FINANCIAL SERVICES

LAW ALERT

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# Brace Yourself – A Tough Economy Lies Ahead

*Jeffrey A. Wurst*

I was recently asked what I saw coming down the pike with respect to business economics. Let me start by saying that I am not an economist. In fact, I have never taken a course in economics. My practice, however, does thrive on a downside economy. So, caveat lector (reader beware). That being said, I am skeptical of professional forecasters. I am especially skeptical of "experts" who forecast because they often fail to seek out reliable indicators.

My grandmother was a great forecaster – of the weather, that is. She would watch Tex Antoine (those of you in the New York market may remember him) as he drew pictures of sunshine, forecasting fair weather. My grandmother would say, "He is wrong. It is going to rain. My bursitis is bothering me and that means it is going to rain." Grandma's forecasts tended to be much more accurate than those of the experts. So many of us working in the restructuring area have been waiting for that "ball to drop" – whether it is during the second quarter or third quarter or fourth quarter, etc. It does appear that we are seeing signs of a downturn now. Of course, one rosebud does not make a Spring. Time will tell if what I think I am seeing actually comes to fruition. Like grandma, I look at what is around me to prepare myself.

Last month my law firm handled more forbearance agreements on newly defaulted loans than we did in all of 2006. That trend appears to be continuing.

We are faced with a growing crisis in the sub prime market. Although there may be some opportunities for distressed investors, I think it is more significant to look at the opportunities for the broader restructuring industry. Follow me through this scenario: The sub prime borrowers are the lowest creditworthy borrowers we have. So it should not be surprising that we are now seeing a rising rate of defaults among those borrowers. What is significant is human nature. The last obligation any individual will default upon is mortgage payments on his home. No one – not even the least creditworthy borrower – wants to see his wife and children thrown out onto the street. Yet that is what is happening. We are seeing the least creditworthy borrowers defaulting. As a result, even their banks – those sub prime lenders – are falling into default and seeking Chapter 11 protection themselves.

Remember "Reagonomics"? The "trickle down" approach? Well I suspect that we are going to see a "trickle up" – the reverse of "Reagonomics". The least creditworthy borrowers (usually the lowest income sectors of our economy) tend to shop at mass merchants such as Wal-Mart, Kmart, and Target. Thus, doesn't it follow that with a drop-off in that sector we will see those large retailers start to feel the crunch? Will that effect domino *up* through the supply chain? If so, then we had better tighten our belts and get ready.

That being said, I suspect that big retail bankruptcies are not likely to occur in this long-anticipated down cycle. As a result of the recent changes in the bankruptcy code, retailers no longer have unlimited time to map out a plan. There are strict limits on their exclusivity period and they only have 210 days – at the most – to determine which leases they will accept or reject (unless their landlords agree to extend that time). I am not ruling out landlords allowing that time to be extended because if things start to slip, they may be content to keep their tenants in the premises rather then having vacant properties.

These changes in exclusivity, as well as the reclamation timing, have also changed the climate of retail bankruptcy. As a result, retailers will likely look for new creative methods to obtain relief no longer available under Chapter 11.

So where do we go from here? I guess that we have to watch while exercising caution and prepare ourselves for what may be a tough period ahead. Retailers – and suppliers to retailers in particular – should proceed with caution, although I suspect that distribution and manufacturing will not escape the impending downturn. Now that I have put my prognostications on the table, let's see who throws this in my face a year or two from now.

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## About the Firm

Founded in 1968, Ruskin Moscou Faltischek P.C. has emerged as Long Island's preeminent law firm. As specialized as we are diverse, we have built cornerstone groups in all of the major practice areas of law, and service a diverse and sophisticated clientele. With more than 60 attorneys, superior knowledge of the law, polished business acumen and proven credentials, Ruskin Moscou Faltischek has earned a reputation for excellence and success. It is this ongoing achievement that makes us an acknowledged leader among our peers and the preferred choice among business leaders.

The strength of Ruskin Moscou Faltischek's resources greatly enhances what we can accomplish for our clients – to not only solve problems, but to create opportunities. We take pride in going beyond what is expected from most law firms. The invaluable contacts and relationships we have have nurtured in the business community and our multidisciplinary approach heighten our value-added services.

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