

Chapter 11 provides flexibility for distressed retailers to preserve value during global pandemic

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The COVID-19 pandemic has wreaked havoc on brick-and-mortar retailers in an already battered industry. Commencing in mid-March, governors from a majority of states issued executive orders shuttering nonessential retail business locations to combat the spread of COVID-19.

Retailers already in chapter 11 faced the risk that their bankruptcy proceedings would devolve into a chaotic (and expensive) motions practice in which creditors raced to obtain court relief against the debtors and their assets.

Retailers who rely on foot traffic to support their businesses felt a swift and severe impact. Supply chain disruptions compounded retailer difficulties. Retailers who recently had filed bankruptcy under chapter 11 had their reorganization efforts disrupted in unprecedented fashion. After more than nine months of enduring the global pandemic, nary a retail business has escaped unscathed.

The impact was particularly severe for businesses in the midst of restructuring. With expenses still accruing and revenue drastically cut, retailers already in chapter 11 faced the risk that their bankruptcy proceedings would devolve into a chaotic (and expensive) motions practice in which creditors raced to obtain court relief against the debtors and their assets. Such an onslaught could eliminate any hope for a successful chapter 11 case.

To address this risk, some retail debtors sought to put their cases “on ice” by requesting orders suspending their cases for a limited period until they could resume operations. At least one retailer relied upon section 305(a) of the Bankruptcy Code, an infrequently cited provision that allows a bankruptcy court to suspend all proceedings if it serves the interests of creditors and the debtor.

This rare, if not unprecedented, tactic aimed at preserving value for stakeholders through a time period in which retail businesses were producing little to no revenue played out in several bankruptcy courts at the inception of the pandemic.

In the US Bankruptcy Courts for the District of Delaware and the Eastern District of Virginia — both prominent destinations for retail companies seeking chapter 11 relief — CraftWorks Parent, LLC, a restaurant chain operator, and Pier 1 Imports, Inc., a home goods retailer, each obtained orders from the respective courts granting relief that allowed them to mothball their cases for a short, fixed duration until state governors allowed businesses to re-open.

The standstill orders generally authorized the debtors to defer payment of noncritical expenses, including rent, for a period of time and restricted the ability of creditors to seek disruptive relief against the debtors and their assets.

In approving the temporary standstill in the Pier 1 case, Bankruptcy Judge Kevin R. Huennekens commented that “we’re not going to go on forever and ever” in response to vociferous objections from Pier 1’s landlords who were not receiving post-petition rent during the period.

In the interim, the court permitted the furniture retailer to operate under a limited budget that included only critical expenses, such as employee wages, insurance and trust fund taxes, until such time as the company could arrange for a wind-down budget with its lenders.

The mothballing of retail chapter 11 bankruptcy cases during the COVID-19 pandemic demonstrates the flexibility of the Bankruptcy Code to accommodate even the most dire of business interruptions.

After obtaining an initial standstill order from Delaware Bankruptcy Judge Brendan L. Shannon, CraftWorks sought an extension while simultaneously announcing a deal with its senior secured lender to effectuate a semi-private sale. Judge Shannon described the deal as a “welcome prospect” in the midst of the COVID-19 crisis.

In another chapter 11 case, *In re Modell’s Sporting Goods, Inc.*,¹ in which the company was already committed to liquidating when the pandemic struck, the debtor filed a motion to suspend all payments except for wages and insurance pursuant to section 305(a). The

US Bankruptcy Court for the District of New Jersey approved the motion for an initial 30-day period.

In granting the relief, the court acknowledged arguments of frustration of purpose and intervening impossibility triggered by the COVID-19 pandemic. That order was subsequently extended for several months until Modell's could resume its store closing sales.

The company, its landlords and the creditors' committee appointed in the bankruptcy case ultimately negotiated a stipulation providing for the partial payment of rent during the standstill period in exchange for the agreement of the consenting landlords not to object to plan confirmation based on the failure to pay postpetition rent in full, which is typically required in order to confirm a chapter 11 plan.

The mothballing of retail chapter 11 bankruptcy cases during the COVID-19 pandemic demonstrates the flexibility of the Bankruptcy Code to accommodate even the most dire of business interruptions. Through entry of the standstill orders, the courts allowed the debtors to preserve substantial value for the benefit of their creditors and other constituencies.

Although not a panacea, the orderly business wind-downs or going-concern sales that followed were far superior to a chaotic free-for-all that could have ensued without bankruptcy court intervention. Underscoring the uniqueness of these decisions and the flexibility of bankruptcy courts, these proceedings occurred remotely through video. Bankruptcy courts were among the first in the nation to fully adopt this technology to accommodate the exigent needs of struggling businesses.

The company was successful in obtaining first-day relief to seamlessly transition into chapter 11 with the goal of exiting in less than two months despite the substantial disruption the COVID-19 pandemic had caused to its business.

Even the extended duration of the pandemic has not proven impossible for some larger retailers to overcome through use of chapter 11. Notably, Chinos Holdings, Inc., owner of the J.Crew and Madewell retail clothing brands, filed chapter 11 to effectuate a pre-arranged financial restructuring in May 2020 in the midst of the pandemic.²

The company obtained plan confirmation in less than four months despite the temporary closure of 500 of its retail

stores. In November 2020, Guitar Center, the largest music retail chain in the US, sought chapter 11 protection in the US Bankruptcy Court for the Eastern District of Virginia.³

On the first day of the case, the company filed a pre-packaged chapter 11 plan seeking to consummate a balance sheet restructuring and pay unsecured trade creditors in full. The company was successful in obtaining first-day relief to seamlessly transition into chapter 11 with the goal of exiting in less than two months despite the substantial disruption the COVID-19 pandemic had caused to its business.

The depth of the unprecedented economic crisis caused by the COVID-19 pandemic has forced many retail establishments to close simply because foot traffic has fallen off the cliff. Nevertheless, as the above examples illustrate, chapter 11 bankruptcy provides flexibility for retailers to maximize value for their stakeholders, whether through a reorganization or a liquidation.

The pandemic has revealed that bankruptcy judges in jurisdictions where retailer companies commonly seek chapter 11 protection will exercise their equitable powers appropriately to balance the requirements of the Bankruptcy Code with the stark reality of the impact of the current economic crisis on both retail tenants and their landlords and other creditors.

Although the chapter 11 process is expensive, it remains the most prudent and predictable option for many retailers to address severe financial challenges, even an unforeseen global pandemic.

Hunton Andrews Kurth LLP and its corporate restructuring attorneys have experience advising distressed retailers and their creditors across the country in effectuating restructurings or liquidations. Attorneys with Hunton Andrews Kurth LLP represented interested parties in the chapter 11 bankruptcy cases of *In re Craftworks Parent, LLC* and *In re Pier 1 Imports, Inc.*, and serve as co-counsel to the debtors in *In re Guitar Center, Inc.* and *In re Chinos Holdings, Inc.*

Notes

¹ *In re Modell's Sporting Goods, Inc.*, Case No. 20-14179 [Docket No. 115] (Bankr. D.N.J. March 23, 2020).

² *In re Chinos Holdings, Inc.*, Case No. 20-32181 (Bankr. E.D. Va.).

³ *In re Guitar Center, Inc.*, Case No. 20-34656 (Bankr. E.D. Va.).

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