

## In The News

# In The Coronavirus Crisis, Some Retailers In Chapter 11 Are Too Stuck To Reorganize

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Struggling retailers and secured lenders usually push for Chapter 11 bankruptcy proceedings in the hopes of escaping debt and reorganizing under the court's authority, but the national coronavirus pandemic has made some of these proceedings much more complicated.

The process took an unprecedented turn when Modell's Sporting Goods and Pier 1 Imports obtained court rulings that deployed rarely used bankruptcy code rules to raise the possibility of giving retailers an extended break from paying rent even after the standard, 60-day reprieve allotted in Chapter 11 bankruptcy.

Through Chapter 11 bankruptcy, troubled retailers are traditionally able to retain their assets and operations while streamlining their debts and planning future operations. During this process, a firm generally has a 60-day reprieve from paying rent, but this concept is being scrutinized as retailers already in reorganizations face a shutdown of epic proportions from the coronavirus.

At least two retailers, Pier 1 and Modell's, asked courts to stop their Chapter 11 proceedings for a time period and to possibly grant rent reprieve as long as their spaces cannot be occupied.

A Virginia-based U.S. bankruptcy court in the Pier 1 Imports case suspended the retailer's Chapter 11 bankruptcy proceeding along with the store's planned liquidation of stores and rent payments indefinitely, Munsch Hardt Dallas attorney Kevin Lippman said.

Meanwhile, the court in Modell's said it would determine if additional rent reprieve beyond the legally allotted 60-day time period and a continued stall of the retailer's bankruptcy proceeding is still needed at a hearing later this month, Lippman said.

"The bankruptcy code is being extremely tested right now in this current situation," Lippman said. "We are dealing with an unprecedented economic time given the almost complete shutdown of retail activity. The shutdown is preventing the liquidation of assets, which is the intent of these bankruptcy filings. It is going to create a necessity for creative solutions by the constituencies in these cases."

Cole Schotz attorney Michael Sirota worked up the Modell's bankruptcy case for the retailer and says to date, the court has not granted a reprieve in rent beyond the traditional 60 days. It did delay its hearing by 30 days, and could consider a longer rent reprieve later this month.

But Sirota said it's unprecedented for attorneys to try to stop a Chapter 11 reorganization already in process in circumstances like these.

"I don't believe before our case that there was a case in the country that ever used section 305 [of the bankruptcy code] to suspend a Chapter 11 case in order to attempt to account for this unprecedented pandemic and the implications flowing from it," he said.

Section 305 allows courts to suspend or end a bankruptcy proceeding if it finds doing so would better serve the interests of the parties.

Sirota said an emergency suspension of the Chapter 11 bankruptcy liquidation process was needed in the Modell's case because the retailer was unable to access its properties to sell them off or to generate cash flow during the coronavirus shutdowns. He said the use of section 305 to stall the bankruptcy proceeding and the rents owed is a benefit to all of the parties in the long run.

"I think what would have happened [without the 30-day hearing delay] is that the lenders would not have approved our cash collateral budget and would have seriously considered converting the case to a Chapter 7 [liquidation proceeding], which would have enormous implications for all stakeholders, including landlords."

If the case moved to Chapter 7, Modell's would have less flexibility to try to retain value for all assets and stakeholders. Generally, in Chapter 7 filings, the firms have no chance to reorganize and they lose control of how the process will be handled. Instead, a trustee is appointed to liquidate all assets and to pay off creditors.

Some landlords believe extending a rent pass to retail tenants beyond the normal 60-day rental reprieve in bankruptcy allows financially strapped retailers and their lenders to game the bankruptcy process.

"They [the landlords] are going to say, 'OK, you have now forced the landlords to become involuntarily lenders in the sense that they are not being paid for the debtors' ongoing use of their space,'" Lippman said.

Landlords also could make the argument that a secured lender with a loan tied to a troubled retailer benefits from having landlords handle the rent during the shutdowns.

From their perspective, the lender is compensated by not having a defaulted retail tenant and by not having to cover the rent itself. Then, later on, when the retailer goes through reorganization, the lender is listed as a creditor and could get paid before the landlord.

This concern is echoed by other landlord attorneys, including Stark & Stark law firm partner Joseph Lemkin out of New Jersey.

Lemkin said in the Modell's case, the landlord objected to a proposed payment schedule in which the landlord feared other secured creditors, including the lenders, would be taken care of first after the shutdowns end.

"I think the feeling was 'you are almost double taking advantage of us,'" Lemkin said. "The court in Modell's said everyone needs to share the pain."

The court in Modell's case has yet to rule on how missed rent payments will be assessed in relation to other creditors' interests when the bankruptcy proceeding is no longer stalled, Lemkin said. The hope is that all parties will come to mutual agreements that allow them all to receive equitable returns at some point in the process.

He said neither the Pier 1 Imports or Modell's cases should encourage retailers to pursue Chapter 11 proceedings on the false belief that a bankruptcy court will give them rent reprieve beyond the standard 60 days.

Lemkin is aware of another bankruptcy court that refused a retailer's request to delay a Chapter 11 bankruptcy proceeding and to offer a rent reprieve. And, in those types of cases, if the retailer cannot cover the rent or other expenditures, a Chapter 11 reorganization can quickly be turned into a court-ordered Chapter 7 liquidation to raise the funds needed to pay creditors.

"You can't assume the court is going to suspend," Lemkin said. "The court may say if you don't have ability to pay and you can't comply with the obligations, we will put you in Chapter 7."

To learn more, [click here](#).

## Primary Contacts



**Kevin Lippman**

Dallas  
214.855.7553  
[klippman@munsch.com](mailto:klippman@munsch.com)

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