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Client Alert: Pier One Bankruptcy Court Approves Request to Delay Rent Payments to Commercial Landlords

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After Pier One Imports filed for Chapter 11 on February 17, 2020, the company expected to move quickly through a process to approve a consensual reorganization plan. Due to Covid-19 restrictions, however, nearly all of the company's retail outlets shut down in the 30 days following the bankruptcy filing and, according to the bankruptcy court, "revenue dried up overnight." In order to preserve liquidity and try to preserve enterprise value, Pier One arranged a "shelter in place" for its business that included store closings, employee furloughs, salary decreases, and negotiations with the landlords of its retail locations. Pier One also turned to the bankruptcy court to seek relief in the form of requesting a deferral of its obligations to pay rent to its commercial landlords. The court granted that request on May 5, 2020, over the objection of certain landlords and on May 10, 2020, issued a written opinion outlining the basis for its decision.

Section 365 of the Bankruptcy Code provides some special accommodations to the landlords of commercial property when a tenant files for bankruptcy. Among other things, the tenant is supposed to pay rent "timely" once it has entered bankruptcy. This has typically been construed to mean that even if a tenant has been delinquent with rent payments prior to filing bankruptcy, it is required to resume making regular rent payments pursuant to the dates required under the lease in order comply with the statute requiring "timely" rent payments. Pier One requested permission to defer making regular "rent" payments on a "timely" basis with the proviso that it would continue to make payments for utilities and insurance where such payments were due directly from Pier One (i.e.—not to the landlord). Pier One also sought permission to pick and choose which rent payments it sought to defer and to negotiate rent payments that varied from the terms of the lease agreement. The deferral for regular "rent" payments was requested to extend through May 31, 2020 based on the company reopening its retail stores by June 1, 2020. Pier One also agreed, absent further extenuating circumstances and subject to further court order, that it would make "catch-up" rent payments by "the middle of July."

In granting Pier One's request, the court noted that the Bankruptcy Code provision requiring rent to be paid "timely" provides no consequence for non-compliance. More importantly, while unpaid post-bankruptcy rent is granted an "administrative priority" for payment, it is not considered an expense entitled to "super-administrative" priority under the Bankruptcy Code and compelling that such rent be paid "timely" under the circumstances would effectively elevate that rent to "super-priority" status. The court also stated that while a landlord is entitled under the Bankruptcy Code to "adequate protection" with respect to its rights under the lease, such "adequate protection" is intended to protect the rights of the landlord for any "decrease in the value" of that landlord's interest in the leased property as a result of the bankruptcy filing. In granting Pier One's request, the court determined that deferring the obligation to pay rent "would not decrease the value of any Lessor's interest" in their property—particularly where insurance and utilities were being paid and Pier One intended to resume regular rent payments in June and make catch-up payments in July. The court also noted that there were many creditor constituencies in the case including active employees whose pay had been cut 50 percent and some 9400 furloughed employees for whom the company was still paying health care benefits. Accordingly, the court found that the request by Pier One "presented a short-term allocation of … scarce resources to meet immediate needs and preserve … value … for all creditor constituencies" pending the reopening of the Pier One stores.

The ruling by the court in favor of Pier One is not surprising given the overlay of the effect of Covid-19 restrictions—particularly given the short-term nature of the relief granted to Pier One. Whether store openings and the resumption of business on the scale envisioned by Pier One can occur by June 1 is an open question. Indeed, the longer-term viability of operations for many retailers likely remains something of a mystery throughout the remainder of 2020. Clearly, the bankruptcy court was impressed with what appears to be a pro-active approach by Pier One. While other debtor tenants will likely seek to use this decision as precedent to seek a deferral of their post-petition rent obligations, the breathing spell they might hope to achieve will be dependent on the underlying facts presented to the court.

Shumaker does not represent Pier One Imports and is not representing any of the landlords in connection with the Pier One bankruptcy case.

Shumaker's bankruptcy team is available to work with commercial landlords in representing their interests when tenants file for bankruptcy and can assist in negotiations with tenants for lease restructurings that will best protect the landlord's interest.

For the most up-to-date legal and legislative information related to the coronavirus pandemic, please visit our Shumaker COVID-19 Client Resource & Return-to-Work Guide at shumaker.com. To receive the latest news and updates regarding COVID-19 straight to your inbox, sign up here.

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