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"Temporary" Suspension of Bankruptcy Cases in the COVID-19 Crisis

JONES
DAY

COMMENTARY

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"Temporary" Suspension of Bankruptcy Cases in the COVID-19 Crisis

IN SHORT

The Situation: In the past few weeks, due to the severe impact of the COVID-19 crisis on non-essential businesses forced to close and terminate employees after filing for chapter 11 protection, bankruptcy courts have been confronted with requests by debtors to temporarily suspend their bankruptcy cases using the courts' equitable powers and a seldom-used provision of the Bankruptcy Code: 11 U.S.C. § 305(a).

The Result: The bankruptcy courts presiding over the chapter 11 cases of Modell's Sporting Goods, restaurant and brewpub chain CraftWorks, and home-furnishing retailer Pier 1 Imports recently entered orders temporarily mothballing the debtors' bankruptcy cases in an effort to weather the COVID-19 storm and, hopefully, preserve value for all creditors.

Looking Ahead: As the economic and operational damage wrought by COVID-19 continues (for the indeterminable future), debtors, creditors, and other interested parties may look to section 305(a) to provide a breathing spell to rethink the strategy going forward.

Hourly headlines have chronicled the global financial fallout from the COVID-19 pandemic, ranging from predicting a recession to noting the devastation wrought by volatile markets, shuttered businesses, idled aircraft, furloughed or terminated employees, and expectations (yet to be borne out) that there will be large uptick in bankruptcy filings across industries. Despite financial aid packages by governments and central banks, the precipitous drop in consumer spending and limited credit availability means that even companies that commenced chapter 11 cases pre-pandemic are finding that their prepetition strategies may be undone by factors beyond their control. This problem particularly impacts non-essential brick-and-mortar retailers, which, in addition to the recent contraction of consumer demand for certain discretionary products, were already confronting a challenging outlook due to the growth of online commerce and other factors.

As courts of law and equity, bankruptcy courts have always had the inherent power to delay proceedings by taking matters under advisement—either to allow parties time to reach a consensual resolution or for facts and circumstances to evolve. Recently, however, bankruptcy courts were confronted with requests by debtors to temporarily suspend their cases under the courts' equitable powers and a seldom-used provision of the Bankruptcy Code: 11 U.S.C. § 305(a).



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On March 27, 2020, a New Jersey bankruptcy court suspended for 60 days the chapter 11 cases of Modell's Sporting Goods, Inc. and its affiliated debtors (collectively, "Modell's"), which were in the

process of conducting going-out-of-business sales. See *In re Modell's Sporting Goods, Inc.*, No. 20-14179 (VFP) (Bankr. D.N.J. Mar. 27, 2020).

The Delaware bankruptcy court presiding over the chapter 11 cases of restaurant and brewpub chain CraftWorks Parent LLC and its affiliates (collectively, "CraftWorks") and the Virginia bankruptcy court overseeing the chapter 11 cases of home-furnishing retailer Pier 1 Imports Inc. and its affiliates (collectively, "Pier 1") recently granted similar relief, mothballing the debtors' bankruptcy cases (over the objections of landlords and various other creditors) in an effort to weather the COVID-19 storm and, hopefully, preserve value for all creditors. See *In re CraftWorks Parent, LLC.*, No. 20-10475 (BLS) (Bankr. D. Del. Mar. 30, 2020); *In re Pier 1 Imports, Inc.*, No. 20-30805 (KRH) (Bankr. E.D. Va. Apr. 2, 2020).

In short, these debtors were able to persuade the courts that a temporary pause in the proceedings will give them an opportunity to resurrect their prepetition restructuring plans.

At the other end of the spectrum is *In re Art Van Furniture, LLC.*, No. 20-10553-CSS (Bankr. D. Del. Mar. 8, 2020). In that case, the debtors' (collectively, "Art Van") pre-pandemic plan involved reducing its overall operational footprint and emerging with a rightsized balance sheet. Unfortunately, the case was filed only days before state and local governments issued social distancing and stay-at-home directives. Art Van sought to follow CraftWorks, Modell's, and Pier 1 and pause the case, but it was unable to propose a viable path forward that garnered the support of Art Van's secured creditors and other stakeholders. Thus, to avoid administrative insolvency, Art Van moved to convert the cases to chapter 7, which the court approved on April 6, 2020.

In ordinary times—and even during the financial crisis of 2008–2009—bankruptcy courts expect debtors to keep cases moving apace. See *Taggart v. Lorenzen*, 139 S. Ct. 1795, 1803 (2019) ("a chief purpose of the bankruptcy laws [is] to secure a prompt and effectual resolution of bankruptcy cases within a limited period" (internal quotation marks and citations omitted)). The relief granted in *Modell's*, *CraftWorks*, and *Pier 1* illustrates that courts recognize the ongoing economic and operational damage wrought by COVID-19. As such, debtors, creditors, other interested parties and bankruptcy courts may have a new tool in section 305(a) to provide a breathing spell to get past the pandemic as long as the case stakeholders and court are convinced that such a "pause" is not simply a delay tactic to avoid an inevitable liquidation.

While it is impossible to determine when the pandemic will subside, there may come a time when the ongoing interruption to a bankruptcy case is too detrimental—whether, for example, because asset values nose-dive or secured creditors' interest accrues at default rates such that there is no value for other creditors—with the result that suspending the case destroys value to all parties-in-interest. Thus, while bankruptcy courts appear to embrace the "wait and see" approach for now, there may come a time when a court requires the debtor to justify the hiatus by demonstrating that there will be viable restructuring options when the case resumes.

TWO KEY TAKEAWAYS

1. As courts of law and equity, bankruptcy courts have always had the inherent power to delay proceedings by taking matters under advisement—sometimes in an effort to allow parties time to reach a consensual resolution, other times merely to allow facts and circumstances to naturally evolve.
2. The relief granted in *Modell's*, *CraftWorks*, and *Pier 1* illustrates that bankruptcy courts recognize the unprecedented circumstances of the COVID-19 pandemic and that section 305(a) may be a useful tool for debtors (and creditors) to temporarily pause proceedings, take stock of the situation, and attempt to develop or negotiate a revised strategy to move the case forward.



Bruce Bennett
Los Angeles / New York



Heather Lennox
Cleveland / New York



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Washington



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Chicago



Timothy Hoffmann
Chicago



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Dallas



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