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How Far Can Debtors Take Motions to Pause in Chapter 11?

by Kerri K. Mumford, Travis Vandell and Howard Robertson

Retailers and restaurants are facing unprecedented challenges due to the impact of the COVID-19 crisis. Many of these businesses who have sought chapter 11 protection have used the Bankruptcy Code to seek a “pause” in bankruptcy proceedings, and more specifically, a deferral of post-petition rent obligations due to landlords. While it may have been previously unheard of to take a “time-out” during chapter 11 proceedings, a growing number of debtors and their professionals view this as necessary in the current financial climate, especially when the full impact of this novel crisis is not known, making it difficult to determine the path forward.

Setting New Boundaries in Case Law

As the COVID-19 crisis has

created dramatic changes in so many other aspects of life and business, it also has prompted debtors to utilize the Bankruptcy Code in new ways to maneuver these uncertain times. Specifically, professionals and judges are relying on three U.S. Bankruptcy Code provisions: Sections 105(a), 305(a)(1), and 365(d) (3). Debtors’ professionals are using these provisions to achieve similar goals—minimizing the administrative burn on the debtors and giving the debtors time to fully understand the pandemic’s economic effects and the exit strategy.

How each of these provisions have been used has varied in both application and approval, depending on the individual relief being requested—whether it is a request to pause the entire case (a so-called “mothball motion”), a request to delay

various deadlines or other obligations, or a request to grant for cause the deadline to satisfy post-petition rent obligations. Several cases provide examples of how bankruptcy professionals and judges are using the Bankruptcy Code to help soften the impact of COVID-19. Cases such as True Religion Apparel, Inc.; Modell’s Sporting Goods, Inc.; restaurant brand owners and franchisor Craftworks Parent, LLC; Pier 1 Imports, Inc.; and fashion retailers Forever 21, Inc. and J. Crew (Chinos Holdings, Inc) offer useful insight into how the Bankruptcy Code can be utilized to provide debtors necessary relief while balancing the interests of creditors.

Mothball Motions

Prior to *Modell’s Sporting Goods, Inc.*, suspension, Section 305(a)(1) has never been used to suspend *an*

entire bankruptcy case for the purpose of deferring a debtor's obligations to meet required deadlines and pay its expenses. Section 305(a)(1) states in relevant part, "The court, after notice and a hearing, ... may suspend all proceedings in a case under this title, at any time if the interests of creditors and the debtor would be better served by such dismissal or suspension." Courts hold that suspension is an extraordinary remedy and reiterate the statutory standard requiring a showing by the debtor that both the debtor and creditors will benefit from suspension.¹ To evaluate whether suspension is in the best interest of both the debtor and creditors, courts look to several nonconclusive and indeterminate factors.²

In the *Modell's* case, the debtors requested a suspension of the entire bankruptcy case under Sections 105(a) and 305(a)(1). When the pandemic hit, Modell's was in the process of liquidating its inventory through going-out-of-business (GOB) sales—which were halted by the states various stay-at-home orders. Thus, the debtors sought to pause the case until the liquidation could commence again. The requested relief was met with substantial resistance

from landlords. However, the court granted the relief requested, allowing the sporting-goods retailer to pause its proceedings initially for 60 days through April 30, 2020, which was extended by further order for an additional 30 days through May 31, 2020. On June 5, 2020, the bankruptcy court again extended the suspension through and including June 15, 2020. The previous two orders were appealed to the United States District Court for the District of New Jersey by one of the landlord creditors where the issue was pending appeal as of the time this article was written.

105 Motions to Establish Procedures/Relief

In *CraftWorks Parent LLC*, the debtor relied exclusively on Section 105 in requesting the court implement certain temporary procedures limiting the ability of parties in interest to file motions and the page limitations of such pleadings. Judge Shannon advised the debtors that he "was not going there" prior to the hearing on relief, noting that although he was able to hear matters on expedited bases, the requested relief unduly burdened creditors and other parties in interest.

Ultimately, the debtors engaged with their constituents and presented a consensual order streamlining rejection procedures, relief from stay procedures, and stipulations that would permit approval of certain actions without extensive motion practice.

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In *Pier 1 Imports*, the debtors' cases were filed prior to the pandemic and the debtors had begun their sale process. Following the "shelter-in-place" laws, the debtors sought relief from the Bankruptcy Court for a "Limited Operation Period" during which it sought to (a) only pay critical expenses (employees, insurance, trust fund taxes, critical operating expense and professional fees), (b) temporarily delaying all other

¹ *In re Monitor Single Lift I, Ltd.*, 381 B.R. 455, 462–63 (Bankr. S.D.N.Y. 2008)

² *In re Amc Inv'rs, LLC*, 406 B.R. 478, 488 (Bankr. D. Del. 2009)

payments, including rent and vendor obligations, and (c) automatically adjourning various motions. Pier 1 Imports relied primarily on Section 105(a) appealing to the equitable power of the Bankruptcy Court to give it a “breathing spell” for the debtors during this unprecedented period and on several common law doctrines in arguing for the pause of its rent payment obligations while still maintaining its right to use and occupy the premises. With respect to the nonpayment of rent, the Court noted that “Section 365(d)(3) does not provide landlords a separate remedy to effect payment” and if the debtor fails to pay, they have an administrative claim noting that if the Court were to require payment now it “would be to elevate payment of rent to the Lessors to super-priority status.” With respect to the lessors’ demand for adequate protection, the Court noted that since the debtors were maintaining the property (insurance, security, utility, and similar payments were “critical” payments under the requested relief), the continued use did not decrease the value of any lessor’s interest in the property. Finally, the Court notes: “There is no feasible alternative to the relief sought in the Motion. The Debtors cannot operate as a going concern and produce revenue

necessary to pay rent because they have been ordered to close their business.... Any liquidation efforts would be ineffective and potentially squander assets that could otherwise be administered for the benefit of all creditors in this case. ...The severe cost reduction measures ... allow [the Debtors] the best possible chance of effectuating a value-maximizing value for the sale of the benefit of all creditors.” The debtors did not seek to extend this relief and have sought to winddown its business following the sale of its intellectual property and e-commerce businesses.

Delaying Post-Petition Rent

Debtors have relied on Section 365(d)(3) to request a suspension of their obligations arising under existing executory contracts and unexpired leases, rather than the entire case. Section 365(d)(3) of the U.S. Bankruptcy Code requires debtors to “timely perform all the obligations of the debtor... arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title.” However, with a showing for cause, requirements under Section 365 (d)(3) can be suspended for up

to 60 days, and judges have routinely held that the “stay-at-home” orders and related pandemic issues establish cause to create breathing room for distressed debtors.

While it may have been previously unheard of to take a “time-out” during chapter 11 proceedings, a growing number of debtors and their professionals view this as necessary in the current financial climate, especially when the full impact of this novel crisis is not known, making it difficult to determine the path forward.

As part of their first day filings, the debtors in *True Religion*, relying on Section 365(d)(3), requested the court suspend their payment obligations to landlords for 60 days and Section 105 to establish other temporary procedures for filing for rejection motions, relief from stay motions, and stipulations regarding agreed to relief – substantially similar to those granted by Judge Shannon in *Craftworks*. The debtors argued that state-mandatory store closures due to COVID-19 provides sufficient “cause” under Section 356(d)(3) for a 60-day suspension of their obligation to landlords. After negotiations

between the creditors and debtors, all parties consented to and the court entered an order granting the debtors' request. The debtors did not seek further extension of the suspension of their rent obligation to landlords, but requested a 30-day extension of the temporary procedures.

The Forever 21 case, the oldest case discussed in this article, has taken a different twist as its inventory liquidation and GOB sales were halted due to the COVID-19 outbreak. The unique difference in this proceeding was that the *buyer* was seeking relief from the Court—permitting them to reject leases despite the inability to remove inventory. Sustaining the objections of numerous landlords, the Court determined it did not have the authority under Section 105 to grant the relief requested by the debtors because Section 105 “is not a blank check” and the relief requested “contravenes Section 365(d)(4),” which prevents rejection until possession is surrendered. Judge Walrath noted, “There is no in between. Neither the debtor, nor the buyer—who stands in its shoes—can purport to reject a lease, not pay rent, but not give up possession.” Section 105 cannot be used in contravention of Section 365(d) (3) and (4).

Lastly, and most recently, *J.*

Crew filed a motion to defer its rent obligations under Section 365(d) (3) on the petition date. Similar to *True Religion*, *J Crew* argued that the effects of COVID-19 have resulted in exigent circumstances that constitute “cause” for approving a 60-day suspension of its rent obligations. The court granted the motion stating, “the court can think of no circumstances that would invite [the application of Section 365(d)(3)] so much as the present one.” The court found cause to extend the time for performance of the debtors' lease payment obligations for 60 days.

Conclusion:

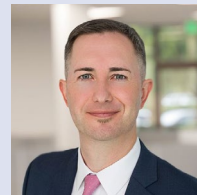
It's clear that retailers and restaurants are at great risk for being in a losing position due to the COVID-19 crisis and as a result, their stakeholders are all sharing in the pain, including employees, vendors and landlords. With the growing burdens of the global pandemic on retailers' and restaurants' ability to survive in the current environment, their only hope may be for all of their stakeholders to compromise and make concessions. As the 60-day breathing spell granted to debtors expires, it will be incumbent on the landlords and the debtors to reach consensual resolution on the amount of rent to

be paid—taking into account the debtors' various state law defenses to payment, the ability to satisfy the obligations and the efforts to ensure an ongoing “brick and mortar” presence for the benefit of the landlords and the debtors. ☐

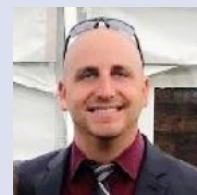
About The Authors:



Kerri Mumford is a partner at Landis Rath & Cobb LLP in Wilmington, Delaware.



Travis Vandell is managing director at Stretto in Irvine, California.



Howard Robertson is an associate at Landis Rath & Cobb LLP in Wilmington, Delaware.

About This Publication:

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