

COVID-19 “Suspends” US Chapter 11 Proceedings

David H. Conaway sends in his report on the affects of the crisis in the US courts



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CCOVID-19 has, and for the foreseeable future will, have an unprecedented adverse impact on the global economy and all companies’ business operations.

Governments and banking systems throughout the world have initiated massive aid programs to blunt the impact of the COVID-19 crisis. Regardless, there will be substantial market disruptions including the supply and deliver of goods and services.

The COVID-19 crisis has accelerated and exacerbated the urgency and risk for all stakeholders involved with companies that were already in the zone of insolvency, companies that have now become insolvent, and companies that filed Chapter 11 before the onset of the COVID-19 pandemic. Companies have reacted by working with stakeholders to avoid filing Chapter 11, and by filing Chapter 11 to push through pre-filing strategies of an expedited Section 363 sale or a prepackaged or prearranged restructuring.

In some cases, debtors have sought a suspension or modification of their Chapter 11 proceedings and procedures, using Section 105 and the not often relied upon Section 305 of the US Bankruptcy Code:

“Section 105(a)

The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be

construed to preclude the court from, *sua sponte*, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

Section 305 - Abstention

- (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; or
 - (2) (A) a petition under section 1515 for recognition of a foreign proceeding has been granted; and (B) the purposes of chapter 15 of this title would be best served by such dismissal or suspension.
- (b) A foreign representative may seek dismissal or suspension under subsection (a)(2) of this section.”

In particular, debtors in the Chapter 11 cases of *Modell’s Sporting Goods, Inc.*, *Pier 1 Imports, Inc.* and *CraftWorks Parent, LLC* have all requested the Bankruptcy Courts to temporarily suspend their Chapter 11 proceedings, to accommodate a suspension or “mothballing” of their business operations. The purpose of the suspension is to allow these debtors to delay their restructurings or liquidations until the COVID-19 crisis abates.

Modell’s Sporting Goods, Inc. (New Jersey)

Modell’s filed Chapter 11 to liquidate their 134 stores and e-commerce site through store closing sales, which requires a consensual use of the lenders’ cash collateral. The COVID-19 crisis prevented the debtors from conducting robust liquidation sales and left them with no alternative but to temporarily mothball their operations to preserve value, with the hope that they can recommence operations and successfully liquidate their inventory when stores can be open for the liquidation sales.

On 23 March 2020, Modell’s filed a motion to mothball its operations in compliance with the government directives regarding non-essential businesses and to comply with social distancing mandates, with a temporary suspension of all deadlines and activities in the Chapter 11 case for 60 days.

In addition, Modell’s sought to defer payment of all but absolutely essential expenses. Modell’s ceased its operations, including closing all 134 retail stores, the termination of store-level and distribution center employees; and cessation of all in-person operations at corporate headquarters and termination of most corporate employees, leaving in place a skeleton crew of essential employees to effectuate critical human relations, finance, and infrastructure technology functions during the operational suspension.

The basis for the debtors’ suspension was Section 305 of the Bankruptcy Code, which is



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considered an “*extraordinary remedy*” where the movant bears the burden of proving that “*the interests of the debtor and its creditors would benefit from ... the suspension of proceedings under § 305(a)(1).*” Modell’s asserted that the suspension will enable the debtors to avoid incurring unnecessary administrative costs, including professionals’ fees, and the automatic stay will ensure no creditor will take action detrimental to the debtors’ estates, including its creditors.

The pre-petition lenders supported the suspension and agreed to allow Modell’s to use the lenders’ cash collateral pursuant to the stripped-down budget, only paying essential expenses for the debtors to “*reoperationalise*” in order to maximise the success of store closing sales after the COVID-19 crisis. However, many of Modell’s landlords objected that relieving debtors of the post-petition obligation to pay rent for 60 days would strip the landlords of rights to receive rent post-petition, as provided by Section 365 of the Bankruptcy Code. The Bankruptcy Court nevertheless ordered the requested suspension, initially for 34 days, to 30 April 2020, which order was subsequently extended to 31 May 2020.

Pier 1 Imports, Inc. (Virginia)

In Pier 1, the debtors filed Chapter 11 to seek a reorganisation or going-concern sale of substantially all of its assets. The debtors refused to “*sit idly by and let the global pandemic control their fate,*” and interfere with their efforts to maximise the value of the Chapter 11 estates for the benefit of creditors.

Prior to the impact of the COVID-19 crisis, the debtors were in extensive negotiations with potential going-concern bidders including possibly some of the pre-petition lenders. Pier 1 also obtained lender support to allow Pier 1 to use the lenders’ cash collateral to pay critical expenses under an approved bare-

bones budget. In addition, all motions and hearings would be adjourned for no less than 45 days.

Unlike Modell’s, Pier 1 sought relief under Section 105, not Section 305. The Bankruptcy Court entered an order which approved a bare-bones budget, approved a temporary cessation of non-critical payments, and adjourned motions and court hearings. On May 19, 2020, however, Pier 1 “*threw in the towel*” and sought Bankruptcy Court approval to liquidate all stores with a July 15, 2020 auction date.

Craftworks Parent, LLC (Delaware)

CraftWorks is a leading US operator and franchisor of brewery and craft-beer, focused on casual dining restaurants. CraftWorks and affiliates filed Chapter 11 to pursue a Section 363 sale of substantially all of the debtors’ assets.

The debtors’ prepetition lenders have supported the Chapter 11 by agreeing to provide DIP financing, and by submitting a stalking horse bid for the assets.

As a result of the COVID-19 crisis, the debtors were forced to cease all operations for their 261 restaurants and to “mothball” their operations. On 20 March 2020, the debtors filed a Motion to establish temporary procedures for not less than 60 days, primarily designed to limit parties from taking action in court in order to minimise professional fees and litigation stress while the debtors’ retail operations are closed. The temporary procedures included that attorney conferences are required prior to the filing of any pleadings, and all hearings will be held telephonically.

Telephonic court hearings

As US and foreign insolvency professionals are aware, participating in US Bankruptcy Court hearings telephonically has been a growing trend in the US. As a direct result of the COVID-



19 crisis, bankruptcy courts throughout the US have expanded and streamlined the use of telephonic court appearances. Being substantially involved in several major Chapter 11 cases in the US’s bankruptcy “hotspots,” Delaware (Borden Dairy), the Southern District of New York (LSC Communications) and the Southern District of Texas (McDermott International, Dean Foods and Neiman Marcus), we have observed these courts have adapted to the crisis and embraced and encouraged telephonic court appearances. Parties are able to make oral arguments, examine witnesses and present testimony, as well as “listen only.” The recent “first day” hearing in Neiman Marcus had over 300 telephonic appearances.

Chapter 15 Suspension

Sections 105 and 305 are also applicable in Chapter 15 cases, such that foreign insolvency administrators may take advantage of the automatic stay to protect US assets but suspend the proceedings if the foreign representative can demonstrate the benefit of a suspension to the debtors’ estates and to the creditors. ■



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