

CLIENT ALERT

BANKRUPTCY IN THE TIME OF CORONAVIRUS

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The Coronavirus crisis has arrived. This global pandemic has placed a hard stop on economic activity across the board, sending markets into freefall and skyrocketing unemployment claims to unprecedented heights. Chapter 11 filings are anticipated to surge, forcing bankruptcy courts to clean up large swaths of the crisis' aftermath. But for now, it is anyone's guess when the uptick in filings will start. Comparisons to past economic crises like the Great Recession are

unreliable indicators as, unlike prior market disruptions which affected discreet sectors of the economy, this crisis touches every corner of society with no definite end date in sight. Major industries including airlines, retailers, restaurants and hotels have shifted to survival mode. Debtors are reluctant to enter bankruptcy proceedings until the true level of government assistance and debt restructuring becomes clear, and creditors are wary to make accommodations without any assurance of when business will resume.

Meanwhile, before the anticipated boom of bankruptcy cases arrives, bankruptcy courts do continue to function, but with altered procedures both to protect the public health and to reflect the new economic reality. Multiple jurisdictions, including the Northern District of Illinois, Southern District of New York, and the District of Delaware have stopped all personal appearances, permitting telephonic/video appearances only, and have pushed many non-time sensitive hearings and meetings of creditors out several weeks.

PENDING CASES FORCED TO PIVOT

Large bankruptcies filed just before the outbreak are calling on courts to use its § 305 suspension powers until business can resume. Sporting goods retailer Modell's filed for chapter 11 on March 11, promptly beginning its orderly liquidation just as President Trump declared a national emergency and various states enacted stay at home orders. On March 23, the Debtors cited the "[t]he unprecedented, exponential spread of Coronavirus

disease” and sought an emergency order suspending its Chapter 11 cases for 60 days.^[1] The pandemic caused all Modell’s retail locations to shutter, eliminating the market for a meaningful sale of assets. The suspension motion is currently pending while the Debtors seek agreeable terms with its creditors.

CraftWorks, a parent company of several restaurant chains, entered chapter 11 in Delaware on March 3. By March 30, CraftWorks sought to “mothball” its locations and requested a minimum 60-day suspension in its cases.^[2] The Delaware Bankruptcy Court found the Coronavirus and related “numerous state orders that limit or preclude the Debtors’ operations... constitute compelling circumstances to modify procedural rules.” [Docket No. 217 at 2]. The court opted to streamline procedures, allowing the case to progress. Omnibus hearings were cancelled, and an array of procedural events will now be accomplished through notice procedures instead of hearings, with stipulations between parties being strongly encouraged.

In another significant bankruptcy, Pier 1 Imports^[3] entered chapter 11 on February 17 with a plan to turnaround its business and achieve confirmation in less than three months. The intervening crisis caused the Debtors to close its 500 plus retail outlets. Although its e-commerce sales remained “strong” and the Debtors boldly stated they would “not sit idly by and let the global pandemic control [its] fate,” [Docket No. 438 at 2] certain adjustments proved necessary. The Debtors took drastic action to preserve the company as a going concern, furloughing thousands of employees and defaulting on rent obligations. The Pier 1 debtors rejected certain store leases and abandoned any remaining inventory in those sites. The bankruptcy court approved Pier 1’s motion to cease non-critical payments, adjourn certain motions, and enter a period of limited operation while the pandemic runs its course. Other debtors around the country undoubtedly will seek similar adjustments in efforts to preserve value for all parties.

ENTER THE CARES ACT

While pending cases navigate the market’s rough waters, the federal response is taking shape. On March 27, the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”) was signed into law. The CARES Act contains several bankruptcy-specific provisions and offers loans to small businesses which may work their way into bankruptcy court.

SBRA AMENDMENTS

Small businesses are already taking the brunt of the ongoing Coronavirus Crisis. The CARES Act amends the brand-new Small Business Reorganization Act (“SBRA”), which could not have come at a more opportune moment. The SBRA was created to provide a more affordable, faster and easier way for small businesses to reorganize under Chapter 11. Traditionally, chapter 11 was designed for large companies with tens of millions in debt, and the significant procedural costs and requirements proved overwhelming to many smaller businesses. As a result, many of these businesses were unable to successfully reorganize under chapter 11 and were liquidated. Untold numbers of businesses avoided filing altogether, knowing they would not be able to survive a chapter 11, and were stuck in a deep financial hole.

Initially only available to businesses with around \$2.7 million in debt, CARES increased the debt limit to \$7.5 million for small businesses for the next twelve months. Significantly, insider debt and unliquidated contingent debt does not count towards this cap. There is a potential that the 12-month sunset will not occur after the market starts to

realize the cost and efficiency of the SBRA process.

Small business chapter 11s also offer increased oversight and a streamlined process to guide the business to solvency. The court appoints a trustee in every case, relieving the small business of onerous debtor-in-possession requirements. The small business trustee is envisioned as a consultant to the debtor, as opposed to an examiner. The SBRA grants stronger negotiating powers against creditors by allowing plan confirmation over impaired creditor's objections. Certain procedural fees which can overwhelm a small business are eliminated. Finally, and, perhaps most importantly, it enables small business owners to retain ownership while reorganizing their balance sheets and presumably preserving enterprise value. Small businesses are already starting to take advantage of this new bankruptcy, and the CARES Act amendments should lead to more businesses taking advantage of the new law.

SMALL BUSINESS LOANS

As widely reported, the CARES Act has multiple provisions aimed at provided funding to affected businesses. The Paycheck Protection Program ("PPP") will provide loans to help small businesses stay operational. PPP loans can be used to meet payroll, rent, utilities, and interest on loans, and have relaxed requirements from traditional SBA loans. Small business owners can obtain funds without pledging collateral or committing to personal guarantees. Plus, PPP loans offer partial forgiveness so long as the borrowers meet certain criteria, such as employee retention and use of funds on certain allowed business expenses.

The CARES Act also: (i) includes \$562 million for SBA disaster loans, while expanding the loan eligibility to include sole proprietors, independent contractors and other employers with less than 500 employees; and (ii) allocates \$10 billion for Emergency Economic Injury Grants, with the promise of \$10,000 within three days of the application, which will not have to be paid back even if the grant is subsequently denied. Notably, CARES Act does not exclude a business in active bankruptcy proceedings from utilizing these programs, so shrewd debtors could attempt to finance reorganization with post-petition financing provided under CARES. How these loans are implemented in active and future bankruptcy cases remains to be seen.

The crisis is fluid, and only time will tell which businesses will survive and prosper in the coming months, and which businesses will shutter or liquidate. In these times, seasoned leadership from skilled legal practitioners is a necessity. If you have concerns about the solvency of your company and need help navigating the decision-making process, HMB's attorneys have extensive experience and can assist in virtually any situation. The same is true for companies touched by customer, vendor, lessor and contract party bankruptcies. To be sure, no business will be immune from the adverse financial impacts of Coronavirus and insolvency professionals should expect to add tremendous value as the United States looks to survive and ultimately rebuild after the crisis.

HMB Legal Counsel will continue to provide updates as the situation evolves. The ongoing issues related to the spread of the Coronavirus (COVID-19) have had and will continue to have a significant impact on individuals, families, businesses and markets. [Visit our collection of resources providing guidance during these fast-changing circumstances.](#) Please reach out to your HMB team member to answer specific questions.

[1] See *In re Modell's Sporting Goods, Inc.*, No. 20-14179 (VFP) (Bankr. D. N.J., Mar. 23, 2020), Debtors' Verified Application in Support of Emergency Motion for Entry of an Order Temporarily Suspending Their Chapter 11 Cases Pursuant to 11 U.S.C. §§105 and 305 [Docket No. 115].

[2] See *In re CraftWorks Parent, LLC*, No. 20-10475 (BLS) (Bankr. D. Del. Mar. 20, 2020), Motion of Debtors for Entry of an Order (I) Establishing Temporary Procedures and (II) Granting Related Relief [Docket No. 174]

[3] *In re Pier 1 Imports, Inc.*, No. 20-30805 (KRH) (Bankr. E.D. Va.)