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What a Post-COVID-19 World: Debtors' Extraordinary Responses to COVID-19

By Gerard S. Catalanello and Kimberly J. Kodis

It has been said by many, in many different ways and in many different settings, that "desperate times call for desperate measures." Practically since its enactment more than forty years ago, that idiom has been the foundation of various business and legal strategies employed by those clinging to the Bankruptcy Code while pressing an argument in court for some form of relief. Indeed, the Bankruptcy Code is, by all accounts, a safe harbor for businesses and people in search of a "fresh start," a venue to liquidate in an orderly fashion or just the opportunity to demonstrate that it is worth saving through a balance sheet and/or operational restructuring. Current times are desperate indeed, as the impact of the pandemic rages on and, in its path, leaves many businesses and industries demolished or, at best, severely impaired. Once again, the Bankruptcy Code has been called upon to provide relief to those in dire need, relief that could certainly be called extraordinary in many respects.

Abstention and Inherent Power: The Suspension of Proceedings

In relevant part, section 305(a)(1) of the Bankruptcy Code provides that "[t]he court, after notice and a hearing, may … suspend all proceedings in a case under … [T]itle [11], at any time if — the interests of creditors and the debtor would be better served by such dismissal or suspension." Traditionally, courts have interpreted section 305(a) to apply to a suspension of all proceedings, rather than to certain proceedings. *See, e.g.*, *In re Rookery Bay*, No. 95-04781 (Bankr. M.D. Fla. Nov. 17, 1995) (granting the debtor's motion for abstention, holding that it was "appropriate to suspend any further proceeding in the involuntary case" until the debtor's pending appeal of the creditor's judgment was resolved); *In re Milestone Educ. Inst.*, No. 93-20747 (Bankr. D. Mass. May 25, 1994) (finding that a creditor's

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ABCs As An Alternative To Bankruptcy for Implementing Distressed Transactions

By David S. Kupetz

Companies suffering financial distress frequently reach a crossroads where they need to either implement some type of transaction or will be forced to liquidate. Among the transaction vehicles that may be considered include out-of-court restructuring, an assignment for the benefit of creditors (ABC), foreclosure, Chapter 11 bankruptcy reorganization, or Chapter 7 bankruptcy liquidation. In developing a plan for moving forward, management should evaluate and determine, with appropriate input from outside experts, feasible alternatives. Considerations include whether the business needs a balance sheet restructuring (deleveraging debt), an operational reorganization (eliminating certain locations and/or reducing or terminating parts of the business), and/or the use of a sale or merger process to clean the slate. Even if the business is no longer viable standing on its own, is it still attractive (at least in part) to a potential acquirer or joint venture partner?

There are major differences between distressed transactions and healthy deals. Speed often

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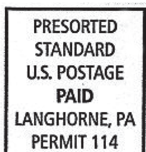

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"motion for relief from stay for cause and concomitant suspension of all activity" would, among other things, permit the state appellate court to "address novel and unsettled issues of receivership law").

Modell's Sporting Goods, Inc. and its affiliated debtors and debtors in possession filed for protection under Chapter 11 on March 11, 2020, the same day that the World Health Organization declared the novel coronavirus outbreak a global pandemic. Less than two weeks following the filing, the debtors emergently sought to avail themselves of the protections afforded by section 305(a). Citing to the "unprecedented, exponential spread of Coronavirus disease … along with the resulting, state-imposed limitations and prohibitions on non-essential retail operations," the debtors requested, pursuant to section 305(a), the imposition of an "Operational Suspension," which, among other things, sought the entry of an order deferring the payment of all expenses other than those essential expenses set forth on a "Modified Budget" for a period of up to sixty days, subject to extension. *See, In re Modell's Sporting Goods, Inc.*, No. 20-14179 (Bankr. D.N.J. Mar. 23, 2020). The modified budget did not include certain post-petition rent obligations, notwithstanding the requirement of section 365(d)(3) of the Bankruptcy Code, which, in relevant part, provides that "[t]he trustee shall timely perform all of the obligations of the debtor, except those specified in section 365(b)(2), 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 … title [11]." That is — breaking with tradition — the contours of suspension were fashioned to meet the specific needs of the case.

The United States Bankruptcy Court for the District of New Jersey authorized, among other things, the suspension of those certain rent obligations for a period of 35 days, notwithstanding objections filed by numerous landlords. Although the court suspended all deadlines during the "Suspension Period," it explicitly noted that parties (*i.e.*, landlords) could seek relief from the court, "with respect to exigent and unforeseen circumstances," and that "the court w[ould] make itself available in its own discretion and as circumstances may permit or warrant." The court would go on to grant a second, 32-day suspension of certain of the debtors' rent obligations over the objection of approximately 40 landlords. Similarly situated debtors have followed suit. *See, e.g., In re Bread & Butter Concepts, LLC*, No. 19-22400 (Bankr. D. Kan. Apr. 22, 2020) (seeking relief under 305(a) to, among other things, continue to pay only critical expenses and temporarily ceasing making or delaying all other payments not contemplated by the "Interim Budget").

Alternatively, debtors seeking to suspend certain operations or temporarily cease making or delaying certain payments have sought relief under section 105(a) of the Bankruptcy Code, which provides that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of … [T]itle [11]." In *In re Pier 1 Imports, Inc.*, No. 20-30805 (Bankr. E.D. Va. Mar. 31, 2020), Pier 1 Imports, Inc. and its affiliated debtors and debtors in possession sought the United States Bankruptcy Court for the Eastern District of Virginia's authorization and approval, primarily pursuant to section 105(a), moving alternatively under section 305(a), of an interim

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Consumer Bankruptcies In 2021 Can Benefit Both Client and Practitioner

By Joshua Denbeaux, Lee M. Perlman and Heidi Spivak

With 2020, with its unprecedented and unforeseeable economic devastation, now in the rearview mirror, consumers face 2021 not as the dawn of a new day (cue the hallelujah choir), but with a sense of foreboding and the looming specter of total financial collapse (cue the John Williams score — Jaws, not Superman). As in past times of economic turmoil, it is anticipated that there will be a surge in residential foreclosures, debt collection activity, and the resultant wave of consumer bankruptcy filings.

Simply stated, the current way of practicing bankruptcy is not going to cut it for 2021.

With a relatively steady flow of bankruptcy filings, and a predictable level of personal financial angst (such as we have become accustomed to over the past 10-12 years), it is easy for consumer bankruptcy practitioners to become complacent. Many attorneys consider the bankruptcy discharge to be the ultimate goal of a consumer bankruptcy case, and the best way to protect the consumer client. But the new wave of bankruptcy debtors will be experiencing a new, post-pandemic, financial crisis — sudden, total, affecting all family wage earners, with diminishing hope for short term recovery. And as in any time of financial crisis, they will have encountered significant financial fraud, mistreatment and mistakes.

Lawyers will be talking to so many people with so many similar complaints of false credit reporting, bad faith creditors and collection actions, and mortgage foreclosure servicing mistakes, that our current and standard model of obtaining a discharge to stanch the bleeding will no longer be enough. The consumer bankruptcy process can, and should, be used to achieve more than just a discharge. The bar must be set higher when it comes to protecting consumers.

The good news here is that taking the time to do a detailed review of the clients' debts does not have to mean taking a hit to your bottom line. In fact, marrying consumer protection with bankruptcy practice will return a benefit to the consumer and a significant increase in fees to debtor's counsel. Toward that end, it is critical to identify and pursue defenses to alleged debts owed to creditors, and it is equally important to identify affirmative causes of action that almost always include mandatory counsel fees and penalties.

This can, of course, mean complex litigation, which is not the forte of most bankruptcy practitioners. It is imperative to form relationships with consumer rights attorneys who can provide expertise, co-counsel relationships, or appear in adversary proceedings.

As bankruptcy practitioners, we have simple techniques and strategies in our toolbox that can have a big impact. And it starts, first and foremost, the same way you already run your practice: talk to your clients. Every potential bankruptcy client comes to your office, or your zoom screen, ready to open up about his/her financial situation. The clients are an open financial book, ready to talk and desperate for help.

The investigation begins before the case is filed. There are certain things that should be looked at for any significant debt. A mortgage loan is a good example — you would want to know the identity of not just the servicer, but also the investor; whether the loan is federally backed or private, the loan type and terms, the maturity date, whether there were previous loss mitigation efforts. Getting this type of background information and looking beyond simply the current status of the debt, will hold clues to help determine whether there is something more to pursue beyond a mere cure of arrears.

In a Chapter 13 case, after the case is filed, it is crucial to review filed proofs of claim. A claim will be "deemed allowed" unless objected to, so it is critical to object to any claim timely so the objection, and any concomitant affirmative cause of action, is not lost. Let us use the example of a mortgage loan again: mortgage servicers are notorious for filing claims containing mistakes and misstatements. And the longer the loan has been delinquent, the higher the likelihood that the claim will reflect unapplied payments, a mishandling of suspense funds, an improper escrow calculation, and the like. Review the claim with the clients — they are your most valuable resource for information. Was there a COVID-19 forbearance? Review the underlying note and mortgage — is there a title issue which might impact the validity of the mortgage?

Mortgage loans are the low hanging fruit; consumer protection issues can be hiding in other types of debts as well. But you have to know where to look. The Retail Installment Sales Act (RISA) governs the financing of consumer goods with cash values of $10,000 and less. The RISA has very strict prohibitions on the inclusion of fees and charges not permitted by the statute. If you have a client with a financed purchase of a consumer good at an outrageous interest rate, or that seems questionable in any way, there is a potential opportunity for a cause of action.

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is an important factor motivating distressed transactions. It can be imperative to move quickly so that the business is held together. Delay may result in the loss of key employees. Negative cash flow leads to further liability risk and uncertainty. These situations are frequently viewed as the proverbial "melting ice cube."

Buyers and owners of businesses transferred or salvaged through a distressed sale or restructuring are understandably focused on avoiding the risk of assuming liabilities. Frequently they are unwilling to assume all known debt. They are even more wary of becoming exposed to unknown or unquantifiable liabilities of the target company. In distressed financial scenarios, otherwise standard contractual protections designed to mitigate risks, such as indemnification provisions, may either not be available or may not provide meaningful protection.

On the other hand, depending how the transactions is structured, acquirers may find that the protections of a distressed transaction vehicle are actually a stronger mechanism for protecting against assumption of unwanted liabilities than is available in a non-distressed deal. Distressed transactions are generally structured as an asset purchase (rather than a purchase of equity) and are frequently effectuated through a cleansing process such as a bankruptcy, foreclosure, or ABC.

Conventional Distressed Transaction Vehicles

Conventional approaches to implementing distressed transactions include out-of-court workouts or the filing of a bankruptcy case. As an alternative, if there is a secured creditor willing and able to foreclose, the assets of a distressed company may be cleansed of the risk of other liabilities following them and acquired through a foreclosure sale. Additionally, an ABC is a somewhat less historically conventional vehicle for facilitating a distressed transaction.

Out-of-court arrangements to address and resolve financial issues are consensual. They are negotiated in the shadow of a potential bankruptcy case. Unlike in Chapter 11 bankruptcy, outside of court, debtors cannot force concessions and contractual modifications on creditors and other counterparties. The opportunity to successfully implement an out-of-court restructuring can be maximized through good communication, accurate information, and building trust with stakeholders.

Restructuring arrangements may provide, among other things, for adjustment of payment terms (abatements, moratoriums, deferrals, extensions, reductions, and others), forbearance agreements, and/or loan, lease and other contract modifications. In many cases, there will be insufficient time, lack of cooperation, and/or just too many complexities to accomplish a necessary restructuring out-of-court.

Chapter 11 provides a means for businesses to reorganize or implement a sale transaction where all company debt is not being satisfied. Upon commencement of a Chapter 11 case, an automatic stay puts all litigation and collection efforts on hold and provides breathing space. The company filing for Chapter 11 relief gains the power to reject, assume, or assume and assign leases and other executory contracts, even if prohibited under the contract. Further, landlord claims arising from rejection of leases are capped.

The goal of a Chapter 11 case is generally to obtain court approval of a plan of reorganization. A confirmed plan is binding on creditors and equity holders of the debtor. The plan provides for the treatment of claims against the debtor, and the obligations under the plan replace pre-bankruptcy obligations of the debtor. Confirmed plan can impose (cramdown) on creditors, equity holders, and other counterparties non-consensual modification of contract rights and restructuring of debt.

A company can deleverage its debt and re-set its balance sheet under a Chapter 11 plan. It can also streamline operations by reducing or eliminating locations, divisions, and other parts of its business and addressing related claims (which may be minimized and/or, depending on the circumstances, receive no payment). Upon confirmation of a reorganization plan, the debtor receives a discharge from its pre-confirmation debt. Chapter 11 can also be used to implement a going concern sale of the debtor's business or to sell specific assets under section 363 of the Bankruptcy Code. Subject to satisfying Bankruptcy Code requirements, 363 sales are generally free and clear of liens and claims. Further, pursuant to court authorization, the sale process is often implemented on an expedited basis when circumstances warrant quick action.

In order to minimize expense, delay, and uncertainty involved in the Chapter 11 process, a "pre-packaged" plan can be presented. In these cases, a plan is developed, negotiated, and prepared prior to the commencement of the case. Frequently, a plan support agreement is entered with key stakeholders to memorialize their support for the plan and the chapter 11 process. Upon commencement of the case, the support agreement and the plan are filed with the court and the process can move forward on an expedited basis.

Another route to a streamlined reorganization process is also available to small businesses under subchapter V of Chapter 11. Pursuant to Coronavirus Aid, Relief, and Economic Security (CARES) Act enacted in March, 2020, Subchapter V relief is available to companies with less than $7.5 million of non-contingent, liquidated debt.

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Subchapter V is designed to make Chapter 11 reorganizations for small businesses more efficient, streamlined, and less expensive. It eliminates some of the required steps to plan confirmation and also some of the creditor protections that otherwise come into play in the confirmation process in ordinary Chapter 11 cases.

Chapter 7 of the Bankruptcy Code provides for liquidation. For practical purposes, it can be viewed as a formal burial process. A bankruptcy trustee (the identity of whom is unknown prior to commencement of the bankruptcy case) is appointed, acts as a fiduciary for creditors, and is responsible for marshalling and liquidating assets of the debtor and distributing available proceeds if any, to creditors. A debtor's business operations almost always cease prior to the commencement of a Chapter 11 case. Accordingly, while Chapter 7 can be used to purchase assets from a bankruptcy trustee, it is not a viable means of accomplishing a going concern transaction.

Assignment for the Benefit of Creditors

"An assignment for the benefit of creditors is a business liquidation device available to an insolvent debtor as an alternative to formal bankruptcy proceedings." *Credit Managers Assn. v. National Independent Business Alliance*, 162 Cal. App. 3d 1166, 1169, 209 Cal. Rptr. 119 (2d Dist. 1984). Unlike federal bankruptcy proceedings, ABCs are governed by state law.

In many instances, where the goal is to transfer the assets of the troubled business to an acquiring entity free of the unsecured debt incurred by the transferor and wind down the company in a manner designed to minimize negative publicity and potential liability for directors and management, the most advantageous and graceful exit strategy can be an ABC. An assignment for the benefit of creditors can serve as a very useful and efficient means of: 1) accomplishing a wind down and the liquidation or going concern sale of a troubled business unable to reorganize; 2) maximizing a secured creditor's recovery from the assets of a distressed debtor; and/or 3) facilitating a buyer's acquisition of a troubled business or assets from an entity burdened with unsecured debt (and, with the cooperation of secured creditors, secured debt).

The process of an ABC is commenced by the distressed entity (the Assignor) entering an agreement with the party which will be responsible for conducting the wind down and/or liquidation or going concern sale (the Assignee) in a fiduciary capacity for the benefit of the Assignor's creditors. The assignment agreement is a contract under which the Assignor transfers all of its right, title, interest in, and custody and control of its property to the third-party Assignee in trust. The Assignee liquidates the property and distributes the proceeds to the Assignor's creditors. In an ABC (as in a formal federal bankruptcy proceeding), unsecured creditors of the Assignor have no right to pursue the assets assigned to the Assignee, but rather must submit a proof of claim to the Assignee and, if the claim is allowed, will ultimately participate in the Assignee's distribution of funds from the assignment estate.

The option of making an assignment for the benefit of creditors is available on a state-by-state basis. During the meltdown suffered in the dot-com and technology business sectors in the early 2000s, California became the capital of ABCs. In discussing assignments for the benefit of creditors, the below discussion focuses primarily on California ABC law.

In order to commence the ABC process, a distressed corporation will generally need to obtain both board of director authorization and shareholder approval. While this requirement is dictated by applicable state law, the ABC constitutes a transfer of all of the Assignor's assets to the Assignee and the law of many states provides that the transfer of all of a corporation's assets is subject to shareholder approval (although this approval may be obtained, in some instances, retroactively). *See, e.g.*, California Corporations Code §§1001, 151 and 152.

Assignments for the benefit of creditors in California are governed by common law and are subject to various specific statutory provisions. In states, like California, where common law (with specific statutory supplements) governs the ABC process, the process is non-judicial. The basis for applicability of common law in California is set forth in California Civil Code §22.2 which provides that "[t]he common law of England, so far as it is not repugnant to or inconsistent with the Constitution of the United States, or the Constitution or laws of this State, is the rule of decision in all the courts of this State." An assignee in an assignment for the benefit of creditors serves in a capacity that is analogous to a bankruptcy trustee and is responsible for liquidating the assets of the assignment estate and distributing the net proceeds, if any, to the assignor's creditors. *See, Credit Managers Association of Southern California v. National Independent Business Alliance*, 162 Cal. App. 3d at 1170-72. ("Under the common law of assignment, the assignee stands in the place of the assignor …. "[A]s trustee for all the creditors, [assignee] was charged with the duty to defend the property in its hands against all unjust adverse claims."); *see also, In re AB Liquidating, Inc.*, 18 B.R. 922, 924-26 (Bankr. E.D. Va. 1982).

Advantages of an ABC

Compared to bankruptcy liquidation, assignments may involve less administrative expense and can be a substantially faster and more flexible liquidation process. In addition, unlike a Chapter 7 liquidation, where generally an unknown trustee will be appointed to administer the liquidation process, in an assignment for the benefit of creditors, the Assignor can select an Assignee with appropriate experience and expertise to conduct the wind down of its business and liquidation of its assets. In prepackaged

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ABCs, where an immediate going concern sale will be implemented, the Assignee will be involved prior to the ABC going effective.

In situations where a company is burdened with debt that makes a merger or acquisition infeasible, an ABC can be the most efficient, effective and desirable means of effectuating a favorable transaction and addressing the debt. The assignment process enables the Assignee to sell the Assignor's assets free of the unsecured debt that burdened the company. Unlike bankruptcy, where the publicity for the company and its officers and directors will be negative, in an assignment, the press generally reads "assets of Oldco acquired by Newco," instead of "Oldco files bankruptcy" or "Oldco shuts its doors." Moreover, the assignment process removes from the board of directors and management of the troubled company the responsibility for and burden of winding down the business and disposing of the assets.

From a buyer's perspective, acquiring a going concern business or the specific assets of a distressed entity from an Assignee, in an ABC sale transaction, provides some important advantages. Most sophisticated buyers will not acquire an ongoing business or substantial assets from a financially distressed entity with outstanding unsecured debt, unless the assets are cleansed either through an ABC or bankruptcy process. Such buyers are generally simply unwilling to subject themselves to potential contentions that the assets were acquired as part of a fraudulent transfer and/or that they are a successor to or subject to successor liability for claims against the distressed entity. Buying a going concern or specified assets from an Assignee allows the purchaser to avoid these types of contentions and issues and to obtain the assets free of the Assignor's unsecured debt.

From the perspective of a secured creditor, in certain circumstances, instead of being responsible for conducting a foreclosure proceeding, the secured creditor may prefer to have an independent, objective third party with expertise and experience liquidating businesses acting as an Assignee. It is common for an Assignee to enter into an appropriate subordination agreement with the secured creditor and to then liquidate the Assignor's assets and turning the proceeds over to the secured creditor to the extent that the secured creditor holds valid, perfected liens on the assets that are sold.

In many instances involving distressed enterprises, an assignment for the benefit of creditors may be the best means for exiting a business that has reached the end of its lifecycle by minimizing negative publicity, limiting the potential liability of officers and directors, and relieving the officers and directors of responsibility for winding down the business and disposing of its assets by entrusting that responsibility to qualified, independent professionals. Additionally, the ABC process allows buyers of going concerns and specific assets require those assets in an expeditious and efficient manner and at the same time minimize risks associated with the acquisition. Finally, in certain circumstances, the secured creditors may determine that using the ABC process provides advantages compared to pursuing a foreclosure.

Disadvantages of an ABC

Unlike in a bankruptcy case, because the ABC process in California and numerous other states is non-judicial, there is no court order approving a sale by the Assignee. As a result, a buyer who requires the clarity of an actual court order approving the sale will not be able to satisfy that desire through an ABC transaction. That being said, the Assignee is an independent, third party fiduciary who must agree to the transaction and is responsible for the ABC process. The buyer in an ABC transaction will have an asset purchase agreement and other appropriate ancillary documents that have been executed by the Assignee.

Executory contracts and leases cannot be assigned in a ABC without the consent of the other party to the contract. There is no state law equivalent of Bankruptcy Code Section 365. Accordingly, if the assignment of executory contracts and/or leases is a necessary part of the transaction and, if the consent of the other parties to the contracts and leases cannot be obtained, an ABC transaction may not be the appropriate approach. Further, *ipso facto* default provisions (allowing for termination, forfeiture, or modification of contract rights) based on insolvency or the commencement of the ABC are not unenforceable as they are in a federal bankruptcy case.

Secured creditor consent is generally required in the context of an ABC. There is no ability to sell free clear of liens, as there is in some circumstances in a federal bankruptcy case, without secured creditor consent, unless the secured creditor will be paid in full from sale proceeds. Moreover, there is no automatic stay to prevent secured creditors from foreclosing on their collateral if they are not in support of the ABC.

Conclusion

Assignments for the benefit of creditors can be particularly useful when fast action and distressed transaction and/or industry expertise is needed in order to capture value from the liquidation of the assets of a troubled enterprise. The ABC process may allow the parties to avoid the delay and uncertainty of formal federal bankruptcy court proceedings. In many instances involving deteriorating businesses, management engages in last-ditch efforts to sell the business in the face of mounting debt. However, frequently the value of the business is diminishing rapidly as, among other things, key employees leave. Moreover, the parties interested in acquiring the business and/or assets will only move forward under circumstances where they will not be taking on the unsecured debt of the distressed entity along with its assets. In such instances, especially when the expense of a Chapter 11 bankruptcy case may be unsustainable, an assignment for the benefit of creditors can be a viable solution.

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budget, including the temporary cessation of non-critical payments (and adjournment of certain motions and applications for payments related thereto) during the "Limited Operations Period." *See also, e.g.*, *In re CEC Entm't, Inc.*, No. 20-33163 (Bankr. S.D. Tex. Dec. 14, 2020) (debtors arguing that section 105(a), among others, gives the court equitable power to alter CEC's rent obligations).

Similarly, in *In re CraftWorks Parent, LLC*, No. 20-10475 (Bankr. D. Del. Mar. 20, 2020), CraftWorks Parent, LLC and its affiliated debtors and debtors in possession sought a "breathing spell" of at least 60 days to enable the debtors to deal with COVID-19's implications. Here and in pertinent part, however, the debtors sought the approval of temporary procedures which would essentially require creditors and all other parties in interest to seek substantive relief, in the procedural manner and form laid out by the debtors, from the debtors themselves, as opposed to the court, prior to the filing of any request for relief with the court (other than for motions for admission *pro hac vice*). In a March 23, 2020 letter to the debtors' counsel, the court expressed that, despite the good faith efforts to address the problems, the temporary procedures "[were] well beyond any relief [the court] would be likely to grant," noting that "[t]he burden imposed on creditors who are simply seeking to vindicate their rights is too high." The court strongly encouraged the parties to develop and propose alternative procedures. To that end, the debtors proposed revised procedures on March 30, 2020, which were approved by an order of the court entered that same day.

There is a dearth of established case law on similarly situated Chapter 11 debtors seeking, and receiving, such tailored relief under sections 305(a) and 105(a). However, as the pandemic continues and as the virus continues to undergo several major mutations, it is all but certain that bankruptcy courts will see a precipitous uptick in the number of debtors moving for relief under these sections. In the first two weeks of 2021 alone, three retail chains sought protection under Chapter 11.

Rent Deferral

To preserve liquidity, Chapter 11 debtors have also sought, pursuant to section 365(d)(3) of the Bankruptcy Code, to extend the time required to make rent payments. In relevant part, section 365(d)(3) provides that:

> [t]he trustee shall timely perform all the obligations of the debtor, except those specified in section 365(b)(2), 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. The court may extend, for cause, the time for performance of any such obligation that arises within 60 days after the date of the order for relief, but the time for performance shall not be extended beyond such 60-day period.

Revisiting the case of *In re Pier 1 Imports*, the debtors argued that the multiple state-mandated closures as a result of COVID-19 satisfied the "cause" requirement of section 365(d)(3) to temporarily cease post-petition rent payments. *See also, e.g.*, *In re Chinos Holdings, Inc.*, No. 20-32181 (Bankr. E.D. Va. May 26, 2020) (order extending the time for the debtors' performance of obligations arising under unexpired non-residential real property leases for a period of 60 days); *In re J.C. Penney Company, Inc.*, No. 20-20182 (Bankr. S.D. Tex. June 11, 2020) (ordering that the time for the debtors' performance of monetary obligations arising within 60 days of the petition date under any unexpired lease of nonresidential real property was extended, provided that the debtors not seek to further extend the extension period).

In a written opinion issued on May 10, 2020, the court in *Pier 1 Imports* explained that, while section 365(d)(3) required the debtors to "timely perform all of the[ir] obligations" under their leases, "section 365(d)(3) does not give the [l]essors a right to compel payment from the Debtors in accordance with the terms of the underlying leases." Rather, if a debtor fails to timely perform its post-petition obligations, a lessor is entitled to an administrative expense claim under section 365(d)(3). *See also, e.g.*, *In re Circuit City Stores, Inc.*, No. 08-35653 (Bankr. E.D. Va. Feb. 12, 2009) ("Section 365(d)(3) does not provide a separate remedy to effect payment. If a debtor fails to perform its obligations under §365(d)(3), all a Lessor has is an administrative expense claim under §365(d)(3), not a claim entitled to superpriority."). Notwithstanding this fact, the Court found that the landlords were entitled to adequate protection under sections 361 and 363 of the Bankruptcy Code. The court concluded that the landlords were, in fact, adequately protected on account of the debtors' continued payments of insurance, utility, security costs, and other similar obligations as required under the applicable leases.

Bankruptcy courts across the country continue to see such requests for similar relief by Chapter 11 debtors as a direct result of the pandemic. *See, e.g.*, *In re RTI Holding Company, LLC*, No. 20-12456 (Bankr. D. Del. Oct. 8, 2020) (seeking up to a 60 day extension to perform obligations arising under leases of nonresidential real property); *In re Art Van Furniture, LLC*, No. 20-10553 (Bankr. D. Del. Apr. 24, 2020) (same); *In re True Religion Apparel, Inc.*, No. 20-10941 (Bankr D. Del. Apr. 13, 2020) (same); *In re Hitz Restaurant Group*, No. 20-05012 (Bankr. N.D. Ill. June 3, 2020) (holding, pursuant to section 365(d)(3), that the debtor's "obligation to pay rent is reduced in proportion to its reduced ability to generate revenue due to the [COVID-19] executive order.").

The CARES Act and Rent Deferrals

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act became law. On Jan. 3, 2020, Congress again amended the CARES Act, thereby increasing payment flexibility for Subchapter V debtors-lessees of nonresidential real

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property. Specifically, the bill amended section 365(d) to permit debtors in Subchapter V cases to move to extend the time to comply with its lease obligations by 60 days. This arguably could mean that, because Congress chose to allow Subchapter V debtors to delay their performance under a lease, debtors operating outside of Subchapter V must pay rent as it becomes due. This idea is further strengthened by a review of other amendments to the CARES Act, which do not specify which debtor may avail itself of specific Bankruptcy Code protections. For example, all debtors now have 210 days to assume or reject a lease pursuant to section 365 of the Bankruptcy Code.

E-Commerce Is King

The pandemic, and the economic impact it had and continues to have, has accelerated the need for longer-term strategic solutions regarding brick-and-mortar retail and its future viability. This is due to, among other things, shelter in place orders and other stay at home guidance and consumer unwillingness to shop in person. *See, e.g.*, *In re L'Occitane, Inc.*, No. 21-10632 (Bankr. D.N.J. Jan. 26, 2021) (the debtor's retail revenue between April and December 2020 decreased by 56.5% compared to the same period during 2019.). As a result, Chapter 11 debtors are "aggressively address[ing] the rapidly widening gulf between its brick-and-mortar retail revenue and [their] substantial lease obligations, which no longer reflect the market." On Jan. 25, 2021, for example, chocolate retailer, Godiva, announced that it was exiting its 128 brick-and-mortar locations in North America by the end of the first quarter of 2021. Restaurateurs are also facing this dilemma. *See, e.g.*, *CiCi's Holdings, Inc.*, No. 21-30146 (Bankr. N.D. Tex. Jan. 25, 2021) (requesting first day relief to reject approximately 20 of its 51 real property leases).

One such solution may be the investment in, and development of, a strong e-commerce platform. Digital commerce behemoth, Walmart, has continued to capture market share throughout the pandemic. Walmart U.S. Q2 comp sales grew 9.3%, and Walmart e-commerce sales grew 97% with "strong results against all channels." In Q3, Walmart U.S. comp sales grew 6.4%, and Walmart U.S. e-commerce sales grew 79% and contributed approximately 570 basis points to comp sales. Target's total comparable sales grew 20.7% in the third quarter, reflecting comparable stores sales growth of 9.9% and digital sales growth of 155%. *See also, e.g.*, *In re L'Occitane, Inc.*, No. 21-10632 (Bankr. D.N.J. Jan. 26, 2021) (from April through December 2019, e-commerce sales increased by 72%). Few restaurants with a robust online presence are also raking in the dough. Chipotle's third quarter highlights, which incorporate the impact of COVID-19, included digital sales growth of 202.5%, which accounted for 48.8% of sales for the quarter.

Conclusion

As the case law above suggests, there are a number of tools available to a Chapter 11 debtor in need of relief from post-petition monetary obligations to try to blunt the impact of the pandemic on its restructuring or liquidation efforts, whether in the form of suspension of part of the Chapter 11 case under section 305(a), withholding payments under section 105(a), deferring such payments under section 365(d)(3), or a combination of the foregoing. However, what is less than clear is whether this relief, as extraordinary as it may be, will be sufficient to carry the debtor through the challenging economic environment caused by the pandemic to permit it to implement its desired exit from Chapter 11, or is instead simply delaying the inevitable quick sale of assets in a less than desirable manner. Of course, the answer to that question is not universal, but rather lies in a number of facts and circumstances unique to the subject debtor. Although the Bankruptcy Code is a safe harbor, ultimately the proverbial ship will sink or sail based upon the strength of the assets being protected under Chapter 11 and the options available to the debtor as determined by the market.

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Bankruptcies

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Errors in filed claims range from mistake to outright consumer protection violation. And the way you handle them within the bankruptcy case also has a range — from motion to strike the claim, to adversary proceeding. When representing consumer debtors, you must be able to spot consumer protection issues, and should be able to determine which issues can be handled through motion practice, and which would more properly be brought in an adversary proceeding. With each case, you must also consider whether you want to litigate the potential claims on your own or hire special counsel with a concentration in consumer litigation. That distinction will add a lot of value to the consumer bankruptcy practice, value to the client, and it will also improve the bottom line of the business in the form of increased revenue.

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