

Bankruptcy and Creditor's Rights Department

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Notice to Clients and Friends

Retail Bankruptcies Approach Highest Number In A Decade

COVID-19, the global pandemic, has caused individuals and business entities to face many challenges. It shuttered much of the global economy, including airlines, major retail chains, oil companies, among others, and now these businesses are struggling to stay afloat and pay their debts as they become due. According to Kevin Hassett, Senior Advisor to President Donald J. Trump, businesses have been obligated to make some tough adjustments, including laying-off employees, depending on monetary incentives provided by the federal government, and even declare bankruptcy. According to Mr. Haslett, the unemployment rate is comparable to that of the Great Depression.¹

Retail is one of the most affected sectors during this pandemic. Falling consumer demand, reduced entertainment spending, and stay-at-home orders mandating that businesses remain closed continue to take their toll on a retail industry that has been struggling for the past several years as consumers seek product/brand differentiation and pivot to online shopping. During the month of April 2020 alone, retail sales dropped 16.4%, 4.1% more than was predicted by economists.² Retailers that were already struggling before the pandemic began are beginning to crumble and are seeking bankruptcy protection at the corporate level. In the last few months, we have seen Chapter 7 or 11 filings of companies in the consumer sector, including stores and fitness centers, among others. Some retailers that have file for bankruptcy protection include True Religion, J. Crew, Neiman Marcus, JCPenney, Papyrus, Ascena Retail Group (parent company of Ann Taylor, Loft, Lane Bryant, and others), and Le Tote (owner of Lord & Taylor, and Tailored Brands, and parent company of Men's Wearhouse.³ Of those retailers who have not declared bankruptcy, such as Nordstrom, The Children's Place, Zara owner Inditex, Guess, Calvin Klein owner G-III Apparel Group, Signet Jewelers, and Victoria's Secret owner L Brands, have announced an unprecedented number of store closings which, as the pandemic drags on, are expected to grow exponentially and disproportionately affect malls.⁴ Others like Pier 1 Imports, which filed for relief under Chapter 11 in February of 2020, have announced plans to start a wind-down of operations when unable to find a buyer during the pandemic.⁵

Officially, the total retail bankruptcy filings so far this year total forty-three, according to tracking by S&P Global Market Intelligence.⁶ With only four months left in the year, there have been more retail bankruptcies filed in 2020 than in the past eight years according to S&P Global.⁷ Compare the 441 retailers who filed for bankruptcy in 2008 with the 48 retailers who filed in 2010 amidst the financial strain of the recession.

In the retail sector, there are a myriad of reasons to file for bankruptcy protection, the first being the shift in consumption patterns away from traditional brick-and-mortar stores to online stores. Department stores

¹ Ashley Brown & Jack Arnholz, *COVID-19 jobless rates will be comparable to Great Depression: Trump economic adviser*, ABC News (April 26, 2020), <https://abcnews.go.com/ThisWeek/covid-19-jobless-rates-comparable-great-depression-trump/story?id=70348765>.

² Jeff Cox, *Retail Sales Plunge a Record 16.4% in April, Far Worse Than Predicted*, CNBC (May 15, 2020), <https://www.cnbc.com/2020/05/15/us-retail-sales-april-2020.html>.

³ Áine Cain, *These 16 retailers and restaurant chains have filed for bankruptcy or liquidation in 2020*, Business Insider (June 1, 2020), <https://www.businessinsider.com/retailers-filed-bankruptcy-liquidation-closing-stores-2020-2>.

⁴ Hayley Peterson, *More than 2,100 store closings are announced in a single week, delivering a crushing blow to malls — and the pain is only going to get worse* (Jun 11, 2020), <https://www.businessinsider.com/retail-store-closings-mount-in-blow-to-shopping-malls-2020-6>.

⁵ David Choi, *Pier 1 Imports gets approval from a judge to liquidate its remaining stores*, Business Insider (May 29, 2020), <https://www.businessinsider.com/pier-1-bankruptcy-judge-approval-liquidate-stores-2020-5>.

⁶ Melissa Repko and Lauren Thomas, *As pandemic stretches on, retail bankruptcies approach highest number in a decade*, CNBC (August 3, 2020), <https://www.cnbc.com/2020/08/03/with-pandemic-retail-bankruptcies-approach-highest-number-in-a-decade.html>.

⁷ *Id.*

nationwide have been losing ground to online retailers. Even with the “reopening” of the economy as stay-at-home orders slowly begin to wane, consumers are hesitant to cram into tightly-packed spaces like retail stores. It seems that, at least for the foreseeable future, social distancing is here to stay. For some retailers, these temporary changes could implicate bigger problems and the longer stores remain closed, the more likely retail chains are to strategically employ Chapter 11 reorganizations to legally shed stores and lighten their rent burden. Filing for bankruptcy protection is also triggered by the level of debt of a retail-debtor. As a result of the forgoing, we have seen an increase of consumer related businesses seeking relief under Chapter 11 in an attempt to cut costs by closing store locations.

What seems most necessary for creditors, including retail landlords, is to identify certain key legal and practical issues that may arise if debtor-tenants file for bankruptcy relief, including:

- **Ipso Facto Clauses.** Generally, ipso facto clauses are unenforceable. An unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such lease may not be terminated or modified, at any time after a debtor files for relief under the Bankruptcy Code solely because of a provision in such lease is conditioned on (a) the insolvency or financial condition of the debtor; (b) the commencement of a bankruptcy case under any title; or (c) the appointment of a trustee. See 11 U.S.C. § 365(b)(2).
- **Debtor-in-Process Financing.** The trustee or debtor-in-possession may enter into what is commonly referred to as a “DIP Loan”, that is, a loan and security agreement with a lender to fund its business operations and other related costs throughout a bankruptcy case. Usually the DIP Loan lender wants certain conditions that improve its position with regards to payment of a DIP Loan, such as absolute priority that places repayment of a DIP Loan ahead of existing debts, including secured creditors.
- **Assumption or Rejection of Nonresidential Lease Agreement.** Assumption of a lease is, essentially, a decision to retain the lease; rejection of a lease is essentially a decision to terminate the lease. In bankruptcy, to assume a lease, the trustee or debtor-in-possession will need to cure or provide adequate assurances that it will promptly cure any defaults, other than defaults relating to the bankruptcy filing or the insolvency of the debtor.
- **Obligations Due Under Nonresidential Lease Agreement Pending Assumption or Rejection.** Until a lease of nonresidential real property is assumed or rejected, and unless the court orders otherwise after notice and a hearing, the trustee or debtor-in-possession *is required to timely perform all obligations due* under such lease. See 11 U.S.C. § 365(d)(3). Whether the debtor is a landlord or tenant, the debtor’s duties before the assumption or rejection of an unexpired lease of nonresidential real property is the same.
- **Time for Assumption or Rejection of Nonresidential Lease Agreement.** In a case under Chapter 11, an unexpired lease of nonresidential real property of the debtor is deemed rejected and the trustee or debtor-in-possession shall immediately surrender such nonresidential real property to the landlord if the trustee or debtor-in-possession do not assume or reject such lease within 120 days after filing for Chapter 11 relief, or within such additional time as the court fixes, for cause, or a landlord otherwise consents. See 11 U.S.C. § 365(d)(4). If the trustee or debtor-in-possession rejects a lease, the landlord may only assert an unsecured claim for rejection damages, that is, breach of contract.
- **Obligations Due Under Nonresidential Lease Agreement After Assumption.** A lease of nonresidential real property may not be assumed unless, at the time of assumption, the trustee or debtor-in-possession (a) cures, or provides adequate assurance that it will promptly cure, any default arising from its failure to perform nonmonetary obligations under such lease; (b) compensates, or provides adequate assurance that it will promptly compensate landlord for any actual pecuniary loss resulting from such default; and (c) provides adequate assurance of future performance under such lease. See 11 U.S.C. § 365(b)(1). In the context of a landlord-debtor, when the trustee or debtor-in-possession assumed the lease, the assumption

results in the cure of all defaults, or in negotiated changed of the lease terms between the debtor-in-possession landlord and tenant-creditor.

- **Special Provisions for Shopping Center Leases.** The Bankruptcy Code affords additional protections to shopping center landlords that other lessors do not have. By way of example, Section 365(b)(3) of the Bankruptcy Code provides that “adequate assurance of future performance” of a lease located in a shopping center shall include assurance of: the source of rent or other consideration due under such lease; percentage rent due under such lease will not decline substantially; assumption or assignment of such lease to a third party is subject to all the provisions thereof, including but not limited to radius, location, use, or exclusivity; and assumption or assignment of such lease will not disrupt any tenant mix or balance in such shopping center. See 11 U.S.C. § 365(b)(3). These provisions are justified in part because of the impact a debtor-tenant’s bankruptcy may have on other tenants.

Section 365(h) of the Bankruptcy Code likewise provides a special set of rules where the debtor is a landlord, rather than a tenant. Where a debtor-landlord rejected an unexpired lease of real property, and the rejection amounts to a break that would ordinarily allow the creditor-tenant to treat such lease as terminated under the terms of the lease, such creditor-tenant may treat such lease as terminated by the rejection. See 11 U.S.C. § 365(h)(1)(A)(i). If the creditor-tenant treats the lease as terminated, it may file a claim for damages for breach of contract as if the rejection/termination occurred immediately before the filing of the debtor-tenant’s petition for relief. Alternatively, if the lease term had already commenced when the debtor-landlord rejected the same, the creditor-tenant may exercise its rights under 11 U.S.C. § 365(h).

- **Monitoring.** Once a debtor-tenant or debtor-landlord files for bankruptcy, the creditor-landlord or creditor-tenant will want to carefully monitor the debtor’s compliance with the lease terms.

While bankruptcy does not inherently mean that a retailer will go out of business, it does spell news of changes to come for shopping malls.

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