PRESENTED AT

54th Annual William W. Gibson, Jr.
Mortgage Lending and Servicing Institute

September 17 – 18, 2020

Apocalypse Now: Tips for Managing the Onslaught of Tenant Distress and Bankruptcy in the Age of COVID

Judge Richard S. Schmidt (retired)
Katharine Battaia Clark
Holly E. Magliolo

Katharine Battaia Clark
Thompson Coburn LLP
Dallas, Texas

kclark@thompsoncoburn.com
972-629-7114

Holly E. Magliolo
Winstead PC
Dallas, Texas

hmagliolo@winstead.com
214-745-5117

Judge Richard S. Schmidt
(retired)
The Claro Group
Corpus Christi, Texas

rschmidt@theclarogroup.com
713-955-8402

APOCALYPSE NOW: TIPS FOR MANAGING THE ONSLAUGHT OF TENANT DISTRESS AND BANKRUPTCY IN THE AGE OF COVID

PART I: COMMERCIAL TENANT BANKRUPTCIES – THE INCREASING DELUGE AND EMERGING TRENDS

A. Introduction

B. The Broad Swath of Distress Across Industry Types Impacting Commercial Landlords and Their Lenders

1. Clothing retailers
2. Fitness and related service and products providers
3. Food service industry
4. Miscellaneous

C. Jurisdictional Hotspots – Is Texas the New Delaware?

D. Emerging Trends and Lessons Learned So Far

1. Lease negotiations to lease rejections in a blink
2. Rent abatement
3. Gap period rent
4. Landlords as retailers?
5. Fighting over limited pie
6. The ripple effect

E. Conclusion

PART II: COMMERCIAL TENANT BANKRUPTCIES – LANDLORD CONSIDERATIONS

A. Introduction

B. Before a Tenant's Bankruptcy – Proactive Lease Protections for Landlords

1. Know Your Tenants
2. Understand the Implications of Abatement and Deferral Arrangements
3. Letters of Credit v. Security Deposits
4. Guaranties
5. Don't Waste Energy on Unenforceable Lease Provisions
6. Don't Wait – Promptly Enforce Remedies against Defaulting Tenants

C. After a Tenant's Bankruptcy Filing – Landlord's First Steps

1. Retain Counsel – Real Estate, Bankruptcy, & Local Counsel in the Bankruptcy Venue
2. Communicate with Property Managers
3. Notify Lenders
4. Determine the Desirability of Assumption or Rejection of the Lease

a. Consequences of Lease Assumption (and Possible Assignment)
b. Consequences of Lease Rejection

D. Reviewing Tenant's Form of Bankruptcy Amendment

1. Effective Date
2. Permissive Assignment
3. COVID-19 Remedies

E. Conclusion

PART I: **COMMERCIAL TENANT BANKRUPTCIES—THE INCREASING DELUGE AND EMERGING TRENDS**

Katharine Battaia Clark and Judge Richard S. Schmidt (retired)

A. Introduction. Prior to 2020 and the dawn of the COVID era, retailers and their lenders had been adjusting to ecommerce trends (or failing to do so and going out of business accordingly), which decreased the need for traditional retail space. And while in the last several years analysts had been foreboding a retail tenant apocalypse, the rate of bankruptcy filings had reached a point of relative stasis. The rate of 2020 bankruptcy filings and attempts at out-of-court workouts has brought obvious and extensive disruption to the traditional retail landscape and beyond. With 2020 only halfway complete, chapter 11 bankruptcies remain sharply on the rise. Retailers of all sizes and segments have fallen victim. Bloomberg reports[1] that at least twenty-five major retailers filed for bankruptcy from January 2020 to early August 2020, with more having already been filed or in the pipeline as of this writing. And these more recent retail tenant workouts come even as some experts report that overall retail sales and spending are reaching equilibrium or, in some segments, slight gains.[2] In other words, it is no longer a traditional retail versus ecommerce problem—tenancies of all types are at risk. Thus, current forecasts suggest more than a retail tenant crisis—there is a real estate apocalypse that is just beginning to take shape and grow in scale.

Landlords and their lenders should be aware of the deluge in bankruptcy cases impacting their portfolios, the spreading of the bankruptcy battlefield, and the ever-changing landscape and pace of these cases, as debtors and their lenders get more creative in pushing the legal envelope to shift risk.

B. The Broad Swath of Distress Across Industry Types Impacting Commercial Landlords and Their Mortgage. 2020's chapter 11 filings have included retailer giants but also an expansion beyond clothing retailers to a variety of product categories. The following are some representative examples of 2020 chapter 11 large filings:

1. Clothing retailers. *J Crew [In re Chinos Holdings, Inc.]*, Eastern District of Virginia, Case No. 20–32181 (KLP) (May 4, 2020); *Steinmart, Inc*., Middle District of Florida, Case No. 20-02387 (JAF) (Aug 12, 2020); *Tuesday Morning Corporation*, Northern District of Texas, Case No. 20-31476-hdh (May 27, 2020); *J.C. Penney Company, Inc*., Southern District of Texas, Case No. 20-20182 (May 15, 2020); *Brooks Brothers Group, Inc*., District of Delaware, Case No. 20-11785 (July 8, 2020); *Lord & Taylor [Le Tote, Inc., et al]*, Eastern District of Virginia, Case No. 20-33332 (KLP) (Aug 2, 2020); *Ann Taylor [Ascena Retail Group, Inc.]*, Eastern District of Virginia, Case No. 20-33113 (July 23, 2020); *Pier 1 Imports, Inc*., Eastern District of Virginia, Case No. 20-30805 (Feb 17, 2020); *Neiman Marcus Group LTD LLC*, Southern District of Texas, Case No. 20-32519 (DRJ) (May 7, 2020); *Lucky Brand Dungarees, LLC*, District of Delaware, Case No. 20-11768 (July 3, 2020); and *Men's Wearhouse [Tailored Brands, Inc.]*, Southern District of Texas, Case No. 20-33900 (Aug. 2, 2020).

[1] *See* Katherine Doherty and Jeremy Hill, *Busted Retailers se Bankruptcy to Break Leases by the Thousands*, (BLOOMBERG BUSINESS Aug. 6, 2020) (available at https://www.bloomberg.com/news/articles/2020-08-06/busted-retailers-use-bankruptcy-to-break-leases-by-the-thousands) (last visited Aug. 30, 2020).

[2] *See, e.g.*, U.S. Census Bureau data (available at https://www.thebalance.com/u-s-retail-sales-statistics-and-trends-3305717) (last visited Aug. 31, 2020).

2. Fitness and related service and products providers. *Gold's Gym [GGI Holdings, LLC]*, Northern District of Texas, Case No. 20-31318-hdh-11 (May 4, 2020); *GNC Holdings, Inc.*, District of Delaware, Case No. 20-11662 (June 23, 2020); *24 Hour Fitness Worldwide, Inc.*, District of Delaware, Case No. 20-11558 (June 15, 2020); In re Modell's Sporting Goods, Inc., District of New Jersey, Case No. 20-14179 (VFP) (March 11, 2020).

3. Food service industry. *Chuck E. Cheese [CEC Entertainment, Inc.]*, Southern District of Texas, Case No. 20-33163 (June 24, 2020); *California Pizza Kitchen, Inc.*, Southern District of Texas, Case No. 20-33752 (July 29, 2020); *NPC International, Inc. [largest franchisee of Wendy's and Pizza Hut-branded eateries]*, Southern District of Texas, Case No. 20–33353 (DRJ) (July 1, 2020); *SLT Holdco, Inc. [Sur La Table]*, District of New Jersey (July 8, 2020); *Dean & DeLuca New York, Inc., et al.*, Southern District of New York, Case No. 20-10916 (MEW) (March 31, 2020); *Garbanzo Mediterranean Grill, LLC, et al.*, Eastern District of Missouri, Case No. 20-43963 (Aug 12, 2020).

4. Miscellaneous. *The Hertz Corporation*, District of Delaware, Case No. 20-11218 (May 22, 2020); *RGN-Group Holdings, LLC [operator of Regus co-working affiliate]*, District of Delaware, Case No. 20-11961 (Aug 17, 2020).

C. Jurisdictional Hotspots – Is Texas the New Delaware? As more and more chapter 11 cases are filed amidst a pandemic, Delaware is no longer the preferred venue for debtors with commercial retail space to shed or restructure. As the preceding list exemplifies, multiple jurisdictions are gaining in popularity for debtors seeking relief, most notably the Southern District of Texas (perhaps for its centralized location and reputation for handling highly complex oil-and-gas restructurings) and Eastern District of Virginia (which has gained increasing popularity after the Toys-R-Us filing in 2017). And while Delaware and the Southern District of New York continue to see filings, still other debtors determine to file in venues outside the "hot" zones for larger cases, such as New Jersey, the Middle District of Florida, or in the debtor's actual hometown.

The impact for landlords and their lenders of new bankruptcy venues, in particular at the current fast clip of filings, is the need to develop strategies for not only quickly understanding the new venues, but also for effectively and efficiently protecting landlord rights in the venue. With each new hotspot, in particular across federal circuit lines, comes the chance for differing court determinations on matters of import. As this cycle is in its early stages, landlords and their lenders should endeavor to find able local counsel in the venues gaining popularity in order to understand not just the local practices but the potential for the legal impact of the debtor's choice of venue for landlords and lenders. For instance, from a practical perspective, creditors should consider whether local counsel is required or suggested, and if there are local practices particular to the venue with practical impacts for the creditor.

D. Emerging Trends and Lessons Learned So Far. If 2020 retail bankruptcies were game shows, they would be in a perpetual lightening round – the pace of the average matter involving retail space to restructure and/or shed is challenging for the lawyers directly involved in the proceeding to manage, much less the average creditor client to absorb. Savvy and sophisticated

Title search: Apocalypse Now: Tips for Managing the Onslaught of Tenant Distress and Bankruptcy in the Age of COVID

Also available as part of the eCourse
2020 William W. Gibson, Jr. Mortgage Lending and Servicing eConference

First appeared as part of the conference materials for the
54th Annual William W. Gibson, Jr. Mortgage Lending and Servicing Institute session
"Apocalypse Now: Tips for Managing the Onslaught of Tenant Distress and Bankruptcy in the Age of COVID"