cases regarding the actual value of the bankrupt company’s assets and how the value will be distributed among unsecured creditors and shareholders, who are last in priority to recover in bankruptcy.¹⁰⁶

Hearings in Late November and December

On November 24, 2020, at a remote hearing, the equity holders committee agreed to drop its objections to JC Penney’s proposal for distributing the assets of the \$1.75 billion asset sale after Judge Jones offered to remove the legal releases for equity holders from the Chapter 11 plan and offered to be a “gatekeeper” of the shareholder lawsuits, sorting derivative shareholder claims from personal claims.¹⁰⁷ After a short break, in which the equity committee counsel conferred with the committee members, the committee agreed to Judge Jones’ proposal, and the Judge approved the Chapter 11 plan.¹⁰⁸ On November 25, 2020, Judge Jones confirmed, meaning he approved, JC Penney’s plan of reorganization for the PropCo assets, pursuant to the company’s asset purchase agreement with the Simon & Brookfield JV and the First Lien Majority Group and supported by the First Lien Minority Group and the unsecured creditors committee.¹⁰⁹

On December 7, 2020, JC Penney closed on the 363 asset sale, of the PropCo and OpCo assets, which had been approved by Judge Jones on November 9, 2020.¹¹⁰ With closing of the asset sale, JC Penney obtained access to \$1.5 billion of new financing including a new ABL Facility loan, led by Wells Fargo and FILO Facility loan in order to allow JC Penney’s exit from Chapter 11 bankruptcy.¹¹¹ The negotiating of the particularly complex master lease agreements, lasted all the way up to closing of the 363 asset sale; an attorney for JC Penney’s lenders stated that the master lease agreements are the “most complex document[s] I’ve ever seen” and Judge Jones also referred to the agreements as the “most complex lease agreements known to mankind.”¹¹²

The First Lien Majority Group and the First Lien Minority Group negotiated the asset purchase agreement via marathon mediation meetings, which included weekends, with Judge Isgur, according to JC Penney’s counsel.¹¹³

PropCo Assets Transferred to Trust

In late December of 2020, a SEC filing released the details regarding the management of the PropCo assets.¹¹⁴ The First Lien Majority Group transferred the PropCo assets to the Copper Property CTL Pass Through Trust, a liquidating trust for tax purposes. This trust has four subsidiaries, a trustee and a manager.¹¹⁵ To aid in visualizing the relationships between the entities involved with the trust, at the end of this article is an Exhibit with an organizational chart of the trust, its subsidiaries, manager to the trust, and trustee.¹¹⁶

The trust owns, directly or indirectly, 100 percent of the equity interests in four subsidiary entities, CTL Propco I LLC, CTL Propco I LP, CTL Propco II LLC and CTL Propco II LP, own the fee simple or ground leasehold title to the PropCo assets, the 160 retail properties and 6 warehouse distribution center properties, acquired in the 363 asset, which have been leased pursuant to two separate triple-net master leases to an entity or entities, which are one or more newly formed subsidiaries of Copper Retail JV LLC, the entity that acquired the OpCo assets, controlled by the mall landlord Simon and Brookfield.¹¹⁷ The CTL Propco I LLC entity is the general partner to the CTL Propco I LP entity. The CTL Propco II LLC is the general partner to the CTL Propco II LP entity.¹¹⁸ If the properties are not sold within a year of the effective date of the trust’s registration statement or longer period approved by a majority of the certificate holders of the trust, then the properties may be transferred to a newly-formed REIT, added to an existing REIT or transferred into other investment vehicles; the transfer would need to be approved by a majority of certificate holders.¹¹⁹

The manager of the trust is Hilco JCP, LLC and is unaffiliated with the trust except that each

of the trust's officers is an officer of the manager.¹²⁰ Hilco is an affiliate of Hilco Real Estate LLC, which provides strategic services for real estate disposition and repositioning.¹²¹ GLAS Trust Company LLC entity is the trustee of the trust and is unaffiliated with the trust and the tenants.¹²² The trustee may only facilitate the sales of the properties; cooperate with the manager with respect to the marketing and sale of the properties and causing the trust to enter into such other documents and take such other actions reasonably directed by the manager to facilitate the sales or disposition of the properties.¹²³ The Trustee must use commercially reasonable efforts to assist the manager in ensuring that tenants, Simon & Brookfield, comply with their obligations under the master leases.¹²⁴ The trust, in its amended registration statement filed with the SEC, reported that with respect to the assets the trust owns, the trust "compete[s] for buyers based on a number of factors that include location, rental rates and suitability of the property's design to prospective tenants' needs" and considers the trust's "peer group to be public and private triple-net lease real estate investment trusts (REITs), particularly retail-focused REITs... with contracted lease step-ups providing high visibility of future cash flow."¹²⁵

Trust's Sale of Distribution Centers

On December 23, 2021, the Copper Property CTL Pass Through Trust announced that it had sold its entire portfolio of JC Penney's distribution centers, which is comprised of six warehouses totaling 10.1 million square feet for \$557.2 million, to National Industrial Portfolio Property Owner, LLC.¹²⁶ The six distribution centers currently generate annual base rent of about \$35.4 million and have a long-term triple net master lease with JC Penney operating company, now owned by the Simon & Brookfield JV.¹²⁷ The net proceeds from the sale will be distributed to the certificate holders.¹²⁸ As of December 23, 2021, the trust's subsidiaries held 149 retail properties.¹²⁹ The sale of the six distribution centers was part of the trust's objective to sell the

portfolio properties to third party buyers at market prices pursuant to the trust agreement.¹³⁰ The trust's operations are limited to owning, leasing and selling the PropCo properties. The trust's objective is to sell the properties to third-party buyers as promptly as possible.¹³¹

Analysis of Distressed Investment Positions in JC Penney's Case

In May 2020, JC Penney stated it planned to close about 242 unproductive retail stores, about 29 percent, of its 846 retail stores in Chapter 11.¹³² As of late September, 2021, JC Penney had permanently closed 174 stores and now has 670 retail stores operating.¹³³ Currently, JC Penney is still winding down certain parts of the old JC Penney in Chapter 11.¹³⁴ The uncertainty of real property values during ongoing pandemic played a crucial factor in the bids offered. After a five month marketing process for the 363 sale, which reportedly had four bids, two from the Simon & Brookfield JV and bids from Sycamore Partners and Hudson Bay, the total amounts offered in each of the bids were close; only one of the bids turned out to be a "qualified bid" pursuant to the bidding procedures, meaning the bid was satisfactory to JC Penney's board and the First Lien Majority Group.

Equity or fairness, according to the US Supreme Court, is a foundational principle of the bankruptcy laws and courts; the concept of equity is also shown by bankruptcy courts encouraging settlements between disputing parties and through the broad disclosure requirements of the bankruptcy process. The bankruptcy laws reflect the notion that disclosure is viewed as crucial to promoting a fair and impartial process in bankruptcy. Frequently in Chapter 11, if parties fail to resolve a dispute, the bankruptcy court will encourage the parties to confer and reach a settlement. The Bankruptcy Code favors settlements since settling disputes saves time, money and provides certainty of outcome.¹³⁵ Judge Jones' rulings encouraged a 363 sale that would save JC Penney and as many jobs as possible and

promoted settlements and facilitated consensus, as much as practical under the circumstances.

At certain points of the Chapter 11 process, the equity committee seemed to suggest that a liquidation sale could allow for recovery for the equity holders.¹³⁶ However, the bankruptcy laws do not impose a duty to liquidate on the debtor. As long as directors of the board make informed decisions, in good faith and on a disinterested basis then they are “not liable for decisions they make and actions they take in an effort to prolong the corporation’s viability, even in the face of bankruptcy.”¹³⁷ If market conditions had been more favorable the First Lien Minority Group, led by Aurelius, may have been in position to acquire JC Penney via a “loan-to-own” strategy. Losing the DIP loan battle was an important factor in the outcome since the DIP lenders did significantly influence the negotiations. The depressed asset values due to the uncertainty of the pandemic also was an important factor since higher bids could have put the Minority Group’s debt claims in position to recover as the fulcrum security.

As Exhibit 1 shows the First Lien Minority Group, also called the “crossholder group” because of its positions in both first lien and second lien debt, had large positions in second lien debt that could have allowed for a “loan-to-own” scenario if favorable market conditions and circumstances allowed. The First Lien Minority Group positioned itself so that it could recover in a “loan-to-own” scenario if favorable market conditions and circumstances allowed or fall back on the “hold-up value” scenario if necessary, which ended up occurring in the JC Penney case. A huge gap existed between paying off all of the creditors sufficiently and reaching the equity holders; recovery for the equity holders would have been very difficult. No duty to liquidate exists; the foundational goals of bankruptcy laws are to provide fairness, or “equity,” to the debtor and all stakeholders including employees, to provide a “fresh start” for the debtor and put the debtor in the position to continue as a viable business, as a going concern.

DIP financing has “super priority,” higher priority of recovery over existing debt, equity and other credit claims in Chapter 11, as JC Penney’s Chapter 11 case demonstrates.¹³⁸ Since the beginning of the case, equity holders had been battling to be a significant participant in the bankruptcy case and were in staunch opposition to the sale, which they strongly argued grossly undervalued JC Penney’s assets, and thereby hurting their chances for recovery.¹³⁹ Under the absolute priority rule of bankruptcy, creditors must be paid in full for their claims before equity holders can recover for their claims. Equity holders usually do not recover value for their equity claims since they have the last priority of recovery and no assets remain for recovery after the secured and unsecured creditors are paid. In rare cases, such as in the recent Chapter 11 bankruptcy case of the rental car company Hertz Global Holdings, Inc. and the Washington Prime Group Chapter 11, equity holders recover value in Chapter 11. Indeed, bankruptcy court Judge Mary Walrath, who confirmed Hertz’s plan of reorganization on June 10, 2021, described the case as a “fantastic result” that “surpasses any result that I’ve seen in any Chapter 11 case that I’ve faced in my 20-plus years.”¹⁴⁰ Under the Chapter 11 plan, Hertz’s creditors recovered full payment in cash and equity holders recovered over \$1 billion of value.¹⁴¹

Distressed Investing and “Loan-to-Own” Strategies

Distressed investing is defined as the purchasing or selling of debt or equity, bank debt, credit default swaps or other claims of companies under financial distress. While each distressed investing opportunity depends on the underlying facts and circumstances, certain factors are common stress points, such as the target company’s capital structure and the amount of leverage, the urgency and the extent the target company needs financing, how long the target company can preserve its relations with suppliers, customers, key employees and consent rights of counterparties such as lenders, lessors

and customers.¹⁴² These factors were evident in JC Penney's Chapter 11 case.

In JC Penney's Chapter 11 case, the First Lien Majority Group provided DIP loan financing to JC Penney and the DIP loan claims were used to credit bid, pursuant to Section 363(k), on JC Penney's real property assets, 160 retail stores and 6 distribution centers in a 363 asset sale. The Majority Group's acquisition of assets was a "loan-to-own" transaction. A private equity firm or investor can engage in a "long-to-own" strategy in a number of ways including by buying existing debt claims from creditors or providing a DIP loan to the company and using the superpriority claims to credit bid in a 363 asset sale or for the debt to convert to a controlling position in the company's reorganized equity after a court approves the Chapter 11 plan of reorganization.¹⁴³

The fulcrum security is the security that will convert into the reorganized equity of the company or the security that is used to credit bid and acquire the target company's assets in a 363 asset sale. In the JC Penney case the DIP loan ended up being the fulcrum security, which the First Lien Majority Group used to credit bid to acquire JC Penney's PropCo assets in a 363 sale. The First Lien Majority Group, which included ten private equity firms and hedge funds, by acting as a group, was able to collectively hold well over 2/3 of the first lien debt, and thereby prevented a "blocking position" and allowed the group to position itself to obtain the DIP financing along with the RSA, and ultimately to acquire certain of JC Penney's real property assets. Under more favorable market conditions (for example, without an ongoing pandemic), JC Penney's assets would likely have been worth substantially more; in such case, the fulcrum security could have been the second lien debt which would have put the First Lien Minority Group in the position to acquire JC Penney's assets via credit bid or pursuant to a plan of reorganization.

In the JC Penney case, the First Lien Minority Group did not have a blocking position since the First Lien Majority Group held 73 percent of the first lien debt well over the 2/3 voting power needed to

control the vote and hence hold "majority" voting power. As the JC Penney case demonstrated, because the fulcrum security depends on the valuation of the target company, private equity firms and hedge funds, seeking to carry out a loan-to-own strategy have self interest in disputing the valuation of the company.¹⁴⁴

Private equity funds or investors may buy credit default swaps as a hedge against the risk of default if they own the underlying debt or to short the debt meaning to bet on the default of a company's or index's debt without owning the underlying debt. For instance, both Aurelius and Carl Icahn engaged in shorting strategies by purchasing credit default swaps and betting on default; Aurelius bet on the company Windstream's default and Icahn bet on a declining CMBX 6 index. In JC Penney's bankruptcy, as often is the case in mega Chapter 11 cases, private equity firms and hedge funds fought fiercely, with their competing agendas along with the competing agendas of bondholders, secured lenders, vendors, other claimants and shareholders.¹⁴⁵

Attempting to Stop the Bleeding, Mall Landlords Buy Anchor Tenants

Simon & Brookfield JV's bid was a defensive move because the mall owners wanted to keep JC Penney's retail stores open in their malls. Simon and Brookfield together are landlords to about 161 JC Penney retail stores.¹⁴⁶ During the ongoing pandemic, landlords have faced unprecedented pressure to maintain sufficient liquidity due to tenant's nonpayment of rent along with the threat of anchor tenants possibly going of business.¹⁴⁷ Since 2015, during the ongoing "retail apocalypse," 136 retailers have filed for bankruptcy; the pandemic has simply added fuel to the already existing fire.¹⁴⁸ During the first year of the pandemic, retailers that had existed for several decades, including Modell's Sporting Goods, which had been in business for well over 100 years, were forced to liquidate.¹⁴⁹ The trend of increasing popularity of e-commerce along with the continued decline in brick and mortar businesses will likely continue.¹⁵⁰

Given such dire circumstances, certain landlords, including Simon and Brookfield, have been compelled to rescue their tenants and themselves. Simon and Brookfield have a strategic advantage in acquiring anchor tenants since they operate mostly upscale malls, where retailers have a greater chance at performing well; this acquisition strategy would not likely work for owners of average malls, who have been hit very hard by the pandemic's lockdown orders.¹⁵¹ During the ongoing pandemic, retailers, who filed for Chapter 11 to reorganize, faced difficulties in formulating a new business plan including deciding which of the hundreds of leases the company will assume, reject or assume and assign to third parties pursuant to section 365 within 210 days.¹⁵² In response to the pandemic, certain bankruptcy courts, by exercising the courts equitable powers under the Bankruptcy Code, allowed companies to suspend or defer rent payments; thereby putting landlords in further risk of financial distress.¹⁵³

Simon, the largest mall owner in the United States, has a JC Penney store in about half of its US malls.¹⁵⁴ JC Penney is one of Simon top anchor tenants, only Macy's Inc. is a higher ranking anchor tenant.¹⁵⁵ In addition to acquiring JC Penney's operating business, Simon and other joint venture companies recently acquired Forever 21 Inc. and Brooks Brothers in 2020 and also acquired Aéropostale Inc. in 2016.¹⁵⁶

Aurelius' Distressed Investing Strategies

Aurelius manages "distressed credit and event-driven funds." The chief investment officer of Aurelius is Mark Brodsky, a former bankruptcy lawyer, who is known for his unique brand of distressed investing strategies. Aurelius's investment strategy consists of:¹⁵⁷

- i. Evaluating and "exploit[ing] legal and capital-structure issues with the same level of sophistication as business issues;"
- ii. Engaging selectively in activism meaning that Aurelius and/or "its affiliates will be active participants in the reorganization or other process that is expected to shape the outcome of the investment;"
- iii. Seeking "opportunity throughout the capital structure." Aurelius "believes that all levels of the capital structure should be considered." Since the fulcrum security could turn out to be in any level of the capital structure considering all levels of the capital structure, meaning all of the tranches of debt and all of the equity interests, is necessary in order to carry out a "loan-to-own" strategy; "[c]onduct investment research meticulously." Aurelius "believes that investment analysis remains an area where persistent, meticulous effort can provide a meaningful investment edge" (for example, analysis of the operative documents such as bond indentures rather than prospectus; also, Brodsky and/or "other senior personnel are personally involved in the research process, thereby ensuring that their experience and expertise will be brought to bear."¹⁵⁸

Aurelius has previously engaged in "hold-up value" strategies; by holding up or delaying the bankruptcy proceeding along with the bankruptcy policy promoting settlements, Aurelius is able to negotiate additional value for its debt claims. In Nine West Holding Inc.'s Chapter 11, Aurelius obtained a settlement of \$120 million from Sycamore Partners by arguing that Sycamore's earlier buyout left Nine West insolvent and enriching Sycamore by over \$1 billion.¹⁵⁹ In the JC Penney case, Aurelius obtained settlement agreements twice for the DIP loan dispute and also to resolve its objection to the 363 sale, the settlements are shown in Exhibit 1.

Bankruptcy Code Sections 363 and 365 Analysis

Pursuant to Section 363(k), a secured creditor can credit bid up to the face value of the debt they hold;

under Section 363(f), a purchaser of assets in a sale pursuant to Section 363, buys the asset “free and clear” of liens or claims against such assets. Under Section 363(m), unless the 363 sale is stayed, the sale is final; the sale order cannot be overturned as long as the buyer purchased in good faith. Thus, a court may decline to consider appealing the sale order if the 363 sale is not stayed. In the JC Penney case even if a party such as a shareholder appeals the 363 sale order, the only potential chance of challenging the sale order would be to prove bad faith on part of the buyer. Section 363(m) promotes finality of sale orders and allows the debtor to reorganize without the threat of delay.¹⁶⁰

Section 365, allows debtors to reject unprofitable leases, eliminate unprofitable stores and to restructure the lease portfolio, which was of critical importance in JC Penney’s reorganization; Section 365 allowed JC Penney to close about 242 unprofitable retail stores and assume, assign and sell another 160 retail stores to the First Lien Majority Group in the 363 asset sale. Section 365 gave JC Penney significant leverage to negotiate voluntary modifications or changes to leases with landlords. The Bankruptcy Code does not require a company or organization to be insolvent to file for Chapter 11; a good faith filing is only required.¹⁶¹ For instance, a company could use Chapter 11 simply to restructure its contractual relationships by rejecting or selling contacts and leases under Section 365 or to settle tort plaintiff claims from lawsuits as in the Purdue Pharma and PG&E’s Chapter 11 cases.

Fiduciary Duties of Ad Hoc Committees and Official Creditor Committees

In bankruptcy, a court has held that members of an ad hoc committee may owe fiduciary duties to all of the members of the particular committee they are a member.¹⁶² By extension and under the equitable principles of bankruptcy law, ad hoc groups, such as the ad hoc group in the JC Penney case, may also owe fiduciary duties to all of the members of the group they are a member. Private equity firms and

hedge funds often participate as members of ad hoc committees or group, which subjects them to potential liability for breach of fiduciary duties.¹⁶³

Members of an official committee of unsecured creditors owe fiduciary duties to all of the unsecured creditors and to other members of the committee and to maximize the recovery for the benefit of the unsecured creditors. In the retailer Neiman Marcus’ Chapter 11 bankruptcy, a hedge fund Marble Ridge’s fund manager, Dan Kamensky who was a member of the unsecured creditor committee, breached his fiduciary duty owed to unsecured creditors when he pressured a Jefferies’ employee to abandon a higher bid for Mytheresa, an asset that Neiman Marcus owned so Kamensky could buy Mytheresa at a lower price for his hedge fund Marble Ridge.¹⁶⁴

Conclusion

As JC Penney’s Chapter 11 case demonstrates, both retailers and landlords in the face of the ongoing pandemic face unique challenges with depressed asset valuations and non-paying tenants. Private equity firms and hedge funds continue to be very active in investing in and actively being involved in the asset sales and reorganizations of retailers and mall landlords have established a pattern of rescuing anchor tenants and themselves in Chapter 11 retail proceedings as more anchor tenants file for Chapter 11.

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NOTES

- ¹ Kate Duguid, Reuters, Federal Reserve’s \$3 trillion virus rescue inflates market bubbles, (July 13, 2020).
- ² Section 363 of the U.S. Bankruptcy Code.
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- ⁵ First Lien Majority Group, Rule 2019 Statement, Document 516, (June 4, 2020); First Lien Minority Group, Rule 2019 Statement, Document 1515, (Sept. 30, 2020).
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- ⁸ *Id.* at 60.
- ⁹ JCPenney news release, JCPenney to Reduce Debt and Strengthen Financial Position, (May 15, 2020). Through Restructuring Support Agreement (May 15, 2020), 2. In re J. C. Penney Company, Inc., et al., Chapter 11, Case 20-20182, Document 25, Declaration of Bill Wafford, Executive Vice President, Chief Financial Officer of J.C. Penney Company, Inc. In Support of Debtors' Chapter 11 Petitions and First Day Motions, 12, (Bankr. S.D. Tex. May 15, 2020).
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- ¹⁹ *Id.* at 26; See In re Braniff Airways, Inc., 700 F.2d 935, 940 (5th Cir. 1983).
- ²⁰ *Id.* at 14, 20, 24, 27.
- ²¹ JC Penney Expert Report at 1, 10.
- ²² *Id.* at 13.
- ²³ Kirkland Presentation June 4 at 9. See Exhibit 1, Chart of J.C. Penney's pre-bankruptcy Secured Debt Capital Structure.
- ²⁴ Kirkland Presentation June 4 at 20. See In re ION Media Networks, Inc., 2009 WL 2902568 (Bankr. S.D.N.Y. 2009).
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- ⁸⁴ *Id.*
- ⁸⁵ *Id.*
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- ⁹⁹ Walter Loeb, *Forbes*, “Survival of JCPenney’s Heritage Is In Question,” (February 4, 2021).
- ¹⁰⁰ *Id.*
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- ¹⁰⁵ *Id.*
- ¹⁰⁶ *Id.*
- ¹⁰⁷ Archer, *supra* n.90.
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- ¹¹⁰ JC Penney News Release, “JC Penney’s Retail and Operating Assets to Exit Chapter 11,” (December 7, 2020).
- ¹¹¹ *Id.*
- ¹¹² Hill, *supra* n.54.
- ¹¹³ *Id.*
- ¹¹⁴ Copper Property CTL Pass Through Trust, Form 10, pursuant to Section 12(b) or Section 12(g) of the Securities Exchange Act of 1934, (December 29, 2020).
- ¹¹⁵ *Id.* at 2.
- ¹¹⁶ Recreated from diagram on page 3 of Copper Property CTL Pass Through Trust, Form 10, post-effective amendment no. 1, pursuant to Section 12(b) or Section 12(g) of the Securities Exchange Act of 1934, File No. 000-56236, (March 18, 2021).
- ¹¹⁷ *Id.* at 2, 3.
- ¹¹⁸ *Id.* at 3.
- ¹¹⁹ *Id.* at 4. “To the extent that all of the Properties [held by subsidiaries of the trust] are not sold within a year after the Effective Date (or such longer period approved by the Majority Certificateholders), the Properties may be transferred into a newly-formed REIT, contributed to an existing REIT or transferred into other investment vehicles, each of which would be beneficially owned by the Certificateholders. Any such transfer will require approval from the Majority Certificateholders including at least three (3) Certificateholders who are not Affiliates of one another.”
- ¹²⁰ *Id.* at 5.
- ¹²¹ *Id.*
- ¹²² *Id.* at 4.
- ¹²³ *Id.*
- ¹²⁴ *Id.* at 5.
- ¹²⁵ *Id.* at 6. “We consider our peer group to be public and private triple-net lease REITs, particularly retail-focused REITs such as Essential Properties RealtyTrust (NYSE: EPRT), Four Corners Property Trust Inc. (NYSE: FCPT).....each of these peers own [retail properties], generally tenanted by national brands, with weighted average remaining lease terms of 10 years or greater, and with contracted lease step-ups providing high visibility of future cash flow.”
- ¹²⁶ Press Release, “Copper Property CTL Pass Through Trust, Copper Property CTL Pass Through Trust Sells its JCPenney Distribution Center Portfolio for \$557.2 Million,” (December 23, 2021).
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- ¹²⁸ *Id.*
- ¹²⁹ *Id.*
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- ¹³² Kelly Tyko, JCPenney closing more stores after bankruptcy. Will your store shutter? See the closure list, *USA TODAY*, (September 21, 2021).
- ¹³³ *Id.*
- ¹³⁴ *Id.*
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- ¹³⁷ *In re Midway Games*, 428 B.R. 303, 315 (Bankr. D. Del. 2010).
- ¹³⁸ 11 U.S.C. § 364(c).
- ¹³⁹ Hill and Ronalds-Hannon, *supra* n.42.
- ¹⁴⁰ Ella Chochrek, “JCPenney Shareholders Reach Compromise, Won’t Challenge Department Store’s Bankruptcy,” (June 10, 2020).
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- ¹⁴² Eric Lopez Schnabel, “Buying a Troubled Business: Bankruptcy and Other Options,” *Private Equity Focus*, Dorsey & Whitney LLP, 2 (June 26, 2008).
- ¹⁴³ *The Art of Distressed M&A: Buying, Selling, and Financing Troubled and Insolvent Companies*, H. Peter Nesvold, Jeffrey Anapolsky, Alexandra Reed Lajoux, 397 (2011).
- ¹⁴⁴ *Distressed Mergers and Acquisitions*, Wachtell, Lipton, Rosen & Katz, 195 (2018). *See Peter Michael Allen, Private Equity Firms and Hedge Funds’ Distressed*

- Investing Strategies in Chapter 11 and Out-of-Court Corporate Restructuring and Distressed M&A, *The Investment Lawyer*, June 2018, for more about valuation and distressed investing generally.
- ¹⁴⁵ See Peter S. Kaufman, Henry F. Owsley, Distressed Investment Banking: To the Abyss and Back, 15 (2005).
- ¹⁴⁶ *Id.*
- ¹⁴⁷ Liz (Ji Yon) Park, Maja Zerjal Fink, *Journal of Corporate Renewal*, “Taking Destiny into their Own Hands. Landlords Purchasing Distressed Retailers,” 32, (June 2021).
- ¹⁴⁸ CB Insights Research, “Here’s a list of 136 bankruptcies in the retail apocalypse—and why they failed,” February 16, 2022.
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- ¹⁵⁰ *Id.*
- ¹⁵¹ *Id.*
- ¹⁵² Section 365 of the U.S. Bankruptcy Code.
- ¹⁵³ CB Insights Research, *supra* n.150.
- ¹⁵⁴ Lauren Hirsch and Lauren Thomas, “J.C. Penney announces plan to cut 1,000 jobs, gets more time from lenders in push for survival,” (July 15, 2020).
- ¹⁵⁵ Alexander Gladstone and Andrew Scurria, *Wall Street Journal Pro Bankruptcy*, “J.C. Penney Landlords Nearing Deal to Buy Bankrupt Retailer,” (Aug. 12, 2020).
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- ¹⁵⁸ *Id.*
- ¹⁵⁹ Hill and Ronalds-Hannon, *supra* n.42.
- ¹⁶⁰ 11 U.S.C. § 363(m). See *Cinicola v. Scharffenberger*, 248 F.3d 110, 121-122 (3d Cir. 2001).
- ¹⁶¹ 11 U.S.C. §109(d), which provides eligibility requirements for a debtor under Chapter 11, does not require insolvency.
- ¹⁶² *In re Washington Mutual Inc.*, No. 08-12229 (MFW), 128, (Bankr. D. Del. Sept. 13, 2011).
- ¹⁶³ Ad Hoc Groups have in their 2019 Rule filings in the JC Penney case and in other cases explicitly stated they are not a “Committee” as defined in Rule 2019; however this may not exculpate them from fiduciary duty liability since bankruptcy courts often exercise their equitable powers in similar situations.
- ¹⁶⁴ Kamensky told the Jefferies’ employee that Marble Ridge had been a good business partner to him and Jefferies and that if Jefferies placed the bid, then “they would not be partners going forward.” *In re Neiman Marcus Group Ltd LLC, et al*, Case 20-03402, Adversary Proceeding, Complaint, Mariposa Intermediate Holdings LLC, Neiman Marcus Group Ltd LLC v. Marble Ridge Capital LP, 15, (August 26, 2020). After Kamensky pleaded guilty to bankruptcy fraud, a U.S. District Court Judge sentenced him to jail for six months. Jessica Hamlin, Institutional Investor, Marble Ridge Founder Daniel Kamensky Sentenced to Six Months in Prison, (May 7, 2021).

Exhibit 1—Key Disclosures in JC Penney’s Chapter 11 Bankruptcy			
JC Penney Pre-Bankruptcy Filing Secured Debt Capital Structure			
Secured Debt (in \$ millions)	Principal	First Lien Majority Group	First Lien Minority Group
ABL Facility (Wells Fargo)	1,179		
First Lien Term Loan	1,521	Holds ~ 73%% of First Lien Debt	Holds ~ 16% of First Lien Debt
First Lien Notes	500		
Second Lien Notes	400		
Total Secured Debt	\$3,600M (\$3.6 billion)		
* Information is from JC Penney Expert Report at 4; Kirkland Presentation June 4 at 6, 7. The First Lien Debt is the total debt of the First Lien Term Loan and First Lien Notes. **Amounts are the secured debt of JC Penney prior to filing for Chapter 11 bankruptcy.			
Rule 2019 Disclosures in JC Penney’s Chapter 11 Bankruptcy			
<i>Capital Structure during Chapter 11 Bankruptcy</i> (Majority Group, Rule 2019 Statement, Document 516, 06/04/20; Minority Group, Rule 2019 Statement, Document 1515, 09/30/20). “M” means million. “K” means thousand. Amounts are rounded down to nearest ten thousandth.			

Ad Hoc First Lien Majority Group

	Principal Amount of Term Loans	Principal Amount of First Lien Notes	Principal Amount of Second Lien Notes	Principal Amount of Unsecured Bonds	Principal Amount of DIP Loans
Hedge Funds, Private Equity Funds & Other Investors					
Apollo Capital Management, L.P.	4.23M				3.20M
Ares CLO Management LLC	28.27M				20.34M
Brigade Capital Management, LP	62.77M	14.07M	50K	101.60M	57.46M
H/2 Capital Partners LLC	471.63M	11.98M			361.45M
KKR Credit Advisors (US) LLC	55.44M		4.25M		41.91M
Owl Creek Asset Management, L.P.	57.99M	57.17M			87.06M
Sculptor Capital LP	49.15M	16.32M	31.37M		48.95M
Silver Point Capital, L.P.	78.82M	104.37M			106.04M
Sixth Street Partners, LLC	57.08M	65.80M			88.14M
Whitebox Advisors LLC	1.25K	41.51M	11.60M		31.38M
TOTAL	\$865.42M	\$311.24M	\$47.27M	\$101.60M	\$845.96M

Ad Hoc First Lien Minority Group

Hedge Funds, Private Equity Funds & Other Investors	Principal Amount of Term Loans	Principal Amount of First Lien Notes	Principal Amount of Second Lien Notes	Principal Amount of Unsecured Bonds	Principal Amount of DIP Loans
Aurelius Capital Management, LP	45.38M	8M		2K	12M
Avenue Europe International Management, L.P.		8.61M			1.64M
Bank of America, N.A.	3.08M				
BofA Securities, Inc.		12.56M	31.56M	52.41M	
Canaras Capital Management, LLC	3.95M				
Carlson Capital, L.P.	20.90M	5M	26.44M		4.95M
Cetus Capital LLC	7.92M	28.96M	43.12M		5.53M
Credit Suisse Loan Funding LLC	3.92M	8M	11.79M	6.81M	4.37M
D.E. Shaw Galvanic Portfolios, L.L.C.	11.59M	24.34M			2.01M
First Pacific Advisors, LP	30.89M				6.93M
FS Global Advisor, LLC	6.33M	2M			1.59M
GoldenTree Asset Management LP	6.62M		28.53M		1.26M
LMR Partners LLC		35.05M			2.57M
MFP Partners, L.P.	4.19M				802K
MSD Partners, L.P.	12.61M	5.85M			7.03M
Par Four Investment Management LLC	4.58M				
Total	\$162M	\$138.39M	\$141.46M	\$59.23M	\$50.76M

First Lien Majority Group's Initial Bid had DIP loan recovery weighting of 90% and first lien debt recovery weighting of 10%

DIP Facility loan recovery	900M	First lien debt recovery	100M
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(Objection of First Lien Minority Group, Document 1532, 3, Oct. 5, 2020) (for PropCo assets only)

First Lien Minority Group counter bid proposal in response to First Lien Majority Group's initial bid (prior to settlement)

Total DIP loan recovery (900M) (50%) and total First lien debt (900M)(50%) recovery are equally weighted (for both PropCo and OpCo assets)

DIP Facility loan	claims	% of class	recovery	recovery %	First lien debt	claims	% of class	recovery	recovery %
Majority Group	844M	93.80%	844M	100.00%	Majority Group	1,177M	74.90%	674M	57.3%
Minority Group	56M	6.20%	56M	100.00%	Minority Group	304M	19.40%	174M	57.3%
Total	900M	100.00%	900M	100.00%	Other lenders	90M	5.70%	52M	57.3%
Source:JC Penney, Document 1754, 34, Nov. 5, 2020					Total	1,571M	100.00%	900M	57.3%
* Under the First Lien Minority Group's counter bid proposal: \$900M x .24 = \$216M; 216 - 24M = \$192M additional recovery									

Settlement Amounts ("Hold-up value") for Ad Hoc Minority Group

June 2020 Court Approved Settlement	November 2020 Court Approved Settlement
Paid \$50.76M to resolve objection to DIP loan financing	Paid \$40M to resolve objection to asset sale

Settlement agreement (in the Amended Plan of Reorganization)

Unsecured Creditors Earnout Pool	between \$110M to \$140M
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363 Sale:PropCo assets portion and OpCo assets portion

363 Sale, Copper Retail JV LLC (Simon & Brookfield) purchased OpCo assets from JC Penney

363 Sale, Copper BidCo LLC (First Lien Majority Lenders) purchased PropCo assets from JC Penney

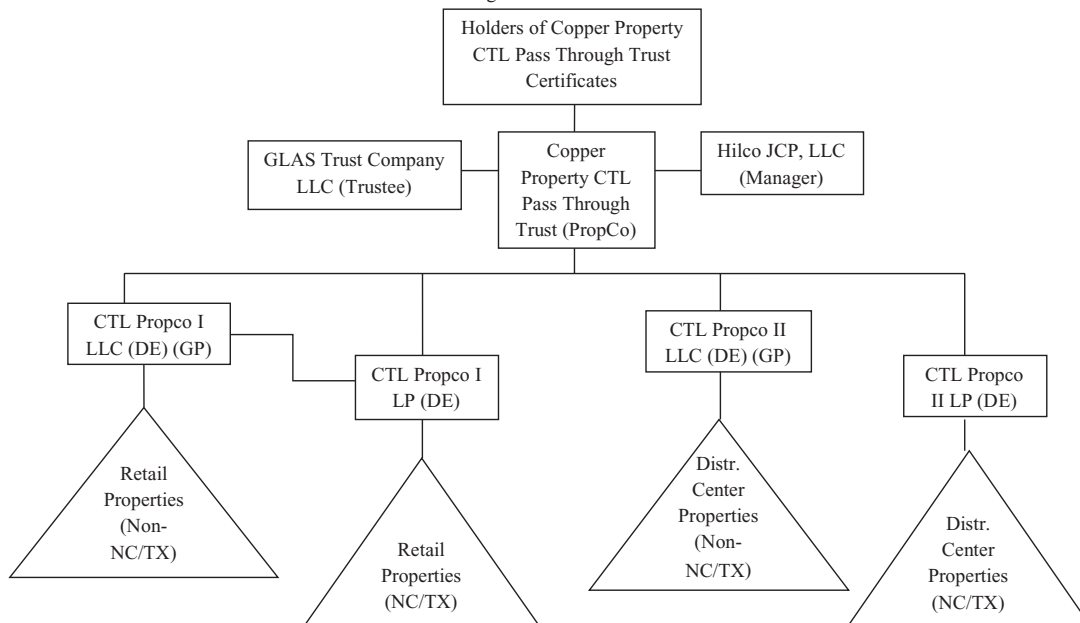
Transfer assets

Copper BidCo LLC (PropCo assets) \Longrightarrow Copper Property CTL Pass Through Trust (160 retail properties, 6 DC properties)

363 Auction Sale

Bidders	Type of buyer	Bid Amount	Non-monetary factors
Sycamore Partners	Private Equity firm and strategic purchaser	\$1.7B	Heavy layoffs; rebranding
Hudson Bay Co.	Strategic purchaser	\$1.6B	(unknown)
Simon & Brookfield JV and First Lien Majority Group	Private equity firms, hedge funds, REIT, asset manager and strategic purchasers	\$1.75B	Preserves jobs and JC Penney’s operating business

Copper Property CTL Pass Through Trust
Organizational Structure



*Source: Copper Property CTL Pass Through Trust, Form 10, post-effective amendment no. 1, pursuant to section 12(b) or 12(g) of the Securities Exchange Act of 1934, File No. 000-56236, March 18, 2021. CTL Propco I LLC, CTL Propco I LP, CTL Propco II LLC and CTL Propco II LP, own title to PropCo assets leased to one or more subs of Copper Retail JV LLC (owned by Simon & Brookfield), pursuant to two separate master leases.

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