AMERICAN BANKRUPTCY INSTITUTE

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Business Breakout

New World Orders: Post-COVID Practice

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CONCURRENT SESSION

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NORTHEAST VIRTUAL BANKRUPTCY CONFERENCE & CONSUMER FORUM
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JULY 29-30, 2020

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- Debtors' Responses to COVID
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Overview

- Stay-at-home and mandated closures forced non-essential brick-and-mortar businesses, including most retailers, restaurants, movie theaters, and sports venues to close their doors without realistic prospects of a return to normal operations.
- Without sales, liquidity and cash flow were all but shut off for most affected businesses.
- In response, some debtors already in bankruptcy moved to suspend all or a portion of their chapter 11 cases to conserve liquidity.
- Other companies were forced to file for chapter 11 protection as a result of COVID.
  - June 2020 saw 23% more bankruptcy filings than June 2019.[1]
- Bankruptcy courts have been forced to adapt to an increase in Chapter 11 filings in a post-COVID era, and have done so by altering their procedures and Local Rules to limit in-person hearings, meetings, and conferences.

[1] Vince Sullivan, *Rise In Ch. 11 Cases Echoes 2008 Financial Crisis*, Law360.com, July 17, 2020, *available at https://www.law360.com/articles/1289289/rise-in-ch-11-cases-echoes-2008-financial-crisis*

Debtors' Responses: Operational Suspensions

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- Many debtors already in chapter 11 prior to the COVID-caused shutdown in the United States sought extraordinary relief, including in some cases a request for suspension of specific payments typically made in chapter 11.
  - With in-store sales impossible, and liquidity dwindling, some debtors sought to 'suspend' operations and postpone or waive all but the most critical payments to preserve liquidity.
  - These requests frequently included a suspension of rent payments.
- Some debtors even requested a suspension of all proceedings pursuant to 11 U.S.C. § 305(a), which provides:
  - (a) The court, after notice and a hearing, may dismiss a case under this title, **or may suspend all proceedings** in a case under this title, at any time if—
    - (1) the interests of creditors and the debtor would be better served by such dismissal or suspension.
- Courts have traditionally interpreted § 305(a) to apply to a suspension of the entire case, rather than certain proceedings or payments.

- The debtors in *In re Modell's Sporting Goods, Inc.*, for example, sought to suspend their cases under 11 U.S.C. § 305(a) less than two weeks after filing. *See In re Modell's Sporting Goods, Inc.*, Case No. 20-14179 (VLP), Bankr. D.N.J., ECF No. 115.
- The debtors in *Modell's* requested the imposition of an "Operational Suspension" of the debtors' cases:
  - "deferring, among other things, certain rent and non-critical obligations;" ceasing all in-store sales and store closing sales; terminating all but essential employees; and staying and extending all deadlines until 21 days after the termination of the Operational Suspension.
- Although the bankruptcy court's suspension order postponed all deadlines during the suspension period, the Order explicitly noted that parties 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." *In re Modell's Sporting Goods, Inc.*, Case No. 20-14179 (VLP), Bankr. D.N.J., ECF No. 166.
- The Operational Suspension expired on June 15th, at which point the debtors were able to negotiate consensus with the unsecured creditors' committee and certain landlords for payment of reduced rent at certain locations.
- Presently, the debtors are conducting going out of business sales at all of their locations.

- Other debtors seeking to suspend just certain operations or withhold certain payments have sought relief under 11 U.S.C. § 105(a), which provides:
  - "The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."
- For example,
  - The debtors in *In re Pier 1 Imports, Inc.* relied primarily on 11 U.S.C. § 105(a), but moved alternatively for relief under 11 U.S.C. § 305, in moving the court to impose a "Limited Operations Period" that would (a) limit payments to all but critical expenses, cease rent payments, and adjourn and postpone hearings for 45 days. *In re Pier 1 Imports, Inc.*, Case No. 20-30805 (KRH), Bankr. E.D.Va., ECF No. 438.
  - The debtors in *In re CraftWorks Parent, LLC* sought relief exclusively under the bankruptcy court's equitable powers under 11 U.S.C. § 105(a) in moving the court to impose "Temporary Procedures" that would (a) require creditors and other parties in interest to meet and confer prior to seeking any relief in the bankruptcy court and (b) limit the pleadings that could be filed in the bankruptcy court.

Debtors' Responses: Rent Deferral

- In addition to seeking suspension of their cases, debtors have moved to "extend" the time required to make rent payments under 11 U.S.C. § 365(d)(3) to preserve liquidity.
- 11 U.S.C. § 365(d)(3) provides:
  - "The 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.**"

- In *Pier 1 Imports*, for example, the bankruptcy court concluded that 11 U.S.C. §365(d)(3) does not require a debtor to pay rent as it is due under the lease, but rather that a landlord is only entitled to an administrative expense claim.
- Pier 1 Imports, Inc. and its affiliated debtors filed for Chapter 11 relief on February 17, 2020 in the Eastern District of Virginia. *See In re Pier 1 Imports, Inc.*, Case No. 20-30805 (KRH), Bankr. E.D.Va.
- On March 31, 2020, the debtors moved to enter a "Limited Operations Period" to
  - pay only "critical expenses," such as employee benefits for furloughed employees, reduced wages for critical employees, insurance, trust fund taxes, essential operating expenses, and necessary professional fees;
  - temporarily cease rent payments and certain payments to vendors, shippers and suppliers; and
  - automatically adjourn all motions and hearings for 45 days.
- On April 2, 2020, the bankruptcy court approved the debtors' requested Limited Operations Period, and subsequently extended it on April 28, 2020.

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- In a supplemental written opinion issued May 10, 2020, the bankruptcy court explained that while section 365(d)(3) required the debtors to "timely perform" their obligations under the respective 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, to the extent that the Debtors are obligated to pay rent and fail to timely pay such rent, the Lessors are entitled to an administrative expense claim." *In re Pier 1 Imports, Inc.*, Case No. 20-30805 (KRH), Bankr. E.D.Va., ECF No. 493.
- Nevertheless, the bankruptcy court found that landlords were entitled to adequate protection under sections 361 and 363.
- The bankruptcy court further found that landlords were adequately protected on account of the debtors' uninterrupted payments of insurance, utility, and security costs, as required under the applicable leases.

- The Limited Operations Period in *Pier 1* expired on May 31st, at which time the debtors agreed:
  - to pay stub rent for all stores reopened for the period of May 22 through May 31 concurrently with June rent;
  - to resume all rent payments on June 1st;
  - to pay unpaid April and May rent no later than the week ending Sept. 12, conditioned on such landlord's agreement to a lease rejection date that would permit the debtors to remain in the stores through the end of the store closing process; and
  - commence a wind-down of their operations.
- Other bankruptcy courts have approved "extensions" of debtors' requirements to pay rent, including:
  - On May 26, 2020, in *In re Chinos Holdings, Inc.* [J. Crew], Case No. 20-32181 (KLP) Bankr. E.D.Va., the bankruptcy court approved the debtors' request for a 60-day "Extension" of the debtors' obligation to pay rent, and postponed all motions for relief from stay (absent life threatening circumstances), and motions to assume or reject such unexpired lease for 60 days.
  - On June 11, 2020, in *In re J.C. Penney Company, Inc.*, Case No. 20-20182 (DRJ), Bankr. S.D.Tex., ECF No. 721, the bankruptcy court entered similar relief as in J. Crew.
- Critical to the success of these motions is ensuring that the debtor will be able to satisfy the rental obligations after the deferral period. *See In re PQ New York, Inc., et al.*, Case No. 20-11266 (JTD), Bankr. D. Del., ECF No. 74.

Going Out of Business Sales

- Although many pre-COVID retail chapter 11 cases ended in liquidation or going out of business ("GOB") sales, at the outset of the pandemic, shelter in place orders and other stay at home guidance put additional pressure on retail chapter 11 debtors. At that time, mandatory store closures has called into question whether traditional GOB sales were the proper avenue for all retailers.
  - *See In re Modell's Sporting Goods, Inc.*, Case No. 20-14179 (VLP), Bankr. D.N.J., ECF No. 438.
- However, GOB sales are picking up again as the country reopens and we adjust to the "new normal."
- Nevertheless, there are issues that need to be addressed:
  - Ensuring customer and employee safety.
  - The importance of online sales and other alternative channels.
  - Whether and how liquidation values are impacted if some or all stores must close again.

- Some debtors and courts are also considering whether to mothball operations and conduct sales (or try to emerge) at a later date rather than forcing an immediate liquidation of inventory.
  - *See In re VIP Cinema Holdings, Inc.*, Case No. 20-10345 (MFW) Bankr D. Del. (conducting an orderly liquidation after filing a consensual prepackaged plan to strip $150m of debt from its balance sheet).
- Regardless of which option debtors ultimately determine is in the best interest of their estates, COVID has forced debtors to adjust timelines of their cases.
  - Uncertainty drives quick 363 sale timelines.
- The forced closure of retail stores presents challenging valuation questions.
  - Repeated shutdowns and mandated reductions in capacity may call for valuation tools to be adjusted.
  - Without accurate revenue or foot-traffic forecasts, debtors, courts, and potential bidders may have concerns relying on traditional asset valuation for purposes of section 363 sales or enterprise-wide valuation.

Severance Obligations Post-COVID

- In response to coronavirus, many employers reduced hours and pay and, in some cases, closed stores, sites, or operations indefinitely.
- In cases filed just before COVID, some debtors utilized section 305(a) to temporarily halt payment to employees.
- Even other debtors actually sought to not only pay wages in the ordinary course through the traditional first day "wages" motion, but to also pay severance to employees terminated both pre and postpetition in full to ease the financial burden on those employees.

- *In re Pier 1 Imports, Inc.*, Case No. 20-30805 (KRH), Bankr. E.D.Va.
  - Debtors sought authority to maintain non-insider severance program under Section 363(b).
  - On March 13, 2020, the debtors received authority on a final basis to pay 50% of all pre- and postpetition severance obligations, up to $3.4m, and an additional $1.625m for Canadian employees, under Section 363(b), but without prejudice to seek subsequent relief under Section 503(c).
- *In re Chinos Holdings, Inc.* [J. Crew], Case No. 20-32181 (KLP) Bankr. E.D.Va.
  - Debtors sought authority to maintain non-insider severance program under Section 363(b).
  - On May 5, 2020, the debtors received authority on a final basis to continue the Non-Insider Severance Program under Section 363(b), not Section 503(c), for employees terminated postpetition.
- *In re Centric Brands, Inc.*, Case No. 20-22637 (SHL) Bankr. S.D.N.Y.
  - On July 17, 2020, debtors received authority to pay prepetition and postpetition severance obligations, up to the 507(a)(4) priority cap.

Third CLE Code: 48697
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CARES Act and PPP Loans

- On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") became law. The CARES ACT established the Paycheck Protection Program (the "PPP"), administered by the Small Business Administration (the "SBA").
- Under the PPP, small businesses can obtain unsecured loans in an amount up to the lesser of $10m or 2.5 times an applicant's average monthly payroll to fund payroll and other related expenses.
- Applicants do not pay fees for obtaining PPP loans, and interest and principal payments are deferred for six months.
- The PPP loans may be ultimately forgivable if the borrower maintains employments and wage levels.
- Notwithstanding that the CARES Act was silent on the whether a debtor in a bankruptcy proceeding could receive a PPP loan, the SBA issued an interim final rule (the "IFR") that rendered an applicant ineligible for a PPP Loan if the applicant was:
  - "the debtor in a bankruptcy proceeding, **either at the time it submits the application** or **at any time before the loan is disbursed**." 85 Fed. Reg. 23,450 (April 28, 2020).

- The IFR triggered a flurry of litigation in cases that were pending prior to the enactment of the CARES Act.
- Most bankruptcy courts have upheld the IFR's limitations on a debtor's eligibility to receive PPP Loans,
  - either rejecting the bankruptcy court's jurisdiction to enjoin the SBA; or
    - *See Carranza v. Hidalgo County Emergency Service Foundation (In re Hidalgo Emergency Service* Foundation), No. 20-40368 (5th Cir. June 22, 2020).
  - holding that the IFR was neither arbitrary or capricious, or does not run afoul of the anti-discrimination provisions of 11 U.S.C. § 525(a);
    - *See Tradeways Ltd v. Dept. of the Treasury*, Case No. 20-1324 (D. Md. June 24, 2020); *Henry Anesthesia Associates v. Carranza (In re Henry Anesthesia Associates)*, Case No. 20-06084 (Bankr. N.D. Ga. June 4, 2020); *Schuessler v. SBA*, Adv. Proc. No. 20-02065, 2020 WL 2621186 (Bankr. E.D. Wis. May 22, 2020).
- However, two bankruptcy courts have concluded that the IFR ran afoul of 11 U.S.C. § 525(a) and enjoined the SBA from enforcing the restrictions of the IFR.
  - *See Springfield Hospital Inc. v. Carranza (In re Springfield Hospital Inc.)*, Case No. 20-01003 (Bankr. D. Vt. June 22, 2020); *Roman Catholic Church of the Archdiocese of Santa Fe v. U.S. (In re Roman Catholic Church of the Archdiocese of Santa* Fe), Case No. 20-1026 (Bankr. D.N.M. May 1, 2020).

- In the chapter 11 cases of two unrelated Maine hospitals, *In re Calais Regional Hospital*, Case No. 19-10486 (Bankr. D. Me.), and *In re Penobscot Valley Hospital*, Case No. 19-10034 (Bankr. D. Me.), both debtors filed adversary proceedings against the SBA to enjoin the IFR. The bankruptcy court ordered the adversary proceedings consolidated under Fed. R. Civ. P. 42.
- On April 30, 2020, the bankruptcy court entered TROs in both cases enjoining the SBA, and concluding that the debtors were likely to succeed on their claims that the IFR violated 11 U.S.C. § 525(a). *Penobscot Valley Hosp. v Carranza*, Adv. Pro. No. 20-1005 (May 1, 2020), ECF No. 18.
- However, following a trial on the merits, the bankruptcy court entered Proposed Findings and Conclusions finding that the IFR was nor arbitrary or capricious, and did not run afoul of 11 U.S.C. § 525(a). *Penobscot Valley Hosp. v Carranza*, Adv. Pro. No. 20-1005 (June 3, 2020), ECF No. 58. The Proposed Findings and Conclusions are currently before the district court.

- Despite the mixed results to challenges to the IFR, some debtors have been able to commence bankruptcy proceedings after receipt of PPP loans.
  - For example, in *In re TooJay's LLC*'s chapter 11 case [No. 20-14792] (Bankr. S.D. Fla.), filed April 29, 2020, the debtor received a $6.4 million PPP loan on the eve of Chapter 11.
- Some debtors already in a chapter 11 case moved to voluntarily dismiss their pending cases, quickly apply for a PPP Loan, and then refile a subsequent chapter 11 case on limited notice.
  - Dismissal and reinstatement:
    - In *In re Advanced Power Technologies, LLC*, Case No. 20-13304 (Bankr. S.D. Fla.), the debtor sought an order dismissing the case without prejudice to refile. The bankruptcy court dismissed the debtors' first case on April 24, 2020, but explicitly preserved the DIP lender's rights under the DIP order. On May 5, 2020, after securing $1.8 million in PPP loans, the debtor moved to vacate the April 24, 2020 dismissal order and reinstate the case. The court granted the motion to vacate the dismissal order on May 12, 2020.
    - The debtors in *In re Starplex Corporation*, Case No. 20-02208 (DPC), Bankr. D. Ariz., employed a similar maneuver, where they moved to dismiss their case obtain PPP funds, and once a PPP loan was secured, moving to reinstate their case under Fed. R. Civ. P. 60(b), which the court granted.
  - Dismissal and new filing:
    - In *In re Eastern Niagara Hospital*, the debtor's original chapter 11 case was dismissed on June 24, 2020 so that the debtor could secure a PPP loan. Once the debtor secured the PPP loan, it refiled a second chapter 11 case on July 8, 2020, *In re Eastern Niagara Hospital*, Case No. 20-10903 (CLB), Bankr. W.D.N.Y.

Bankruptcy Courts' Responses

- Bankruptcy courts have adapted to the health risks posed by COVID-19 by curtailing in person hearings, expanding remote/telephonic appearances, and suspending local rules.
- While bankruptcy courts continue to conduct business and hold hearings, most courts are operating remotely. Many courthouses are closed to ensure the safety of debtors, creditors, the public and court staff, and in-person proceedings have been suspended, or significantly limited.
  - **Bankr. S.D.N.Y.–** All hearings telephonic until further notice. *See,* General Order M-543 (Mar. 20, 2020)
  - **Bankr. S.D. Tex.–** All hearings virtual through September 8, 2020. *See*, General Order 2020-18 (June 29, 2020).
    - The U.S. Bankruptcy Court for the Southern District of Texas had initially entered a general order that tolled all court-imposed deadlines by the number of days that the court's COVID-19 protocols were in place. The tolling provision terminated May 4, 2020, after being in effect for 41 days in the Houston division.
- Some bankruptcy courts, such as the District of Delaware, have resumed in-person hearings on a limited basis, based on guidance from public health officials, but have not required parties to attend in person.
  - **Bankr. D. Del. –** Resumed limited in-person hearings, effective June 17, 2020, at the discretion of each bankruptcy judge, but encouraged litigants and counsel to continue to attend hearings by phone. *See,* Fifth Amended Order Governing The Conduct Of Hearings Due to Coronavirus Disease 2019 (COVID-19) And Reconstituting Operations (June 17, 2020).

- At present, all Bankruptcy Courts in the First Circuit are conducting hearings remotely through the end of August.
  - **D.Me. –** All hearings telephonic through August 31, 2020. *See*, Fifth General Order (July 22, 2020).
  - **D.N.H. –** All hearings telephonic through August 31, 2020. *See*, Ninth General Order (July 22, 2020).
  - **D.Mass. –** All hearings telephonic until further notice.
  - **D.R.I. –** All hearings conducted via Zoom until further notice. *See*, General Order 20-009 (July 15, 2020).
  - **D.P.R. –** All hearings conducted via Skype for Business until September 9, 2020. *See*, General Order 20-10 (July 20, 2020).

- Bankruptcy courts have adopted a variety of methods for to facilitate hearings:
  - Pre-COVID-19 telephonic appearance lines – Massachusetts; New Hampshire.
  - CourtCall/CourtSolutions– S.D.N.Y. (certain proceedings); Delaware; Maine.
  - Zoom/ZoomGov – S.D.N.Y. (certain proceedings); Connecticut; Rhode Island; E.D.Va.; Vermont.
  - Skype for Business – D.P.R.
  - GoToMeeting – S.D.Tex.
- Where parties must submit evidence, some courts have also either established protocols or announced that judges will create protocols with the parties on an *ad hoc* basis.
  - For example, some courts require parties to submit evidence in advance of trial by electronic filing via ECF.

- In addition to suspending the in-person hearings, many bankruptcy courts have suspended the requirements for obtaining original signatures on petitions, schedules, and other documents.
- For example:
  - **Bankr. D. Mass.** – Temporarily suspended Local Rule requiring attorneys to obtain a "wet signature" of a non-attorney prior to filing, but requiring attorneys to obtain such wet signature within 14 days. *See*, Standing Order 2020-02, March 17, 2020.
  - **Bankr. D. Conn.** – Temporarily suspended the requirement that attorneys obtain a physical signature of the signatory prior to filing document. *See*, General Order, March 23, 2020.
  - **Bankr. D. R.I.** - Temporarily suspended the requirement that attorneys obtain a physical signature of the signatory prior to filing document. *See*, General Order 20-005, March 25, 2020.

- The U.S. Trustee Program has suspended the requirement for in person Section 341 Meetings of Creditors, nationwide, through October 10, 2020.
- A critical element of the 341 Meeting of Creditors is the Chapter 7 Trustee's verification of the debtor's identity, address, and Social Security Number.
- In an in-person 341 Meeting, the debtor ordinarily produces identification documents to the Chapter 7 Trustee.
- With 341 Meetings conducted by telephone or videoconferencing for the foreseeable future, various U.S. Trustee offices have implemented different procedures for debtors' to verify their identity, address, and Social Security Number.
- For example:
  - In Region 2 (New York, Connecticut, and Vermont) the U.S. Trustee requires debtors to sign affidavits verifying the required information, and their attorneys to specify the manner in which the attorney verified the information.
  - In the Eastern District of Pennsylvania, the U.S. Trustee requires debtors to furnish documents to verify the required information at least one week prior to the telephonic 341 Meeting.

Fourth CLE Code: 87964
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