

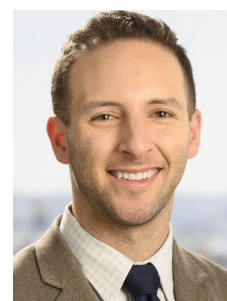
## Which Pandemic-Era Retail Bankruptcy Changes Will Stick?

By **Scott Fleischer** (December 5, 2022, 2:22 PM EST)

The past few years have been transformative and volatile in many ways, and retail bankruptcies were no exception.

For each of the topics covered — Subchapter V, lease decision timing, lease obligation extensions, deferred rent payments and case conduct — this article reviews what has happened and assesses what might happen going forward.

Did the changes stick, or was this all just a phase?



Scott Fleischer

### Subchapter V

The Small Business Reorganization Act,[1] which went into effect in February 2020,[2] added Subchapter V[3] to Chapter 11 of the U.S. Bankruptcy Code[4] to provide small businesses with a more efficient, cost-effective way to reorganize.

At first, only businesses with up to \$2,725,625 of noncontingent, unliquidated debt owed to nonaffiliates or insiders were eligible.[5] However, in March 2020, the debt limit was increased to \$7.5 million for one year.[6]

March 2021 saw Congress extend the \$7.5 million debt limit by another year, through March,[7] and in June — the deadline was missed, but the legislation was retroactive — the debt limit was extended through June 2024.[8]

Subchapter V retains many features of regular Chapter 11 cases, but it also differs in a number of ways, including:

- No creditors committee;
- No U.S. trustee fees;
- The appointment of a Subchapter V trustee;
- A 90-day deadline to file a plan;
- Permanent exclusivity to file a plan;

- No required disclosure statement for the plan;
- The ability to retain equity as a change to the absolute priority rule; and
- Payment of amounts owed over time, which may include the debtor's net disposable income over a three- to five-year period.

Many small businesses have taken advantage of Subchapter V since its inception, including single-location or small chain retailers, with approximately 23% of Chapter 11 petitions being of the Subchapter V variety in the first year of enactment,[9] which increased to about 38% of Chapter 11 filings in 2021.[10]

The decreased costs and streamlined process compared to a normal Chapter 11 case, along with the ability to retain equity, seem to be the most significant driving factors, and a new middle market of retail and other Chapter 11s has therefore emerged.

It is widely expected that the \$7.5 million debt limit will be extended, either temporarily or permanently, prior to its scheduled sunset in June 2024 to facilitate the continued, substantial use of Subchapter V.

### **Lease Decision Timing**

Since 2005,[11] debtors have had an initial period of 120 days to assume or reject their unexpired leases of nonresidential real property — i.e., retail store leases — with a potential 90-day extension for cause that could take the assumption or rejection period to 210 days under Section 365(d)(4) of the Bankruptcy Code.

In December 2020, Congress amended Section 365(d)(4) to provide for an initial 210-day period to make lease decisions, which may be extended by up to 90 days for a total of up to 300 days.[12] This amendment is scheduled to sunset Dec. 27, though it would continue to apply to cases commenced prior to the sunset date.

The increased time to make lease decisions mostly affected retail company Chapter 11's filed in 2020 through mid-2021, when there was more uncertainty amid closures and restrictions.

Since in-person retail operations have mostly stabilized given the lack of recent legislation or other governmental measures hindering such operations, and the fact that the 210-day limitation was enacted to protect landlords, an extended period of up to 300 days for debtors to assume or reject leases appears unlikely to stick.

### **Lease Obligation Extensions**

Section 365(d)(3) of the Bankruptcy Code was generally thought of as a debtor's requirement to timely perform its lease obligations.

Without any legislative change, though, this was turned on its head in many retail bankruptcy cases from 2020 and 2021. It turns out that very section also provides for an extension of a debtor's lease obligations for cause by up to 60 days.[13]

Congress did make a change when it came to Subchapter V cases, where a potential additional 60-day

extension — for a total of up to 120 days — was available for a COVID-19-related material financial hardship.[14]

In regular Chapter 11 cases, 60-day extension requests quickly became very common and were nearly always granted.

Since retail has stabilized — relatively speaking — and store closures are no longer at play, retail debtors have generally stopped making these requests and the practice as it applies to Section 365(d)(3) seems to have gone back to normal.

In Subchapter V cases, initial 60-day extension requests were not as common as in larger Chapter 11 cases, and additional 60-day requests were extremely rare. It is therefore expected that Section 365(d)(3)(B) will sunset and Subchapter V debtors will operate under the same rules as in other Chapter 11 cases.

### **Deferred Rent Payments**

Prior to its amendment, Section 547 of the Bankruptcy Code exposed payments made by a tenant outside the ordinary course of business within 90 days of its bankruptcy filing to potential clawback, meaning the recipient could be sued by a debtor or trustee to demand the return of the payments.

In recognition of the chilling effect this could have on retail landlords, Section 547 was amended in December 2020 to carve out covered payment of rental arrearages.[15]

With this change, payments made by tenants pursuant to lease amendments, deferral agreements, or both on or after March 13, 2020, would not be considered preferential transfers subject to clawback. Just as with certain other provisions of the Consolidated Appropriations Act of 2021, this is scheduled to sunset Dec. 27.

While this might have provided some comfort to landlords, it does not appear the change had a significant impact. Preferences are often waived, affirmatively buried or simply not pursued, plus the deals at issue were negotiated before the enactment of this provision.

Since we are now past the time in which most debtors or trustees would pursue preferential transfers from Chapter 11 cases that were filed in the 90 days following March 13, 2020, this might sunset and bring Section 547 back to what it was.

However, there's also no harm in extending the amendment to ensure that any such payments are protected, so it remains to be seen what Congress does on this front.

### **Case Conduct**

Large retail debtors frequently file their Chapter 11 petitions in select jurisdictions where they feel the conditions — the specific bankruptcy court and set of judges — are most favorable, irrespective of what venue may be home to its headquarters or other base of operations.

With the wide adoption of virtual appearances, forum selection has only been exacerbated.

While there are upsides, such as a decreased cost to the debtor's estate by limiting travel, there are also

downsides, such as losing personal interactions and encountering technological issues.

Anyone who was on the first-day hearing in the In re: Cineworld Group PLC matter in the U.S. Bankruptcy Court for the Southern District of Texas in September[16] can attest to the latter, as phone issues and a movie-themed presentation didn't quite deliver a box-office hit through no fault of the parties.

Unless the Bankruptcy Venue Reform Act of 2021[17] — which proposed to limit a Chapter 11 debtor's choice of bankruptcy court venue to a district where its principal place of business or principal assets are located — or similar legislation is passed, debtors will likely continue to have nearly free rein.

In the meantime, though, certain bankruptcy courts are taking measures to make debtors think twice about this practice.

The Southern District of Texas bankruptcy court, consistently among the most popular courts for retail debtors, very recently came out with its general order, effective Jan. 1, which allocates the percentage of Chapter 11 cases, among others, that are assigned to the various bankruptcy judges.[18]

In recent years, either U.S. Bankruptcy Judges David Jones or Marvin Isgur presided over their district's large retail cases.

Seemingly as a direct response to debtors filing in the White Plains division of the U.S. Bankruptcy Court for the Southern District of New York to access U.S. Bankruptcy Judge Robert D. Drain, as of November 2021, mega Chapter 11 cases would be "assigned on a random basis ... irrespective of the courthouse in which the case is filed." [19]

It will be interesting to see whether other courts follow suit or venue legislation is passed, as either or both of which could provide for a more equitable spread of Chapter 11 retail cases but likely with less predictability as to certain bankruptcy courts that may not have been utilized as frequently.

---

*Scott Fleischer is counsel at Barclay Damon LLP.*

*The opinions expressed are those of the author(s) and do not necessarily reflect the views of their employer, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.*

[1] Small Business Reorganization Act (SBRA) of 2019, Pub. L. No. 116–54, August 23, 2019, 133 Stat 1079.

[2] The SBRA took effect on February 19, 2020, 180 days after its August 23, 2019 enactment date.

[3] Subchapter V is codified at 11 U.S.C. §§ 1181-1195.

[4] 11 U.S.C. §§ 101, et al.

[5] See Ralph Brubaker, The Small Business Reorganization Act of 2019, 39 No. 10 Bankruptcy Law Letter NL 1, 5 (2019).

[6] See Coronavirus Aid, Relief, and Economic Security Act (CARES Act), Pub. L. No. 116–136, March 27, 2020, 134 Stat 281.

[7] See COVID-19 Bankruptcy Relief Extension Act of 2021, Pub. L. No. 117–5, March 27, 2021, 135 Stat 249.

[8] See Bankruptcy Threshold Adjustment and Technical Corrections Act, S.3823, 117th Cong. §2(d) (2022).

[9] See Bloomberg Law, Analysis: Four Statistical Snapshots of Subchapter V's 1st Year, Tedra Pugh, Feb. 22, 2021, <https://news.bloomberglaw.com/bloomberg-law-analysis/analysis-four-statistical-snapshots-of-subchapter-vs-1st-year> (accessed Dec. 1, 2022).

[10] See Law.com, Legislation Expanding Subchapter V Bankruptcy Eligibility Awaits Congressional Vote, George Angelich and Travis Vandell, June 3, 2022, <https://www.law.com/newyorklawjournal/2022/06/03/legislation-expanding-subchapter-v-bankruptcy-eligibility-awaits-congressional-vote/?slreturn=20221101194636> (accessed Dec. 1, 2022).

[11] See Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005, Pub. L. No. 109–8, April 20, 2005, 119 Stat. 23.

[12] See Consolidated Appropriations Act, 2021, Pub. L. No. 116–260, December 27, 2020, 134 Stat 3219.

[13] 11 U.S.C. § 365(d)(3)(A).

[14] See Consolidated Appropriations Act, 2021, Pub. L. No. 116–260, December 27, 2020, 134 Stat 3217.

[15] See Consolidated Appropriations Act, 2021, Pub. L. No. 116–260, December 27, 2020, 134 Stat 3220.

[16] In re Cineworld Group plc, Case No. 22-90168 (MI) (Jointly Administered) (Bankr. S.D. Tex. 2022).

[17] S.2827 – 117th Congress (2020-2021): Bankruptcy Venue Reform Act of 2021, S. 2827, 117th Cong. (2021), <https://www.congress.gov/bill/117th-congress/senate-bill/2827/text>.

[18] General Order 2022-7, Work Order (Effective January 1, 2023), United States Bankruptcy Court for the Southern District of Texas, accessible at <https://www.txs.uscourts.gov/file/6676/download?token=K4QvBcJp>.

[19] Local Bankruptcy Rules for the Southern District of New York, Rule 1073-1(f), accessible at <https://www.nysb.uscourts.gov/sites/default/files/LocalRules2021.pdf>.