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## Changing the Landscape: Implications of COVID-19 on the Landlord-Tenant Relationship in Bankruptcy

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Statewide “stay-at-home” and “shelter-in-place” orders have further challenged Chapter 11 debtors in the retail space. With no customer traffic in brick-and-mortar stores, retail debtors are struggling to meet their monthly lease obligations, including rent payments. While the Bankruptcy Code requires timely performance of lease obligations, certain debtors have been successful in obtaining a deferral or cessation of rent payments and other non-essential expenses, as explained below. Landlords and other creditors must stay apprised of the success of these arguments, as the outcomes will directly impact their bottom lines.

### *Primer: What Does the Bankruptcy Code Require of Debtor-Tenants?*

A debtor in bankruptcy has the right to “assume” or “reject” unexpired leases of non-residential real property under section 365 of the Bankruptcy Code. A debtor has a finite amount of time to make this decision, and until that point, must continue to timely perform its post-petition lease obligations, including paying rent. But in a global pandemic with social distancing and non-essential business closures, where is a debtor to look for cash flow to meet its lease obligations? Debtors are getting creative. *Pier One*, *Modell’s Sporting Goods* and *Craftworks* are three recent cases in which courts from various jurisdictions have allowed deferral or cessation of rent payments and in some cases, operations entirely.

### *Recent Cases: Pier One, Modell’s, and Craftworks*

Home décor and furniture retail chain Pier One filed for chapter 11 bankruptcy in the Eastern District of Virginia on February 17, 2020. In re *Pier 1 Imports, Inc., et al.*, Case No. 20-30805. At its peak, Pier One operated more than 1,000 stores across the United States and Canada. The COVID-19 pandemic has resulted in the closure of non-essential brick-and-mortar businesses, including Pier One stores. Shortly after the bankruptcy filing, the Debtors experienced 80 mandated store closures and thereafter the Debtors’ in-store sales compared to the prior year fell between 55 percent and 65 percent.

On March 31, 2020, the Debtors filed a motion to, among other things, temporarily cease making or delay all payments not contemplated by a proposed budget, including rent payments to landlords who had not voluntarily consented to a rent deferral. On May 10, 2020, the Court granted the requested relief, over a number of landlord objections. In its opinion, and relying on its broad equitable powers under section 105 of the

Bankruptcy Code, the Court clarified that the specific relief requested was not to abolish the Debtors' obligation to pay rent, but instead to delay such payment during the 'limited operations period' in the Motion. All unpaid rent would continue to accrue and would need to be paid before the Debtors could confirm a plan, in accordance with the Code's administrative claim requirements.

As of the publication of this alert, the Pier One Debtors' motion to wind-down operations and close its stores was pending. According to the motion, the Debtors are working with their lenders and the creditors' committee to develop a budget to facilitate an orderly wind-down and conclusion to the chapter 11 cases. The Debtors anticipate the wind-down budget will include payment of store rent obligations, including payments missed during the limited operation period, referenced above.

Shortly before the Pier One decision, the Bankruptcy Court for the District of New Jersey reviewed a similar issue in *In re Modell's Sporting Goods, Inc., et. al.*, Case No. 20-14179. Prior to filing for bankruptcy, Modell's operated 134 sporting goods retail stores in ten states plus the District of Columbia. On March 23, 2020, the Debtors filed a motion requesting temporary suspension of all deadlines and activities in their chapter 11 cases, including deferral of all expense payments other than those that were absolutely essential, pursuant to a proposed budget and suspension of operations, including the pending going out of business sales. Relying on sections 105 and 305 of the Bankruptcy Code, the Court authorized the requested suspension until April 30, and then again, until May 31, 2020, without prejudice to requests for further extensions.

The District of Delaware Bankruptcy Court also addressed the issue in *In re Craftworks Parent, LLC, et al.*, Case No. 20-10475. Prior to its chapter 11 bankruptcy filing on March 3, 2020, Craftworks owned and franchised casual dining restaurant brands, including Logan's Roadhouse. On March 27, 2020, the debtors filed a request for additional debtor-in-possession financing in the amount of \$4 million, and attached a proposed six-week budget through the week ending May 10, 2020. Notably absent from the proposed budget was rent payments to landlords. In the words of objecting landlords, the motion did not request authority to defer lease obligations, but instead, in effect, sought an indefinite, de facto extension of lease obligations until some point in time beyond May 10, 2020—at least 68 days after the bankruptcy filing. Over landlord objections, the Court approved the requested funding on April 2, 2020.

At the time of this alert, similar requests for relief are pending in *In re Cinemex Holdings USA, Inc., et al.*, Case No. 20-14696 (requesting authority to suspend obligations to landlords until June 24, 2020) and *In re Chinos Holdings, Inc., et al.*, Case No. 20-32181 (requesting that obligations arising within 60 days of the bankruptcy filing under unexpired leases be extended through July 6, 2020).

### Takeaways

Now more than ever, landlords must pay particular attention to retail and other tenants in bankruptcy. While landlords have been able to rely on certain provisions of the Bankruptcy Code that require timely performance of post-bankruptcy filing obligations, until "assumption" or "rejection," they now need to consider the potential for a

significant loss in timely cash flow from their tenants. As long as “stay-at-home” and “shelter-in-place” orders and other limitations remain in effect, more and more debtors may find themselves in a position of seeking to delay or shed non-essential expenses, relying on *Pier One*, *Modells’ Sporting Goods*, and *Craftworks*, particularly now that there is precedent for the grant of such authority.

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