

Recipe for Survival: What Restaurants Should “Takeaway” From Recent Retail Bankruptcies

Part Two of a Two-Part Series Covering Hospitality Industry Bankruptcy Considerations

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In the best of times, the restaurant industry is notorious for its carpaccio-thin profit margins. Now, COVID-19 has forced most restaurants to limit service to delivery/takeaway, or shut their doors altogether. Similar to hoteliers, many restauranteurs face mounting expenses, plunging revenues, and significant uncertainty as to when, if, and in what capacity they will be able to reopen. Recent retail bankruptcies provide a menu of creative options for restaurants considering bankruptcy amid the COVID-19 crisis.

COVID-19 Devastates Restaurant Industry

The National Restaurant Association represents 15.1 million employees, which is almost 10% of the U.S. workforce.[1] A recent survey by the Association showed that April 2020 sales plummeted by 78% compared to April 2019, and that the industry is losing \$30 to \$50 billion a month.[2] Not surprisingly, 88% of those in the industry have reported layoffs and 61% anticipate further layoffs despite the existing Paycheck Protection Program (PPP) loans administered by the Small Business Administration (SBA) and other relief.[3]

Many states, including Massachusetts, New Jersey, New York, and Pennsylvania have announced criteria for reopening businesses that correlate to local COVID-19 infection rates. Based on the current number of cases, it will be weeks or months before cities like Boston, New York and Philadelphia allow their restaurant and retail businesses to reopen. Even after restaurants reopen, operations may be severely curtailed, as social distancing requirements will likely remain in place, forcing restaurants to reduce their table-counts and, thus, their profitability. Those restaurants fortunate enough to have received PPP loans may have difficulty meeting the program's loan forgiveness criteria, either because they remain shuttered or because they must operate at a reduced capacity for diners' safety. Additionally, in areas of the country that have begun to reopen, restaurants have struggled to bring back staff, some of whom may earn more from coronavirus relief than by working.[4]

Many big-name restaurant chains, including Cosi (Delaware),[5] were in trouble before COVID-19. Limited operations and a lack of federal relief tailored to the needs of the industry have led many restaurants to file for bankruptcy in the wake of the crisis, including CraftWorks (Delaware),[6] a number (73) of Sonic Drive-In franchises (North Carolina),[7] and Bravo Fresh's parent company FoodFirst Global Restaurants (Florida).[8]

Bankruptcy Filing Considerations

Bankruptcy can provide relief to restaurants of all sizes, from mom-and-pop diners, local pubs and bars, and your favorite specialty coffee shop, to chains like those listed above. Some of the benefits of bankruptcy include:

- imposition of an automatic stay that halts most actions by creditors;
- potential debtor-in-possession financing to allow the restaurant to continue to operate, including paying employees and vendors;
- the option to reject or renegotiate contracts and leases that no longer benefit the restaurant (e.g., unwanted locations) or that include overly burdensome terms;

- possible election for a small business bankruptcy under Subchapter V, which aims to make bankruptcy proceedings more expeditious and less costly, and allows certain post-petition expenses to be paid over time;
- the ability to discharge certain debts; and
- if the restaurant owner wants to exit the business, a unique opportunity to maximize the value of the restaurant by conducting a sale that is “free and clear” of liens and claims and exempt from transfer taxes.

While bankruptcy can provide significant debt relief, once a business enters bankruptcy, it must comply with certain post-petition deadlines, reporting obligations, and other requirements, including proposing a post-petition budget and timely paying operating expenses. Fulfilling these obligations – particularly making lease payments and debt service – may be difficult or impossible while revenues remain depressed, which may lead many restaurants to postpone a much-needed bankruptcy filing. However, the recent retail bankruptcy cases of Modell’s Sporting Goods and Pier 1 Imports may have found the recipe for weathering the crisis.

Modell’s Sporting Goods

On March 12, 2020, Modell’s Sporting Goods – the nation’s oldest sporting goods chain, with 141 retail stores in the northeast, including multiple stores in New York and Philadelphia – filed Chapter 11 bankruptcy in New Jersey. Modell’s originally planned to conclude its going-out-of-business sales within seven weeks after its bankruptcy filing. However, the “unprecedented, exponential spread of Coronavirus” derailed these well-laid plans.[9] Relying on the heretofore rarely used Section 305 of the Bankruptcy Code, the retailer sought and obtained a “first-of-its-kind” bankruptcy court order suspending the bankruptcy case and most business operations until COVID-19 abates and liquidation sales can safely continue.

By suspending its case, Modell’s was able to temporarily defer or eliminate significant expenses, including most employee compensation, rents to landlords, and loan payments to pre-petition lenders. However, the automatic stay, which protects assets from creditor actions, remained in place to enable Modell’s to wait out the coronavirus crisis.

Pier 1 Imports

The Texas based retailer, which specializes in imported home furnishings, filed for Chapter 11 bankruptcy on February 17, 2020. Following numerous stay-at-home orders, 80 of the Pier 1 stores were subject to mandatory closures and revenues across all of their stores were down 65%.[10] Despite the significant impact to their retail stores, the e-commerce side of their business remained strong.

Instead of relying on Section 305 for a full suspension of its case and business operations, Pier 1 invoked the bankruptcy court’s equitable powers under Section 105 to create a “Limited Operation Period” that allowed the profitable aspects of the retail business to continue while temporarily closing unprofitable stores and deferring certain associated costs. The bankruptcy court specifically relieved Pier 1 from paying rent to landlords during the Limited Operation Period.

Recipe for Survival: Creativity

The “takeaway” from Modell’s and Pier 1 is to think creatively about problems arising from the current crisis. Modell’s relied on a rarely-used provision in the Bankruptcy Code to suspend its case, allowing it to savor many benefits of bankruptcy protection while deferring expenses. Similarly, Pier 1 obtained court approval to operate its profitable e-commerce business, while cutting costs, including rents, of its less-profitable brick-and-mortar stores.

Despite the inherent difficulty with making financial projections in the current climate, restaurant owners should evaluate how long they can realistically operate under current conditions and at a reduced capacity once COVID-19 restrictions ease. If lenders, landlords, and vendors are unwilling to make realistic concessions, restaurateurs should consider whether filing for bankruptcy provides a viable solution and, if so, whether an à la carte approach to post-petition operations and expenses might help them survive until customers return. Similarly, given early reports that restaurants may have difficulty meeting PPP loan forgiveness criteria, bankruptcy may also buy time while Congressional pressure mounts to pass legislative relief tailored to the needs of the industry.

Modell's and Pier 1 provide good examples of BYOB – building your own bankruptcy. Restaurants contemplating bankruptcy should take equally creative approaches in addressing their business needs to ensure short-term survival and long-term success. As Modell's and Pier 1 have shown, many bankruptcy courts have an appetite to help businesses through this unprecedented crisis.

Lawyers at White and Williams LLP have been active in advising businesses in various industries, including retail and hospitality. This includes lease workouts, employee issues, and Chapter 11 bankruptcy reorganizations. If you have questions or would like additional information regarding these issues, please contact Amy Vulpio (vulpioa@whiteandwilliams.com) or James Vandermark (vandermarkj@whiteandwilliams.com; 646.837.5791).

As we continue to monitor the novel coronavirus (COVID-19), White and Williams lawyers are working collaboratively to stay current on developments and counsel clients through the various legal and business issues that may arise across a variety of sectors. Read all of the updates [here](#).

[1] <https://www.forbes.com/sites/taranurin/2020/04/25/the-national-restaurant-association-still-doesnt-want-to-pay-sick-workers-to-stay-home/#39fbb18b1cbb>

[2] <https://www.qsrmagazine.com/finance/national-restaurant-association-asks-240b-recovery-fund>

[3] <https://www.qsrmagazine.com/finance/national-restaurant-association-asks-240b-recovery-fund>

[4] <https://www.wsj.com/articles/coronavirus-relief-often-pays-workers-more-than-work-11588066200>

[5] <https://www.restaurantbusinessonline.com/financing/cosi-files-bankruptcy-protection-has-closed-30-units>

[6] <https://www.restaurantbusinessonline.com/financing/restaurant-bankruptcies-are-increasing-more-could-be-way>

[7] <https://www.restaurantdive.com/news/sonic-to-buy-73-units-from-bankrupt-franchisee/572055/>

[8] <https://www.restaurantbusinessonline.com/financing/brio-bravo-parent-files-ch-11-bankruptcy-after-closing-71-units>

[9] <https://www.nytimes.com/2020/03/11/business/modells-bankruptcy.html>

[10] *In re Pier 1 Imports, Inc. et al.*, Case No. 20-30805 (Bankr. E.D. Va.), Doc. No. 438, Debtors' Emergency Motion for Entry of an Order (I) Approving Relief Related to the Interim Budget, (II) Temporarily Adjourning Certain Motions and Applications for Payments, and (III) Granting Related Relief, ¶ 12.

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