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Staples Downsizing May Be Alarm Call For Traditional Retail

By **Matt Chiappardi**

Law360, Wilmington (March 11, 2014, 12:00 PM ET) -- With Staples Inc.'s announcement last week that it plans to close up to 225 stores, bankruptcy professionals wonder whether it marks part of an alarm call for brick-and-mortar retailers facing online competition — and if the office supply giant could be staring at Chapter 11 if its aggressive downsizing strategy fails.

Massachusetts-based Staples unveiled the news Thursday that it plans to shutter as many as 225 of its more than 1,800 North American locations as part of a strategy to shed \$500 million in costs. The retailer simultaneously announced that fourth-quarter sales dropped 4 percent compared to the same period of 2012, except for one week, and that the company had experienced at least four consecutive quarters of sales declines.

Experts say Staples faces pressure on two fronts: one from more diversified retailers getting deeper into the office supply business, and another that threatens the brick-and-mortar sector of retail at large from the explosion of online sales over the past several years that reduced the need for consumers to even walk through the door.

Closing a swath of stores, which Staples says it hopes to complete by the end of 2015, is a step in the right direction to bring the company's sales numbers back to black, says bankruptcy attorney Timothy W. Walsh, a partner at McDermott Will & Emery LLP. But if the strategy doesn't work, Staples could find itself under "substantial pressure" to file for Chapter 11 and take advantage of unique benefits under court protection, the attorney said.

"They could face a potential filing within the next year," Walsh said, speculating on the outcome if the downsizing fails. "Having said that, it looks like they're taking the right steps to avoid a potential filing."

Under Chapter 11 protection, Staples would be able to assume leases for locations it may wish to vacate — some that might be under market value — and assign them to third parties, generating value for the estate while dropping more locations, Walsh said.

Short of bankruptcy, Walsh said that Staples would also need to analyze all of its product lines, especially since other retailers that don't necessarily specialize in office supplies are increasingly getting into that business.

Staples appears to be doing just that, taking the types of steps Walsh says would be a map to avoid bankruptcy.

On Thursday, the company also announced that it plans to refresh about 20 percent of its

inventory, removing about 1,000 types of items and adding roughly 1,600 products, including retail supplies for small businesses, gifts for office parties, organizational products and early educational toys, Staples said in a statement.

The company also said that nearly half of its business is now done online and is altering its makeup to reflect that.

"As customers shift online, we are taking aggressive action to right-size our retail footprint," Staples spokesman Mark Cautela said in an email Monday. "We are committed to providing great service and every product businesses need, whether it's in-store, online or through mobile."

In the event Staples does have to file, don't expect it to either disappear or abandon physical locations anytime soon to become an exclusively online merchant, Walsh said.

Instead, the chain would likely come out reorganized as a "leaner and meaner" Staples, with fewer storefronts and a priority shifted from attracting feet to the sales floor to directing fingers to a mouse, he said.

It's part of a trend Walsh believes the retail sector as a whole will be experiencing as it deals with competition, not only from 800-pound gorillas like Amazon.com Inc. but other retailers crowding to get into the lucrative online sales space that the attorney says shows little sign of abating anytime soon.

Large retailers rode a wave of suburban expansion in the 1980s and 1990s to significantly increase their footprints across the United States, but now that tide seems to be turning. The Internet is now making such a glut of locations not only no longer necessary, but actually a liability, Walsh said.

"At one point, retailers said we need to get out and flood the market with our stores," the attorney said. "Any retailer whose business model was bricks-and-mortar expansion and faces online competition will have to rethink that strategy."

Walsh's opinion appears to have some currency, as other big retailers such as The Children's Place Retail Stores Inc., J.C. Penney Co. Inc., Macy's Inc. and RadioShack Corp. have also recently announced store closings.

But restructuring financial consultant Edward T. Gavin, founding partner of Gavin Solmonese LLC, is not yet ready to say a wave of retail Chapter 11 filings is going to hit the bankruptcy courts.

That blanket trend already happened at the early part of the economic crisis with chains like Circuit City Stores Inc. and KB Toys Inc. liquidating away, according to Gavin.

"Now it will be more niche-oriented and specific to capital structures and individual problems, as opposed to retail as an industry," Gavin said.

In fact, he said Staples may even be at an advantage over other retailers because a large portion of its business is born out of convenience for customers who might not be willing to wait days to have a particular office supply shipped to their homes.

Many of Staples' issues are specifically tied to the number of stores serving a particular area and, in some cases, how closely some are located to one another, he said.

"Having one Staples a 10-minute drive from another Staples, you're doubling your fixed costs but splitting the same customer market," Gavin said.

Gavin also believes that because online shopping is now so ubiquitous, it's unlikely the Internet will see even more substantial growth as a sales vehicle, giving traditional retailers a chance to adapt to the new landscape rather than be overwhelmed by it.

Nonetheless, he still pegs the chances Staples will hit Chapter 11 within the next year or two at an even 50-50, and also said he wouldn't be surprised if another of the big-name retailers — without specifying which — also winds up reorganizing under court protection.

Bankruptcy attorney Thomas W. Waldrep Jr. of Womble Carlyle Sandridge & Rice LLP agrees that it's only a matter of time until several retail mainstays either ditch the bulk of their brick-and-mortar locations or reorganize under a judge's supervision.

Waldrep, who is a former bankruptcy judge, declined to comment specifically on Staples or any other particular retailer, but said brick-and-mortar stores are increasingly at a "huge competitive disadvantage" with the need for change in business strategy coming sooner than people might think.

"One day, if it hasn't already, Cyber Monday will eclipse Black Friday," Waldrep said. "We'll stop shopping en masse and fighting crowds as the confidence in online shopping grows."

--Editing by Katherine Rautenberg.

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