

Bankruptcy Courts are Easing Traditionally Rigid Lease Payment Requirements for Commercial Tenants In COVID-Related Filings

06/22/2020

Bankruptcy courts in multiple jurisdictions have granted tenant-friendly relief to companies that have filed for Chapter 11 bankruptcy in recent months. While the Bankruptcy Code typically requires timely performance of lease obligations under 11 U.S.C. § 365, bankruptcy courts have employed little-used provisions like 11 U.S.C. §§ 105 and 305(a) to grant debtors' mothball motions— i.e., requests for deferral or cessation of rent payments and other non-essential expenses.

On March 23, 2020, Modell's Sporting Goods requested that the Court temporarily suspend all bankruptcy proceedings and defer payment of all expenses other than those that are absolutely essential (i.e., not including rent) for 60 days. Modell's asserted that the suspension would ultimately result in the availability of more money for distribution to creditors and cited § 305(a), which permits the dismissal of a case or suspension of proceedings if the interests of creditors and the debtor would be better served by such dismissal or suspension. Given the unprecedented economic situation created by the COVID pandemic, Modell's argued, the application of such an extraordinary remedy was warranted. Persuaded that the suspension would preserve Modell's orderly liquidation plans, the Court authorized the suspension pursuant to its authority under §§ 105 and 305.

On March 31, 2020, Pier 1 requested that the Court grant its proposal for a limited operations period to take a pause on payments to landlords, shippers, suppliers, and vendors so that it could pay only critical expenses. Pier 1 cited § 105(a) which provides that a bankruptcy court may issue any order, process, or judgment that is necessary to carry out the provisions of the title, and argued that a "breathing spell" in these unusual circumstances is precisely the sort of relief the bankruptcy process was designed to provide under § 105(a). The Court was persuaded that suspending proceedings would allow Pier 1 the breathing room it needed to preserve its restructuring plans and stave off liquidation and, pursuant to § 105, temporarily relieved Pier 1 from paying post-petition rent to its landlords. The Court reasoned that: (1) the relief would not abolish Pier 1's obligation to pay rent, but instead would delay such payment during the limited operations period; and (2) all unpaid rent would continue to accrue and would be due before Pier 1 could confirm a plan, in accordance with the Bankruptcy Code's administrative claim requirements.

In April 2020, a consolidated group of debtor restaurants operating in the Kansas City area filed an emergency motion to suspend post-petition rent payments to landlords. The Court stated that before the COVID-19 pandemic forced restaurants to cease operations, the debtors demonstrated potential for a successful reorganization and, further, acknowledged that the unprecedented circumstances require (1)

flexible application of the Bankruptcy Code and (2) exercise of the Court's equitable powers under § 105 to grant relief notwithstanding § 365. It cited the *Pier 1* and *CraftWorks* cases, stating that "no reasonable alternative" exists, and the relief sought offers "a short-term allocation of scarce resources to meet immediate needs and preserve the value of the Debtors' estates for all creditor constituencies." In making its ruling, the Court exercised its equitable power to override the landlords' statutory right to payment of post-petition rent in favor of maintaining (1) the debtors' perceived going-concern value and (2) prospects for recovery to all creditors.

Given that this trend arose out of the rapid economic decline that COVID-19 shutdowns thrust upon many major companies, landlords and tenants can expect similar decisions in future COVID-induced filings. Prior to the pandemic, post-petition rent payments under commercial leases have traditionally been required. However, bankruptcy courts are courts of equity, and extraordinary times like the COVID-19 pandemic have caused some courts to weave flexibility into the ordinarily strict requirements.

For the foreseeable future, bankruptcy courts will likely stretch its equitable powers to new limits to preserve reorganization opportunities for debtors. The potential impact of this trend may extend beyond landlord-tenant issues, as business debtors could make similar equitable arguments related to requests for adequate protection payments or relief from stay. As the pandemic continues, and if businesses are unable to recover even as states loosen restrictions, more and more debtors may find themselves seeking to delay non-essential expenses, likely relying on *Pier 1*, *Modell's Sporting Goods*, and other cases as precedent. Landlords should consider this trend when faced with tenants looking to rework or delay terms of a lease.